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Do you have the humility to be a good investor?

Do you have the humility to be a good investor?

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Investors tend to make their biggest mistakes when they have too much faith in their own judgment and fail to admit when they are wrong. That's why a little humility is essential to profitable investing. Let's look at the four biggest mistakes investors make:

n Failing to diversify. No one is right 100 percent of the time. Diversifying, not only by individual security and asset class but also by investment strategy, increases the potential for your portfolio to perform well in all market environments. It also limits the exposure to loss that you have with just one individual investment. You never want one investment to have the potential to hurt you so badly you can't keep going.

n Buying the sizzle without taking a hard look at the steak. There are a lot of good stories out there. But they don't all have happy endings. Before you invest in a stock or sector with a good story, know the numbers behind the story. Stories don't produce results; good products and good management do. And even those two aspects don't guarantee success.

Circumstances change. Kmart might have stayed a strong retailer had it not been for the advent of Wal-Mart and discount stores such as Costco. Restaurant concepts are particularly prone to competition and changing fads that turn a good story bad.

The No. 1 reason for buying any investment without taking a hard look at the details is greed. You are so eager to make a killing that you set aside good judgment. Any time the story sounds too good, red flags should start flying.

n Leaving money in an underperforming investment. Admitting you made a mistake is hard in any circumstance, but it's even harder when you've made an emotional commitment to an investment by falling for the story and believing in management or the potential of the industry.

That's why you need hard-and-fast rules as to when you cut your losses. You can always buy back into an investment when its prospects improve, as long as you haven't lost your money following it down.

The Janus 20 Fund lost 70 percent of its value from March 2000 through March 2003. A \$10,000 investment diminished to \$3,000. If you had a rule to sell once an investment lost 15 percent of its value, and then buy back into the fund when it showed three months of steady progressive gains, you would have sold in April 2000 and then bought back in May 2003 to experience a 40 percent gain through the end of 2004. Ten thousand dollars invested in the Janus 20 Fund at the market's high in March 2000 would be worth \$11,900 today instead of roughly \$4,500 if you bought and held through the decline.

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n Letting greed get the better of you. Train yourself to be reasonable in your expectations. Shortcuts and promises of excessive returns tend to obscure our better judgment. Steady growth that takes advantage of the power of compounding has created far more millionaires than investing in the latest and greatest stock scheme.

Successful investing requires admitting that there's always more to learn and that you are not smart enough to always have the one right investment. A little humility and a lot of hard work goes a long way in this business.

wall on the street

w/mug of Warren Wall

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