AdviceIQ Trusted. Financial. Guidance.

Guidance
Find opportunities. Avoid traps.

Wall Street Investing Myths

Submitted by Mark Fried on Fri, 06/29/2012 - 9:00am

Wall Street has nine myths it wants you to believe. They are designed to allow the Street to keep making money from you. Exposing them will help you be a better investor.

In today's volatile investment environment, you hear three voices. One is the hysterical shouting of the panic-stricken, telling you to cash in all your investments and keep your money in a sock under your bed. A second is the comfortable pacification of the passive, urging you to wait out the long-haul with no changes to your portfolio. A third voice: the persuasive promise of the get-rich-quick crowd, whispering secret formulas guaranteed to line your pockets with gold.

Either way, Wall Street gets a cut. You need to go beyond the voices, and listen to reason that calms the panic, refutes passivity and debunks so-called secret formulas. Here are the nine top investment myths Wall Street wants you to believe.

Investment Myth No. 1: *Everyone should invest in the stock market.*

Always, never, everyone, no one...those are words that should raise red flags, particularly when applied to money. Is the stock market a time-tested and viable investment vehicle? Without question. Does it necessarily follow that everyone should invest in the stock market all of the time? By no means.

The fact is, no matter how much potential the market offers, it also has inherent risks. Those risks may be too great for certain individuals to either comprehend or accept. For them, investing in the stock market generates continual anxiety and fear, and a significant bear market could induce panic or hysteria. Living under constant tension offsets any possible monetary gain.

Investment Myth No. 2: *The stock market will go up, up, up.*

SMART ADVICE

Why All Investors Need Good Advisors

By Larry Light, Editor-in-Chief

At AdviceIQ, we believe that everyone should have a financial advisor – a good one, vetted through our system to ensure that he or she has a clean background. Hiring an experienced, capable advisor gives you the services of someone who knows the landscape of investing and other necessary financial matters, such as the amount and type of insurance you should have, and how you should set up your estate.

Many people fall victim to the basic assumption that the stock market is guaranteed to grow, and that their net profits will expand. Sure, there may be some dips along the way, the argument goes, but nothing really serious. This is, indeed, a view that is quietly propounded by many financial institutions and asset managers. Why? Because this belief encourages investors to increase their exposure to stocks and to take a passive investing approach.

This belief is unfounded and often dangerously optimistic. Both bull and bear markets are regular parts of the stock market cycle. A fundamental law of investing is the uncertainty of the future: There are always a greater number of unknowns than knowns. That doesn't mean that you should avoid risk altogether, because uncertainty creates opportunity. But it does mean that simply investing in the markets is not a guarantee of financial victory.

Investment Myth No. 3: *No matter what happens in the market, stick it out.*

Suppose a grease fire started on your stove. You'd grab the pot lid and smother the flames. But suppose a lightning strike started a raging inferno in your home. You'd leave – quickly.

Likewise, good managers have a plan for both bull and bear markets. Slight downturns might be waited out. But if your plan doesn't include an exit strategy for serious stock problems, then it isn't a bona fide plan. Every major market in the world experienced a decline of 70% to 90% during the last century. Our stock market and others around the world will likely experience similar declines in the future.

Investment Myth No. 4: *A good investment strategy focuses on gains.*

Too many investors enter the stock market concerned only with how much they can make, without understanding that avoiding significant loss is the real key to long-term success. Losses are inevitable if you invest in the stock market. But while some losses are a necessary part of a successful investment process, you must avoid significant losses, even at the cost of missing out on possible gain.

Successful investing is a humbling process. It requires doing what's necessary to align your assets with the market and, more importantly, correcting mistakes before they become significant losses. In the investment game, it's not so much about being "right," it's about not being "too wrong."

Investment Myth No. 5: *To increase your return, increase your risk.*

From time immemorial, people risked everything to cash in on gold mines, oil fields and the fountain of youth. Most of those folks risked everything, and lost everything.
Despite the occasional overnight success story, avoiding volatility and exposure typically enhances returns over the long term. High-risk strategies (given enough time) almost always result in serious loss. Most

fortunes are built by consistent application of a process grounded in sound risk management.

Investment Myth No. 6: *Historical averages will eventually pay off.*

Passive investment practice dictates that, during steep market declines, you should stay focused on the long term because historical averages are a good indication of future returns. Just wait it out, and you will pocket a profit.

While understanding probabilities can make us better investors, recognize exactly what "averages" are: They contain the highest profits and the greatest losses ever experienced, and then even them all out into a fairly straight line. For that reason, averages mask volatility, and can mislead investors into thinking that the journey will be smooth and uneventful.

Instead, investors need to free themselves from thinking in terms of "averages" and recognize that they live in a world that is controlled by extremes. With that in mind, you are free to play the odds, but always be willing to do what's necessary to avoid financial disaster.

Investment Myth No. 7: *Diversification of assets will always protect your investment.*

Diversification is important, but is overrated as a means of controlling risk. The reason? During catastrophic events, most assets become highly correlated, meaning they drop together. So diversification does very little to protect your portfolio. Put simply, when one block is pulled out, the whole tower comes tumbling down.

The success of a portfolio is not just the result of its holdings, but the quality of the underlying investment process. This process should include a healthy exit strategy and carefully set loss-control measures. There is no way to insulate yourself from risk through diversification alone.

Investment Myth No. 8: *Time in the market reduces risk.*

Common market philosophy states that successful investing is accomplished by staying fully invested over the long-term, to capture *the market's* average return. However, the idea that holding an investment long enough will somehow reduce risk is greatly flawed.

Mathematical calculations prove conclusively that the risk associated with wealth does not decline by extending your time horizon. Nobel Laureate Paul Samuelson probably said it best: "The longer you hold an investment, the greater your chances are of suffering a crash or a series of crashes." It is not a question of time in the market that will bring you financial success, but a well-founded investment strategy.

Investment Myth No. 9: *The best strategy is to set it and forget it.*

Successful stock investing takes more than a single decision to buy a mutual fund or a basket of stocks. After all, the market environment changes over time, as do your personal needs. Doesn't it make sense that your investment strategy needs to change, too?

The best way to navigate the stock market is to move with it. If you're standing still, eventually you get run over. The penalty for taking a passive approach to investing is (at best) taking unnecessary risk, and (at worst) experiencing a devastating loss. The reward for taking an active approach is the ability to control risk and gain steady profit.

Follow AdviceIQ on Twitter at @adviceiq.

Mark Fried is the president of TFG Wealth Management in Newtown, Pa. His website is www.tfgwealth.com.

AdviceIQ delivers quality personal finance articles by both financial advisors and AdviceIQ editors. It ranks advisors in your area by specialty. For instance, the rankings this week measure the number of clients whose income is between $250,000 and $500,000 with that advisor. AdviceIQ also vets ranked advisors so only those with pristine regulatory histories can participate. AdviceIQ was launched Jan. 9, 2012, by veteran Wall Street executives, editors and technologists. Right now, investors may see many advisor rankings, although in some areas only a few are ranked. Check back often as thousands of advisors are undergoing AdviceIQ screening. New advisors appear in rankings daily.

Topic:
Investing
Stocks
Asset Allocation