Four pitfalls to avoid when investing

By Anet Ahern

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When we think of diversification in investing, we usually think of investing across countries and currencies. But there's more to it than that. A good geographic spread is, of course, a sensible starting point and likely to lower investment risk - but true diversification requires a deeper look.

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Here are a few common pitfalls to avoid:

Having all your eggs in one asset class basket

Asset allocation is a major determinant of your future returns (and the volatility you're likely to experience along the way). Getting the basic building blocks right upfront is pivotal. While tactical changes along the way may occasionally be useful, a strategic long-term allocation – accompanied by the required patience and discipline – goes a long way when simply left to do its work.

Fundamental asset classes to consider include equities, fixed income and cash. You should aim for an optimum mix that will give enough growth (equities in the long run) and enough stability and yield (cash and fixed income) to match your time horizon and needs.

Not enough sectors

If you only invest in a single asset class – only in gold or only in property, for example – this can cause your concentration risk to increase significantly. Rather, aim for a spread of industries. This is where global investing really comes into its own, as there are several growth industries that are beyond your reach if you only invest locally.

Ineffective exposure

If you only own a handful of stocks or are exposed to very few counter-parties, this will increase your risk. When it comes to equities, a minimum number of instruments and a maximum percentage per instrument will help to diversify away from share-specific risk. In the same vein, there should be a spread of banks and instruments within your fixed income and cash portfolio.

Not diversifying across managers

Sticking with one capable manager for the long term can be a very good strategy. However, if the manager stays true to one style, it is likely that there will be periods during which the approach works better than other times. Therefore, it is useful to combine managers with different styles (provided both have established track records). For example, you could combine a value manager with a momentum or growth manager, or a passive solution with an active manager. This can mean that when a particular style is out of favour, your portfolio will not necessarily languish in the doldrums.

The reality of investing is that we are dealing with an uncertain future, in an uncertain environment. Diversification is one way to navigate this journey, because it improves your odds of meeting your goals while better managing your risks. As a critical component of your investment strategy, also keep in mind that the process of building a robust, long-term portfolio is often best performed with a qualified and experienced financial adviser.

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