The 7 Biggest Mistakes Fund Investors Make

ISACO

LET'S GROW WEALTH TOGETHER.

Contents

Disclaimer	3
Introduction	5
Mistake number 1: Making 'low fees' your highest priority	6
Mistake number 2: Buying funds that own laggard stocks	7
Mistake number 3: Buying funds at market tops	8
Mistake number 4: Focusing on the economy, instead of the stock market	9
Mistake number 5: Playing 'buy and hold'	10
Mistake number 6: Not keeping score	11
Mistake number 7: Investing too conservatively	12
8 Investment Lessons for Success	13
Final thoughts	16

Disclaimer

The information provided here is based on ISACO Ltd's research and it does not constitute financial advice. Any information should be considered in relation to specific circumstances. ISACO Ltd does not make personal recommendations for particular stocks or investment funds or any other security or any other investment of any kind.

If particular stocks or investment funds are mentioned, they are mentioned only for illustrative and educational purposes. ISACO Ltd offer non-advised sales. These refer to a situation where no personal recommendation is made and the client is left to decide how they wish to proceed.

Please note that we do not provide advice, and therefore, are not required to assess the suitability or appropriateness of investments that you choose. This means you do not benefit from the protection of the FCA's rules on assessing suitability. If you have received a recommendation from your adviser they will be responsible for the suitability of the recommendation.

YOU SHOULD SEEK ADVICE FROM A REGISTERED FINANCIAL PROFESSIONAL PRIOR TO IMPLEMENTING ANY INVESTMENT PROGRAM OR FINANCIAL PLAN.

ISACO Ltd and its employees are not agents, brokers, stockbrokers, broker dealers or registered financial advisors. ISACO Ltd does not guarantee any results or investment returns based on the information in this guide. Past performance is no indication or guarantee of future results and the value of any investment you make can go down as well as up. ISACO Ltd does not accept any responsibility for loss occasioned to any person acting or refraining from acting as a result of information contained in this guide.

This guide presents information and opinions believed to be reliable, but the accuracy cannot be guaranteed. ISACO Ltd is not responsible for any errors or omissions. ISACO Ltd is authorised and regulated by the Financial Conduct Authority (FCA 525147). www.fca.org.uk

Important Information

The value of a fund and the income from it can go down as well as up so you may get back less than you invested. If your fund invests in overseas markets, changes in currency exchange rates may affect the value of your investment. If your fund invests in small and emerging markets, these can be more volatile than other, more developed, markets. Past performance is not a guide to future returns. Due to the greater possibility of default, an investment in corporate bonds is generally less secure than an investment in Government bonds. Default risk is based on the issuer's ability to make interest payments and to repay the loan at maturity. Default risk may therefore vary between different government issuers as well as between different corporate issuers.

Copyright

Published by ISACO Ltd.

Stephen Sutherland.
ISACO's Chief Investment Strategist and author of *Liquid Millionaire*.

My name is Stephen Sutherland and my passion in life is investing. I was fortunate enough to have instant success when I first got serious about the stock market. That success early on in my trading career made my love and curiosity for the market strengthen. It's now in my blood and I live, eat and breathe the market 24/7. Some would say I'm obsessed and maybe they are right.

Today, you and I are going to look at the 7 biggest mistakes fund investors make and how you can avoid them. Common investment mistakes can add up, resulting in underperformance, missed targets and disappointment. Ultimately mistakes reduce the value of your portfolio. However, by becoming aware of these mistakes you can make better informed decisions.

May I ask you some questions? Do you manage your own investments? Are you completely happy with how they have been performing? Most people I speak to want to see some level of improvement and my goal today is to share information that I'm certain will help to give a boost to your investment performance. I'm going to help you recognise the common errors many fund investors make and provide tips on how to safely navigate around them.

I'm confident that the information inside this report can help you increase your chances of reaching your investment goals on time. In case you are wondering, my clients are ISA and SIPP investors who typically have over £250,000 actively invested. If you are an ISA or SIPP investor with over £250,000 actively invested, this report was written especially for you.

Happy fund investing!

Stephen Sutherland
Chief Investment Strategist and author of *How to Make Money in ISAs and SIPPs.*

Please note past performance should not be used as a guide to future performance, which is not guaranteed. Investing in funds should be considered a long-term investment. The value of the investment can go down as well as up and there is no guarantee that you will get back the amount you originally invested.

Mistake number 1: Making 'low fees' your highest priority

Let me be clear – when investing in funds, I always aim to keep your fees, charges and costs low. For example, I encourage you to fight for every percentage point by using ISAs and SIPP wraps to protect your gains from the tax man. I also strongly recommend you manage your portfolio on a low-cost dealing platform that offers 'clean' share class versions of the funds you wish you purchase.

The mistake investors make is therefore not with aiming to keep fees low – instead it's when investors make low fees their 'highest priority' when deciding which fund or funds to buy. For example, even though the 'Ongoing Charges' of a fund are something I always pay a lot of attention to, in my opinion this is not as important as the future expected return of a fund. My feeling is, what's the point of buying a cheap fund if it underperforms the market by a wide margin?

Instead of focusing on the cheapest funds, my suggestion would be to seek out funds that have low ongoing charges but focus on the ones likely to help you 'beat' the market. When I search for funds to buy, I focus on the ones being managed by exceptional fund managers, especially ones that are right in the middle of the money flow. I like to make sure the fund manager has proven they can beat the market in the short and the long-term.

To do that you simply compare the manager's performance with a benchmark, such as the FTSE 100, the S&P 500 or the NASDAQ Composite. I like to use the NASDAQ – the US technology index – because it's arguably one of the strongest indexes in the world. When I see that the fund manager has beaten the NASDAQ in the short and long-term, it tells me I've found a star and it also tells me the manager is probably going to continue to perform well in the future.

Of course there are no guarantees they will continue to outperform but I like to think in terms of probabilities. In my mind, fund managers are like football managers. The best managers have a strategy that works. However, let's not forget that fund managers also have mandates. A mandate tells the manager which types of stocks they have to invest in. For example, their mandate may state that they have to invest in UK stocks.

This might not seem so bad but if the big institutional money is not flowing into UK equities, it puts the manager at a disadvantage and means trying to beat the market will become an even more difficult task. Because they are restricted in this way on what they can and can't buy, sometimes you see star-performing fund managers not continuing to perform well. Fund managers Anthony Bolton and Neil Woodford are two good examples of this.

Therefore the reason why some top managers with great track records stop performing is not because their strategy no longer works, but because the money flow has moved out of the areas they have to invest in. In Anthony Bolton's case, he was restricted with only being able to invest in Chinese equities and during the time he managed the fund, the Shanghai Composite (Chinese main index) was performing horribly, which means most Chinese equities were heading down instead of up.

The key then is to search for fund managers that are outperforming the NASDAQ in both the short and long-term. Once I've found a fund that's suitable, I then stay fully invested in the fund until I see the fund clearly underperforming. My mantra is, stick with your winners and dump your losers.

Mistake number 2: Buying funds that own laggard stocks

Many rookie investors unfortunately buy funds that own laggard stocks. We class a laggard as an equity that is currently underperforming the general market. Since we began investing back in 1997, we've noticed time and time again that the strongest stocks tend to get stronger and the weakest ones tend to get weaker. This is why we pay a lot of attention to funds that own stocks making new highs.

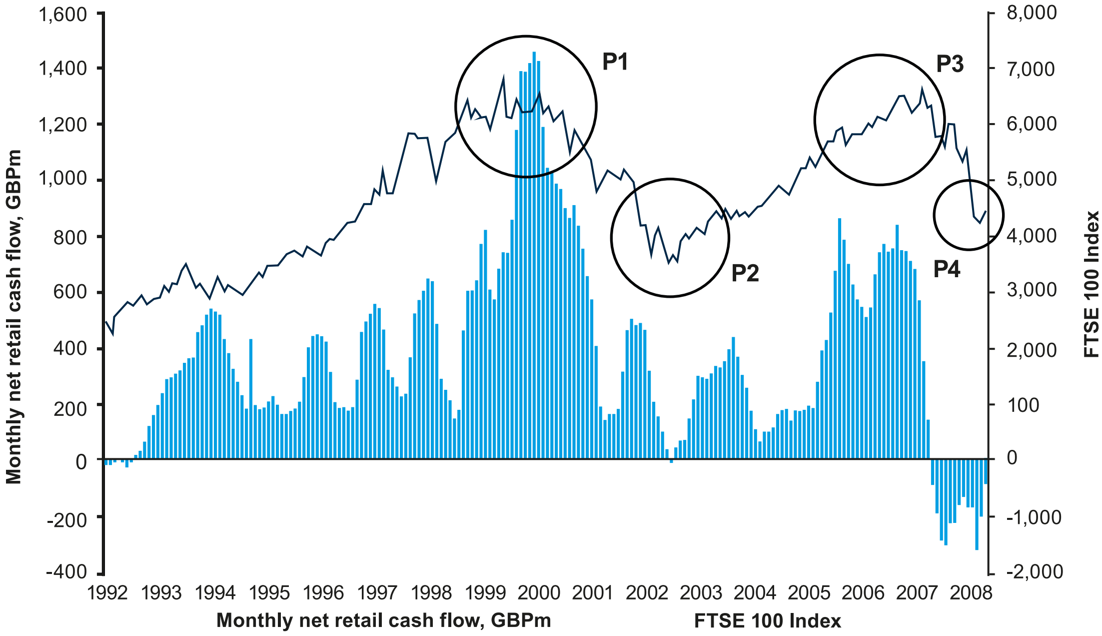
Buying a fund that owns companies making new price highs is psychologically challenging for most investors. It just doesn't feel right due to our make-up. Most of us would rather buy something when it's cheap and beaten down. Why? It's because when a stock is well off its highs, it feels as if we are getting a bargain and as human beings, most of us love a bargain. But beware because when equities are beaten down, nine times out of ten we find that they are low in price for a good reason.

On the flip side, when a stock is breaking into new high ground, there's a good reason for that too. When stocks are trading near their lows, it's usually because the company is going through a bad time financially. Sales are usually on the slide with no indication of a turnaround. And when companies are hitting fresh highs, it's usually because the company is breaking sales and profit records.

Let me ask you a question. Which fund would you like to own? Fund A which owns companies with record sales and profits, or Fund B, which owns companies with serious financial difficulties? Most investors are familiar with the adage 'buy low, sell high' but is this a sound investment strategy? Are low priced 'bargain' stocks really a bargain if their performance continues to lag behind the rest of the market? The task for astute investors is to locate funds that own strong, leading companies and avoid funds that own weak, laggard performers.

Mistake number 3: Buying funds at market tops

Investors realise the importance of aiming to buy when the market is low and sell when the market is high, however evidence suggests that they struggle to put this concept into practice. The chart below shows historic net investment flows (investment buying minus investment selling by retail clients) into equity funds by UK investors alongside movements of the FTSE 100 Index, between 1992 and 2009.



For illustrative purposes only.
Source: IMA, MSCI. Monthly cash flow data shown reflects 6 month moving average.

As can be seen, investment flows (buying) increase significantly as markets peak, especially during P1 in 2000 and P3 in 2006/2007, and decrease during market dips, especially during P2 in 2002 and P4 in 2008, when we see net outflows (selling) from funds. The challenge investors face is when the market is at its bottom, no investors feel like investing.

And when the market is at its top, most investors find it hard not to buy, again because of how they feel. Investors go through a range of emotions at different points of a market cycle. Unfortunately, as you've just seen, all too often this can result in investors entering or exiting the market at precisely the wrong time. As markets peak, investor sentiment is running high with emotions of excitement, thrill and euphoria, tempting investors to flood into highly priced markets.

But as markets dip, sentiment begins to run low and negative emotions of panic, despondency and depression lead investors to exit the market and realise a loss. My suggestion to avoid this happening to you would be to try not to let your emotions get in the way. How do you do that? Personally, I like to use rules rather than relying on emotions. My rules are very contrarian and similar to Warren Buffett's. Warren says that when the crowd is greedy, get fearful, and when the crowd is fearful, get greedy.

Mistake number 4: Focusing on the economy, instead of the stock market

Did you know that the market is forward-looking? True, and this means if you are looking at news headlines and economic indicators to guide you, you may find those signs appearing about six months too late.

Where many investors go wrong is when they avoid looking at the technical side of the market. Technical analysis is the study of the market itself and technical analysts typically use price and volume charts to look for patterns that suggest future behaviour.

Did you know that approximately 75% of the market's movement comes from institutional investors? It's true, institutional investors have the largest influence on the market's future direction and this means that if these huge investors are buying, smaller investors like you and me can jump onto their coat-tails.

By watching the market every day using charts, and keeping a close eye on price and volume activity, you can see exactly what institutional investors are doing with their money – effectively allowing you to get in sync and trade not only alongside them, but also to trade with the market's trend, instead of against it.

Mistake number 5: Playing 'buy and hold'

It is easy for investors to believe that the best investment strategy is a passive buy-and-hold approach.

In my opinion, this is not a good strategy. Burying your head in the sand after buying a fund and crossing your fingers and hoping for the best will not help you achieve a good rate of return. This situation is not uncommon. Many investors don't realise that there are four questions that need to be asked and answered each and every day.

1) Should I be invested right now?
2) If yes, should I be fully invested or partially invested?
3) If I should be invested, what should I be invested in?
4) Should I be staying in those investments or making an adjustment?

Therefore a better strategy than playing the buy and hold game is to be active. For example, we have an active investment strategy which aims to control risk and deliver superior performance. We invest in a number of actively managed funds to form a complete investment portfolio and select what we believe to be the best funds in each asset class. We then monitor all the investments selected, replacing under-performers and continuously rebalance our portfolio, with the aim of maximising growth potential and managing risk.

This means that our fund allocations can be adjusted quickly to adapt to changing economic conditions or to capitalise on opportunities as they arise. The investment process involves us identifying the world's best managers and combining them effectively to achieve diversification and reduce our exposure to risk. This strategy ensures that our return is not dependent upon any one manager's performance. If like us you decide to select the top experts in a market, country or sector, you create optimum diversification and improve risk management.

Mistake number 6: Not keeping score

Overconfidence is a decision-making bias that humans are prone too. Psychological studies show that, although people differ in their degrees of overconfidence, almost everyone displays it to some degree. For example, much more than half the population claim to be above average drivers, or have an above average sense of humour. There is also a tendency for individuals to place too much confidence in their own investment decisions, beliefs and opinions.

To avoid overconfidence in your own investing, my suggestion would be to carefully document and review your investment record. It's easy to remember the fund you picked that gained 50% in a 12-month period, but your records may reveal that most of your investments are under water for the year. Overconfidence stems from inexperience. For instance, more than 70% of naive investors wrongly assume they are enjoying above-average returns.

Also, bear in mind that professional fund managers who have access to the best investment industry reports and computational models in the business can still struggle to achieve market-beating returns. The best fund managers know that each investment day presents a new set of challenges and that investment techniques constantly need refining. Just about every overconfident investor is only a trade away from a very humbling wake-up call.

The important thing to remember is to always look at your total portfolio return and this is easy to do. If you are seeking growth, our suggestion would be to try to beat the FTSE 100 over the long term. This means the FTSE 100 would be your benchmark. Each year, make a note of what the price of the FTSE 100 is trading at, as well as noting your portfolio value.

Also, make notes throughout the year of any additions and withdrawals. As the year comes to a close, look at the closing value of the FTSE 100 and the end value of your account. To calculate your portfolio return, you could use a compounding calculator such as the one found at the following link:
www.moneychimp.com/features/portfolio_performance_calculator.htm

Next, calculate the percentage change of the FTSE 100 for the year. If your account has grown by a larger percentage than the FTSE 100, it is classed as a success. The idea is to keep a track of your annual performance as you move through time. Do this regardless of whether you are getting help or not. It's important that you know how you're performing so that you can either keep on doing what's working, or change your approach – or adviser – because it isn't working.

Mistake number 7: Investing too conservatively

Most investors understand that growth funds are a great and appropriate vehicle if they have a long time until retirement. However, many investors in their late 50s and 60s – approaching retirement or already in it – have been coached by media and industry professionals to think about their investing time horizons in a way that, in my view, is all wrong and one of the most frequently made investing mistakes.

These people naturally think that their investing time horizon ends when they either retire, stop contributing to their retirement funds, or start taking cash regularly from their portfolio. They mistakenly think that's when they should reduce most, if not all, volatility risk and start thinking ultra conservatively. In my view, this can frequently lead to an unnecessary and sometimes serious reduction in quality of life later on. Why? People live longer than ever now, yet many invest, by and large, like they expect to die at age 70.

According to the Office of National Statistics, based on 2016–18 mortality rates, the average 65 year old male will live until they are 83 but some 65 year old men will beat this average and live longer. Therefore, if you're 65 years old or approaching 65, my suggestion is to adopt a long-time investment horizon, especially if you come from a long living family and are in good health. Many investors approaching their retirement mistakenly think reducing risk is smart by moving out of equities and into bonds and cash instruments.

It's true that having an ISA or SIPP portfolio of gilts and cash won't be as volatile, but volatility risk is just one kind of risk. A 2010 poll conducted by Allianz Life Insurance Co. in North America, of people aged 44 to 75, found that more than three in five (61%) said they fear depleting their assets more than they fear dying. By thinking too short-term, many investors approaching retirement invest too conservatively.

It can mean that they get poor returns, fail to stay ahead of inflation and, as the years pass by, their retirement pot slowly but surely gets smaller and smaller. Personally I think it's a big gamble to believe that you and your spouse will be just average and live another 10 years – then find out you're abnormally healthy, live another 20 or 30 years and run out of money after 10.

Plus, it's later in life that you'll want the additional comforts money can buy. Seen that way, investing too conservatively could be seen as high risk. If you are approaching or in retirement and you extend your investment time horizon, you may then decide to take on additional risk by investing in funds that have the potential for attractive long-term returns.

Smart investors use tax wrappers such as ISAs and SIPPs to further boost their returns and pay less tax. Outperforming the market over the long-term may be extremely difficult to achieve. However, it is possible. When an investor is successful in 'beating the market', it helps them achieve higher returns and reduces the risk of running out of capital later in life.

8 Investment Lessons for Success

You are now aware of the 7 biggest mistakes fund investors make and now it's time to move on to looking at my 8 investment lessons for success. By trying to avoid the mistakes and adhering to the lessons, you are probably going to have a much better chance of reaching your goals.

Lesson 1: Aim to outperform the market

With investing, it's vital to have a compelling goal and essential to have a deadline. Knowing what you now know about extended life expectancies and the dangers of being too conservative, my suggestion would be to set your deadline extremely far into the future, allowing you to be more adventurous with your investing. And as we've just heard, those who don't invest for growth could end up running out of money during retirement.

My advice would be to set a goal to 'beat' the market. You don't have to beat it every year because trying to do that will be virtually impossible. Instead your goal should be to beat the market over the long-term. Remember though that outperforming the market over a long period of time will be extremely difficult to achieve. However, when an investor is successful in beating the market, it helps them to achieve higher returns and improves their chances of achieving their long-term objectives.

Lesson 2: Get in sync with market direction

The rule is three out of every four funds move in the same direction as the market and that means, unless you get in sync with the market's trend, it's going to be hard to make any headway. I've found that the best way to determine market direction is to look at charts. As you've heard, price and volume charts help you to see what the professionals are doing so that you can follow in their footsteps. Make a habit of watching the price and volume activity each and every day because the market's health and direction can change very quickly. That means if something changes, you can act swiftly and decisively.

Lesson 3: Buy funds 'in the money flow'

In my opinion, past performance – both long-term and short-term – is the most important element in fund selection. I like to check to see the start date of the present fund manager and check their performance record versus the NASDAQ. I look for proof that they have outperformed the NASDAQ over the long-term.

Once I've checked long-term performance, I look at short-term performance because some star-performing managers will not always be 'in the money flow'. I want to see what the NASDAQ has returned recently and see if the manager has beaten it. For example, if over the last three months the NASDAQ has made a 10% gain and the fund I'm analysing has moved up 15%, it means the manager is 'in the money flow' right now. It means they are probably holding the stocks that are currently leading the market higher. That's good.

Lesson 4: Aim to enter and exit investments at the optimum time

The first thing I do before even considering buying a fund is make sure that the market is confirmed in an uptrend and I do this as you've heard by analysing stock charts. Once I am happy that the market is in an uptrend, I aim to buy the investment if I see it successfully break out past its 'pivot' or ideal buy point. Once owning a fund, I would exit it if it had been underperforming the market over a sustained period of time.

Lesson 5: Keep it simple

I like to keep things simple and I do this in two ways. Firstly, I trade infrequently and secondly, we normally buy about five or six funds and our maximum would probably be no more than eight. We generally make no more than six switches in a year to our portfolio which means we keep it simple and we keep it time friendly. Amateur investors are generally impatient and make the mistake of too much trading due to their funds not doing what they thought they were going to do.

This can increase your costs and hurt your overall returns. Many investors own far too many funds, often ten or more, which is also a mistake due to the time needed to manage them effectively. My suggestion would be to try not to own more than eight funds at any given time and always give your funds a chance to breathe. Giving your funds the chance to breathe means you'll be less likely to overtrade. Also monitor your fund or funds' performance versus the market and understand the direct relation between the market direction and your fund direction. In other words, if the market is experiencing a normal and natural bull market correction, it's perfectly natural for your fund to correct in price too.

Lesson 6: Be active

Smart investors are active. Throughout every cycle, day in day out, I constantly analyse the market and review the behaviour of my investments. As we move through time, I make adjustments to my portfolio, constantly pruning and getting out of any laggard funds and switching into funds where I see the money flow and future growth potential. And whenever I see behaviour that suggests a 'change' in the personality of the indexes and my investments, suggesting that something may be wrong, I immediately become more defensive, exiting from those investments that are no longer performing well and if necessary, raising cash.

Lesson 7: Measure and manage

Personally, I like to carefully document and review my investment record. The important thing to remember is to always look at your total portfolio return and, as you recently discovered, this is easy to do. Put in the time to discover how the stock market really works, educate yourself in market history, brush up on technical analysis, see portfolio losses as a temporary inconvenience and always try to keep your emotions in check.

Lesson 8: Set up a withdrawal program upon reaching your objective

Is your goal to create an income for life? Creating a lifetime income is possible if you take the appropriate action to increase your chance of success. When reaching a long-term target, which could be anything from £500,000 to £15 million or even more, you can set up an automatic withdrawal plan from your ISA and SIPP accounts to pay you an income in order to fund your lifestyle.

The guideline rule is to take out a smaller percentage than the rate your account is growing at. If you had been making 7% per year over the long term, the guiding rule would be to withdraw maybe 3% or 4%, ensuring that your retirement pot would continue to grow. If you continued to stick with this simple formula, you would eliminate the risk of running out of capital and at the same time create a continuous stream of lifetime income.

Final thoughts

Have you made any of the seven mistakes I highlighted? Don't be too hard on yourself if you have because it's very difficult to avoid all the obstacles and challenges that investors face – even for the most experienced investor. Many investors simply don't have the time to process the vast amount of information available today and then apply it to their personal complex investment needs. Hopefully my '8 Investment Lessons for Success' will have helped give you more insight into my approach to investing and will maybe have given you some ideas that you can put into practice.

If you would like some one-to-one help and guidance, feel free to get in touch. Our clients kindly say that my brother Paul and I are incredibly friendly, caring and highly responsive to their questions and requests for help, support and guidance. What's more, if you call or get in touch, I promise that you won't be charged a penny and you won't be passed on to a junior associate. Instead you will speak to me or my brother Paul who are the founders of ISACO.

Email me direct at Stephen@ISACO.co.uk

Or call me on my private line: 01457 831 642.

Your friend,

Stephen Sutherland

Stephen Sutherland
Chief Investment Strategist and author of *How to Make Money in ISAs and SIPPs*.