Investors' 5 biggest mistakes

By John Dyer, MSN Money

The market starts tanking, so you panic and want to get out. You've added to your 401(k), SEP, IRA, or other retirement savings plan for a few years and think it's enough. What other stupid ideas are on your mind?

Whether you're planning to sail around the world after retirement or setting money aside to cover college tuition in 2020, you're probably nervous if you're an investor.

The burst housing bubble and the collapse of some major Wall Street institutions have led to the worst economic crisis since the Great Depression. Portfolio returns aren't pretty. And the success of government rescue efforts remains to be seen.

Traditional harbors, such as Treasuries, pay so little in interest that they have lost much of their appeal. Worse, experts predict the Main Street economy will contract as tight credit chokes demand, forcing companies to lay off workers and shutter factories. The future seems bleak. It's hard for investors to know what to do. It's easy, however, to learn what not to do.

1. Panicking and selling

Leave now, lose now. Abruptly dumping equities for cash is the biggest mistake individual investors make. Why? Because fear often drives such decisions.

As a short-term fix for a short-term problem, a fast exit ignores the markets' propensity for long-term growth. Instead of preserving their money, investors who sell out in bear markets tend to make their losses permanent.

"After you sell, you say, 'I'll go back in when it goes back up,'" says Bob Glovsky of Mintz Levin Financial Advisors in Boston. "All you have done is sold low and bought high. Nothing fancy there." Hanging on may seem counterintuitive when herds of investors are packing up, but history is on the side of the bullish.

Markets took two years to recover from the meltdown of 1987, says Dan Candura of PennyTree Advisers in Braintree, Mass. Investors who resisted the urge to sell in 1987 suffered, but their portfolios eventually bounced back.
"People don't like waiting two years, but when you cash out, you never recover," Candura says.

2. Tuning in too much

The talking heads might be modern-day Chicken Littles. Financial advisers say their clients are consuming an unhealthful amount of news. The media are crucial to the economy, experts say, but the media tend to exaggerate negatives and devote less attention to underlying positives, giving viewers a skewed take on reality.

"Clients are calling as they are watching CNBC," says Eric Godes, the president of Kobren Insight Management in Wellesley, Mass., a subsidiary of E-Trade. "We have people calling us and saying, 'What are your thoughts about the market, because the market is down 380 points right now.'"

Talk about information overload. In this crisis, the incessant yammering of analysts on 24-hour cable stations has been augmented by an avalanche of information from blogs and other online sources. The trick is not to become too wrapped up in the hype.

3. Halting retirement contributions

Don't stop giving to the future. Unless the government boosts Social Security, provides free health care and eliminates utility bills, property taxes and other overhead costs, investors will find that 401(k)s, individual retirement accounts and other vehicles tilted toward mutual funds are still the best way to prepare for retirement.

Investors need to stay steady and remember the goals they had in mind when they opened their retirement accounts years ago. The whole point of owning an IRA is to contribute slowly but surely over time, with a good manager shepherding today's payments into the dreams of the future. Good managers buy during downturns, wait for values to increase, then sell when the time is right. Buying into a downturn tends to lower the average cost or entry price of a fund's investments, in a process called dollar-cost averaging.

With the market so low, now is the time to bulk up mutual funds for the future, PennyTree Advisers' Candura says. "This is a buying opportunity. You need a down market to let dollar-cost averaging work."

Candura adds another reason to continue contributing to mutual funds: With today's volatility, they're safer than individual stocks, where investors can lose everything if they aren't careful. "You never lose all of your money in a mutual fund," Candura says.

4. Veering from your plan

Your investment plan is like the yellow brick road in "The Wizard of Oz." Bad things happen when you're off track.
Too many investors throw well-laid plans aside during downturns, advisers say. Sometimes they abandon their plans in favor of timing the market, trying to take advantage of volatility by selling high and buying low. That strategy almost always loses to steadier approaches.

Unfortunately, more-emotional investors tend to lose confidence in the prudent strategies they established for themselves before crisis struck. It's OK to question your portfolio, but advisers warn against doing surgery in times of stress. At anxious times, stay focused on the long term. If you see a problem within the context of a long-range focus, then consider making changes. Investments can lose value and still achieve their goals.

5. Holding one basket on the upswing

Today it's fear. Tomorrow it's greed. The financial markets will eventually begin to recover, and as they do, investors eager to participate will gravitate toward a new group of hot stocks. It might be biotech, or it might be oil companies. We need to remember not to get over-enthused, the experts tell us. They say the best way to profit from investments in stocks is to diversify holdings and avoid overexposure to any one sector. Investors would do well to remember that lesson when the market improves.