



## Financial Foolishness

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There are numerous mistakes individual investors seem to experience and often repeat. While the list of mistakes to avoid is quite long, I will explain three of the most common and sometimes painful mistakes in a series of articles. They are: no investment plan, emotional investing, and lack of diversification.

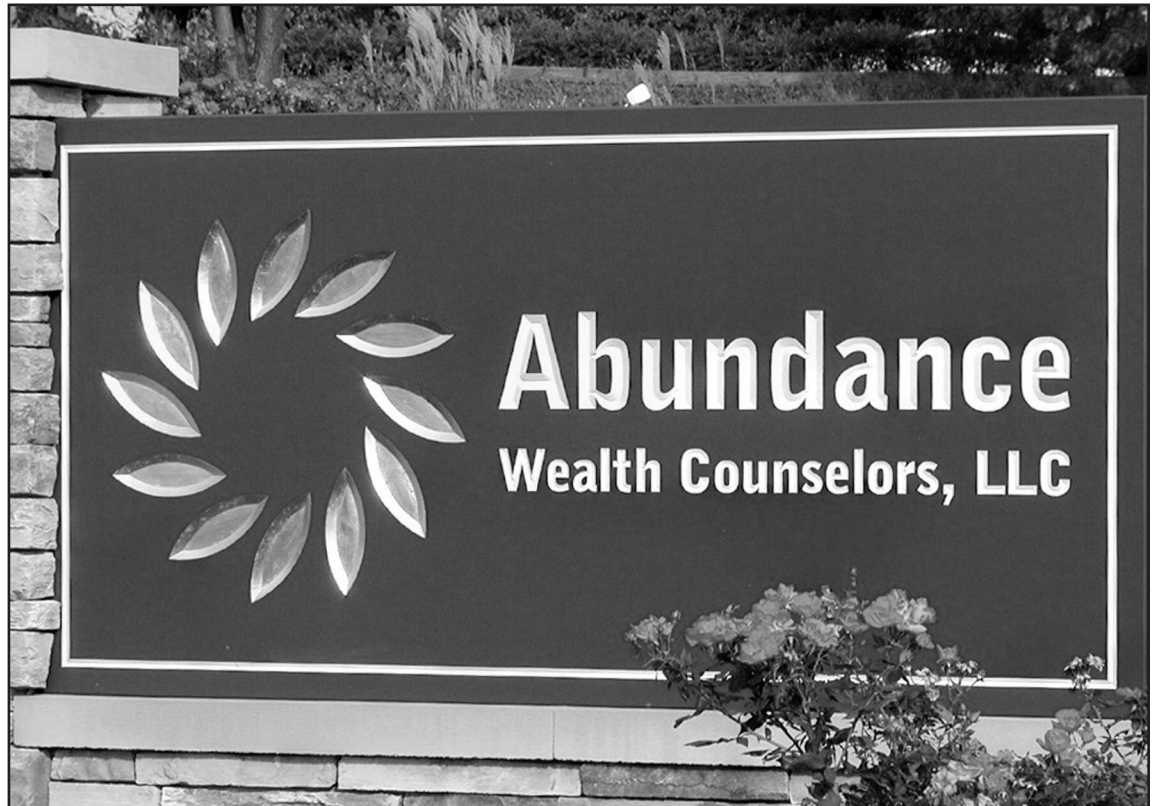
Today we will focus on the first mistake - no investment plan. Before starting, two definitions may be helpful. First, equity in the context of these articles refers to ownership of companies either through individual stock or mutual funds, and second, fixed income refers to bonds, either bond mutual funds, individual bonds, or even certificates of deposit.

The term "investment plan" pertains to several aspects of the investment process. First, clearly define why you are investing - for a new car, a house, next year's vacation, or retirement. Having a defined goal helps deter-

mine what the time horizon is, which leads to how much risk you should be willing to take. Risk is the volatility, or up and down movement of the investment. Why is this risk? Simply put, what if the investment value is down at the exact time you need the money?

When discussing risk, more risk typically means less fixed income and more equity in a portfolio. So 75% equity and 25% fixed income is riskier than 25% equity and 75% fixed income. Therefore, if you need the money within the next year, the percentage of equity should be small. The reason for this is that if there is an equity market correction, or significant decrease in the stock market, you could be left short of the money needed to reach your goal.

Another component to consider is risk tolerance. A way to describe your risk tolerance would be to ask yourself how you would feel if your investment decreased by 25%? Would you be able to stay invested or would



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you sell immediately? Therefore, your risk tolerance depends on how seeing your investment value fluctuate makes you feel. Your risk tolerance in combination with your time horizon are good starting points for determining your equity to fixed income percent.

Lastly, the plan should help you determine how much you need to save based on

the time horizon and your expected return (a topic for a separate article). So before you start investing, take the time to write out an investment plan. It will help to achieve your goal and be a source of support if the markets corrects.

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