Don’t Make These 3 Investing Mistakes in 2014

Description

Sure, we talk a lot about wonder businesses here at the *Motley Fool Canada*. But the fact is, you can load your portfolio up with great stocks and still end up with lousy performance if you make a key mistake.

Sometimes the best way to improve isn’t to be told what to do…it’s being told what *not* to do that makes all the difference. With that in mind, here are the top three investing don’ts for 2014. And while they’re written with the New Year in mind, they’re based on timeless principles that can be applied anytime.

1) Don’t bet big on commodities
It’s been a rough year for the materials sector. Many commodities – like gold, silver, natural gas, copper, potash, wheat, and corn – are near their respective 52- week lows. Investors who bet big on talks of a *commodity supercycle* or *peak something* got burned.

The disturbing thing is that even ordinary investors who had no such thesis got hurt badly by falling commodity prices last year. Take a look at the makeup of the **S&P/TSX Composite Index** (^OSPTX). Over 35% of the index is composed of energy and material stocks. Without even knowing it, millions of Canadians have gone all-in on commodity prices.

Regardless of your macroeconomic views, I think everyone can agree that a somewhat diversified portfolio is a key component of investment success. It’s nice to have one security *yin* while the other *yangs*. And just speaking from my own experience, diversification definitely helps me get a good night sleep by smoothing over the volatility.

The solution to this problem is to be mindful of your portfolio’s exposure to commodity prices. Rather than owning a broad market index, construct a portfolio yourself either with specific sector exchange traded funds or individual stocks. And don’t be afraid to invest south of the border. The United States is a much more diversified market than Canada will ever be.

2) Don’t chase yield
Low interest rates has created a major headache. Short-term debt typically yields less than 1%.

Income hungry investors have been tempted to buy longer term or low quality securities in order to generate an extra 100 or 200 basis points of income.

But this strategy is a bit like picking up nickels in front of a steamroller. It's not that rewarding and incredibly risky.

Consider a 30- year Government of Canada bond that yields 3%, pays interest semi-annually, and is trading at par. If interest rates rise just 2% — still well below historical norms — the value of your bond will decline by almost a third. After inflation and taxes, you're taking on an enormous risk for a few extra basis points.

Other investors start to gravitate to low quality equities in order to fix their yield craving. But unusually high-yields are typically a warning sign.

Reitmans (TSX:RET, TSX:RET.A) shareholders learned this lesson the hard way. Many investors were attracted to the juicy 10% yield the stock sported earlier this year. But due to deteriorating fundamentals, the distribution was no longer sustainable. Reitmans was forced to slash its dividend 75% to conserve cash.

Rather than chase yield, investors should look for small, sustainable payouts that could grow over time. For example if you had bought shares of the **Toronto-Dominion Bank** (TSX:TD, NYSE:TD) ten years ago the yield on your investment would have been less than 3%. But after a decade of steady distributions hikes compounded over time, your yield on cost would now be over 10%.

When building an income stream, its far better to find a dividend trickle that could one day become a raging river.

3) Don't go all-in on stocks

Cash is trash. Or at least that's what I'm always told. Around the world central banks are printing trillions of dollars out of thin air. Everyday day the value of fiat money to is steadily losing value to inflation. You gotta buy something!

While I definitely agree with this sentiment over the long haul, it's a bad mentality to have over a short to medium time horizon. Great investors think of cash as a option with no expiration date.

We don't always have to be invested. If Mr. Market isn't offering a good price on his merchandise, we can simply marshal our resources and wait for a sale.

With equity prices nearing all-time highs, stocks are more or less fairly priced. Many top investors like Prem Watsa and Warren Buffett are actually sitting on large cash piles waiting for a better opportunity to put their money to work.

It's hard to imagine with stock prices performing as well as they have this past year, but a big sell off is coming. I have no idea what the catalyst might be. It could happen next week…next month…or next year. But the skittish nature of investors means a correction is inevitable.

In the meantime keep studying and get your stock shopping list ready. That way you're prepared for when the next panic sell-off occurs.

Foolish bottom line
I have no idea what 2014 might bring. But staying diversified, avoiding unusually high yields, and holding some cash will go a long way to ensuring investment success. Happy New Year!

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