Canadian Investor Alert: The Biggest Mistake You Could Make in Your TFSA or RRSP

Description

The kind of mistake to discuss today can be more costly than those that get you taxed. Canadian investors should be mindful of this common investment mistake, as they make new contributions to their self-directed Tax-Free Savings Accounts (TFSAs) and Registered Retirement Savings Plans (RRSPs) for 2020.

I'm talking about the failure to diversify one's nest egg.

There's the temptation to fully invest all of one's savings into just one or two stocks in which one is overconfident of their chances at outperforming the market, and this overconfidence can be so easily influenced by several factors.

One might have some strong attachment to a stock; others may feel they have some knowledge advantage in the company; or one may be an overconfident executive with some perceived power to influence returns (which they usually don't have at an individual level).

Whatever the reason for concentrating one's investments may be, it's never a good idea to load all your $69,500 in TFSA contributions onto one or two tickers in 2020, no matter how compelling the investment thesis and returns potential is. The risk is just too high.

For example, given the hype and tremendous market success story around **BlackBerry** (TSX:BB)(NYSE:BB) (formerly Research in Motion (RIM)), the company's shares represented a too-good-to-fail Canadian tech winner at the time the 850, an internet-enabled smartphone from RIM, was launched in 1999.

The future was well set, and momentum pulled shares to $140 (after share splits) by early 2008. This was indeed a big winner that would reasonably be expected to hold its own against newcomers **Apple**, with its 2007-launched iPhone, the Android system from Samsung, HTC, and LG, and Motorola and several other adopters of **Alphabet's** (Google) smartphone software platform.

It was so easy to let BB grow to be a very large concentrated position in one's portfolio, and faith had accumulated over time such that one would have been compelled to buy the dips at $50 in 2009 as a contrarian play. Confidence was later boosted by Prem Watsa's (the Warren Buffett of Canada) vote of confidence and support for new CEO John Chen, who had done wonders at a tech firm turnaround story in Europe, so investors continued holding on to old positions.

The stock traded above $70 at the onset of 2010, only to exit the decade trading under $8.50 a share after significant underperformance. One would require a 720% return just to recoup capital losses of the last decade, but such returns don't come cheap, neither can they be seen often.

I wouldn't want to imagine the losses between 2008 ($140-a-share price range) and today, where shares trade below $8.60 apiece.

Fortunately, the initial TFSA balance in January 2010 wasn't so big yet. The TFSA was only introduced in 2009 with an initial $5,000 contribution for that year and an additional $5,000 contribution limit in 2010; maybe one's total capital losses were much lower than the potential losses today.

Imagine a similar scenario happening today after you had placed your entire $69,500 TFSA contribution on this one tech play (assuming you were of age in 2009.)

Such a loss would be devastating and could dampen all investing enthusiasm. Even worse, you may not use tax-loss harvesting to lower your taxes by booking TFSA losses.

Foolish bottom line

A widely diversified portfolio isn't guaranteed of capital protection, but it's advisable, and at times necessary, to diversify one's investments by stock holdings, industries and economic sectors, asset classes, and even geographically to try and minimize excessive risk exposures, especially as the nest egg grows bigger with successive annual contributions.

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2. TSX:BB (BlackBerry)

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