These 3 Big Mistakes Can Make Stock Investors Lose Massive Wealth

Description

Typically, holding 15-20 stocks should be enough to diversify your stock portfolio. When building your stock portfolio, avoid these big mistakes to ensure your retirement fund won’t get a non-recoverable hit.

Buy stocks in the same industry

Stocks in the same industry are likely to move in tandem. For example, lower energy demand, leading to higher supply and lower prices have led to energy stocks doing poorly.

Even blue-chip dividend stocks like energy infrastructure stock **Enbridge** have been depressed. You can imagine the sad state most oil and gas producers are in.

Long-term stock performance depends on the business performance of the underlying company. Businesses in the same industry tend to be faced with similar challenges. They would therefore likely sell off at the same time and appreciate at the same time.

So, aim to buy the best-of-breed company in an industry with bright prospects instead of buying multiple stocks in the same industry when they look cheap *ahem* energy stocks.

Hold too much of the same sector

I was taken aback the first time I heard a retail investor holding 50% of their portfolio across the Big Five Canadian banks on *BNN*. I suppose an investor can do much worse than holding **RBC**, **TD**, **BNS**, **BMO**, and **CIBC** for a long time because in most years, the banks have returns on equity in the teens thanks to the favourable regulatory environment in Canada. However, having that much in the Canadian banks is going overboard.

Why not buy and hold only the top Canadian bank stocks for greater returns?

As a general rule, it’s best not to hold more than 25% in the same sector. This way, if something happens to a sector, your diversified portfolio as a whole will still be more or less intact.

Buy only dividend stocks

I started my investing journey by buying dividend stocks because I felt that even in a down year, I would still get some returns from the periodic dividends.

Dividends aren’t guaranteed, though. Other than the ones declared, companies can cut their dividends anytime.

Dividend cuts are particularly prominent in stocks that have volatile earnings, slow or negative growth, or high payout ratios.

So, when choosing stocks for your diversified portfolio, don’t just look for nice dividends. Seeking total returns is better, especially if you are early on in your investing journey. (But be aware of the downside risk as well.)

A dividend stock portfolio with a nice yield of 3% can deliver total returns of about 10%. A portfolio that achieves a total return of 12-15% per year will turn monthly contributions of $500 into $702,931-$1,099,007 in 23 years. The same contributions to the dividend portfolio will only arrive at $524,984 in the period.

Oftentimes, mature companies pay nice, safe dividends. But there are many more great businesses out there that pay no to low dividend yields. Don’t count these companies out!

The Foolish takeaway

There are different facets to diversification. Ensure your portfolio is diversified across industries with bright prospects, income, and growth.

Match your investment choices against your financial goals.

If you’re a long way off from retirement, you might focus more on growth. If you’re close to or at retirement, you’d want to weigh more on income safety.

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Date
2025/07/07
Date Created
2021/01/17
Author
kayng