3 Investments That Could Crush New Investors' Dreams of Becoming Rich

Description

It's every new investor's dream: get rich in the stock market.

But for every investor who has gotten rich on the stock market, there's a handful of investors who *didn't.* While stock volatility can certainly crush a new investor's dreams of getting rich quickly, oftentimes, it's a matter of *what* you choose to invest in, especially when you're just starting out.

If you're looking for investments to avoid, here are three that top the list.

Penny stocks

Penny stocks are basically companies whose stocks trade for $5 or under. These are typically young start-ups with business potential but a significant lack of funding or cash reserves. Whatever reason for their small size, penny-stock companies typically struggle to get off the ground — oftentimes, falling back in on themselves and going bankrupt.

How could anyone get rich off penny stocks? It's a short-term trading strategy. Basically, you buy an immense number of shares at a low price. If the stock's price moves even a few cents upward, you immediately sell your shares and pocket the profits. Many penny-stock investors, if they're successful, will make only a small amount of profit per transaction. The idea is that if you can profit off a dozen or so penny stocks a day, you can make a pretty sum.

There are many problems with this, but the number one challenge is consistency. Even if you can successfully identify a penny stock whose price will rise in a day, rare is the person who can do this successfully enough to make the venture worth the time. Those who do are professionals, and they'll expend an enormous amount of time and energy picking out the best penny stocks from the losers.

As a beginner, I would avoid penny stocks altogether. Stick with companies that you're familiar with, such as **Shopify** or **Amazon**, and save penny stock investing for the pros.

Micro-caps

A micro-cap stock is a company whose market capitalization (its total shares multiplied by the current price of one share) is between $50 and $300 million. In other words, it's really, *really* small.

Like penny stocks, many micro-cap companies are young start-ups whose products and services haven't quite caught on yet. They may have an explosive business idea, or a market disruptive product. Either way, micro-cap stocks are typically a long way from earning profits.

Because of their small size, micro-caps could present a fairly lucrative investment opportunity. If you can identify a small company that will explode over the long run, you could earn some hefty gains. But that's the challenge — identifying a good micro-cap. For every micro-cap that becomes successful, there are hundreds more that fail. And, for beginning investors, it can be downright tough to distinguish between the two.

As you become more skilled at evaluating stocks using metrics such as P/E ratios and P/S ratios, you may want to add some micro-cap growth stocks to your portfolio. For now, however, I would stick to less-risky stocks, such as blue chips and large caps.

Shorting a stock

Shorting a stock is basically a method of betting against the stock market. In essence, you're betting that a stock's price will fall at some point in the future.

It works like this: you open a position by borrowing shares of a stock that you don't own. You don't own it. You *borrow* it from another investor (usually your broker), and you'll have to return it at some point in the future.

After you borrow shares of a stock, you sell them to another investor at the current share price. You hold on to the money and wait. If the stock does indeed go down, you can buy your shares back, return them to your broker, and keep the profits.

For instance, let's say you think Stock A, which trades at $50, is overpriced. You borrow 10 shares from your broker and sell them to another investor for a total of $500. Let's say the stock goes down to, say, $40. You buy 10 shares of Stock A (at $400), return the 10 shares to your broker, and pocket the $100.

Seems like a good investment, right? If you guess right, then it is. But if you guess wrong? Well, that's when it can start to get ugly.

Let's say, instead of going down, Stock A goes *up.* After a few weeks, share prices hit $60. You wait. A few weeks later, share prices hit $70. Stock A's company has hit a major stride, and you decide to buy back the stock before the price goes even higher. You buy 10 shares (now $700), return them to your broker, and eat the $200 loss.

Again, as with micro-caps, shorting a stock can offer you some hefty rewards. But you have to know what you're doing. If you don't, your losses could be even heftier.

Are these three investments *always* bad?

No. In fact, many investors have gotten rich on micro-caps, short-selling, and, yes, even penny stocks. The point I'm trying to make is that each of these is far riskier than investing your money in blue chips, large caps, and even exchange-traded funds. If you're new to investing, I would get my feet wet with individual stocks and funds first. After you're comfortable choosing stocks wisely, then you can graduate to more advanced investment techniques — if you want to take on more risk, that is.

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