These Beginner Stock Trading Mistakes Could Stop You From Long-Term Success

Description

Lately, stock trading has become immensely popular. Once reserved for wealthy people with time and an appetite for risk, stock trading has become more accessible through stock trading apps, fractional shares, and robo-advising.

That's good — great, in fact. I love to see more Canadians passionate about stocks, as it's one of the best ways to build substantial wealth over the long term.

But with more accessibility comes a higher likelihood of making mistakes. Even more so with a stock portfolio on your phone. You might feel tempted sell when it's wiser to hold on, for instance, or you might pick a bad stock, simply because you didn't spend time researching the company itself.

If you're new to stock trading, and you don't want to go broke, here are three common mistakes to avoid.

1. Buying a stock because everyone else is

When you're new to stock investing, you might gravitate toward stocks that other investors have hyped up. You might see a stock that climbs significantly overnight, or you may have heard stories of a stock that's more than doubled its value in a year. And you might feel tempted to buy shares on this knowledge alone.

But, in general, it's not wise to buy stocks simply because everyone else is. While, yes, hype could lead you to a good stock pick, the method by which you arrived at it is flawed.

Instead, you should invest in companies you understand and believe have long-term value. Thatmeans you should dig into your stocks, regardless of whether other investors believe in them. Useevaluation metrics, like a P/E ratio, to dig deeper into the stock’s price. If your independent researchtells you that stock is a good pick, then by all means — buy some shares.

2. You mistake “trading” as “investing”

“Stock trading” and “investing” aren’t interchangeable. Traders and investors want to earn profits from their investments — true. But the way they go about doing this is different.

Investors identify stocks that have long-term value and growth potential. They buy shares of these stocks and then hold them for the long run. Their goal is to increase their initial investment over five, 10, or even 15 years.

Stock traders, however, move in and out of stock positions daily. They don’t necessarily care about long-term growth. They want to find a stock that will performance exceptionally in the short term. And they want to sell their shares and earn a profit before the stock dips.

Newbies to stock trading should understand that what they’re doing isn’t investing. It’s trading, and it comes with more risks than investing. As long as you understand the risks involved with stock trading and as long as you know what you’re getting yourself into, I won’t discourage you from it. But if you’d rather get long-term growth rather than short-term gains, you might want to consider changing your strategy.

3. You use margin to buy stocks

When you open a margin account, you can borrow up to 70% of a stock’s value from your broker (this percentage varies from broker to broker as well as from security to security). For instance, if you wanted to buy $1,000 worth of stock, you could borrow $700 from your broker and contribute $300 of your own money.

In theory, it sounds like a good idea: with borrowed money, you can buy more stock with less of your own cash. But in practice, it can easily go astray.

For one, you can lose a lot of money fast. For instance, if you had invested $1,000 in a stock, and your stock lost 50% of its value, you could sell your shares and walk away with $500. That’s a $500 loss, but it’s not a total loss.

With margin trading, you would have a total loss in this scenario. You would lose your $500 investment, and you would have to return the other $500 to your broker. On top of that you would also pay interest on top of what you borrowed (much like a loan), along with fees. As you can see, this can get expensive.

As a new investor, I'd say stay away from margin accounts, at least until you gain some more experience. Use your own money to invest, not borrowed money, and you won't risk losing moremoney than you can stomach.

Our Foolish bottom line

If you're new to investing, I would suggest learning different investing strategies, picking one, and then sticking with it. Though you might feel tempted to trade stocks for quick gains, you're probably better off establishing a long-term investing strategy first.

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