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5 Common Mistakes Young Investors Make

by Wayne Pinsent (Contact Author | Biography)

When learning any skill, it is best to start young. Investing is no different. Missteps are common when learning something new, but when dealing with money, it can have serious consequences. Investors starting young generally have the flexibility and time frame to take on risk and recover from their money-losing errors, but sidestepping the following common mistakes can help a novice investor be more successful over time.. (In addition to this article, read *Eight Financial Tips For Young Adults*.)

1. Procrastinating
Procrastination is never good, but with asset prices and the market moving constantly, it can be especially detrimental while investing. Good investment ideas are not always easy to find. If, after doing research, a good investment idea arises, it is important to act on it before the rest of the market takes note and beats you to it. Young investors can be particularly prone to not acting on a good idea out of fear or inexperience. Missing out on a good idea can lead a young investor to two very bad scenarios:

- The investor will revise his opinion upward and still purchase an asset when it is not warranted. Perhaps the investor rightly develops an opinion that an asset priced at $25 should be worth $50. If it moves up to $50 before he or she buys it, the investor may artificially revise the price target to $60 in order to rationalize the purchase.
- The young investor will look quickly for a replacement. In the previous example, the investor who failed to buy the asset that rose from $25 to $50 may quickly try to identify the next asset that will double. As a result, the investor might purchase another asset quickly, without doing the proper work and research, in order to try to make up for the previous "missed opportunity." (Young investors often find themselves with too many options and not enough money. Read more in *Competing Priorities: Too Many Choices, Too Few Dollars*.)

2. Speculating Instead of Investing
A young investor is at an advantage in his or her investing life. Holding the level of wealth constant, an investor's age affects how much risk an he or she can take on. So, a young investor can seek out bigger returns by taking bigger risks. This is because if a young investor loses money, he or she has time to recover the losses through income generation. This may seem like an argument for a young investor to speculate, but it is not.

Any young or novice investor will have an inclination to speculate if they do not fully understand the investment process. Speculation is often the equivalent of gambling, as the speculator does not necessarily have a reason for a purchase except that there is a chance that it may go up in value. This can be dangerous, as there are many experienced professionals waiting to take advantage of their less-experienced counterparts.

Instead of speculating and gambling, a young investor should look to invest in companies that have higher risk but greater upside potential over the long term. So, while a diversified portfolio of small-cap growth stocks would not be appropriate for an investor nearing retirement, a young investor is better equipped to take on that risk and can take advantage accordingly.

A final risk of speculation is that a large loss can scar a young investor and affect his or her future investment choices. This can lead to a tendency to shun investing altogether or to move to lower or risk-free assets at an age when it may not be appropriate. (For more insight, see *Personalizing Risk Tolerance*.)

3. Using Too Much Leverage
Leverage has its benefits and its pitfalls. If there is ever a time when investors have the ability to add leverage to their portfolios, it is when they are young. As mentioned earlier, young investors have a higher ability to recover from losses through future income generation. However, similar to speculation, leverage can shatter even a good portfolio.

If a young investor is able to stomach a 20-25% drop in his or her portfolio without getting discouraged, the 40-50% drop that would result at two times leverage may be too much to handle. The consequences of such a drop are similar to those resulting from a loss due to speculation: the young investor may become discouraged and overly risk averse for the rest of his investing life. (Want to learn more about leverage? See *Leverage's "Double-Edged Sword" Need Not Cut Deep* for more.)

4. Not Asking Enough Questions
If a stock drops a lot, a young investor might expect it to bounce right back, but more often than not, it is down for good reason. One of the most important factors in forming investment decisions is asking why. If an asset is trading at half of an investor's perceived value, there is a reason and it is the investor's responsibility to find it. Young investors who have not experienced the pitfalls of investing can be particularly susceptible to making decisions without locating all the pertinent information.

5. Not Investing
As mentioned earlier, an investor has the best ability to seek a higher return and take on higher risk when they have a long-term time horizon. Investors have their longest time horizons, and therefore a high tolerance for risk, when they are young. Young people also tend to be less experienced with having money. As a result, they are often tempted to focus on how money can benefit them in the present, without focusing on any long-term goals (such as retirement). Spending money now instead of saving and investing can create bad habits and contribute to a lack of savings and retirement funds. (For more on this, read *Young Investors: What Are You Waiting For?*)

The Bottom Line
Young investors should take advantage of their age and their increased ability to take on risk. Applying investing fundamentals early can help lead to a bigger portfolio later in life. There are also many risks that a young/less-experienced investor will face when making decisions. Hopefully,

avoiding some of the common mistakes above will help young people learn investing early and embark on a fruitful investing career. (If you're a parent looking to teach your child about investing, take a look at our article *Teach Your Child About Investing*.)

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