AIM Well To Invest Well

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It's a proven fact that a goal-based investment process is the key to achieving investment success for investors. While a time horizon assigned to each of the goals helps in ascertaining an appropriate asset allocation, it also ensures that the investment process kick-starts on the right note. Having a well-defined time horizon and asset allocation also makes it easier for investors to tackle market volatility and stay focused on the goals during periods of turbulence in the stock market.

However, despite having a clear roadmap, some internal and external factors can create challenges for investors from time to time. The level of investment success an investor can achieve will also depend upon how these challenges are tackled and whether basic investing principles are followed or not. Therefore, you must stick to your asset allocation and make rational investment decisions during your defined time horizon. Here are some of the factors that can derail your investment portfolio, if not tackled well.

Lack of Diversification and | or Over-Diversification — While diversification is the key to curbing volatility in the portfolio, lack of diversification and | or over-diversification in the portfolio can expose you to higher risk. Remember, a concentrated portfolio has the potential to generate higher returns, but the losses could be higher too. Similarly, over-diversification in the portfolio allows non-performing investment options to remain in the portfolio and that can make a dent in your portfolio return. Therefore, you must avoid over-diversification and monitor the progress of the portfolio regularly to weed out non-performers from the portfolio.

Investing in 'Flavour of the Month' Funds — Investing in aggressive funds like small-caps, sector and thematic funds topping the chart during certain market phases can result in much higher volatility and losses in the portfolio. While it is true that these funds have the potential to deliver higher returns during certain market phases, there is no guarantee that it will happen. In fact, if the timing of entry and exit is not right, the losses can be detrimental to your investment process.

Relying on Recent Performance — Relying on short-term performance for fund selection can either make your portfolio very aggressive or very conservative based on what's working out at that point of time. While higher allocation to equity based on short term performance in a rising market can take you beyond your risk-taking capacity, a conservative portfolio can bring your real rate of return down.

Disregarding your Time Commitment — Remaining committed to your time horizon can help you manage losses. Since equities do well over the long term, losses should be treated as drop in portfolio valuation rather converting them into real losses. Over time, equity portfolio can deliver positive real rate of return. Therefore, once a time horizon is decided, stay committed to it to benefit from the true potential of equities and enhance the chances of achieving your long-term goals.

Ignoring Opportunity Losses — Opportunity loss is the value or potential gains that an investor forgoes by choosing a specific type of asset, investment option or strategy. Frequent instances of opportunity losses can make a significant impact on what you get to accumulate over time. Therefore, monitor your portfolio regularly and be aware of opportunities that can help you improve your portfolio returns. Of course, making frequent changes can become counter-productive.

Investing Conservatively Can Backfire — There can be a temptation to invest in less risky investments like bonds, fixed deposits (FDs) or small saving schemes to avoid losses in the portfolio. However, ignoring the risk of inflation and staying away from market-linked products can result in a heavy loss in terms of negative real return. Therefore, including equity and equity-related funds should be a priority for long-term investments.