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10 iconic mistakes investors make

(and how to avoid them)

Even the best investors succumb to emotion when making decisions. Understanding how emotion can impact your investment decisions will put you in a much better position to make rational decisions.

By devising an investment plan suitable to your own situation - and sticking to it – will also ensure you are appropriately positioned to avoid the most common errors (and emotions) investors experience when buying and selling shares.

To avoid expensive investment traps you must second-guess the investor herd-mentality, which is typically fuelled by fear, greed and uncertainty. Whilst it may seem counterintuitive to defy 'conventional' investor wisdom, buying when others are selling, and exiting those stocks when those same investors are crawling over themselves to buy more, is a sensible approach. Legendary value investor Warren Buffett says so too!

To help you avoid costly errors going forward, here's a refresher on the ten most commonly made investment mistakes even seasoned investors fall into.

1. Treating the share market like a lucky dip
2. Buying tomorrow's dogs
3. Riding the market down instead of selling
4. Fascination with price over value
5. Lured by unsustainable yield
6. Overlooking the big-picture
7. Setting and forgetting
8. Not having an investment plan
9. Quick buck syndrome
10. Backing value destroying capital raisings

How many of these iconic mistakes have you made in the last year?

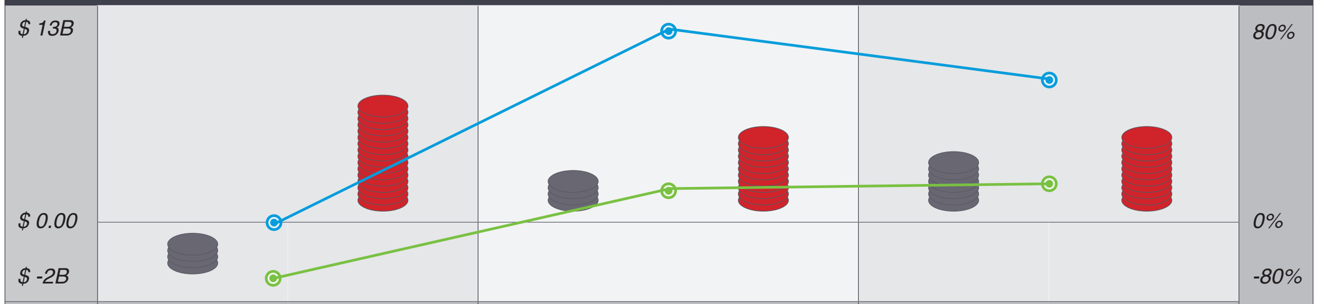
Treating the share market like a lucky dip

While punters are happy to trade-off higher levels of risk on the off chance it might deliver higher-than-average returns, smart investors reduce the risks associated with holding a listed company while maximising returns.

Part of being a good investor is recognising that you're buying into a business that employs staff, borrows money, generates earnings from one or more core business activities, and where appropriate pays dividends. So unless you're a day trader, buy companies based on quality fundamentals not share price momentum, and avoid low quality businesses displaying little opportunity for growth.

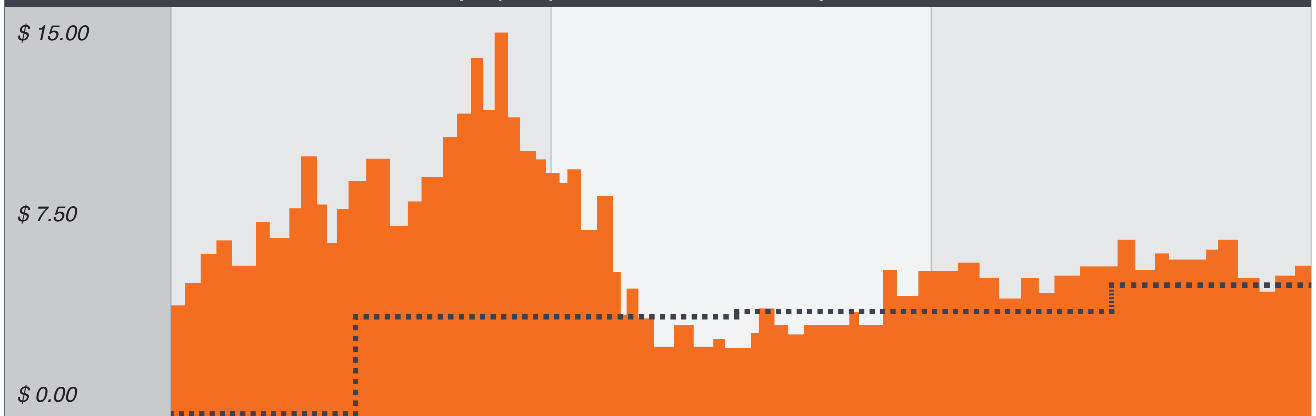
Fortescue Metals Group (FMG) share price peaked at almost $13.00 in 2008. That year the company had more than $6 billion debt on its balance sheet and reported a net loss of more than $2.5 billion. Skaffold estimated its business was worth $0.00. By the end of 2008 FMG's shares had fallen to less than $1.30. Avoid low quality businesses and stop treating the share market like a lucky dip.

Skaffold presents Fortescue Metal Group's (FMG) history of equity, debt, profits and business performance



	2008	2009	2010
Equity	$-1,639.68	$1,048.43	$1,659.36
Debt	$6,306.62	$3,167.75	$3,358.25
NPAT	$-2,516.24	$626.046	$655.409
ROE	0.00%	64.53%	48.70%

Skaffold Line chart of Fortescue Metal Group's (FMG) intrinsic value and share price



	2008	2009	2010
Share price	$11.90	$3.79	$4.12
Intrinsic Value	$0.00	$3.05	$3.08

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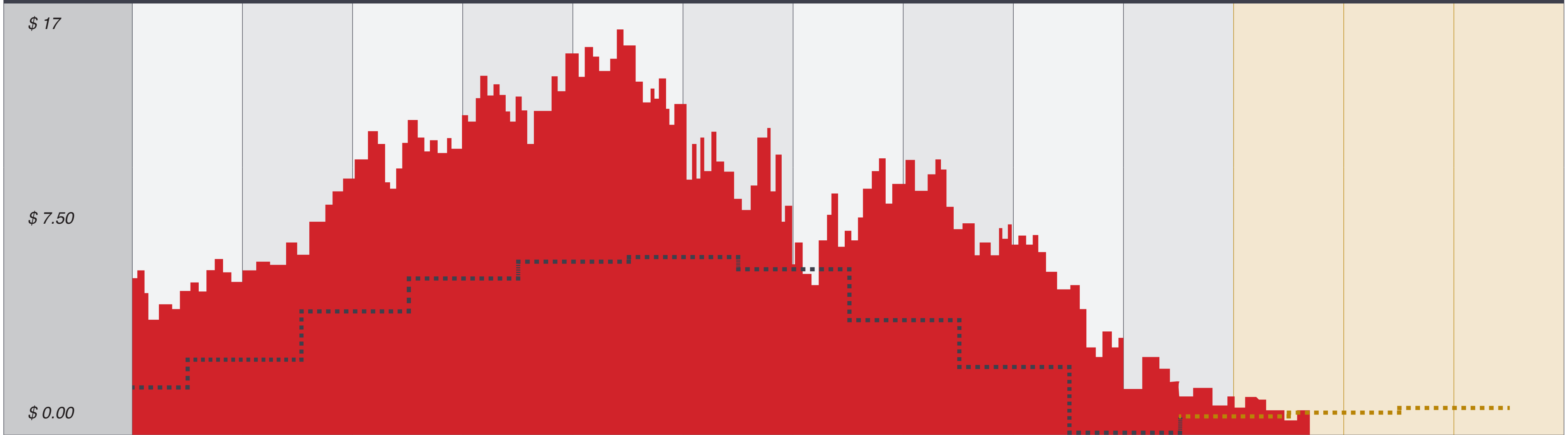
Buying tomorrow’s dogs

As an astute investor you need to recognise whether the company you’re considering buying represents value for the price you’re prepared to pay for its shares. Remember, Buffet proved convincingly that share prices eventually converge with a company’s intrinsic value (the sum total of the company’s worth based on earnings, dividends, equity and debt). Ideally you want to buy good companies when there is a large discount between the share price and its underlying value. Paying too much for a top-quality company can destroy wealth as fast as investing in those with excessive debt. Similarly, avoid value-traps. While they appear cheap (based on P/E), these companies have questionable debt levels, fading competitiveness and declining cash flows. If you’re drawn to a company because its shares are under the psychological $1 barrier you could be confusing affordability with value.

In the early noughties Billabong was a market leader. When the company failed to adapt to the changing youth market its sales plummeted – so did the company’s intrinsic value and its share price.

Skaffold Line chart of Billabong International’s (BBG) intrinsic value and share price



	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Share price	$4.66	$6.28	$10.36	$11.66	$13.64	$8.21	$6.96	$6.95	$4.78	$1.08	$0.15		
Intrinsic Value	$2.58	$3.17	$4.72	$5.66	$6.10	$6.24	$5.80	$3.98	$2.16	$0.00	$0.01	$0.05	$0.15

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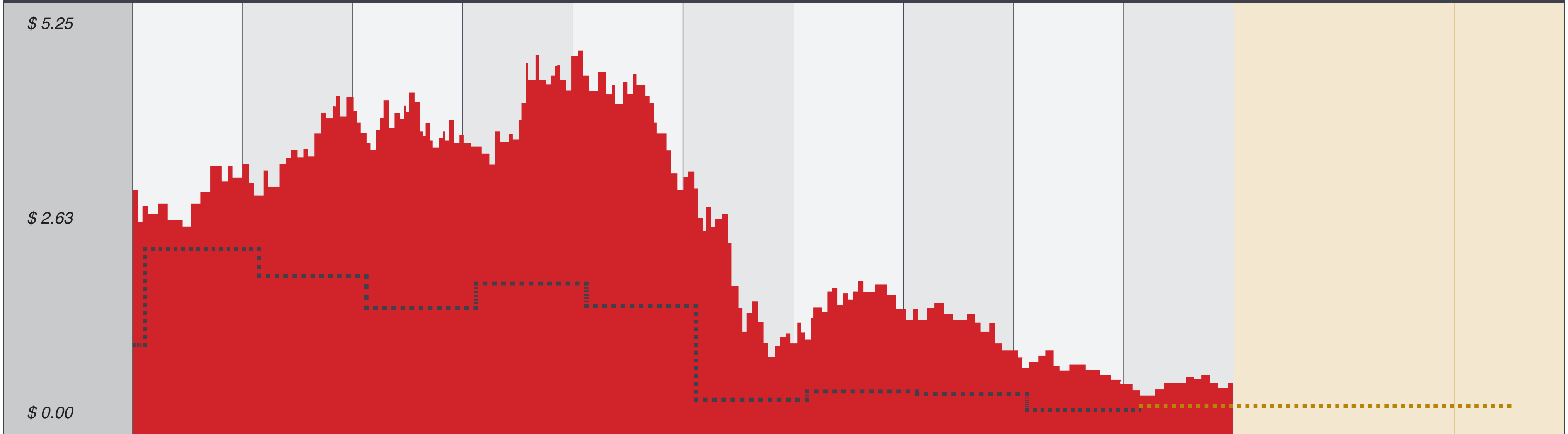
3 Riding the market down instead of selling

The closer a company's share price gets to its intrinsic value, the greater the risk of holding the stock. And the more the share price exceeds a company's intrinsic value, the greater the argument for locking in your gain. So don't be too greedy and don't rely on unwarranted optimism.

In early 2007 Fairfax Media's share price was almost three times higher than what its business was worth. Locking in a profit would have been the wise decision. FXJ is now trading around $0.50 and its intrinsic value, according to Skaffold, is closer to $0.30.

Equally important, remember this: stocks with low P/E ratios or high dividend yields have typically become that way for good reason. Take these smouldering time-bombs out of your portfolio before they do greater damage, and use the funds to buy superior investment opportunities.

Skaffold Line chart of Fairfax Media's (FXJ) intrinsic value and share price



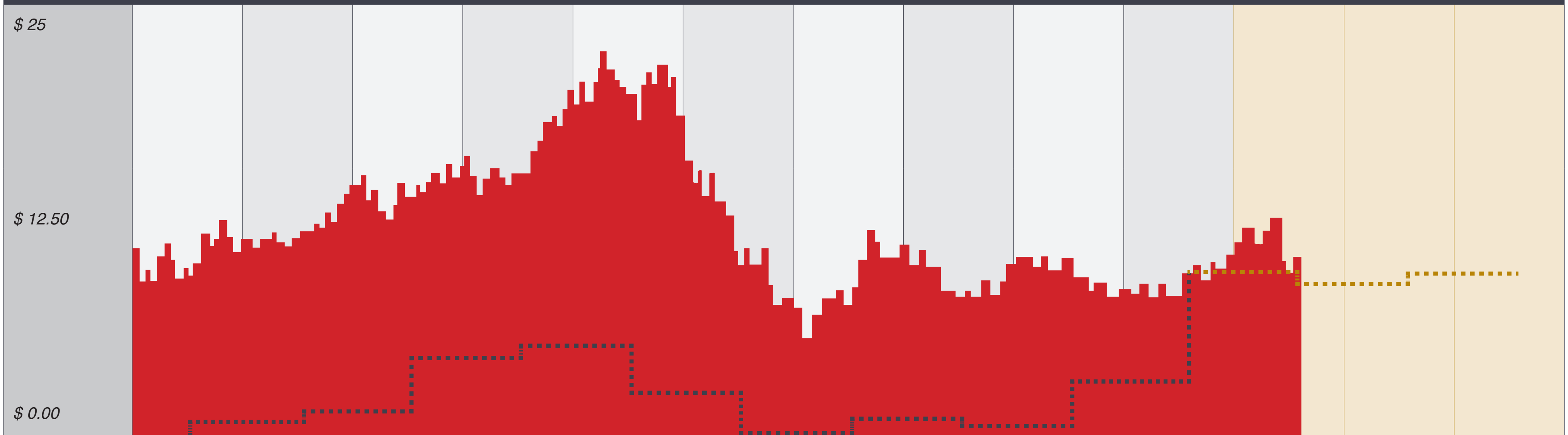
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Share price	$2.67	$3.46	$3.99	$3.48	$4.36	$2.69	$1.23	$1.36	$0.98	$0.58	$0.49		
Intrinsic Value	$0.96	$1.55	$1.48	$1.25	$1.72	$1.59	$0.50	$0.59	$0.55	$0.26	$0.28	$0.30	$0.31

4 Fascination with price over value

Contrary to popular opinion, P/E ratio - (current) share price / (historical) earnings per share - reveals nothing of the value of a company. All it reveals is what the market is prepared to pay for the current earnings per share. More meaningful measures when it comes to stock selection are the following performance ratios: Intrinsic Value; return on equity (ROE), which should be greater than 15%; management's track-record; net-debt to equity, which should be under 40%; and earnings per share (EPS) growth, which offers a snapshot into future prospects and profitability.

Lend Lease (LLC) appears cheap on a P/E ratio of 9.7, however a comparison of value and price reveals the stock is overvalued by more than 15%. Future growth is also forecast to be flat over the next few years.

Skaffold Line chart of Lend Lease Corp's (LLC) intrinsic value and share price



	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Share price	$8.07	$9.93	$12.52	$13.52	$17.91	$9.23	$6.77	$7.33	$8.97	$7.20	$8.15		
Intrinsic Value	$0.00	$0.39	$0.70	$3.98	$4.34	$1.82	$0.00	$0.40	$0.15	$3.16	$8.13	$7.67	$8.06

5 Lured by unsustainable yield

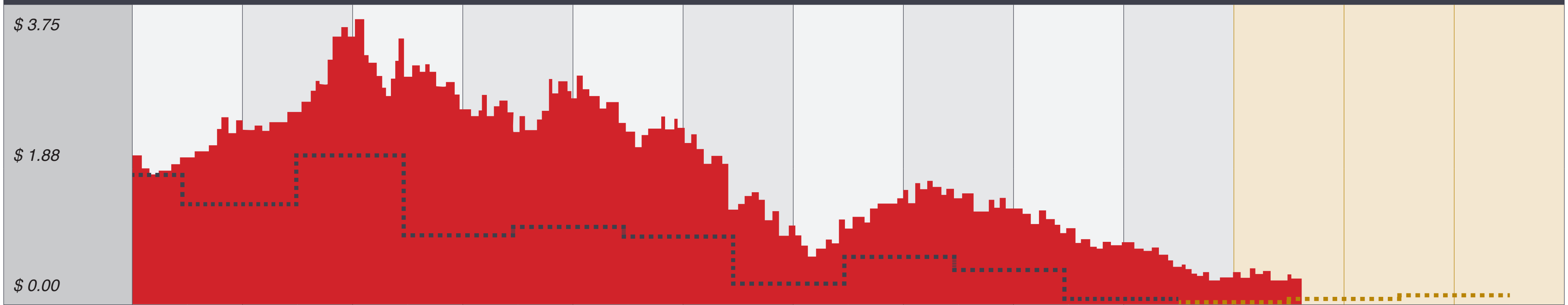
A key determinant of affordable dividends is the quality of the underlying business, and its ability to consistently grow earnings. So avoid companies offering dividends that cannot be supported through cash generated by the business, and those that only have a high dividend yield based on a falling share price due to declining fundamentals like high debt, falling profits or negative cash flow. View any signals that current dividend levels are no longer affordable as an opportunity to exit the stock.

In 2004, 2006, 2011 and 2012 Ten Network paid dividends that exceeded its reported profit. In 2009 the company reported negative net profit of $89.354 million, and still paid out almost $20 million in dividends. Between 2004 and 2010 TEN's dividend yield fell from around 7% to 0%. Over time TEN's dividend policy eventually caught up to the economics of its business. TEN's share price has headed in the same direction.

Skaffold presents Ten Network's (TEN) recent history of cash flow

	2008	2009	2010	2011	2012
NPAT	$273.482	$-89.354	$150.007	$10.614	$-2.497
Dividends	$125.225	$18.505	$0	$114.976	$58.351
Cash Flow from Ops	$146.420	$66.639	$105.713	$96.537	$41.790
Funding Surplus/Gap	$-18.957	$25.271	$87.680	$-59.279	$-42.782

Skaffold Line chart of Ten Network Holdings (TEN) intrinsic value and share price



	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Share price	$1.82	$2.65	$2.89	$2.12	$2.05	$1.33	$0.98	$1.07	$0.74	$0.32	$0.27		
Intrinsic Value	$1.47	$1.13	$1.64	$0.63	$0.70	$0.58	$0.19	$0.46	$0.35	$0.01	$ 0.00	$ 0.02	$0.09

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6 Overlooking the big-picture

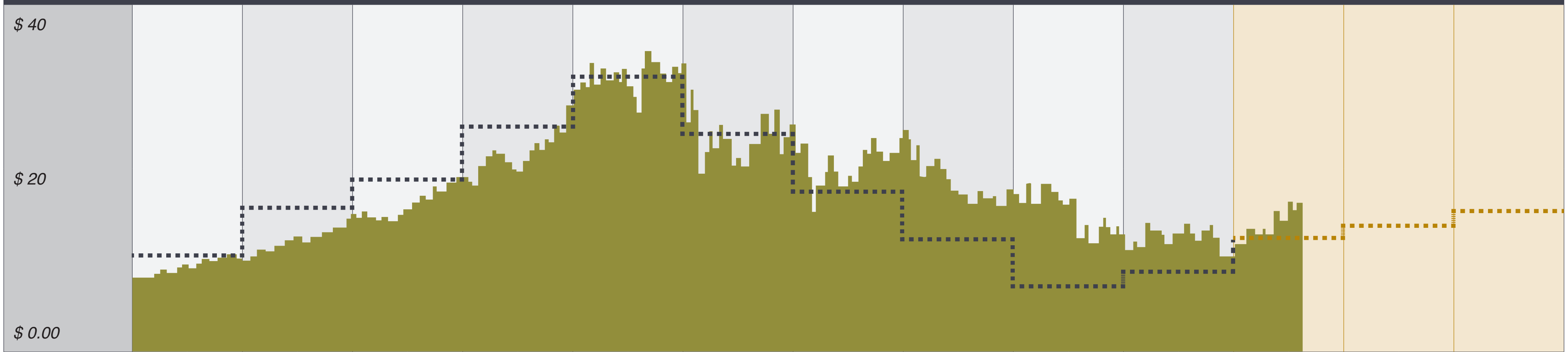
Every company, whether listed on the ASX or privately owned, is impacted by a wide variety of macroeconomic influences. These leading (domestic) indicators provide useful insights into what sectors and stocks stand to benefit (or lose) from the economic activity directly beyond their control. The key economic indicators you need to keep an eye on include: Interest rates, currency, job vacancies, unemployment rate, building approvals, trade balance, GDP, housing credit, commodity prices, and inflation as measured through CPI. By keeping abreast of the global and local economy, you'll be better positioned to actively review your investment portfolio in light of those sectors that will either benefit or suffer going forward.

7 Setting and forgetting

Within an environment where the market can move as much as 1% in a week, a 'set & forget' approach must give way to a strategy for actively managing shares. Remember that value is constantly moving and keeps pressure-testing your stocks against key fundamentals. Companies with strong brand names, high profiles and a long history of good performance cannot be relied upon to be perennial bellwethers. That's because past performance is no guarantee of future returns.

QBE's intrinsic value rose between 2003 and 2007, then fell to a low of $5.73 by 2011. Failing a catastrophic natural disaster (or another GFC), Skaffold forecasts QBE's intrinsic value should rise over the next two years.

Skaffold Line chart of QBE Insurance Group's (QBE) intrinsic value and share price



	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Share price	$10.60	$15.35	$19.60	$28.85	$33.34	$25.81	$25.60	$18.15	$12.95	$10.90	$15.30		
Value - Actual	$10.78	$16.49	$19.61	$26.19	$31.78	$24.77	$19.17	$10.45	$5.73	$6.23	$11.25	$13.54	$16.18

8 Not having an investment plan

It can be incredibly empowering to comprehensively review your current financial position, and if you do, you're more likely to develop an investment strategy that's custom made for your specific requirements. Before devising an investment plan, it's important to have an accurate picture of your cash flow, including income, regular outgoings - especially any discretionary spending - and your capacity to save/invest surplus money. "Do not save what is left after spending, but spend what is left after saving", is a handy piece of advice from Warren Buffett.

The right plan for you will depend on a myriad of factors - none the least being your age, earnings and existing assets - which have a direct bearing on both your investment time-horizon, and risk/reward profile. While cautious investors would also like above average returns, their need for wealth preservation is higher than more aggressive investors who can afford to take greater risks in pursuit of higher gains.

All good investment plans will have one aim in common, wealth accumulation over time. Learning how to invest and understanding why will help crystallise your short and longer-term financial goals, and ensure you diversify your portfolio's exposure to key asset classes according to your risk appetite. Exactly how much of your portfolio is allocated to each asset class should directly reflect economic conditions and investment prospects, plus your requirement for investment generated (or passive) income. Given that markets are constantly moving beasts, your plan needs revisiting regularly.

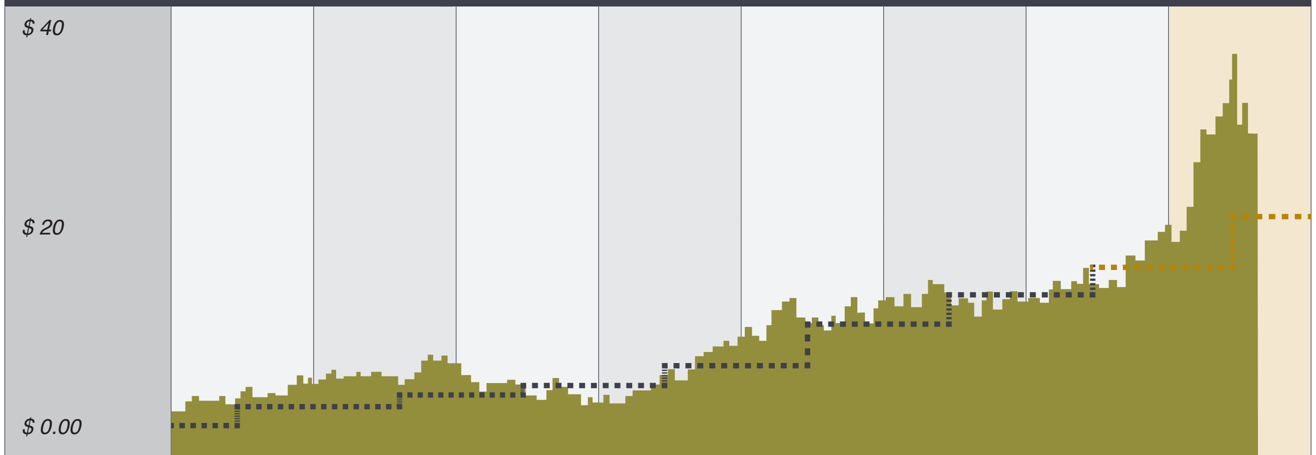
9 Quick buck syndrome

We're entering an era where longevity is the 'new norm', and you may spend as much time in retirement as you did working. So remember that while you'll seek short-term wins, wealth creation through share price appreciation happens over the longer haul.

Since 2003 - 10 years ago - the intrinsic value of REA Group has risen close to 50% per annum, and the share price has followed.

Average returns for the last 18 years (1995 to 2012) saw listed Australian shares deliver 10.93% - at that rate your investment would have more than doubled every 7.2 years. But while it's important to stay 'in the market', that doesn't mean buying stocks and parking them in the bottom drawer indefinitely.

Skaffold Line chart of REA Group's (REA) intrinsic value and share price



	2007	2008	2009	2010	2011	2012	2013	2014
Share price	$5.94	$4.38	$5.95	$10.67	$11.90	$13.71	$27.53	
Intrinsic Value	$1.51	$3.47	$4.45	$6.76	$9.58	$12.28	$19.91	$24.50

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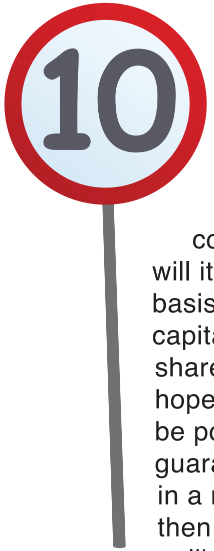
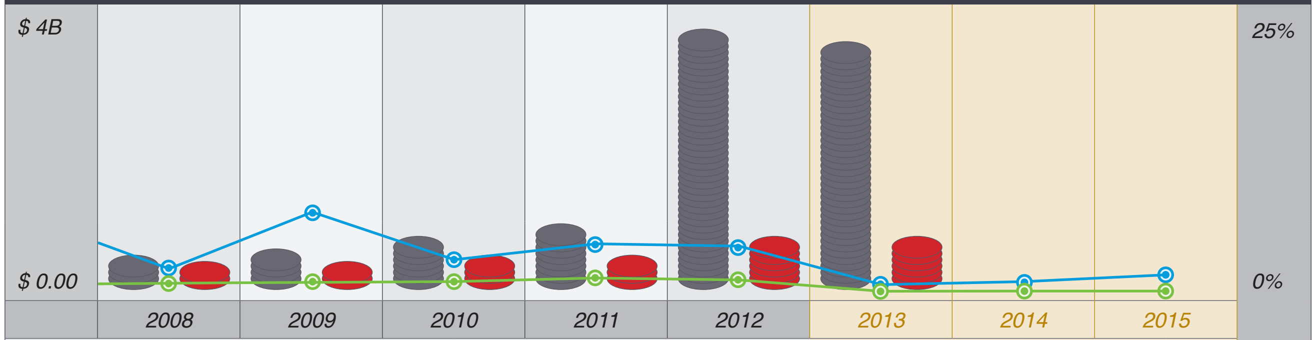


Backing value destroying capital raisings

A capital raising may reduce company debt, but the question is: will it increase value on a per share basis over the long term? Typically a capital raising will dilute earnings per share (EPS) in the short term, in the hope that the future earnings impact will be positive, but this outcome is never guaranteed. So if a capital raising results in a material decline in intrinsic value, then sustainable price increases are unlikely. In the long run a company's share price and its intrinsic value are destined to converge at some future point.

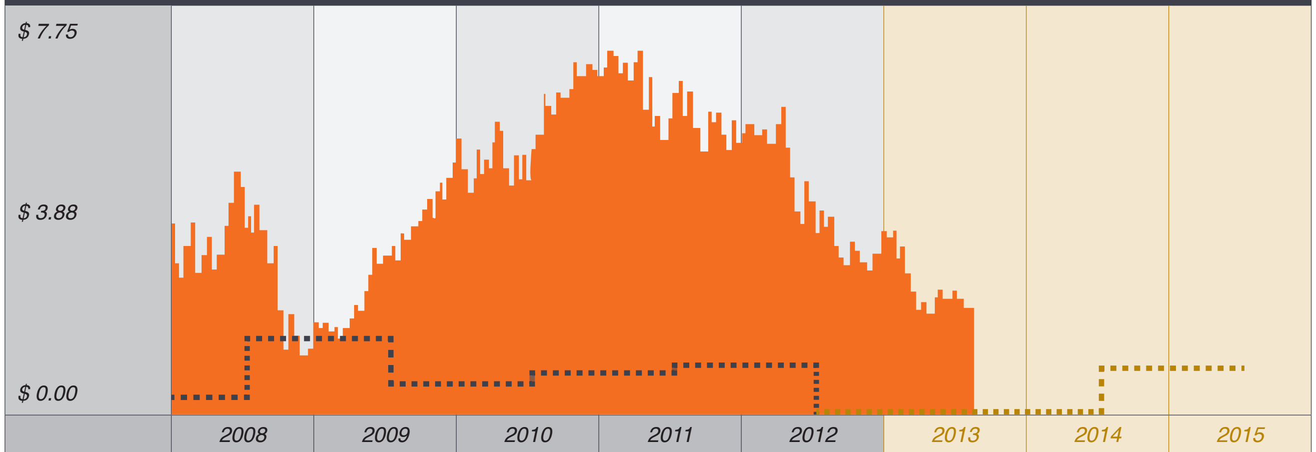
In 2012 Whitehaven Coal (WHC) raised more than $2,500 million and added more than $300 million debt to its balance sheet. Over the same period profits fell $20 million and return on equity more than halved, to 3%.

Skaffold presents Whitehaven Coal's (WHC) history of equity, debt, profits and business performance



	2008	2009	2010	2011	2012	2013	2014	2015
Equity	$489.529	$722.845	$1,023.18	$1,040.54	$3,368.76	$3,325.96	$3,302.79	$3,357.15
Debt	$55.226	$78.268	$94.929	$178.593	$489.446	$487.528		
NPAT	$12.935	$77.318	$38.425	$71.198	$50.213	$-65.702	$-2.915	$101.303
ROE	3.57%	12.66%	4.20%	6.90%	3.22%	-1.95%	-0.09%	3.04%

Skaffold Line chart of Whitehaven Coal's (WHC) intrinsic value and share price



	2008	2009	2010	2011	2012	2013	2014	2015
Share price	$4.47	$3.14	$4.80	$5.83	$4.15	$2.35		
Intrinsic Value	$0.16	$1.24	$0.42	$0.71	$0.71	$0.00	$0.00	$0.38

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About Skaffold

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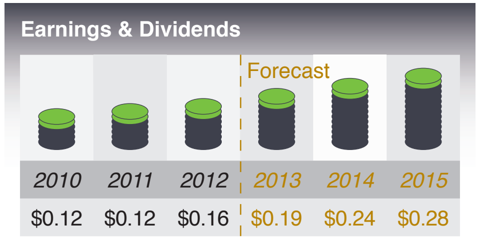
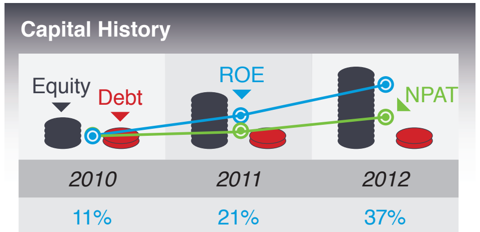
Sophisticated global stock research, as easy as child's play.

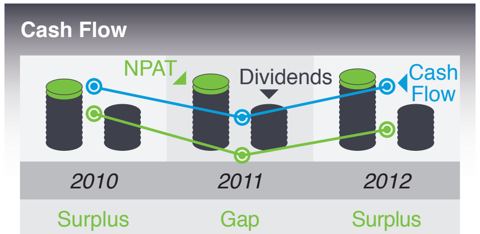
Skaffold makes it easy to pick the best value stocks from around the world in a blink of an eye. You'll be amazed by the level of analytical scrutiny presented in an easy to use interface, allowing you to evaluate thousands of stocks and identify investment opportunities in an instant.



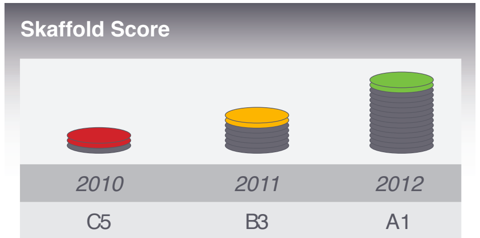
View up to ten years of historic Earnings and Dividends Per Share and where available, three years of forecasts. Instantly see if a company's earnings and dividends have been rising, and if growth is forecast over the next few years.



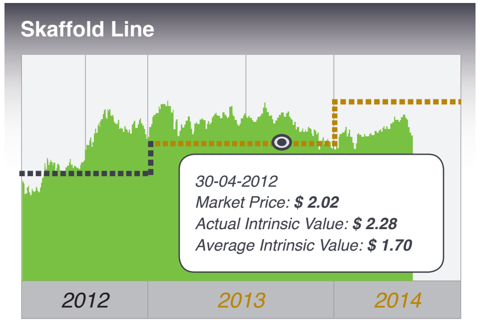
Capital History displays a company's relationship with its owners and lenders to help you understand its history of equity, debt and performance. Are profits rising? Are you comfortable with the level of debt? What about return on equity? A data table provides even more granular information.



Skaffold's Funding Surplus / (Gap), the green line, reveals how the cash generated has been utilised and whether the company has required external funding to finance its activities. Skaffold makes it easy to evaluate these vital aspects of a company's performance.



The Skaffold Score rates the quality and performance of every company, including consistency of earnings, debt levels and the quality of cash flow, from A1 to C5. Its easy to instantly see if a company meets your criteria and is worth further investigation.



A key component in evaluating a company and deciding when to purchase it is to estimate its intrinsic value. Every Skaffold Line chart, for every listed company, displays up to three years of future valuations and ten years of historical valuations so you can identify historically good-performing companies forecast to offer future growth.

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