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Six pieces of financial advice that you shouldn't follow and why

Not all financial advices are created equal. Some are beneficial while others could be damaging to your long-term financial wellbeing. Below are six pieces of financial advice often dished out by well-meaning advisors that you should view with some scepticism:

Time in the market is more important than timing the market-

One of the greatest enemies of most retail investors is their blind faith in a buy-and-hold strategy. Often, many kind-hearted advisors will remind us that it is not timing the market, but time in the market that matters, so we are usually too frightened to make any changes to our portfolio. It is hard to argue with them when they whip out charts after charts to prove that markets always go up in the long run.

However, as saying goes, "in the long run, we'll all be dead". An extreme example is the Nikkei index. It peaked in 1989 at about 39,000 points. However, today, 30 years later, the Nikkei stands at around 22,600 points. The Straits Time index peaked in 2007 at close to 4000 points, but today it stands at about 3200 points.

Blindly following the crowd can lead to financially catastrophic consequences. Often, investors are misled into buying into some hot stocks or overvalued asset classes and when the market turns against them, they hold on to it still in the hope that they can one day break even or recoup their losses. It is not surprising therefore that many retail investors I have spoken to are still holding on to the loss-making Singapore listed China shares they bought over 15 years ago.

To make money in investing, one need to monitor the market 24/7-

As the old adage goes, a watched pot never boils. However, in the hope of achieving double-digit returns every year, many impatient investors have almost zero tolerance for losses and so end up taking on too many risks. If their portfolio is not making progress within a month or two, they may be tempted to make some changes in the hope of improving the overall performance almost instantly. As a result, they often end up switching to the most favoured fund or stock of the day, which does their portfolio more harm than good in the long run as mean reversion kicks in.

So rather than monitoring your investment portfolio 24/7, it may be better to formulate some longer-term asset allocation strategies and review them only periodically. With a value-based strategic approach to asset allocation, you only

need to alter how much to assign to the various asset classes based on their relative valuation attractiveness periodically, say every three months.

This allocation strategy may seem deceptively passive, but you would be surprised to find that it still allows you to be nimble enough to take advantage of the many investment opportunities that present themselves from time to time.

If many people are investing in it, it must be good or safe-

It is only human to seek the warmth of fellow investors. But it pays to remember that the investment game is more like playing poker rather than roulette, as the action of other players can also affect you, whereas in roulette, the behaviour of others at the table is completely irrelevant to you. This means that when more investors are after the same asset class, this may alter the returns as compared to when fewer investors are after it.

When we see people around us buying into a stock that is going up, our minds perceive a pattern and are tricked into thinking that the pattern will continue to repeat itself. This is where there is a schism between real and perceived risk. The broader the schism, the more financial damage it can wreck on an investor's portfolio. In fact, a contrarian disposition to do the exact opposite of what everyone else regards as logical at that point in time is a vital ingredient for investing success.

For instance, in early 2009, I proposed that my clients should consider investing in the Asean market. Although most funds were losing value at that time, the region was more badly hit than most because of the political uncertainty in key markets like Thailand, Indonesia and even Malaysia. Valuations were therefore at an immensely attractive level. Not all were convinced, but those clients who did heed my advice would now be in a very good position to book their profits, as the region has since proven to be one of the top performers.

Risk profiling tests are useful tools for investment-

An interesting observation about risk profiling test is that the result for the same person may differ with changing market conditions. In a bearish market for example, most respondents would indicate their choice of risk aversion. In an environment where investors have been enjoying strong returns over the past years, the results would usually indicate a willingness to take more risks to achieve higher returns.

Theoretically, we should invest more in a bear market (when price is low) and sell into a bull market (when price is high). However, as risk profiling tests are subjective assessment based on the recent experiences of the taker, it may just cause one to invest too aggressively and defensively at the worst possible time.

For example, in the aftermath of the last global financial crisis, most who did their risk profiling tests in early 2009 would have indicated their preference for risk aversion. On hindsight, early 2009 could be one of the best moments in history to invest aggressively as most markets have about tripled in value since.

Diversification is an idiot proof strategy to lower portfolio risk-

While diversification a great theoretical approach to manage portfolio risk, I find that it is considerably harder in real life to reap its full benefit given our very interconnected world. The Diversification principle is centred around the idea that we can find many negatively correlated asset classes. Unfortunately, most asset classes are quite positively correlated. For example, during the last global financial crisis in 2008/09, we find both equity and bond dropping simultaneously. Even safe-haven assets, like gold, were not spared. In the past 2 weeks, while the US stock indices are flirting with their respective new highs, US bonds are also doing exceptional well as the US 10-year government bond yield drops from close to 3% to barely 2% (price goes higher when yield drops). US equities and bonds are demonstrating an almost perfect positive correlation currently. It could be argued then that they are also likely to suffer price correction at the same time.

Further, I have found most investors to be too heavily invested in their home country. One investor I spoke to claim that his portfolio is highly diversified. When probed, I realised he is invested mostly in Singapore real estate, Singapore listed stocks, Singapore corporate bonds with the rest of his money in SGD fixed deposit while working for a Singapore listed company. We can just imagine the impact on his portfolio if Trump decided to one day impose his Tariff on Singapore exports.

Bonds are always safer than equities-

In recent years, several Singapore dollar bond issues have gone under. The defaulters include bonds issued by PT Trikomsel, Pacific Andes Resources Development, Swiber Holdings, KrisEnergy, Ezion Holdings and Nam Cheong, among others. Bond defaults horded the limelight in recent months as a result of Hyflux's default. Different from past defaults which involved bonds privately issued by banks to their more affluent clients, Hyflux bond is a retail bond which was traded on SGX and involved a greater number of smaller investors.

Due to the low interest rates over the past decade, many Singapore investors, both institutional and retail, have opted to invest in bonds and often the riskier ones for their higher yields. The abundant liquidity situation has allowed smaller companies to tap the bond market. The bonds issued by these smaller, less established companies are usually called junk bonds or high yield bond. Such companies are typically more vulnerable to the economic cycle. Investors should remember that there is always a price to be paid for the supposedly higher yields. Many tend to brush aside credit risk when they invest in bonds because of the priority of bondholders over equity investors in the capital structure. This, however, is a mistake as defaults still can and do happen

As interest rates are expected to creep up in the coming decade from their historical lows, it would provide a strong head wind for would-be bond investors as higher interest equals lower bond prices.