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More Wealth, More Choices, More Traps: More Investment Options Can Mean More Perils

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Investing is complicated for everyone, but as you amass more wealth and have more investment choices, it only gets more complex. As it turns out, having more choices isn't always better; it often means more twists, tricks and traps. Here are six potential pitfalls to carefully avoid:

The exclusivity trap — Congratulations, your higher net worth "earns" you the right to invest in limited-access hedge funds, private equity funds, IPOs or other not-for-everyone investment vehicles. The lure of exclusivity may be a plus for marketing purposes, but it's no guarantee of less risk or higher return. In fact, getting past the velvet rope may come at the cost of big minimum investments or higher fees that significantly erode returns. Limited-access investments may also have smaller, less liquid markets or lockup periods that make them harder or impossible to sell.

The glossy brochure trap — When you have more money, you will likely also get more attention. You'll get more phone calls, more emails and more glossy brochures, many of them promoting specific investment products from annuities to commodities to currency trading systems. These marketing materials can be highly persuasive, but you should be cautious about any sales pitch that begins with the product instead of your goals, risk tolerance and income needs. BMW may send you a beautiful marketing piece for its latest high-performance motorcycle, but that doesn't make it the right ride for you.

The expertise trap — More investable income means more choice in general, including the choice to act on the expert advice of market commentators, subscribe to pundit newsletters or take the can't-miss advice of a wealthy friend. Experts can be convincing, but that doesn't make them right. And even when they are right on a stock pick or market-timing call, it still may not be the right investment for you or your goals.

The pre-fee, pre-tax trap — No matter how many times you hear the phrase "Past results are no guarantee of future performance," it's only human to look at historical returns when making investment decisions (along with Morningstar ratings, price/volume charts and other data with no predictive value). What gets less attention but deserves much more is the impact of sales charges, transaction fees, management expenses and taxes. Because what matters most is not what you earn, but what you keep. Fees and tax management are important considerations.

The sacred cow trap — Personal wealth is often concentrated in a single stock, thanks to a long career with one company, the sale or merger of a business, or inheritance. When you treat any big holdings as unsellable based on how you acquired them, the holdings can unnecessarily boost the risk level of your portfolio as a whole. Any single stock can crater based on a scandal, lawsuit, product failure, accident or rumor. Deliberate diversification is a smart, easy safeguard, even when it seems like treason to sell “special” stocks.

The by-the-slice trap — Potentially, the biggest trap of all is the purchase of any investment without an understanding of how it fits into your total portfolio. Overall investing performance — and the ability to meet important financial goals like a comfortable retirement — hinges less on the individual securities in a portfolio than on the overall asset allocation pie. How assets are distributed among stocks and bonds, and among different types of stocks, is the real key to risk and return. Any decisions that don't take overall asset allocation into account pose a real danger, regardless of your level of wealth.

The peril of emotion

These are just a few of the traps that await you in the investment arena, especially as your net worth rises. What's the common thread among them? Well, most have a distinct emotional element, a strong influence on decision-making that's driven by sentiment rather than science. Whether it's envy, loyalty, regret or impatience, emotion doesn't add much value in investing and often subtracts plenty.

As hard as it may be to vanquish emotions from the investment equation, it's one of the most important steps you can take as you negotiate through and around the traps of modern investing.

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Scott has been involved in the financial service industry for more than 20 years. He spent many years as managing partner for Raymond F. Book & Associates before becoming the managing member of Wealth Management Group. Scott uses the combination of tax knowledge and wealth management experience to help clients achieve their financial goals.

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