The 10 golden rules of investing

Most investors place too much importance on trying to choose between specific shares and bonds. However, it is usually core principles that dictate the success or failure of any wealth building strategy. These 10 rules outline the building blocks on which investors can create investment plans for long-term value accumulation.

1. Remember the power of compound interest

Make interest work for you

Compound interest is simple (pun intended). When you invest money, you earn interest on your capital. The next year you earn interest on both your original capital and the interest from the first year. In the third year, you earn interest on your capital and the first two years' interest….and so on. Even Einstein acknowledged the power of compound interest, famously calling it the "8th wonder of the world".

2. Invest on a regular basis over time

Fight emotion with discipline

Buy your selected shares/units at a slow and steady rate regardless of whether you think the market is about to rise or fall. A regular investment strategy not only helps to remove the emotional aspect of investing, it also enforces discipline.

3. Combat risk with diversification

Diversify across assets, sectors, styles, managers and securities

Diversification is one of the most fundamental rules of investing and allows you to take a middle road through the extremes of market performance, allowing your investment to grow regularly with smaller fluctuations along the way. Diversification is the most effective means of managing risk. You'll be less affected by losses in any one investment and losses may even be offset by gains in other investments.

4. Do not attempt to time the market

You can't reach your long term goals with short term thinking

'Market timing' is buying and selling based on the belief you can pick where the markets are heading in the short-term. In reality, this is very difficult to do. Share market growth has often come in dramatic spurts that can easily be missed if you're sitting on the sidelines waiting for an anticipated correction or bear market to occur. Russell research has shown that nobody can successfully time the market on a continual basis.

5. Allow for inflation

Your investments may not be growing as fast as you think

Inflation can wreak havoc on a long-term investor's money. Unless your returns keep pace with inflation, the purchasing power of your savings erode. Your investments should be evaluated not only for their returns before inflation (nominal returns), but also for their returns after inflation.

6. Understand the risk/return trade-off

Get your asset mix right - if you get this wrong, nothing else matters

Asset allocation is the key to meeting your objectives - it is often quoted that asset allocation explains 80-90% of a portfolio's total return. Investing almost always requires you to trade off higher expected returns with greater risk. The solution is getting the asset mix and amount of each asset right. Once you have decided on the mix that is right for you, stick to it, unless your circumstances change. A regular review with a financial adviser will allow you to address changing circumstances.

7. Stay in the market for the long haul

Time is your greatest ally

Time has two wonderful properties - reinforcing the power of compound interest and reducing the risk of a negative outcome. Share markets are naturally volatile, which means investors require greater average returns for investing in them. The range of historical returns for each asset class can guide investors on the range of returns that can be expected for a given period. Russell research has shown equity market volatility is a short-term phenomenon, and that equity markets consistently rise over the long-term.

8. Do not look at past performance

Research shows past performance is not indicative of future performance

Past performance is a very poor guide to future performance. Many investors believe investment managers worth considering are those that have performed well recently. This belief is probably based on the assumption that if a manager has done well lately, they must be clever and doing something right and, therefore, will continue to do well in future. Regrettably, past performance is of limited use as new situations can mean that previous strategies cease to outperform.

9. Do not lose your balance

Rebalance your asset mix to stay true to your tolerance for risk

An asset allocation strategy must have a commitment to preserve its weightings. As time goes by and markets experience ups and downs, your portfolio will gain in some asset classes and lose in others, causing your strategic asset allocation and actual portfolio to fall out of sync; this means you need to rebalance.

10. Call in the experts

Discuss strategies which can help meet your financial goals

If you wanted to design your dream house, you'd call an architect. Similarly, if you want to design an investment portfolio that best fits your needs, call a financial adviser. Quality investment management advice is not cheap but making poor investment decisions is a lot more expensive. Financial advisers are experts in the industry and as such, their advice is well worth taking.

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