Five Really Dumb Money Moves You've Got to Avoid

By Brett Arends | The Wall Street Journal

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You know the smartest things to do with your money. But what are the worst moves? What should you avoid?

Photo By Tim Foley/The Wall Street Journal

Weirdly enough, they are things that a surprising number of people are still doing—even though they probably know, in their heart of hearts, how foolish they really are.

Any list is going to be incomplete. But here are five to avoid.

1. Reaching for yield

What this country needs is a good 5% certificate of deposit. Instead the collapse in interest rates, and the Federal Reserve's policy of keeping them down for as long as possible, is driving people crazy—especially people who need to generate income from their investments.

In these circumstances, people start to do really foolish things in the desperate hunt for higher interest rates. That includes taking on crazy amounts of risk, or investing in complex products they don't understand, in the hope of higher yields. The Fed is producing a bull market in scams, Ponzi schemes and associated rackets.

The Securities and Exchange Commission recently warned about an epidemic of bogus high-yield "corporate promissory notes" being marketed to investors by scam artists.

The Wall Street Journal's Jason Zweig highlighted the woes of those sold complex "reverse convertibles," a legal but complicated product with embedded risks. Eric Lewis, chief investment officer of Bedrock Capital Management in Los Altos, Calif., suggests that if you can't explain an investment to a friend, including what might go wrong, you should think twice.

A high-yield bond fund such as the iShares High Yield Corporate Bond exchange-traded fund, which lends money to risky companies, sports a yield of about 5%. That's the maximum yield you can earn without taking on much more risk.

2. Going into the poor house to send Junior to a country-club college

Over the past 40 years, the cost of tuition and fees at a private university has tripled—after accounting for inflation. The cost of a public university has quadrupled.

The cost of getting a bachelor's degree has become a scandal in this country. Students spend $160,000 on a four-year degree and the results are too often questionable.

Financial planners strongly advise parents against plundering their own retirement savings, which they are likely to need, to pay for this.

Admittedly, a degree has become a protection racket—you can't get a job without one, but there are fewer jobs for those with them. But the smart move for the budget-constrained is to get a bachelor's degree at a public university. The tuition and fees average less than $9,000 a year instead of $30,000 at a private college.

3. Owning stock in your employer

This is one of the silliest and riskiest moves any investor can make. If the company hits trouble, you get whacked twice. You can lose your job and your savings—all in one fell swoop. Ask anyone who worked for Enron…or Lehman Brothers.

The law, amazingly, actually encourages this crazy move. While employers' 401(k) plans are subject to punitive regulations, lest they allow you to take on too much "risk," employers are allowed to offer their own stock among the investment options. Many do.

The Employee Benefit Research Institute says that the percentage of 401(k) assets held in employers' stock has been halved since 2000, but the numbers are still alarming. Furthermore, it's the youngest workers—those best able to take a gamble—who are shunning their employers' company stock.

At companies where the 401(k) plan offers the option, workers aged 40 or over typically hold about 20% of their entire 401(k) account in the company's stock, according to EBRI data. Crazy.

4. Taking Social Security too early

If you can afford to delay taking your Social Security retirement benefit, do.

Someone earning $50,000 a year who starts claiming Social Security as soon as he or she is able, age 62, will typically collect a monthly check of about $1,000, according to the Social Security Administration. If they wait until they are 70, that amount would double.

Taking Social Security too early, or without thinking through the consequences, is one of the biggest financial blunders people can make—roughly on a par with buying tech stocks in 2000 or a Las Vegas condo in 2006. The lure of getting money early can blind people to the big cost down the road.

(Many retirees may not have much of a choice. Hard labor at low pay over a lifetime takes its toll on a person. Also, many companies all but force older workers into early retirements.)

In any case, it doesn't take more than just a few years before the total money accrued with the higher, later benefits surpasses the total earned starting at the earlier retirement age.

But that understates the bigger issue. Social Security is insurance. For many retirees, the big risk isn't that they will run out of money before they turn 70, but after 85. According to the Centers for Disease Control, more than half of women currently age 65 will live to 85 or longer, and three out of eight men.

David Blanchett, head of retirement research for financial research firm Morningstar, says it makes sense for women, married couples and those with good health to wait longer for a bigger paycheck.

5. Buying long-term bonds

A surprising number of people still subscribe to the flawed and circular argument that bonds, including long-term government bonds, are "safe." In reality, bonds—especially long-term government bonds—are the rare example of a bubble that has been explicitly declared.

The Fed is openly printing money and using it to buy up such bonds, driving up the price and driving down the interest rates, in order to help the economy. There is no dispute about this. It's public policy.

A 30-year Treasury bond currently sports an interest rate of just 3.1%. That's barely half a percentage point above long-term inflation forecasts. Based on history, the yield should be at least 4.5%, or two percentage points above inflation.

Thirty-year Treasury inflation-protected securities, known as TIPS, sport a "real" or inflation-adjusted yield of 0.6% a year. Again, it should be 2%.

The only reason to buy such bonds in any quantity is to gamble on a 1930s-style depression and world-wide deflation. Such bonds are a gamble, not a safe haven.