SHOULD YOU SET UP A 'MAD MONEY' ACCOUNT?

Financial planners call them "mad money accounts" or "side accounts." They are accounts that financial planning clients set up to do their own trading of stocks, independent of any portfolio managed by the planner. The lure of high-returning tech stocks coupled with easy, inexpensive online trading and easier access to investment information has convinced many investors they have the stock-picking savvy of a Peter Lynch.

Whether you work with an investment advisor, or manage your own portfolio, here are some tips from experienced Certified Financial Planner professionals about setting up a mad money account.

Keep it separate from your principal portfolio. Planners recommend setting up a separate account with a discount or full-service broker. They recommend a separate account for several reasons. One, your main portfolio, whether managed by you or by an investment advisor, generally has long-range goals—retirement, funding the purchase of a business, college education and so on. You don't want to mix short-term trading of stocks with your long-term efforts.

Second, if a professional advisor is managing your portfolio, it's best not to mix in your own trading, even if the advisor is helping you select stocks for your side account.

Third, it's psychologically smarter to keep a separate account for what typically is higher-risk trading. That way, whether you're doing well or doing poorly, you will be less tempted to dip into your principal portfolio. It's not unlike people who go to a gambling casino with a set amount to gamble—if they lose all of it, that's it. They stop. They don't pull out their household checkbook or credit card.

Use no more than ten percent of your total funds. Most financial planners recommend that their clients limit the size of their mad money account to no more than ten percent of the value of their total portfolio. Some planners prefer five percent, or even less. The percentage you put into your mad money account should depend in part on the goals, reasonable market expectations and the importance of the "serious money" in your main portfolio. For example, if you are going to depend heavily on that portfolio to fund retirement or buy a business, you would want to limit your mad money exposure to a very small percentage of the total portfolio value.

Invest only money you can afford to lose. Don't risk your daughter's college fund, your emergency fund or your retirement money. Don't borrow from your credit cards, home or retirement accounts to finance your trades. Losses in your mad money account should never jeopardize other financial goals or your overall financial picture.

Invest in what you know. This is always good advice for any investments you make. However, the temptation in side accounts is to take flyers, or at least higher-risk investments. CFP practitioners find that their clients do best when they invest in stocks of companies or industries they are familiar with or have a special interest in, though that's never a guarantee of good results. It might be a regional company they know, the company they work for (if they don't already own their employer's stock) or companies in their industry.

Don't compete with your advisor. Setting up a side account shouldn't be a way to try to show your financial advisor that you can get better returns than he or she can. Your financial planner is managing your principal portfolio for your long-term goals and needs. That generally means a well-diversified mix of investments designed to produce steady, realistic long-term gains. A portfolio intended to fund retirement or college, for example, should not load up on high-risk Internet stocks (though it might include some). A side account, on the other hand, tends to be more aggressive, so returns have the potential to be higher—or lower—than the main portfolio.

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