Why New Investors Should Stop Hoping for Quick Gains

Description

The stock market is the place to go to make more money as interest rates remain historically low. For new investors, the stock market could feel like an online casino.

Oftentimes, new investors have set their minds to buy a stock, only to sell it at a higher price for a quick gain. In so doing, they believe they'll make money.

However, what comes after that? In order to earn money from your money, you pretty much have to reinvest those proceeds in another stock and hope to sell it again at a higher price at a future point in time.

Some people buy volatile stocks for this purpose. They watch a handful of stocks and buy at "low prices" and hope to sell at higher prices.

We have **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) as a volatile example to learn from.

Valeant Pharmaceuticals

From end of 2010's $35 a share, Valeant Pharmaceuticals's price shot all the way up to $345 in August 2015. That's a whopping price appreciation of 885%.

Yet Valeant Pharmaceuticals fell from its August high to $200 in late September. It hovered around that price level until mid-October. Some investors might have thought that it was a good time to buy.

However, it fell close to the $145 level near the end of October and fell again later to $93 level before bouncing to $128 and then falling to $117 today.

New investors who didn't know better might have bought around the $200 level, expecting it to bounce to the $300 level for a quick gain on the faulty reason that the stock had reached that higher price before. Or, simply put, they gambled that Valeant would move up in the short term.

More cautious investors might have jumped in when it fell further down to the $145 level. But if they had held until today, they would be sitting on a paper loss of 19%.

Sure, you can argue that a paper loss is not a real loss, but can new investors hold on to such a volatile stock that's like a roller coaster ride every second the stock market is open?

Short-term prices are unpredictable. Long-term prices follow earnings

In my opinion, short-term trading is not a good strategy because in the short term, no one knows where a stock's price is going to go. In the long term it follows business fundamentals and performance.

Simply put, the stock price follows earnings in the long term. If a company's earnings per share continues to rise over the long term, then eventually the share price will follow because the company is becoming more profitable over time.

In conclusion

If new investors buy volatile stocks, they might get into the bad habit of focusing on the price only and aim to buy low and sell high in the short term. Eventually, they're going to get burned really badly.

Instead, you should view stocks as businesses. Look at the business that drives the stock price in the long term.

Valeant's debt/cap ratio is actually around 80%. Usually, high debt levels spell trouble, especially if interest rates start to rise. Additionally, the business has an S&P credit rating of B+, which is hardly investment grade. I look for at least a credit rating of BBB+ for long-term investments. Why risk your hard-earned money on such a volatile stock?

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