Why Is it Dangerous to Invest for Quick Gains?

Description

Some investors (if you would call them that) trade in and out of stocks for quick gains. They must make big bets so the winnings are worthwhile.

However, if they bet wrong, the losses can be huge. That's why it's dangerous to buy stocks with the hopes of selling them for quick gains.

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Short-term stock prices are driven by news

In the short term, stock prices are driven by news and emotion. Here's a recent example of what I mean.

You might recall that in February **Fortis Inc.** (TSX:FTS)(NYSE:FTS) fell as much as 12% in a day. It closed at $41.38 per share the day before, only to fall to as low as nearly $36 the next day.

Short-term prices are unpredictable. That's why there were Fortis buyers the day before the drop. No one knew the utility was announcing the acquisition of ITC Holdings the next day. That's also why it's dangerous to look for quick gains in the stock market–we don't know what's going to happen next.

Long-term stock prices are driven by fundamentals

In the long term, share prices move according to the fundamentals of the underlying companies. Let's continue to use Fortis as an example.

After nearly nine months, Fortis has more than recovered from the 12% drop. In fact, it's 20% higher. On top of that, it completed the US$11.3 billion ITC acquisition and got itself listed on the New York Stock Exchange. It is now one of the top 25 utilities in North America.

Moreover, Fortis has recently hiked its dividend per share by 6.7% and aims to increase it at an average rate of 6% per year through 2020.

Are you a long-term investor?

If you’re a long-term investor, you’ll probably want to know the answers to the following questions for the stock you’re interested in buying.

Is it the kind of business you want to own? Does it earn stable earnings? Is it growing? Is its balance sheet strong? How does this stock align with your financial goals? Is the stock priced at a reasonable or discounted valuation?

Some investors have another requirement for a stock purchase: the stock must pay a safe (and consistently growing) dividend.

Conclusion

Instead of betting on stock prices to rise in the short term for quick gains, it’s much safer to focus on the business behind each stock. If you buy a quality stock at the right valuation, you can hold it forever as long as its fundamentals remain strong.

You’ll need to monitor your holdings–perhaps check back every month, quarter, or year. Additionally, as time elapses, your returns expectation of the stock should change as well.

In the case of Fortis, since it has had a great run since February, it now trades at a multiple of more than 20. So, shareholders should expect lower returns from it in the next year. However, it doesn’t mean Fortis is not a reasonable investment for holding. On top of that, its 3.7% yield is still safe and sound.

CATEGORY

1. Dividend Stocks
2. Investing

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1. Editor's Choice

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2. TSX:FTS (Fortis Inc.)

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