Stop Gambling and Start Investing!

Description

For many investors, there is a thrill associated with buying and selling shares. This is not dissimilar to the feeling experienced when gambling on a sporting event, since it includes elation when a profit is made and despair when a loss is incurred. However, while gambling and investing share the same raw emotions of fear and greed, they are very different in other, more relevant ways.

In fact, it could be said that successful investors are not gamblers. A key reason for this is their focus on the long term rather than the short term. The most successful investor on earth, Warren Buffett, says his favourite holding period is forever and that he invests assuming that he won't be able to sell for at least five years. This contrasts with gamblers for whom the outcome of the event they have placed a wager on will usually be known within a short space of time.

However, many new investors adopt the mentality of a gambler when buying and selling shares. For example, they are often willing to hold shares for a period of months or even just weeks. Considering that the business world moves slowly, this is simply not enough time for a new strategy or product line to positively catalyse a company's earnings. Furthermore, being overly short termist means higher dealing costs since more transactions are undertaken.

It also means that, in many cases, inexperienced investors miss out on capital gains. That's because they all too often lose money during bear markets and fail to make money during bull markets. This is due to a short-term outlook, which does not see beyond the current crisis or beyond the current bubble. More experienced investors, on the other hand, try to look beyond the here and now at the potential for a company given its margin of safety and risk profile.

Successful investors also try to balance risk and reward. In other words, they understand that while the potential reward from an investment may be high, its risks usually will be too. Therefore, it is sensible to seek out a range of companies within a portfolio with diversification providing a degree of stability and resilience in case one company, one region, or one sector endures a challenging period.

On the other hand, gamblers often pile into a smaller number of companies. While this will increase their potential rewards, it can also mean that their losses mount up since no investor or gambler can be right all of the time.

Clearly, investing can be rewarding. However, in its most successful form it doesn't offer the same level of thrill as gambling. Certainly, it is a great feeling when your portfolio generates a high income or large capital gains. However, investors seeking the quick thrill of a win are probably best advised to put a small amount of capital to one side and use that to fulfill the "animal instincts" which are brought out by gambling. Otherwise, they may find their portfolio performance is disappointing and their losing streak becomes akin to a sure bet.

CATEGORY

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Date
2025/08/27
Date Created
2016/11/08
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