This Activity Could Be Destroying Your Investment Returns

Description

It is often said that gambling and investing are not all that dissimilar. After all, both of them involve the prospect of generating a return, with there being a clear risk of loss should things not turn out as expected. As such, many investors treat investing as though it is a form of gambling. They seek to move from one stock to another over a very short timescale. While this may provide a ‘buzz’ in the short run, it can lead to lower returns in the long run.

Link to business

It is easy to forget that investing in a company means buying a stake in a tangible entity. In today’s technologically-enhanced world it is easy to feel remote and disconnected from the company in question. However, by focusing on the fact that buying shares really does mean becoming a shareholder in a business, it can help an investor to improve their returns.

That’s because the business world moves at a relatively slow pace. Certainly, sectors such as technology and retail are relatively fast-moving, but even companies in those sectors will take time to feel the benefit of a change in strategy or the effect of a positive catalyst. Investors expecting shares to quickly double are therefore likely to be disappointed by their short-term returns.

In response, they may decide to sell up and invest elsewhere. In doing so, they may miss out on improving financial performance and a rising share price for the company in question. They may experience the same challenges and frustration elsewhere, while the value of their portfolio lags the gains which would have been made from the original investment.

Costs

As well as the opportunity costs of selling an improving business, there is also a direct cost from buying and selling too frequently. Although commission costs are now much lower than they once were, the ease of trading makes it far more appealing than it once was. Today, it is possible to go online and execute a trade in seconds, which means that commission costs can soon add up and eat into overall returns.

Furthermore, having a limited holding period also means an investor will potentially miss out on dividends. While some investors may not be particularly interested in dividends and would rather focus on capital growth, various research has shown that over a long period the majority of total returns are from the reinvestment of dividends. As such, it can be prudent to hold shares for a sufficient length of time which allows for the receipt of dividends and their subsequent reinvestment.

With the potential for global inflation to move higher over the medium term, dividends and dividend growth could become an even more important driver of share prices.

Takeaway

While buying and selling shares in quick succession may be exciting, it could lead to lower returns in the long run. The higher costs of doing so, the lack of dividends and the opportunity cost of missing out on company growth mean buying and holding shares for the long term could be a more successful strategy for Foolish investors.

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