INVESTING VERSUS SPECULATING

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There is a lot of *speculating* going on these days. While gambling with your hard earned savings is one thing, to do so under the misguided notion that you are actually investing is a whole other matter. Please allow me to explain.

It is a recurring characteristic of, shall we say lofty markets (like today's…), that would-be investors become more and more willing to gamble, throwing caution to the wind and ignoring 'the risk' altogether. This is signified by their willingness to pay absolutely any price for whatever has been hot as of late, regardless of its fundamental merit, or complete lack thereof.

During a market *downturn* (i.e. risk low/stocks cheap), the novice investor concludes that *"this will never end",* and ignores the upside. And in due course, after a prolonged period of rising markets (risk high/stocks expensive) the novice jumps back in, believing that "this time really IS different" and that the party will never end. In doing so, he or she completely ignores the downside. Worse yet, in their "drunken" state, they may even attempt to convince others that there isn't any.

I think the old saying, *"If it sounds too good to be true…"* (you can fill in the rest), might be applicable here. When the proverbial punch bowl is *inevitably taken away,* these now very sober neophytes (who were late to the party to begin with), proceed to blame the markets. Armed with their newfound wisdom (and some costly experience), they conclude that investing doesn't work. *"I'm buying real estate from now on…",* but I digress.

Here's my key observation and concern here. Somehow this obscene behaviour gets confused with actual investing. In this case, these would-be investors have twisted the wisdom to, *"If it sounds too good to be true, BUY IT, at ANY price!"* Surely you can see that such behaviour should not be confused with actual investing in any way, shape, or form. These would-be "investors" weren't really investing at all. They were speculating, and they didn't even know it.

Along these lines, it has always baffled me whenever I've heard the suggestion that investing in stocks is somehow similar to gambling. I often hear the term *"**betting** on the markets".* Quite simply, to compare investing in the stock market to a bet, like throwing your money into a slot machine, is squarely opposed to all of the historical data I've ever seen.

Of course, we all know the odds of winning at the casino are very poor. All of those mega hotels on the Las Vegas strip weren't built because casinos *lose* money. If gambling were a winning proposition, how is it that having a gambling addiction could be something that requires treatment?

Contrary to the very distinct likelihood of losing money when speculating - at the casino, OR in the markets - the act of investing in great businesses can and most definitely should be a winning proposition. As testimony, here is a somewhat arbitrary sampling of long-term average annual returns for stocks (as measured by the Dow Jones Industrial Average (DJIA) to the end of 2017, including dividends):

- ***Since my daughter was born (July 2008); 11.52% per year***
- ***Since I was born (January 1969); 10.62% per year***
- ***Since my father was born (August 1948); 11.42% per year***
- ***Since my maternal grandmother was born (July 1924); 10.40% per year*** (and yes, I still have a living grandparent!)
- ***And finally, since its very inception (dating all the way back to May 1896), the DJIA has returned 10.14% per year. That's a track record that spans more than 120 years.***

Clearly anyone can see how consistent these long-term results have been, provided one doesn't turn a relatively safe, dare I say bet, into a gamble by speculating for outsized gains in the short-term. Given the glaring consistency of this historical data, I simply cannot see how any reasonable comparison can be made between investing in stocks, and taking your money to the casino.

The issue here, of course, is that many market participants don't actually invest in the stock market, they speculate in the stock market. And somehow they do so under the guise of being an actual investor? As is tradition in these missives, let's turn to Benjamin Graham for a thorough understanding of the not-so subtle difference between investing and speculating. In his seminal book, *Security Analysis,* Graham defines an actual investment as follows:

> ***"An investment operation is one which, upon thorough analysis promises safety of principal and a satisfactory return. Operations not meeting these requirements are speculative."***

Apply this formula to any of the hot investment fads of today, as well as all of those that have crashed and burned in the past and you'll quickly recognize the distinct difference between an *actual* investment and a pure speculation.

To wit, ***upon thorough analysis,*** if it doesn't have a sufficient amount of real assets, your principal is at risk. If it doesn't have a long term history of actual profits, the likelihood of a *satisfactory return* is *very much* at risk.

What I'm hearing a lot of these days goes something like this; *"Upon some semblance of analysis (translation: I read an article in the Globe and Mail, I googled it, or I heard about it from a friend), I'm jumping on because this thing just keeps going up and up – and it appears as though it'll never end. Or, surely I'll know when to jump off right before it does. Assets - who needs them? Profits – why should that matter? I'm buying* (betting) *on a company* (fad) *that someday WILL* (or may?) *actually start to make money; tons of it, in fact. After all, I'm an investor and that's what investing is all* about. Isn't it?"

For those who insist on gambling with their hard-earned savings, I suggest doing so with (1) only money that you can *truly* afford to lose; (2) with the full understanding that, at least in this particular endeavour, you are NOT investing; and (3) if your bet does somehow pay off (of course, lottery winners and casino jackpots do happen, despite the dreadful odds) chalk it up to luck, plain and simple. You got away with one. You are no more an investment guru than is the lottery winner, or the gambler whose slot machine paid off.

Here are some additional examples of speculating versus investing:

- **Going to cash when you feel nervous about the outlook for the markets/economy** (i.e. you are attempting to time the markets). You're betting that you can somehow see into the future. The 'experts' who do this for a living are wrong more often than they are right. Also, when you're feeling nervous, you're usually not alone. Others are nervous for the same reasons you are (unless you do indeed have a crystal ball?). As such, that same bearish sentiment is likely the consensus view - which is already priced in. At this point it's too late to get out. It's time to buy, not sell.

- **Betting an imprudent portion of your overall investment portfolio on any one stock, sector, or geography.** You're gambling with the health of your overall portfolio. And if you guess wrong, the damage can be irreparable.

- **Buying a stock based on a hot tip,** i.e. from your cousin, who paints houses by day, but makes his real money day trading. *"Easy money…"* he says - but for some reason he still has to paint houses. Need I say more?

- **Responding to an ad for any investment that has recently (i.e. in the <u>*past,*</u> as in – <u>*before*</u> you owned it), gone up a whole lot.** Like the drunken newbie described above, you're late to the party. By jumping in now you're betting that the punch bowl somehow won't run empty any time soon. This, despite the fact that the room is full of all the other drunken gamblers who are drinking the same Kool-Aid. Regardless of how much longer the party might go on, you won't know when to leave. This seldom ends well. You're a speculator, NOT an investor.

In conclusion, I suggest ***that*** any investment proposition not meeting Graham's definition above is a gamble, NOT an investment. And remember, ***both*** criteria must be met. We seek both *"safety of principal"* AND *"a satisfactory return".* A GIC or Federal government bond meets the first criteria, but not the second. A hot stock tip *may* (someday?) meet the second requirement, but quite likely fails to meet the first.

As stewards of your investment portfolio, we will refuse to settle for one without the other. We are in the business of *investing,* not the absurdity of speculating.