



Fisher Funds

Investor Education Centre

*Making investing enjoyable, understandable
and profitable...*

Are you an investor or a speculator?

02/08/09

There is a difference between investing and speculating, but the difference is not always obvious and investors can get into trouble by speculating when they think they're investing.

In 1934, legendary investor Benjamin Graham explained the difference between the two concepts as: "An investment operation is one which, upon thorough analysis, promises safety of principal and an adequate return. Operations not meeting these requirements are speculative".

The critical part of this definition is the phrase "upon thorough analysis". There is a big difference between buying a stock after thoroughly researching it and buying a stock because you've heard it's good buying.

Analysing an investment can be time-consuming and challenging, and I can understand the appeal of following somebody else's advice or copying an idea rather than doing your own analysis. However, if you don't know and understand why you have made an investment, how will you know when it is time to sell or to buy more?

A few weeks ago, a friend asked me to have a look at his portfolio. As we considered each of his shareholdings, I asked him to explain why he had bought them. He was able to tell me what price he had paid for each, but he couldn't tell me what he liked about each company. Knowing his average cost price did not help him in his investment decision making.

A good investor needs to understand why they have bought shares in a company, what they expect of that company, and what needs to happen to continue holding it. Researching an investment can tilt the odds in your favour making it more of an investment and less of a gamble.

Imagine being offered shares in a company at 40 cents each, the lowest level for 18 months. If you knew that the share price used to be 80 cents, you could be tempted to buy. But then what? Would you sell if the price lifted to 50 cents? Would you buy more if the share price fell to 30 cents? Without additional information, it is impossible to decide an investment strategy. Instead, you have to follow your hunch as to which way the share price will go next.

Now imagine that you received some information about the company. You learned that the company was profitable for many years, but had surprised the market by making a loss last year, resulting in the share price fall. This little bit of information is still not enough to make an investment decision, but it puts you in a better position than when you just knew the share price history.

Just one more piece of information could make all the difference. Imagine you then asked the company why it made a loss, and the company said a major client was late in paying for their order, but had now done so and profitability was back on track. When you bought more shares at 40 cents you would be doing so as an investor rather than a speculator.

Making investing enjoyable, understandable and profitable...