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So You Think You're An Investor?

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"You can't invest without trading; you can trade without investing." - Jason Zweig

Between the enthusiasm for meme stocks, cryptocurrencies (including ones that were literally started as a joke), and blank-check companies (aka, Special Purposes Acquisition Companies), I have been pondering if people really understand what they are doing. Don't get me wrong, I have no inherent problem with speculative investments; I just worry that too many people may be fooling themselves that they are actually "investing" when playing with money they may not be able to lose.

While thinking about all this, I came across an article in the Wall Street Journal by Jason Zweig that summed up my thoughts perfectly. Add the fact that he took his paper and employer to task, and I simply couldn't resist using his article for this newsletter. In part, he said the following…

"I've had it. The Wall Street Journal is wrong, and has remained wrong for decades, about one of the most basic distinctions in finance. And I can't stand it anymore. If you buy a stock purely because it's gone up a lot, without doing any research on it whatsoever, you are not - as the Journal and its editors bizarrely insist on calling you – an 'investor'. If you buy a cryptocurrency because, hey, that sounds like fun, you aren't an investor either. Whenever you buy any financial asset because you have a hunch or just for kicks, or because somebody famous is hyping the heck out of it or everybody else seems to be buying it too, you aren't investing. You're definitely a trader: someone who has just bought an asset. And you may be a speculator: someone who thinks other people will pay more for it than you did."

"Of course, some folks who buy meme stocks like GameStop Corp are investors. They read the companies' financial statements, study the health of the underlying businesses and learn who else is betting on or against the shares. Likewise, many buyers of digital coins have put in the time and effort to understand how cryptocurrency works and how it could reshape finance. An investor relies on internal sources of return: earnings, income, growth in the value of assets. A speculator counts on external sources of return: primarily whether somebody else will pay more, regardless of fundamental value. Nevertheless, the Journal and its editors have long called almost everybody who buys just about anything an 'investor'."

"On July 12, 1962, the Journal published a letter to the editor from Benjamin Graham, author of the classic books 'Security Analysis' and 'The Intelligent Investor'. That June, complained Graham, the Journal had run an article headlined "Many Small Investors Bet on Further Drops, Sell Odd Lots Short." He wrote: "By what definition of 'investment' can one give the name 'investors' to small people who make bets on the stock market by selling odd lots short?" (To short an odd lot is to borrow and sell fewer than 100 shares in a wager that a stock will fall—an expensive and risky bet, then and now.) "If these people are investors," asked Graham, "how should one define 'speculation' and 'speculators'? Isn't it possible that the current failure to distinguish between investment and speculation may do grave harm not only to individuals but to the whole financial community."

"Graham wasn't a snob who thought that the markets should be the exclusive playground of the rich. He wrote 'The Intelligent Investor' with the express purpose of helping less-wealthy people participate wisely in the stock market. In that book, after which this column is named, Graham said, "Outright speculation is neither illegal, immoral, nor (for most people) fattening to the pocketbook." However, he warned, it creates three dangers: (1) speculating when you think you are investing; (2) speculating seriously instead of as a pastime, when you lack proper knowledge and skill for it; and (3) risking more money in speculation than you can afford to lose."

"Most investors speculate a bit every once in a while. Like a lottery ticket or an occasional visit to the racetrack or casino, a little is harmless fun. A lot isn't. If you think you're investing when you're speculating, you'll attribute even momentary success to skill even though luck is the likeliest explanation. That can lead you to take reckless risks. Take speculating too seriously, and it turns into an obsession and an addiction. You become incapable of accepting your losses or focusing on the future more than a few minutes ahead. I think calling traders and speculators "investors" shoves many newcomers farther down the slippery slope toward risks they shouldn't take and losses they can't afford. I fervently hope the Journal and its editors will finally stop using "investor" as the default term for anyone who makes a trade."

Jason Zweig and I are of the same mind when it comes to defining an investor; I too worry some people may be kidding themselves when speculating on something that seems like an investment but is really just a trading instrument. Will this speculation end badly one day? I would guess so, but just as Alan Greenspan was both correct in his "irrational exuberance" observation and incorrect on his timing (since the Tech Crash happened 4-5 years later), these things are easy to observe and hard to predict. The most sensible course of action is to truly be an investor and only speculate with the money you're willing or able to lose. And oh by the way, get some objective input.

As always, thank you for letting us share our objective input, thanks for sharing this newsletter with people that might be interested, and please email or call with any questions. Take care!

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