Investing or Trading?

Most of us work hard for our money and in return, we want our money to work hard for us. There are two fundamental ways to view and try to capitalize returns, through trading or investing. The main differences between trading and investing are the holding time horizon and attitude towards the underlying security.

Traders often “buy” or “sell” stock. They view an asset not for its true intrinsic long-term value, but rather on what the value may be on a short term basis. The holding period for a security is generally short for a trader, sometimes holding it for less than a second!

Traders often employ technical analysis to direct their decisions. Technical analysis involves evaluating securities primarily on the basis of statistics, such as stock price, in order to try and predict future share prices. Recognizing trends and shifts in chart patterns, trend lines and formations are cornerstone to a technician’s determination to buy or sell a security. The goal of technical analysis is not to determine a security’s intrinsic value but rather to recognize chart patterns to determine return prospects for a security.

Investors, on the other hand, “invest in a company” as opposed to “buy a stock”. Investors generally have a longer time horizon. Investing can be dull and boring. Economist Paul Samuelson said, “Investing should be more like watching paint dry or watching grass grow. If you want excitement, take $800 and go to Las Vegas.”.

Investors often use fundamental analysis to evaluate a security. Through fundamental analysis an investor will gather up all data available in an attempt to determine if the security’s current price is above or below its true intrinsic value. This information is often derived from a company’s financial statements, economic reports, industry statistics or other publically available data.

Investing can be further understood by reviewing some of Berkshire Hathaway’s Chairman and CEO, Warren Buffet’s letters to shareholders. Buffet is a notorious long-term investor who has earned the nickname “The Oracle of Omaha”. In his 1988 letter to shareholders, Buffet said, “When we own portions of outstanding businesses with outstanding managements, our favorite holding period is forever." Later in his 1996 letter to shareholders, he wrote, “Our portfolio shows little change: We continue to make more money when snoring than when active.”

Compound interest is the ally of an investor. Compound interest is when return on your monies comes from both the principal amount invested and the previously earned growth. Put another way, interest accumulates on the principal amount as well as previously earned interest. Time mixed with compound interest is a long-term investor’s best friend.

Long-term investors and traders play in the same pool. Sensationalism within the media and the seemingly unlimited availability for news at your fingertips creates white noise on a constant basis that can fog the path for some long-tern investors. This can cause indigestion for some investors and may cause them to start to think and act as a trader. In my experience, it becomes toxic when an investor decides they are a trader without recognizing any changes to their long-term investment goals and objectives. Are you a trader or an investor?

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