Are You an Investor or a Speculator?

By Ryan Zacharczyk, CFP, CSA, CRPC

I often find it humorous to watch CNBC during a market decline and see the talking heads predicting the future. Many of the smart ones will hedge their bets by painting broad strokes of future market projections or giving percentages of this or that event.

It makes me smile because I understand that their job is a futile one. In many cases, traders and mutual fund managers are paid to speculate in the market, and the vast majority of them are unsuccessful. A full 80% of actively managed mutual funds underperform the indexes each year, with little consistency among the winners. This begs the question, if the professionals have little success in performing on par with the markets, what hope is there for me, the small investor? The answer: a lot.

Once you make the decision to be an investor, not a speculator, you spin the odds in your favor. I hear people complain all the time about the advantage the large mutual fund managers and the investment bankers have over the small investor, but I think they miss the big picture. I believe the small investor has a tremendous advantage over the large money managers. Unfortunately, most small investors don't recognize it.

The advantage of the small investor is time. Professionals must constantly move money around to justify their fees and to outwit the market. The pressure on them to perform well every year is tremendous. A year or two of negative returns is unacceptable and could end their career. They are so frantically chasing the next hot sector that they end up drowning in transaction costs and slippage fees (slippage fees are the small cost between the bid/ask spread in an investment transaction). The small investor, with a time horizon of ten or more years, need not worry about the annual fluctuations of the equities market. They can purchase a diversified portfolio of investments, sit back and sell at the end of their time frame, without worrying about the bumps along the way.

This advantage is similar to being the house at the casino. When a player goes to Las Vegas, they know that they could win, but the odds are stacked against them. The house has a slight advantage in most games and a significant advantage in many. This edge will provide profit to the casino over the long run. Sure, there may be times when the player wins, but the longer you play, the more likely the casino will take your money. The best part about being the house is that it never has to worry if it is having a down month or two. Casinos can lose money in short bursts, but the law of averages always provides them with a significant profit in the end.

So, as an investor you have two choices. You can be the player or you can be the casino. The player may get to place their bet wherever they'd like and make money in the short run, but we know what will happen to him at the end of the day. The casino might have to ride through tough times and some erratic returns, but in the long run, it has a good idea of the return it can expect.

As a speculator, the cost of all your trades, slippage in the market, and tax consequences create a scenario similar to being the player. These fees provide a slight advantage to the house. The longer you play the speculating game, the more you will lose. But the investor has the house advantage. We know that over time the market goes up. For the past 200 years, long-term stock investors have handily

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outperformed bond investors. Buying and holding a diversified portfolio with periodic rebalancing gives us that house edge because we get to avoid most transaction costs, slippage, and the large tax consequences. The choice is yours. Would you rather be the player or the house?

This philosophy has been proven time and again. The most successful money managers are those who buy for the long-term. Experts like investing gurus Warren Buffett and Peter Lynch have stated that their preferred holding period is forever. They are successful because they have a remarkable talent for recognizing undervalued assets and holding them for as long as they can. The average holding period for an asset purchased by Buffett is 9 years and 10 months. What is the average holding period of your investments?

I know how tempting it may be to buy more stocks as the market is making new highs and sell as the market is collapsing, but these are the times that you must ask yourself, am I investing in the market or playing the market? If you truly have invested, then you don't care if the market is going lower. In fact, if you are continuing to invest, lower is good. You will be able to buy more shares at a cheaper price. If you are playing the market, I beg you not to do it with too much money. Everyone learns at sometime or another that it is futile to try to time the market. I just urge you to keep your lesson as cheap as possible and invest for the long haul.

Remember, the next time you see someone in a pinstripe suit on CNBC telling you where the market is headed, you can feel sorry for him. If he's wrong, it can cost him his job, but you will always be right, in the long run.

Ryan Zacharczyk is President of Zynergy Financial Planning, LLC, a financial planning firm specializing in working with mature adults 50 years old and above. Zynergy provides comprehensive financial planning services for individuals 50 and older, helping them achieve their objectives in estate planning, investment management, tax minimization, and insurance planning.