Gambling vs Investing

What's the difference?

Investing

- Investing is the act of allocating cash to an asset (e.g stocks), with the expectation of generating profit. Risk and profit go hand-in-hand in investing; low risk generally means low expected profit, while higher profits are usually accompanied by higher risk.
- Investing involves a risk management strategy
- Investors study historical performance and current behavior to improve their chances of making a winning move.
- Stock information is readily available. Company earnings, financial ratios, and management teams can be researched and studied.

Gambling

- Risking money on an event with an entirely uncertain outcome with little to no information that heavily relies on chance.

Separating Investing and Gambling

- A positive risk premium (difference between expected profit from the investment and risk-free profit from bonds) distinguishes investing from gambling.
- Investors taking on risk to earn a risk premium are speculating. Speculation is undertaken despite the risk because of a favorable risk-return trade-off.
- In contrast, gambling is the assumption of risk for no purpose beyond the enjoyment of risk itself. Gamblers take on risk even without a risk premium.

Common Investor Mistakes

I've made them, please try and avoid them.

Not understanding an investment

- Don't understand the company’s business model (how the company makes money)? Get read up before you do.
- Understand the company's current management, their competitive advantage, threats, financial statements, balance books and the value of the company.

Lack of patience

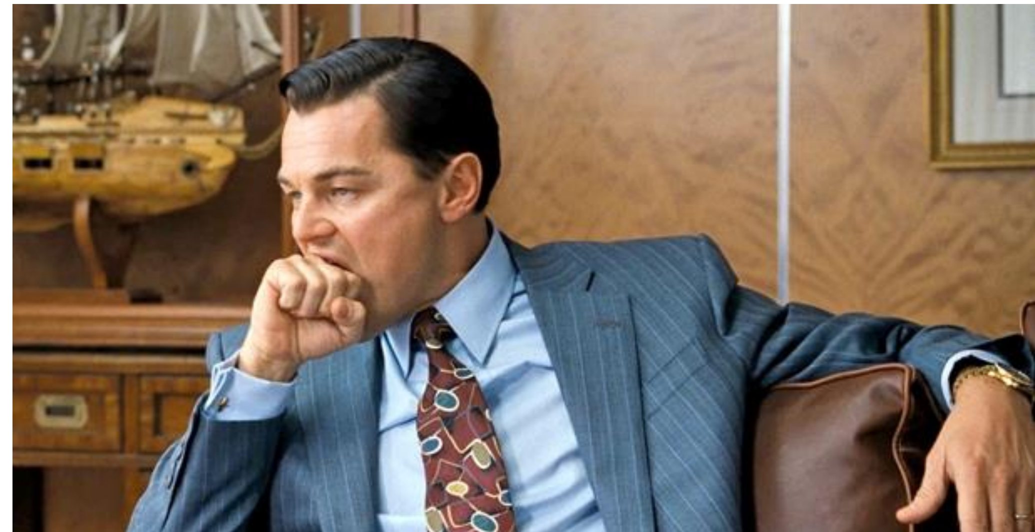
- Slow and steady always comes out on top, in studying for university, in the gym and in investing. A disciplined, planned investment strategy will go a lot further over the long term than trying to rapidly seek high profits.

Cramming doesn’t work for exams or investing!

Waiting to get even

Cut out of losing trades fast.

- Trying to wait to get even on a losing trade will likely ensure that you continue to lose. Don't avoid selling a loser until it's completely worthless, cut the trade and put the remaining money into a better investment.



Portfolio construction mistakes

- Don't expect high profits
- Not having an investment plan or strategy. Randomly buying and selling stocks whenever it feels like the right moment gives you about a 50% success rate (may as well flip a coin).
- Failing to diversify and piling all your money into one stock. This always ends in tears.
- Focusing on short term performance. Stocks fluctuate, focus on the yearly performance.
- Trading too much will incur massive commission fees and destroy your profit!

Time in the market beats market timing

- Market timing is attempting to buy the exact bottom of a market downturn and sell the exact top of a market rally.
- Market timing is possible, but very, very, very hard.
- For people who are not well trained, trying to make a well-timed call can be their undoing.
- An investor that was out of the market during the top 10 trading days for the S&P 500 Index from 1993 to 2013 would have achieved a 5.4% annualized return instead of 9.2% by staying invested.

Finally... EMOTIONS!

- The no.1 killer of profit.
- Don't let emotions such as fear, panic or greed guide your investment decisions.
- All investments will fluctuate and go up and down on a short-term basis but over the long-term large cap stocks will average about 10% a year.
- Focus on the big picture and think long term, riches are made over decades, not over months.

Try not to make these common investment mistakes. Good luck!