The Critical Investment Question

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It may sound deceptively simple, but the first major investment question should be, “Am I a trader or an investor?” Some might say both.

Frankly, that answer can be lethal for investment results. The disciplines, thought process, emotions and analytics, are quite different between traders and investors and frequent switching between these different mindsets can be highly destructive.

For example, all professional traders understand the basics start with containing risk on all levels (positions and leverage, etc.) and cutting losses quickly in the confidence of making them back later. “Your first loss is usually your smallest”. Flattening positions at the end of each day is also a frequently used risk containment technique. These steps require great self-discipline and emotional control. Traders don’t fall in love with companies. Yes, some fundamentals are important (earnings, management, etc.), but traders typically see themselves as trading securities, not companies. Remember, in major short-term declines, stock markets don’t care how great a company is.

Momentum, or the trend, is a key determinant for trading positions. The adages “trade the trend” or “don’t fight the trend” are part of a trader’s psyche.

Trading and investing are both team events where individuals refine their thoughts and quell their emotions in discussion with others. Too often our unchecked emotions can be misleading, particularly when under pressure. Volatility (https://www.caldwellsecurities.com) adds to pressure.

To look at the other category, successful investors operate on a different set of parameters. They tend to look at companies and see their shares as a means to participate in corporate growth. An investor’s time frame is longer and they have the luxury of accumulating positions over a period of time and adding to, or at least holding during market declines.

Volatility, though concerning to all, often represents a period of opportunity to the investor. The adage “bargains live in adversity” was clearly illustrated after the financial debacle in 2008, when massive gains were accumulated.

Long-term investors are more fundamentally focused on earnings, dividend growth, management results and competitive advantages, etc. Typically, an investor should also have a few simple and solid reasons for owning a company. These should be re-examined occasionally to see if they still hold.

If one sees themselves as an investor and then decides to be a trader, the result is usually heightened emotions and selling into market lows scrambling to buy near the highs.

The investor can use the advantage of their longer view and take a step back to examine events and look for opportunities. Selling should be based more upon whether or not a company and its management are continuing to achieve their long-term goals.

Remember, you want to own good to great companies, not necessarily all the companies in an industry as some will prosper and others may fail. This is where fundamental corporate analysis can make a difference. Having a good Investment Manager is also a great emotional buffer.

Value will prevail over time. With today's volatility, don't be too concerned if your opportunistic purchases are made too soon or too late. The goal is long-term growth, not perfection.

Decide which mindset will work for you and try to follow it.

Traders put safeguards in place to control their emotions and operate more on a short-term basis. Investors can be patient in building their positions in good companies or funds and see market extremes as potential opportunities to acquire value or upgrade their investment positions.

Know yourself first.

Thomas S. Caldwell, C.M.
Chairman
Caldwell Securities Ltd.

150 King Street W, Suite 1710 | P.O. Box 47 | Toronto, ON | M5H 1J9
Tel: (416) 862-7755 | 1-800-387-0859 | Fax: (416) 862-2498 | www.caldwellsecurities.com