Investing vs. Trading

Nov 12 2013

In the last article we defined investing as buying an ownership stake in companies who are profitable today and whose profits are expected to rise over time. Trading is any other form of managing your money which may or may not take into account corporate profits as part of the decision-making process.

Trading, which most people confuse with investing, includes any methodology that takes its cues from the price action of various markets, such as, technical trading, day-trading, and momentum (earnings, price or volatility amongst others) trading or buying on rumours because your friends insist the price of the stock is going to go up !

Thus you are left with two choices: to use professional portfolio managers who are trained in evaluating corporate profits or use a system of your own design to pick individual securities based on any one of thousands of types of investing or trading systems. Now, before you make that decision let us review the role of professional money managers.

Professional money managers are paid to perform three basic functions. The first is assess the value of an individual company based on current and expected future profits and then decide if the price today in the stock market represents a good deal? just like buying a car on sale, for example.

There are basically only three broad methodologies used for selecting individual companies with everything else being a variation upon these. They are value-based, growth-based or growth at a reasonable price (GARP) based security selection. But at the end of the day they are all dependent upon expected profit (and economic) growth over time.

Some managers prefer to buy with a 'safety of margin' (value, deep value) while others will pay full price for expected future profit growth (earnings growth managers) while still others want to buy growth but at a slight discount to the expected future profits (GARP). These styles of investing are the process by which one earns investment returns and investment returns are always a by-product of some type of investment process.

The second thing that professional managers do on your behalf is monitor the companies they have purchased on your behalf. This is where the bulk of their time is spent. This activity can include, interviewing and ongoing discussions with the senior management team about strategy etc., reviewing quarterly financial reports including sales and profits amongst other business metrics, monitoring competitors, looking out for disruptive technologies that may make your company's products obsolete (cars putting horse shoe manufacturers out of business) and interviewing the customers of your companies amongst other activities.

Finally, and perhaps the most important task is having your professional managers decide when to sell your ownership position in any one company. The reasons can include locking in profits, to preserve capital from a company that didn't perform or to buy a more attractive opportunity. Sir John Templeton invested with a target of doubling the value of his money over 5 years and if a company did not meet that objective he was always scanning the investment horizon for possible replacements.

Next time we will look at the role of stock markets and the media as they affect your investment approach and returns. What is a stock market? anyway? The answer to this question leads down the path of wisdom and wealth building! Call us today to discuss our approach to investing and growing your capital and assets over time.

Read more about:The Benefits of Professional Advice [1]--->

Questions about your investment strategy?
Contact our office today ! [2]

Tags: investment planning [3]

Source URL:https://northstarwealth.ca/e-newsletter/2013/2013-11/article-1.htm

Links
[1] https://northstarwealth.ca/data/e-newsletter/pdf/now-is-not-the-time.pdf [2] https://northstarwealth.ca/contact-us
[3] https://northstarwealth.ca/taxonomy/term/9