

To: All TCI Clients  
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**Back to Basics #3**

***Investing vs. Speculating***

Over the past 20 years or so, we have seen what we believe to be a very positive evolution in the delivery of financial advice from what I will call the “broker” model to a more holistic approach offered by independent registered investment advisors. This progression has included not only the way clients pay and advisors are compensated, but has included the types of investment products used, the breadth of financial issues that are addressed, and the amount of fiduciary responsibility assumed. These changes have given clients an enhanced framework for financial decision-making. Unfortunately, this transformation is incomplete. The element that still lingers from the “my investment is better than your investment” days is the way most people think and talk about investments, especially the financial media; it is the tendency to view our investments in the short-term.

Webster defines investing as “putting money to use... in something offering potential profitable returns, as interest, income, or appreciation in value.” American economist and the original proponent of value investing Benjamin Graham refines this definition describing an “investment” as: “that which promises safety of principal and an adequate return.” All else is speculation. When we invest in stocks, we are buying shares of businesses whose value over time, corresponds to the value of the underlying enterprises. Over longer\* periods of time (assuming economic growth) the aggregate value of these businesses tends to increase and subsequently so does the value of the shares.

*\* Longer term can consequently mean any time period in which there is economic growth and prices and underlying valuations have time to converge.*

<u>Investing</u>	<u>Speculating</u>
<ul style="list-style-type: none"> <li>• Long-Term Increase in Value</li> </ul>	<ul style="list-style-type: none"> <li>• Short-Term Change in Price</li> </ul>
<ul style="list-style-type: none"> <li>• Promises safety of principal (with an acceptable level of risk) for an adequate return</li> </ul>	<ul style="list-style-type: none"> <li>• Everything Else</li> </ul>
<ul style="list-style-type: none"> <li>• Value</li> </ul>	<ul style="list-style-type: none"> <li>• Momentum/Price</li> </ul>
<ul style="list-style-type: none"> <li>• Fixed longer term mentality</li> </ul>	<ul style="list-style-type: none"> <li>• Readiness to pursue short-term opportunities for profit</li> </ul>
<ul style="list-style-type: none"> <li>• Forecasting the prospective yield of assets over their whole life</li> </ul>	<ul style="list-style-type: none"> <li>• Forecasting the psychology of the market</li> </ul>

Let's contrast the concept of investment with the speculation that has endured and even blossomed. The notion of day trading, punished by the markets in 2000-2002, has re-emerged as traders hold positions in stocks for minutes at a time, attempting to squeeze pennies of short-term profits on large volumes. This is blatant speculation. A more subtle form of speculation we hear and read about every day – the attempt to identify stocks or even asset classes that should be avoided or “loaded up.” Even the daily monitoring of the stock and bond markets create reactions if you pay too much attention as you calculate the decline or boost to your portfolio value. Another form of speculation is gold. To call gold an asset class is giving it too much credit. There is little underlying intrinsic value – gold is not consumed but is accumulated. Over the long-term the value of gold increases at about 1.7% per year. But at any time, the price of gold can become distinctly disconnected from its longer term value due to its speculative nature and especially its perceived safety during periods of intense fear. Gold at its current *price* is only sustainable assuming hyperinflation and a breakdown in the U.S. and the world's monetary systems. It hardly fits any definition of investment.

Recently, I was speaking to a client whom I had dissuaded from buying gold about 18 months prior. He commented to me at the end of our otherwise productive conversation that I was wrong in my advice to him regarding gold, citing the 70% or so increase in the price of gold. Despite that increase, I assert that I was still “right,” just as I would be right to advise him not to take his nest egg, fly to Vegas, and put it all on black. Even if black was the resulting spin, I believe my advice would be “right.” But this mentality towards gold has reached a fever-pitch (notice I am not using the word “bubble”) evidenced by the recent phenomenon of the market capitalization of the lead gold bullion ETF (the SPDR Gold Trust) exceeding that of the SPDR S&P 500 ETF. On that day (August 22<sup>nd</sup>), speculators decided that the 120,000 tons of gold in the world were more valuable than the vast majority of all of the publicly traded companies in the U.S.

To summarize, we believe that the responsible stewardship of your financial assets incorporates the *investment* of those assets into a reasonable collection of asset classes, mixed in such a way to reduce the overall risk to an acceptable level based upon your return needs and your ability both emotionally and financially to bear risk. We make no room for *speculation*.