Market Dynamics

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Performance Management System

Is It Still Feasible To Be A Long-Term Investor?

Portfolios heavy with under-performing stocks almost never outperform the market.

Ignat's Law

Long-term investing is a game that individual investors can win!

In this day and age of ultra-fast computers and "quick–draw" traders, this is an important question. In the late sixties the "gun-slingers" seemed to be winning the game. A lot has changed since then, but now almost everyone thinks short-term trading is the way to go. Is that true?

First of all, it is fundamental to economics that competition removes the excess profits from any activity. This is true of short-term trading as in any other endeavor. How can a short-term trader in a suburb of Denver, Colorado with a $500 computer and a charting service believe that he can beat the trading desk at Goldman Sachs? It is highly likely that he can't. The competition for short-term trading profits will create a flow of money away from Colorado and into the coffers of Goldman Sachs. How can it be otherwise?

The long-term investor is not in competition with the trading desks on Wall Street. He is in a contest with the future. He should view himself as a virtual insider in the business. He is an owner of the business and he has to evaluate whether it is a good business or not. What are its prospects and the outlook for the future. He may only own a few hundred shares of the company's stock but he has to look at the business as an owner. The daily activities on Wall Street usually don't provide very consistent answers to these questions.

In the last 40 or so years the stock market has moved more and more to the short-term trading side and away from the long-term investor's side. The violent fluctuations can subject the short-term trader to big losses as well as the opportunity for big gains. The problem is that he is dealing in paper he doesn't care about or understand. The stock price of an outstanding business can fluctuate greatly just like the stock price of a business that is a piece of junk. These wild fluctuations put the short-term trader into a competitive game with the trading desks on Wall Street. It is a game he is destined to lose. A small mistake in judgment can result in catastrophic losses.

Basic probability theory indicates that the more of these short-term decisions that are made, the greater the certainty of a fatal mistake. Long-term investors make fewer decisions so the likelihood of a wipeout diminishes. Long-term investors in a business are not competing with the traders on Wall Street. They have to concern themselves with the fundamentals of the business. Does the company create "economic valued added?" Are its finances sound and in good enough shape to withstand a period of adversity? The most important question is, Would I buy the whole company at today's price? These are the questions that a long-term investor has to consider. Short-term market movements are less important.

Short-term trading is a zero-sum game—every winner has a loser. Long-term investors participate in the economic evolution of the country— so that all can be winners. The short-term trader should know that the randomness of stock price fluctuations will not let him be a consistent winner. The short-term trader must know how to sell and to sell quickly as Wall Street traders do or he will ultimately be crushed.

W. Clay Allen CFA

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Market Dynamics
7325 S. Jackson St.
Centennial, Colorado

Phone: 303-804-0507

clayallen@msn.com