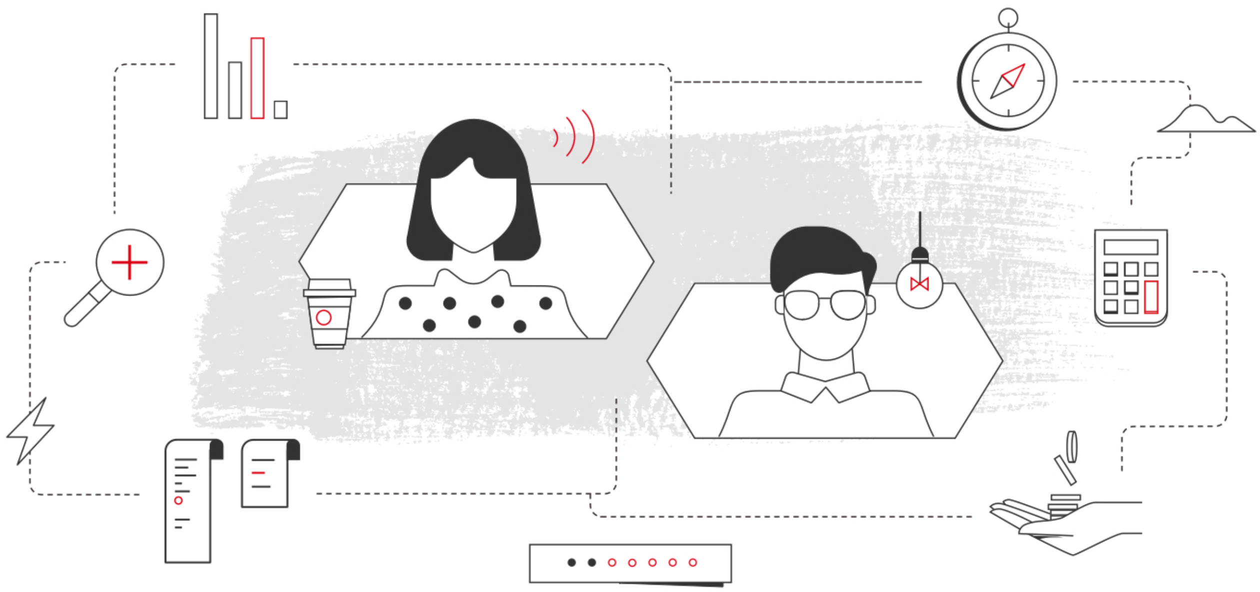

Day 2: Investing vs speculating and how your brain works

Time to read: 5 minutes

Buy low! Sell high! Sure, everybody knows that golden rule of investment. But every year there are people who do the opposite, potentially losing lots of money. Why? Because even the best investors are still human, and humans are emotional.

Today we're going to look at why your brain sometimes plays with your emotions to get you to do things that don't seem logical (like selling low). You'll see that learning how to be a disciplined investor – not a speculator – can help you avoid…well, you!

You're not as smart as you think

Consider this: you've made an investment and the value of that investment is going up. This gives you confidence that you've made the right decision, that you understand risk, and that makes you feel good about yourself. Then, the stock market plummets. You've got a lot of options, but you panic sell. Why?

Because since the early days of humanity, we've been taught to fear loss because our survival depends on it. This built in fear of loss has wired your brain so that you feel more pain from losing HKD1,000 than happiness from gaining HKD1,500.

This wiring is why we're more likely to make emotional decisions instead of rational ones in moments like these. So how do you protect yourself and your investments from making emotional decisions?

Disciplined investing vs speculating – what's the difference?

One way to avoid decisions based on emotion is to be a disciplined investor and recognise when you might be speculating instead of investing.

"An investment operation is one which, upon thorough analysis promises safety of principal and an adequate return. Operations not meeting these requirements are speculative". *Benjamin Graham, The Intelligent Investor*

We like to quote Ben Graham, because he's the guy who taught Warren Buffet about investing and he's probably one of the greatest investors in history.

Ben is telling us three things:

- **"thorough analysis"**= you understand the businesses you're investing in and the risks that they face that might cause your investment to go down or even be lost.
- **"promises safety of principle"** = you are making investments where your risk of losing money is very low.
- **"adequate return"** = don't be greedy. When you're greedy, you're emotional and we already learned that emotional investing leads to mistakes.

Any investment activity that doesn't meet those three requirements, means that you're speculating. In other words, a speculator is willing to take very high risks where the chances of failure are also very high.

So let's look at what a disciplined investor would do.

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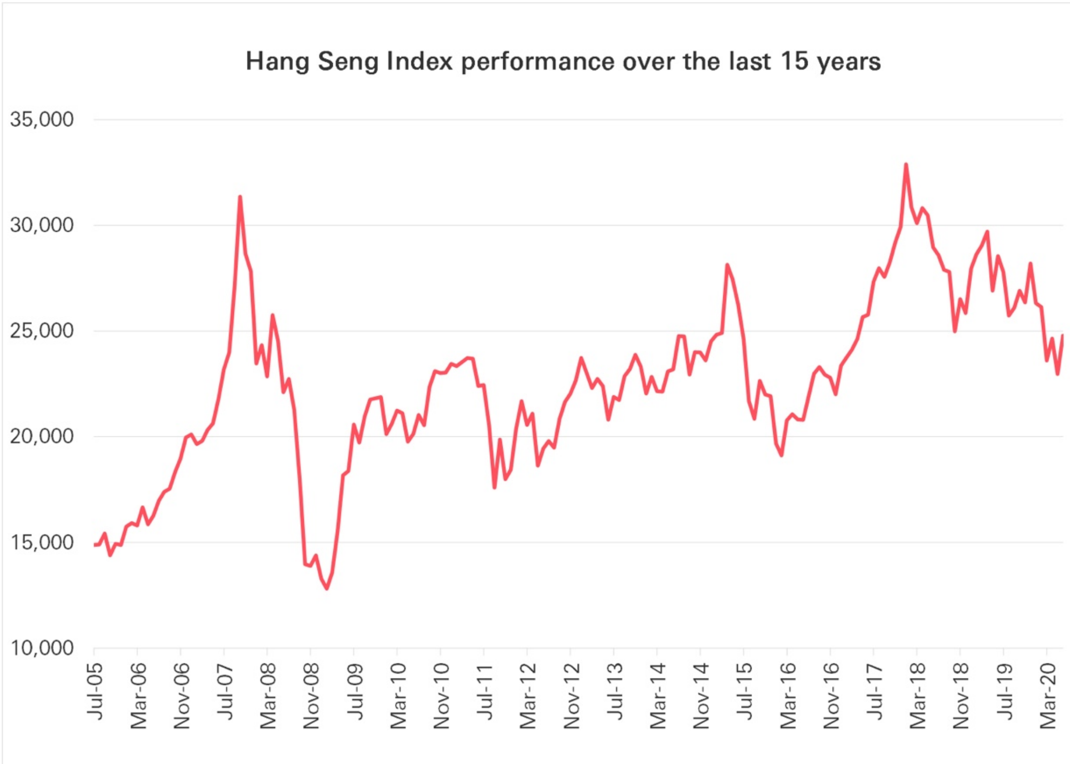
5 disciplines of an investor

Discipline #1: Have a plan
Before investing, you should have an idea about what it is you're looking to achieve. Remember that an investor is looking for an adequate return. If your objective is to "get rich quickly" on the stock market, you're speculating. On day 6, we'll give you a template to help you plan your investing approach.

Discipline #2: Invest in what you understand
Picking a stock because all your friends are talking about it is probably a bad idea, especially if you don't really understand the underlying business. That would be speculation. When you're starting out you might not have the time or expertise to analyse businesses properly, but there are some things you can do to help reduce the risk and we'll talk about those in upcoming lessons.

Discipline #3: Invest for the long term
Speculators are all about short term thinking. But trying to make fast money through short-term investing exposes you to higher risks because of market volatility. One of the best ways to avoid losses is to invest over a long period of time.



Source: AASTOCKS

Discipline #4: Invest regularly
Consistent investing is a must. It takes away the anxiety of having to do lots of work figuring out which stocks and when to invest. Your role as a disciplined investor is to stick to your plan and continue to slowly but steadily build your wealth.

Discipline #5: Don’t react to market news
Reacting to market news is the very definition of emotional investing. When you react to both positive sentiment (stock prices are climbing) and negative ones (prices are falling), you become more susceptible to buying high and selling low – as one example.

It's best to have a plan and invest for the long term. Then you can take a reasonable approach and check your portfolio once a quarter to make any adjustments necessary based on your plan.

What’s next?

Now you understand a little about the psychology of investing and that disciplined investors seek to limit their risk by using 5 key behaviours to keep them from making emotional investing decisions.

Next up, you’re going to learn about the different types of investment products you can choose from and the different types of risks associated with them.

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