CAMELOT
PORTFOLIOS, LLC

True Investing 101 *by Darren T. Munn, CFA*

What are you actually buying?

On a regular basis, I hear people expressing their opinion of the stock market, or investing in general. Most of the time, investing is described as a gamble, a crap-shoot, or just a hope and a prayer. It is very clear to me that most people simply don't understand the fundamental concepts of investing - nor would I expect them to. This gives us, and you, a huge advantage, especially in times like this. If you can understand these concepts, your investing experience should be more profitable and less stressful.

Investing is simply buying a future stream of cash flows. It is not: throwing your money against the wall and hoping it will stick, buying a hot stock and hoping to sell it for double in one month, or jumping in and out of the market based on feelings. Investing is often confused with making a good buying decision, like buying a nice suit/outfit, a high-quality pair of shoes, or a reliable car. While smart buying decisions, these do not produce a future stream of cash flows.

Investing has many different forms: CDs, bonds, stocks, real estate, etc. Ultimately, all investments fit in one of two broad categories - Debt or Equity. Either you are loaning money to an entity in exchange for a stated interest rate or you are purchasing ownership of property or a business entity in exchange for their future cash flows after expenses. It is that simple!

Naturally, with any form of investing (including CDs & annuities), there is never complete certainty regarding the amount or timing of the future cash flows. This is called risk. A rational person will pay more (accept a lower potential return) for a more certain stream of cash flows and pay less (demand a higher potential return) for less certain cash flows.

The shocking thing is, are you ready for this, people (and markets) do not always behave rationally! Gasp! I will pause for a moment while you pick yourself off the floor..... Yes, while shocking, it is true. And people have a wide variety of objectives & motivations. So, much of the price fluctuation we see in the market is not a result of a material change in the potential future cash flows. It is simply an indicator of the price people are willing to pay at any given time, having no impact on actual future cash flows.

I often hear people expressing fear of the market dropping to zero. Hopefully you now understand, this is not possible, barring a complete collapse and destruction of all economic activity, which is not possible while two or more people are alive, except for maybe in Venezuela.

The reality is, risk can largely be defined and quantified. Which means, if investing is done properly, ignoring the day-to-day volatility - it can be done with a high degree of confidence of achieving a reasonable return - a future stream of cash flows.