



Investment or Gamble

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Introduction

Investment is the activity to use monetary resource to get a return higher than the amount used. Many too often, people see investment as gambling. There are some elements that shares. If we follow the definition of Bill Graham then the outcome is not purely depending on the probability but rather than trends of history. Does it?

Gambling

If we use a model to describe gambling, there is a set of rules of the game, a set of rules to guess the outcome of next event, there is a leverage and there is a mental discipline. From a very abstract angle, it is very similar to the investment whether it is sky castle or fundamental analysis. However, the outcome of the event is differently. Gambling is built on the basis of fair and even probability distribution. Investment is mostly on history with a small influence of probability. It is the high probabilistic nature of the gambling that give people the stress which results the endorphin for pleasure. For investment, stress could be reduced if we play it safe and the pleasure could be intellectual and monetary. By understanding this differentiation, we also could observe persistence is the element of success for a punter and an investor to go through tough time. They both have to understand at a point we have to take the money off the table and have a walk. Strangely enough, both believe at the worst moment, a walk away and return later is a good strategy.

A Game of Intellect

Gambling games have many different types. Some have complicated rules that make the understanding of the rules lends advantages like the probability of having a winning hand in poker because there are multiple decision point and strategies associate with each hand. But some of them are purely probability like the roulette. In case of investment, people transplant some of these gambling philosophies to the stock exchange. For example, if it falls 10% the correction is complete. There are many historical events that prove this is not a golden rule. You use it you are dead. The game of investment becomes more complicated when there are incidence and manipulation.

Case Study 1: Gold and US Dollar

Historically, when U\$ falls, gold goes up and vice versa. During the January of 2007, both of them go up together. While many explanation for many reason, the inverse relationship is based on how the U\$ system is established in the Eighteenth Century. When this relationship does not hold it would be a short term (a month or years) but not forever. We see the failure of the relationship as an incidence. This is just like the position of an electron is not precise at a well defined orbit. Modern science continuously proves that the position is a probability as prescribed by the quantum physics. So

anomaly is allowed. At the end, it averages out everything is the same. This sounds like gambling. However, in financial world the probability of abnormally is usually not high but when it happens it could last awhile. But the longer it last, the more rapid it restores to the normal (stable) condition. Along the road of U\$ depreciation, there is also interest rate change activities that make the situation complicate.

Case Study 2: Spiking of Nickel in January 2007

With the growth of BRIC, even the slow down in North American's automobile demand could not reduce the world steel demand. As the quality of life improves, the demand of the developing world increases. Nickel has been on an upward trend since 2000. At the end of 2006, the demand was slowed down along with the North American automobile industry. But the demand was observed wrong, which leads to the exceptionally low in the nickel inventory together with wrecking of a nickel cargo flight which carries 1,000 ton while the inventory at LME is 8,000 ton level. So this is significant. If you are betting on this incident then you have to wait for a very long time but cause there is not way to predict this. As oppose to oil, there are plenty of opportunity to interrupt the oil supply due to the Middle East unrest. To bet on the nickel incident is a gamble but to bet on nickel's long term demand is investment which could have a higher successful opportunity.

Complexity, Intuition, Analysis

At the of the day, when the cow comes home, the bottom line is important. Betting on special events, which is the up and down of a long trend, is not a safe way to play. On the other than, as John Budden usually says, too early could be a gamble.