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Understand the type of investor you are – a trader or a buy and holder

A few months back, a friend asked me during one of our yachting sessions to help him invest a sum of $500,000. He had bought a good class bungalow last year and sold it earlier this year, earning close to $1 million for it.

After carefully considering his request, I decided to decline his offer. I explained that he fell into the category of "trader" in my classification of investors, and such investors typically do not have the patience to adopt my current investment strategy. I was reluctant to take his money into advisory, knowing that his patience seldom lasts more than 3 months, not to mention having to wait much longer.

You see, for the past one-and-a-half years, the solitary advice I was giving to many clients was to hold as much cash and good grade bonds as possible while waiting for buying opportunities to emerge as credit events unfold. To avoid the trouble of having to explain to him why I am recommending so much low-yielding assets if I were to structure a portfolio for him at that time, I pointed out instead other investment alternatives for him to consider.

So, as we struggle with the psychological strain that comes with a bear market, many of us may start to question the investment methodologies and assumptions that we used to take for granted. In this season of self reflection, I would suggest the first thing we should consider is the type of investor we are.

Essentially, there are two types of investor: the trader, and the buy and holder (BAHR). Many commentators claim the superiority of one style over another. As far as I am concerned, both styles are feasible if you can develop a system that can give your investment style an edge. Knowing which category you belong to will help you to better select the right investment strategies that suit you.

Now, traders are concerned about identifying trends quickly so that they can jump on the bandwagon in the early stages of the game. The extra profit he accumulated by buying at a lower price, when the trend is new, will make it easier for him to close his position when the trend turns, empowering him with greater versatility to adjust his exposures when needed.

BAHRs meanwhile rely on value-based and fundamentals analysis. Their research will provide them with the confidence to hold on to their positions when the market turns against them temporarily.

Also, it is important to know when to increase your position by buying more and when not to. As a general rule, traders should not increase their original positions, especially when they are financing their trades with some forms of debt, while BAHRs should consider it a viable strategy as long as the exposure is within their risk tolerance.

If your style of investment is more that of a trader, adding to an original position is dangerous because it contradicts your personal dynamics. If the stock continues to turn against you after you average down, you may panic and end up selling out just before the price resumes its long-term trend. This is especially so if you are using some forms of leverage. Your investment time frame in any position is usually shorter and this may work against you in various situations.

As esteemed trader Dennis Gartman puts it: “Never, ever, ever, under any circumstance, add to a losing position... not ever, not never! Adding to losing positions is trading's carcinogen; it is trading's driving while intoxicated.”

For traders, this is not a business of buying low and selling high. It is instead a business of buying high and selling higher. In other words, their objective should be to identify trends where there are still profit opportunities and hop on for a ride.

Meanwhile, for BAHRs, the best bet is to play the value game by buying value and waiting, always bearing in mind Keynes’ famous words: “Markets can remain illogical far longer than you can remain solvent.” So be prepared to wait a long time for the crowd to come to your party.

Also, traders should always consider taking profit when there is any, while BAHRs can be extremely patient with winning positions.

Overall, if your portfolio is made up of only a few holdings, the risk would be more concentrated and you may wish to spend more time to do your monitoring and homework. Always be prepared to reduce your exposure if the conditions that lead you to buy are no longer valid.

Personally, I divide my portfolio into a core buy and hold portion, and a supplementary trading portion. I have my BAH position, mostly in direct stock holdings and unit trusts that I am prepared to hold for years on end and of which I may even leave some for my children. With this mindset, I wait for the market to realise the value I see in my original positions. For my trading positions, they may include short or long positions in currency and derivatives, like index futures, which I usually do not hold on to for more than a few months.

Basically, do more of that which is working for you. This works in life, as well as in investment management. Always do the things that have been proven of greatest merit and remember to stick to them.