What Is A Good Investment?

Discover How You Can Turn Bad Investments Into Good Ones Using Risk Management, Strategy, And Timing

Key Ideas

1. Explains why investment process matters more than investment product.
2. Learn 3 methods you can use to earn consistent profits.
3. Reveals 3 need-to-know characteristics of good investments.
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Seems obvious, doesn’t it?

Good investments make a profit, of course.

But this glib answer avoids the real issue...

Today, everyone wants to know if precious metals are a “good investment”, 5 years ago it was real estate, and 15 years ago it was technology stocks.

It’s the same mistake over and over again – everyone thinks in terms of product.

If you want to become a great investor, forget about looking for a “good investment” and start focusing on risk management, timing, and strategy.

Stop thinking in terms of “product” and start thinking in terms of “process”.

This distinction is critical to your long-term investment success.

Let’s see how it works.

What’s the Difference Between Product and Process?

Bob the broker calls up Johnny Customer with the latest hot tip from his research department.

“Johnny, stock XYZ is undervalued. Our research shows good things coming down the road for this company, and we recommend buying it,” says Bob.
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Bob is selling a product – not a process.

Notice there is no discussion of the investment process involved (in this case – active stock selection).

Instead, the focus is on the stock which means critical questions will be overlooked.

- Where is the long-term research showing a positive mathematical expectation for prior recommendations?
- How will you know if the recommendation is wrong, and what criteria do you use to decide when to exit (risk management)?
- What percentage allocation is appropriate to any new position (risk management & strategy)?
- Assuming the research department is right and the stock rises, then how do you decide when to sell? What do you replace the position with and why (strategy)?

In short, what is the investment process and how does it work? That’s the relevant question.

Surprisingly, few people focus on that question.

Instead, everyone wants to find the next good investment. They want a magic pill. They want to find the next Microsoft or Google in its infancy.

Sorry, long-term investment success doesn’t work that way.

It’s a process.
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3 Ways to Profit by Getting Just One Thing Right

For example, at the height of the real estate debacle in 2008-2009, everyone agreed houses were a bad investment. Investors were going broke, and prices were in record free-fall.

However, you could still make a great investment if you had a strategy that bought foreclosures and abandoned property at 20 cents on the dollar.

At the right price, any asset can be a tremendous investment – including an asset where the price is declining rapidly.

In this example, the product (real estate) was a terrible investment, but with the right process (a risk management strategy), it could be an excellent investment.

How? Because you can convert a declining asset into a good investment without regard to market conditions when the margin of safety built into the intrinsic value of the price justifies the risk.

The key principle is the risk management process – not the investment product it’s applied to. It’s about process – not product.

Similarly, most people lose money trading options. The stats are abysmal. Few investment experts would disagree that options are a lousy investment product for most people (except gurus selling options trading courses, naturally).
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However, a viable, low risk strategy is to sell out-of-the-money puts on new positions you seek to acquire.

This way, you can add current income to your portfolio while potentially acquiring new stocks for less than they are selling today.

A generally “bad” investment product for most investors can be turned into a low-risk source of income when the right strategy (process) is applied.

The truth is there are no bad investment products. They are neutral and have known characteristics. However, there are bad strategies applied to investment products.

Continuing with examples, gold has been in an 11 year bull market.

Gold isn’t an inherently good investment product as anyone who owned it during the ’80s and ’90s can attest; yet, every now and then, it has a day in the sun.

What’s relevant is a valid timing process that can keep your capital out of the long-term bear markets and in the long-term bull markets.

Again, it’s about process – not product.

So, what can we learn from these three examples?
3 Characteristics Of A Good Investment

From all the above examples there are three ideas you want to note:

1. If you get the timing right, you can be wrong about valuation and strategy, yet still come out with a profit.
2. If you get the valuation right, you can be wrong about timing and strategy and still come out with a profit.
3. If you get strategy right (have a positive mathematical expectation with good risk management), your profit is assured over time even though any single investment can fail on timing and valuation.

The key is to realize there is no such thing as an inherently good or bad investment.

Successful investing is all about process: risk management, strategy, and timing. It takes work and effort.

Everyone wants to know, “What is a good investment?”, but it’s a fundamentally flawed question that sends your thinking in the wrong direction. It’s the myth of the magic pill – a one stop solution.

Good investing is all about risk management, strategy, and timing.

It’s all about process.