The "Investment" Myth

Cullen O. Roche
Founder
Orcam Financial Group, LLC
cullenroche@orcamgroup.com

The Myth of "Investment" - One of Wall Street's oldest tricks...

In an earlier piece we touched on the 5 Wall Street myths that hurt investors. But the myths don't stop there. To me, there is a myth that is devastating in the way it causes misconception across Wall Street, economics and Main Street.

What is "Investment"?

In economics, investment is purchases not consumed, for use in future production. If you start a company and purchase office space you are not consuming. You are investing in your company with the hope that this investment will multiply future profits over time. Another example of investment is investment on primary markets. *(Let's back up a second here just to be clear. Primary markets are different from secondary markets. Primary markets are where investments are made. This includes the private equity market or the IPO market when a company raises capital by selling shares to the public. The secondary market is the market where* ***existing*** *securities are* ***exchanged****. This includes markets like the NY Stock Exchange where trillions of dollars of existing securities are simply exchanged between shareholders.)*

Getting back on point—when a private equity firm invests in a company they are seeding capital. The IPO market is the same. The company is obtaining capital that it will then invest in the company with the hope of leveraging this capital into higher future profits. The company will usually forego a percentage of ownership in exchange for this investment in the firm. When a company goes public they are selling the firm to the public and raising funds in exchange.

But an odd thing has occurred over the years. We now refer to security exchanges as "investment" even though this is not at all an "investment". When you buy securities on a secondary market like the NY Stock Exchange or through an E-Trade account you are engaging in a simple exchange of cash for securities. The company you purchase does not obtain funds or new investment capital. You are not actually investing!

So what are you really doing? You are actually saving. When you obtain income that goes unspent you are saving. If you were to put this in a "savings account" with your local bank they would purchase low risk securities like money market funds or government bonds where you can earn interest. They are, in essence, buying securities on your behalf. They don't call this an "investment account" because that's not what it is. When you transfer funds into a brokerage account your funds will be swept into a default money market account. This is, for all intents and purposes, a near equivalent of the account that your bank might call a "savings account".

When you purchase shares of stock on a secondary market you are engaging in the exact same kind of purchase that occurs in the savings account with your local bank. You are buying shares of existing securities. The only difference is the level of risk involved in these securities. Figure 1 to the right shows how a very basic asset class risk spectrum might look.

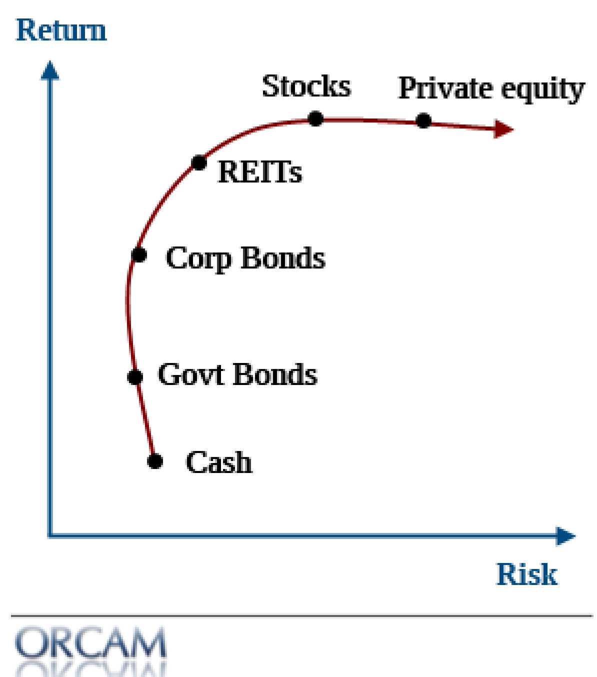

Figure 1—Risk Spectrum

The important thing to note here is that your investment portfolio is not really an "investment portfolio" at all despite the fact that we all refer to it as "investing". What it really is, is a saving portfolio.

Your portfolio is a repository where your unspent income flows and is then allocated in the form of various securities that are designed to achieve a number of different things.

At Orcam we believe your saving portfolio should achieve two primary goals:

1) It should protect against the potential for permanent loss.
2) It should reduce the risk of purchasing power loss.

We believe most of Wall Street and the media creates false perceptions around portfolio design by pitching the saving portfolio as an "investment" portfolio which results in excessive risk, excessive fees, excessive portfolio churn and sub-par performance. Of course, "saving" doesn't sound as sexy as "investing", but when you allocate your unspent income into securities on a secondary market that is indeed what you are doing. At Orcam, we don't believe saving is supposed to be sexy. Your unspent income is saved so you can consume at a future date. If you buy into the "investment" myth you are likely taking on excessive risk and thereby increasing the likelihood that your savings won't be there when you most need it.

At Orcam we view your savings as a repository that results from your primary source of income. It's important not to put the cart before the horse here. Most savers want to protect against the two aforementioned risks so they can then retire and draw on this saving when it is most needed. So you should be thinking about your saving portfolio as a repository that flows from your primary source of income. And that means the best investment you'll ever make is in your primary flow of income or your job or specific area of expertise. Instead, many savers fall for the Wall Street myth that your saving portfolio will generate returns that make you fabulously wealthy thereby offsetting or replacing your primary source of income. This is not the correct way to view your saving portfolio and will substantially increase the odds of failing to meet the goals for your savings.

Orcam Financial Group, LLC

Orcam Financial Group, LLC is a fee only financial services firm offering macro research, personal advisory, institutional consulting and educational services.

For more information about Orcam Financial Group and our products and services please contact us at (858) 220-5383 or via email at info@orcamgroup.com

ORCAM