Market Guide
In collaboration with SEC

The stock market is not a gamble

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Many of our readers would have heard the unjustifiable mantra “Investing in the local stock market is similar to gambling in a casino”. This has become a common topic in political forums and private gatherings.

If an individual equates a stock market to a casino/gambling it clearly shows his ignorance. Such people lack knowledge on how financial markets work. The situation is intensified as these false rumours can create a sense of unwarranted resistance towards the market.

Thus, it is timely to undo the baseless and ignorant statement by inferring into the difference between investing in the stock market and gambling.

Definition on investing and gambling

The advanced Oxford Dictionary defines investing as buying property, shares, etc., with the ‘intension’ of ‘making profits’. Investing in the stock market entails purchasing shares with the expectation of share prices increasing (when company profits increase).

On the contrary, the Advanced Oxford Dictionary defines gambling as the ‘risk of losing money with the hope of being successful’. A gambler puts money in the hope of hitting a jackpot if a random event occurs. Further on, the process of gambling is defined as playing games for ‘chance of money’.

At a glance, it is evident that investing deals more with precision, calculated and informed decision-making. The latter is centralized around probability and luck. A financial investment differs from gambling in three important ways: the investor’s knowledge is relevant to the outcome, an asset is purchased and both parties plan to benefit from the transaction.

Investing in stock market is constructive, gambling is not

Investing in the market is vital for an economy. It promotes efficient allocation of resources by directing funds to the most important and profitable ventures. A stock market could also increase the livelihoods of households as it enables them to invest their savings with the aim of receiving a considerable return.

On the other hand, the impact of gambling does not boost the local economy. It usually brings with it well-documented unpleasant side effects. The nature of investing in the stock market and gambling can be explained further by addressing the difference between the two.

Gambling vs. investing

- **Risk**

Gambling entails a higher level of risk when compared to investing in the stock market. When investing in the market you take a certain amount of risk. Yet, the difference is that it is a calculated risk. For an example, when you want to invest in a company you don’t just pick a stock and invest. You are expected to do sufficient research prior to investing. This will give you a rough sketch on where you are heading and thereby reduce risk. In gambling (unless you have inside information), such a sketch is not visible. It will be similar to searching for gold coins in the dark.

Stock investors and traders have a variety of options to prevent total loss of risked capital. Setting stop losses on your stock investment is a simple way to avoid undue risk. If your stock drops 10 percent below its purchase price, you have the opportunity to sell that stock to someone else and still retain 90 percent of your risk capital. However, if you gamble Rs.1 million and you lose it, you cannot get part of your money back. What you lose you lose forever. Risk exposure would increase further if you put more money to recover the losses or go on debt
when gambling.

- **Time**

Investment is usually long term. Earning profits from the company can last for several years, the investment will grow gradually. During this time you might be rewarded with a dividend payment. However, people gamble to earn quick money.

- **Asset**

When you purchase shares you automatically gain ownership of the company (in proportion to your investment). This is seen as an ideal buffer even during times the stock is not giving you the returns (capital gain and dividends) you expected. Such a tradeoff is not witnessed in gambling. There is nothing to fall back on.

- **Information**

Another difference between investing and gambling is the availability of information. Information is a valuable commodity in the world of gambling as well as stock investing. Relatively stock and company information is readily available for public use. Company earnings, financial ratios and management teams can be studied before committing capital. Stock traders who make hundreds of transactions a day can use the day's activities to help with future decisions. Unfortunately, in gambling, information is centralized among few unlike in the market where disclosure of certain information is a legal duty. As a result, gambling is vulnerable to higher levels of risk.

- **Expected value**

Gambling, especially casino games are designed to have a negative expected return. If you play games in a casino, with time you should be ready to lose money. This is because the casino has set the odds so that you will lose money more often than you will make it.
The stock market as a whole should have a positive expected value. If you passively hold onto a broad market index of stocks, you should make money over time. This is why the stock market exists - to give investors a positive return in exchange for taking on risk. In fact, in the stock market, the companies who issue stocks are basically the customers and they are paying you as an investor to take on risk. This is in contrast to a casino.

What is going wrong?

People who fail to understand the difference between the two are prompt in spreading rumours. Similarly, it is important to understand that these rumours spread as hot cakes due to a few reasons.

Many are unaware of the difference between speculating in the market and gambling. Speculation in contrast to gambling is a form of calculating the future value of the market based on available information, future expectations and historical data. It is not just hitting stocks in the blind. Disciplined speculation is important for a robust market. Yet, some don’t possess the skill (intentionally or unintentionally) required to speculate and go wild when speculating. Inability to differentiate speculation from gambling prompts many to refer to the market as a gamble/casino.

Further on, a few market manipulation cases have acted as engines for these rumours. Market manipulation is another phenomenon that is blown way out of proportion. There have been a few reported cases of manipulation. A person who observes the market closely will notice that only a few stocks are vulnerable towards manipulation.

Manipulation is not limited to the Sri Lankan market as it is the inherent nature of any market. Such misconduct is visible even in developed markets. The famous Raj Rathnam case in the U.S.A. is a classic example. Have you ever heard people referring to the New York Stock Exchange (NYSE) as a casino based on this case? If so, is it justifiable to refer to our market as a casino?

Stock markets are driven by price volatility based on the demand and supply for stocks. In such a situation, market manipulation cannot be completely wiped off, even in developed markets.

Market is not a scapegoat

It could be deduced that most of the people who slander the market lack basic knowledge on the market. They repeat on a hearsay basis, some for ulterior motives and others due to ignorance.

This fallacy has also become a political stunt in the recent past. On the one hand, this argument is used as a barometer to aimlessly condemn the economic policies of the governing party. On the other hand, it is also used as a tool to shield political bankruptcy of the opposition.

Moving on, individuals have a dire thirst for quick money and don’t have sufficient holding power, and should not put the market and fellow investors at stake by attempting to engage in market misconduct. Similarly, certain political activists should use their words sparingly. Financial literacy is very low in our country. In such a situation, false information travels relatively faster than in a literate society. These rumours will create unwarranted fear in society about the market and also prevent the masses from actively investing.

It is disheartening to note that many who are quick on tagging negative labels on the market give a blind ear to the initiatives taken by the authorities to safeguard the interest of the investors.

Don't misuse your rights

Freedom of thought and speech are valuable rights upheld within a democratic framework. Similarly, society has a duty to exercise these rights with utmost responsibility. Criticism can be accepted with open arms, provided it is constructive. The simple word you utter can have a ripple effect on the market and the economy at large.

- See more at: http://www.dailymirror.lk/96409/the-stock-market-is-not-a-gamble#sthash.vOL9FDCx.dpuf