Is Investing in the Stock Market Like Placing a Bet in a Casino?

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The extreme stock market volatility this year has resurrected the question: “Is investing in the stock market like placing a bet in a casino?” The idea behind this question is centered on the basis that investing in stocks is no different than going into a casino where the house is usually the winner. One important difference in this comparison is that many casino participants (otherwise known as gamblers) end up losing everything. For most stock market participants (otherwise known as investors), they end up either losing or making money in the short run but are likely to make money over time due to the underlying characteristics of the stock market. For casinos, the games people play are structured so that the odds of winning in the long-term always favor the house, whereas investors in the stock market are almost always going to win in the long-term.

The question poses a problem in that the structure of stock market investing allows for casino-like bets where the gambler attempts to attain outsized gains, and in some or many cases, will experience outsized losses. One good example of such bets is the performance of selected mutual funds over short-term periods versus long-term results. Each month, The Wall Street Journal provides us with a summary of the best and worst performing funds over various time periods. The latest summary of these comparative return data reveals the veracity of the funds’ casino like returns. Let’s look at the biggest gainer which is the MicroSectors U.S. Big Oil Index 3X Leveraged ETN which gained 75.7% in the month of October and is up more than 270% year to date! Yet the fund’s 5-year annualized return is an <u>annual</u> loss of 10%. Conversely, let’s look at the biggest loser which was a fund with the name UltraShort Bloomberg Natural Gas that gained 6.9% in October but is down 92.5% year-to-date and has lost 52.9% over the past five years annualized! (When you lose 92.5%, you must gain over 900% just to breakeven.)

Traditionally, investors have looked to the bond market to reduce the volatility of being invested in stocks. Unfortunately, that strategy has also been unkind to the gamblers. For example, the UltraPro Short 20+ Year Treasury fund was up 20% in October and is up more than 195% year-to-date. However, the five-year rate of return is an annualized loss of 2.4%. The worst performing bond fund was the Direxion Daily 20+ Year Treasury Bull fund which was down 18.2% and is down more than 75% year-to-date. These supposedly “safe” bond funds are using derivatives to gamble in the bond market. Always check under the hood of any mutual or exchange-traded funds you invest in.

These results are not normal, they are the result of gamblers taking traditional investments and using derivatives and leverage to pump up the potential for gains—or losses and sometimes at three times the index rate. Unfortunately, these gamblers affect the expectations of long-term stock market investors—but only in the short term. For long-term investors the outlook remains bright as history has shown. Remember that the traders/gamblers will always try to bet on the latest prospective winner in the stock market. But investing in the stock market will never be like placing a bet in Las Vegas.