

# Land Investment versus Land Speculation

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One of the most common questions I get asked is about the difference between land “investment” and land “speculation.” For many people, the distinction is important because of the psychological component of investing. Speculation sounds too much like gambling while investing seems prudent, even dull in a way. Speculators are the risk takers who occasionally get handsomely rewarded with great riches, while investors plod along in index funds and other slow motion wealth creation devices hoping to get rich someday in the distant future. There is still the common notion that investors get to sleep at night while speculations stay away worrying about their investments.

The recent stock market and real estate bubble crashes should have erased all notions that there is a distinction between investment and speculation any longer. Investors and speculators, however the terms are defined, lost big money and often their entire capital. Whether your hard earned cash was parked in a patient vehicle like a 401(k) or racing around doing pre-construction condo flipping, you lost money. Everyone who was in the market lost money. It did not matter what reason you had for being in the market.

The distinction between investment and speculation matters only in a literal sense. Benjamin Graham in his classic book, *The Intelligent Investor*, defined the difference

between the two approaches to making money in terms of safety and yield. Speculators trade the chance of losing more of their capital for the opportunity to earn a higher yield. Investors prefer the preservation of capital over its fast growth. Graham's definition is how most investors intuitively look at the investment process. Investments which entail the risk of all capital should bear the highest yield. Put another way---no pain, no gain.

Why I say the distinction between investment and speculation is irrelevant is that all deployments of capital are subject to complete loss. It does not matter what asset you are attempting to buy, a share of stock or a condo in a building. The potential exists for the complete loss of capital and in many recent cases this is precisely what happened to “investors.” If this analysis is true, then according to Graham all “investments” are really speculations by another name. For example, I have heard it said many times that commodities trading is more speculation than investment, but buying and holding single family homes for retirement is more like the reverse. Really? If you are underwater on your home purchases and your equity wiped out, turns out you were a speculator. What if you know something about the commodities market and actually made a prudent choice about supply or demand and made a quick killing? It is certainly true an investment can be easily characterized as an investment or a speculation after the fact. If the process turned out well with your capital never at any real risk, it looks like an investment. But if someone earned a high yield and had a roller coaster ride earning it, then this seems more like a speculation. Of course, this is all in retrospect. How do you characterize a chance to make money as an investment or a speculation beforehand?

The short answer is you cannot, so do not try. This analysis is similar to asking how many angels can dance on the head of a pin? Plus what difference does it make anyway? All “investments” are by their nature highly risky and involve the potential for the complete loss of capital. There are no safe investments. If you buy a stock, a bond, a single family house, or a business, there always exists the possibility you will lose every penny you put up in advance. Some investors try to comfort themselves with the idea that they are more prudent than they really are. Remember all those industry people and real estate gurus who said real estate was a “safe” investment because home values had gone up for the last one hundred years in a row? Sounds silly now, doesn't it?

My advice is do not put labels on your “investments.” Assume you are doing a bit of investing and speculation with each purchase or sale. In my way of thinking, “investing” most resembles stock market fundamental analysis while “speculation” is what technical analysts do. Most techies do not care what products a company makes or even its name. The chart tells the whole story. Fundamental buyers know the price of the stock is wrong, either widely over-or-undervalued, and nothing matters but the company's accounting like ROE, ROI, EPS, and the like. These two types of exclusive investors are polar ends of the spectrum, while most investors tend to use both fundamental and technical analysis when trading stocks, meaning they are investing and speculating at the same time, the ideal place to be no matter what asset you want to own.

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