Diary of a Private Investor Number 1 Colm Fagan 6 September 2015

The broadcaster George Hook reckons that buying shares is a form of gambling: "I don't back horses so I don't buy shares", he says. Hook is wrong. There is a fundamental difference between the two. The average gambler hits the occasional lucky streak but is a sure loser in the long-run, whilst the average share buyer should make a profit, provided they have a reasonable spread of investments and a sufficiently long investment horizon.

Five years is the generally recommended minimum, probably because that was the normal length of an economic cycle – when economic cycles were normal. Nevertheless, some shares are suitable only for gamblers and should be avoided by anyone seeking a good night's sleep.

I am normally cautious when buying shares, but I have gambled occasionally, and have generally regretted it. Applying George Hook's horseracing analogy, I have backed some nags that are still running.

One of my worst experiences started with a January 2013 decision to buy shares in a company called Carclo, on foot of a recommendation in, of all places, the Financial Times, the finance person's pink bible.

According to the FT's columnist, Carclo had a good story to tell. It was a unique player in the world of mobile phones and small computer monitors; it had perfected a technique for printing thin metal lines, invisible to the naked eye, on special film. Without producing any numbers, the columnist claimed the share price had a good chance of doubling over the next 12 to 18 months. Foolishly, I believed his story without checking the numbers.

The share price, far from doubling, halved, and then halved again. I finally got out in November 2014 at less than a quarter of what I had paid. The only consolation was that the amount invested was less than I normally venture.

One lesson learned from that debacle was not to invest in a share that tells a good story but where the promise of great profits has no justification, or can only be justified on heroic assumptions for future growth.

I resolved to avoid high-risk shares in future. My resolve was strengthened by some recent findings in behavioural finance. This relatively new area of study recognises that none of us, not even supposedly super-rational investors, behaves rationally all the time. In fact, investors sometimes behave quite irrationally.

Classic finance theory, which assumes that everyone behaves rationally, says that, on average, risky investments should generate a higher return in the long term. That is no more than common sense - otherwise, why would anyone ever bother taking a risk? We would be just as well off putting our money in the piggy bank.

Things aren't that simple though. At very high levels of risk, it seems that investors tend to behave more like gamblers.

A number of possible reasons have been adduced for this, one of which is called "lottery preferences" and works as follows: none of us is stupid enough to pay €1 to get back just 50c yet hundreds of thousands of us do precisely that on a regular basis, but in the guise of buying Lotto tickets where the individual punter may hit lucky but the overall pay-out ratio is not far off 50 cents in the Euro.

Much the same phenomenon manifests itself in high risk shares: the possibility of the occasional jackpot lures investors into overpaying.

In the light of this painful experience, I also resolved only to buy shares that I had researched carefully myself and not to put my trust in tips, even if they came from a respected source.

I hope to share some of that research with readers, so that you can make your own assessment of a share's worth.

I recognise that my new-found resolve to stay on the straight and narrow path of investment righteousness means that I won't profit from the next hot stock to take the investment world by storm but, by the same token, I hope to avoid the financial pain and indignity of another Carclo.

If the behavioural finance theorists are right, I'll also earn a higher return on my investments as a reward for my virtue.

In the next column, I plan to tell of a much happier experience with a company that - in my opinion, of course - is worth far more than the value placed on it by the market. Such discoveries are the stock-picker's equivalent of the Holy Grail.