

(non) Profitability in Healthcare

THE JOURNAL 2023

Begoña San José

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The Distinction Between Trading and Investing

An overview of the basics of the financial market, differences in trading and investing and risk management strategies.

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key points

- The financial market can seem confusing and is often an unnerving space for the untrained eye.
- Two terms that are often used interchangeably are trading and investing, despite possessing different meanings.
- Investing involves holding (and maintaining) a portfolio of shares, bonds, commodities, currencies, and other alternative investments over the long term.
- Trading styles categorise trading strategies into scalping, day trading, swing trading and position trading.
- Whether one elects to trade or invest in the financial markets depends on their personal preferences, risk tolerance and personality.
- Risk management involves mitigating preventable negative price fluctuations in your trading and investing.

The financial market can seem confusing and is often an unnerving space for the untrained eye. Elaborate vocabulary and frequent misuse of this terminology, together with what appears to be an unending list of strategies designed to help identify opportunities, regularly lead to increased confusion.

Two terms that are often used interchangeably are trading and investing, despite possessing different meanings.

Investing

Investing typically involves holding (and maintaining) a portfolio of [shares](#), [bonds](#), [commodities](#), [currencies](#), and other alternative investments over the long term. Investors seek strong fundamentals, whether a solid macroeconomic landscape for currency investors, for example, or a sound business model with consistent earnings growth for stock investors.

Investing strategies can be categorised as passive or active and broken down into value or growth investing

styles, particularly for equities. Passive investing appeals to inexperienced investors with limited time, allocating funds to low-turnover investments, like [index funds](#) and [Exchange-Traded Funds \(ETFs\)](#). More experienced hands tend to opt for an active approach in which the investor has more of a direct role in selecting investments.

With a focal point on the bigger picture, an investor's objective is to create investment ideas and generate a risk-adjusted return over the long term. This is essentially a way of assessing the profit potential of an investment given the degree of risk involved (usually measured through standard deviation).

Trading

Trading styles categorise trading strategies into four types: scalping, day trading, swing trading and position trading. The first two trading styles appeal to those who desire an active, short-term approach with time to be at the screens. The remaining two trading styles focus on a



medium- to longer-term approach, suitable for those with less time to devote to trading.

The practice of trading involves executing frequent transactions across major asset classes, seldom holding positions open longer than a day or a few weeks. Traders primarily focus on short-term price movements, relying on a blend of [technical](#) and fundamental analysis to determine when to buy and sell, and often containing risk to a pre-determined percentage of one's account equity per trade.

approach identified as providing positive expectancy when deployed over a long enough period) is sufficient to generate consistent returns and achieve their objectives. This could not be further from the truth. While a well-executed approach is a necessary component to achieve consistent profitability, a lack of emotional understanding regarding a trader's or investor's decision-making process can be counterproductive to wealth accumulation. An entire field is devoted to this: behavioural finance. This is largely separated between cognitive and emotional biases.

Trading (or investing) requires a different mindset; it demands that we think differently

Should I Trade or Invest?

Ultimately, whether one elects to trade or invest in the financial markets is down to their personal preferences, risk tolerance, and personality.

Investing might be the better choice if you're looking to build long-term wealth and are comfortable with riding the ups and downs of market trends (volatility). But trading might be a better fit if you're looking for more short-term returns and are comfortable with the risks involved. While investing can be relatively straightforward (especially if you stick to low-cost index funds or ETFs), it does require some basic knowledge of how the markets work and how to evaluate different investment opportunities. Trading, on the other hand, can be more complex, requiring a deeper understanding of market dynamics, advanced analysis and risk management.

Emotional Influences

Newer entrants in the financial markets commonly believe trading or investing is undemanding. They believe a strategy that provides them with an edge (an

While humans may have adapted in many ways across the evolutionary timescale, our response to money and risk remains difficult to manage instinctively. For many, an active trade triggers a 'fight or flight' response; being wrong and losing money produces a number of emotional reactions. And it is for this reason, a trader or investor must not only emphasise the need for a finely tuned approach, but they must also understand that there is a strong underlying emotional connection at play. By way of an example, one component that a short-term trader must learn to become accustomed to is to think in probabilities. You will not win in all your trades; however, if you possess a trading strategy that produces winning trades 40% of the time and generates at least double the return on those winning trades, you will, assuming the risk is contained, generate a return over the long term.

The key point is that trading (or investing) requires a different mindset; it demands that we think differently. Consistent profitability commands a mindset capable of withstanding small, controlled losses and still functioning objectively.



No matter the trader or investor, we all have losing trades. How we respond to those (controlled) losses and manage the winning positions will ultimately determine our bottom line.

Risk Management

Identifying risk and return metrics in trading or investing should be at the forefront of the required knowledge for any market participant. Risk management involves mitigating preventable negative price fluctuations in your trading and investing.

However, risk is a term that can give rise to a few different meanings, depending on who is asked. An everyday investor may state that risk is simply the amount of money he or she could lose. Ask a finance professional, and they will likely state that risk is defined

as the standard deviation of periodic returns. The professional, therefore, does not classify risk as a dollar amount, but more as the volatility, or dispersion, around a central tendency.

As a trader or investor, the primary job is to manage risk. This could be as simple as employing a protective stop-loss order to help mitigate excessive adverse price moves against a position.

Void of risk management and a lack of understanding of the psychological influences, trading or investing can prove a frustrating endeavour. Consequently, devoting time to understanding what it takes to achieve a mindset capable of operating in the market successfully and developing a sound risk-management approach and a well-defined strategy is vital.

FP Markets

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