FINANCIAL PREPAREDNESS

"One of life's most painful moments comes when we must admit that we didn't do our homework, that we are not prepared." ~ Merlin Olsen

Issue #282
July 10, 2026

Bagholders

To make money (other than dividends) investing, it's not enough to buy an asset that's undervalued and out of favor and then wait for it to become fully (or even richly) valued. You also have to find someone who is eager to own it, and would thus happily pay you a premium to buy it from you. Someone who has bought into a story and would be ecstatic to own an asset that was overpriced, perhaps faced a challenging future, and for which there existed few remaining potential buyers. In other words, a bagholder.

In recent decades, the Smart Money investors that run Wall Street have mastered the art of finding large numbers of new bagholders, which is imperative for them to keep the game going and adding to their pile. There are a number of ways that additional shares can be created that at some point will need to be unloaded on the gullible investing masses. Let's take a look.

First, corporate executives (who are generally Smart Money when it comes to their own company) are compensated to a large degree via grants of stock options, restricted stock and common shares.

Second, when conditions are favorable (i.e., when the seller can command a rich premium), the owners of a private company will sell their shares in an IPO, and a publicly traded company that has become very popular with investors will often make a secondary offering of shares or acquire another company using its richly valued stock to pay for it.

Additionally, investment companies respond to investor demand by creating new ETFs that buy and hold the shares that the Dumb Money are clamoring to own. The Smart Money became wealthy largely by *giving the people what they want* (which is usually near the worst possible time).

Bagholders are the dumbest of the Dumb Money. Generally, they barely even know what (and how much) they own, much less details of each holding such as valuation, investor sentiment, etc. The vast majority of bagholders are Mom & Pop investors who own shares of index funds or ETFs. In effect, they are price-insensitive buyers who buy regardless of valuation, sentiment, low profitability/free cash flow/capital efficiency, financial weakness, anemic growth, a meager/flat/reduced/eliminated dividend, likely accounting fraud, short interest, insider selling, poor corporate governance, or the fact that a company has become a *de facto* social justice nonprofit. They buy regardless, because they're aware that a lot of people (the Smart Money) make a lot of money in the stock market, yet they don't know exactly how that happens. (Hint: If you don't know the rules of the game and how it's played, you're the mark.) This makes them the perfect perennial bagholders.

Another significant group of bagholders—the size of which rises and falls with the flow of investors' animal spirits—are those who listen to the tantalizing tales spun by the financial media and brokerage firms that underwrite the issuance of new shares (especially IPOs). While the index fund and ETF owners above provide reliable bagholding services in all market environments, the story believers provide the Smart Money with the opportunity for ginormous capital gains.

So before you buy an asset, it's helpful to pause and ask yourself: "If I buy this, what are the odds that I'll become a bagholder?" Doing that could save you a lot of grief.

Follow Me on X

Newsletter Archive

I would love to hear from you! If you have any comments, suggestions, insight/wisdom, or you'd like to share a great article, please leave a comment.

Disclaimer

Investments carry risk, are not guaranteed, and do fluctuate in value, and you can lose your entire investment. Past performance is not indicative of future performance. You should not invest in something you don't understand, or put all of your eggs in one basket.

Before starting a new diet or exercise regimen, you should consult with a doctor, nutritionist, dietician, or personal trainer.