TOP 10 STOCK INVESTMENT STRATEGIES

Learn from famous gurus in the last 100 years

Additional Tips: The Secrets of Bull Market

Ken Fisher: Super Stocks

Who Is Ken Fisher?

Kenneth Lawrence 'Ken' Fisher is an American investment analyst and the founder and chairman of Fisher Investments. In 1984, Fisher wrote Super Stocks based on his theoretical work identifying and testing the price-to-sales ratio (PSR). Fisher was a student of investor psychology, and his observations about investor behaviour were what led to his PSR discovery.

Birth Of Super Stocks Concept

In Super Stocks, Fisher set out his views on how individual investors should approach and value stocks. His initial screening of the market involves looking for companies that are suffering from "glitches", which frequently occurs in young companies as they grow. He cites setbacks in earnings performance, which is often caused by management teams that make mistakes during the growth cycle, as temporary. The mistake then damages share valuation to present buying opportunities for investors.

Often, he found, companies will have a period of strong early growth, raising expectations to unrealistic levels. Then they have a setback, and their stocks can then plummet as investors overreact. He pioneered the use the PSR to identify these glitches.

Price Sales Ratio: What Is It?

PSR compares the total price of a company's stock to the sales the company generated. It is calculated by taking the total market value of a company (share price divided by shares in issue) divided by the last 12 months' corporate sales.

According to Fisher, stocks with PSRs below 1.5 are good values. But the real winners are those with PSR values under 0.75—that's the sign of a Super Stock.

While the PSR was key to Fisher's strategy, he warned not to rely exclusively on it. Terrible companies can have low PSRs simply because the investment world knows they are headed for financial ruin.

Main Filters: Margins, Financial Strength, Growth

There are other quantitative measures which Fisher applies in his analysis.

Profit margins of the company needs to be at least five percent using a three-year average.

Debt/equity ratio should be less than or equal to 40 percent (excluding financial institutions).

The inflation-adjusted long-term EPS growth rate should be at least 15 percent per year, i.e. 5-year EPS Compounded Annual Growth Rate (CAGR).

He believes these metrics offer an insight into how much business a company does; the basic cost structure associated with that business and the way in which a private owner would think about the business.

Additional filters

In addition, a Super Stock should also have these characteristics:

- Free working capital sufficient to support at least five years of the worst losses imaginable for the company
- Less than 40 percent of its total assets financed by debt
- Sufficient net free working capital to cover at least three years of negative cash flow
- Growth orientation
- Marketing excellence
- A competitive advantage

Like Warren Buffet, Fisher believes that the ‘right’ time to sell a Super Stock is “almost never”. However, a stock would get sold if its PSR gets outrageously high or the company ceases to have those traits which qualified it as a Super Company.

Benjamin Graham’s Value Investing Lesson

Value investing is one of the key cornerstones of investing in the market that is widely followed by many investors. For those who are unfamiliar with value investing, it is a form of investment strategy that involves buying stocks of companies that are trading below their true value as a safeguard against unpredictable future developments.

Benjamin Graham: Father Of Value Investing

Value investing is a system that was developed by the father of value investing, Benjamin Graham. He began developing with his fellow Columbia Business School professor David Dodd in 1928 and together co-authored “Security Analysis”.

Benjamin Graham later on wrote “The Intelligent Investor” which was an inspiration that shaped the investment philosophy of legendary investors as Warren Buffett and Walter Schloss. So how can a retail investor like yourself adopt value investing to create a valuable portfolio that can last a lifetime?

Three Key Principles Benjamin Graham Wants You To Master

Firstly, there are three key principles that Benjamin Graham wants investors to comprehend.

1. **Understand What Kind of Investor You Are**

Benjamin Graham believes that the first step to doing well in the market is to understand your personality and the type of investment style that suits you.

a. **Speculator vs Investor**

Graham believes that it is critical for everyone to determine whether they were investors or speculators.

The difference is simple: an investor looks at a stock as part of a business and the stockholder as the owner of the business, while the speculator views himself as playing with expensive pieces of paper, with no intrinsic value.

Another difference is that speculators often find themselves being constantly worried about the short term movement of share price. An investor knows that he is holding a long term position on the stock, thus is less worried about the short term fluctuation in share price. If you prefer having a piece of mind when you sleep at night, you are probably more suited to be an investor rather than a speculator.

b. **Active vs Passive**

In Graham’s opinion, there are two types of investors: "enterprising investors" (active investing) and "defensive investors" (passive investing).

Active investing requires a lot of time and energy commitment to become a good investor to produce quality hands-on research with the higher expected return. The more work you put into your investments, the higher your return should be. On the other hand, passive investing requires much less time and effort.

Investors need to understand their personality and which kind of investing suits them better. If you have neither the time nor the inclination to do quality research on your investments, then investing in an index is a good alternative. Investing in an index could get a defensive investor an average return equalling to the index, which is more of an accomplishment than it might seem.

2. Margin of Safety

Margin of safety is the principle of buying a security at a significant discount to its intrinsic value. Benjamin Graham believes in buying assets that are worth $1 at a discount (e.g. 50 percent). This creates a margin of safety. In essence, Graham was effectively buying businesses for nothing, which not only provide opportunities for high-return, but also limits his potential loss.

3. Mr Market

Benjamin Graham looks at the market as an imaginary business partner of each and every investor, whom he calls "Mr Market".

Mr Market would offer investors a daily price at which he would either buy an investor out or sell his share of the business. But Mr Market is temperamental and emotional. Thus, he does not care about the intrinsic value of the business. Sometimes, he will be excited about the prospects for the business and quote a high price. Other times, he is depressed about the business's prospects and quotes a low price.

You should not let Mr. Market's views dictate your own emotions nor lead you in your investment decisions. Instead, you should form your own estimates of the business's value based on a sound and rational analysis while using Mr Market to your advantage: get bargains in the market or to sell out when your holdings become overvalued.

Buffett's Track Record

Known as one of the greatest living investing legend, Warren Buffett's investing principles have earned him the moniker of the "world's greatest investor" and "Sage of Omaha".

Berkshire Hathaway returned a compounded annual growth rate (CAGR) in per-share value of 19.7 percent between 1965 and 2013. This compares against a CAGR of 9.8 percent for the S&P 500 over the same time period. In other words, Warren Buffett has managed to outperform the market by an incredible 9.9 percentage-point over the span of almost 50 years.

Buffett And Value Investing

So how did Warren Buffett accumulate such vast amount of wealth?

Like Benjamin Graham, Warren Buffett also adopts the value investing methodology, albeit with a slight twist. Warren Buffett has been able to invest without the hype and fear of Wall Street. Instead, he implements a rational investment strategy that allocates capital systematically to take stakes in companies that offer the greatest value.

4 Principles You Need To Learn From Buffett

As the world's greatest investor, there are a number of investing principles that Warren Buffett applies to his investments that every value investor NEEDS to understand.

1. Owning Great Business At An Ok Price

Warren Buffett's entire investment philosophy can be summarized in six words: Own quality businesses at reasonable prices. Note that the keyword here is "OWN", instead of "BUY".

Warren Buffett wants to invest in great businesses that possess what he terms as "moat". This refers to companies which can keep its competitors at bay through branding, better products, innovation, geography or any other means. This would make it difficult for competitors to usurp its profits and allow for a more stable and sustainable business. A simple way to identify whether the company possess such moat is to ask the following question: am I able to overtake the company even if I had all the money in the world? If the answer is no, then the company in question possess a certain degree of wide economic moat.

Buffett not only wants to own companies with a wide economic moat, but only at an ok price. This is because it gives him a margin of safety that protects him from any downside in the near term, a similar principle to the one adopted by Benjamin Graham.

2. Buffett's Two Cornerstone Rules For Investing

Rule No. 1: Never lose money

Rule No. 2: Never forget rule No. 1

Warren Buffett has two key rules for investing that he adheres to regardless. Counterintuitive as it sounds, he believes that the key to making money is to not lose money in the first place. If you lose half of your capital, you need to make a 100 percent gain on your leftover capital to breakeven. Why should you make life difficult for yourself when you could just avoid such a sticky situation by abiding to Buffett's two rules for investing?

3. Be Fearful When Others Are Greedy. Be Greedy When Others Are Fearful

Warren Buffett believes that investors should be "very happy" to see a sinking stock market. This is because there is no better time to stock up their portfolio with excellent stocks at very cheap prices than the times when stock markets are sinking.

At the depth of the financial crisis in September 2008, Warren Buffett struck a deal to buy $5B of Goldman's preferred stock which pays a 10 percent annual dividend as well as a warrant that gave him 2.8 percent of Goldman. This is further exemplified by Warren Buffett's recent stake in Phillips66 amidst the oil price plunge.

4. Diversification Is Only For the Ignorant

While theory states that diversification protects your portfolio against adverse events, Warren Buffett sees it as protection against ignorance. To Buffett, it makes little sense to diversify if you know what you are doing. Why should you dilute your holdings in a great company for the sake of diversifying?

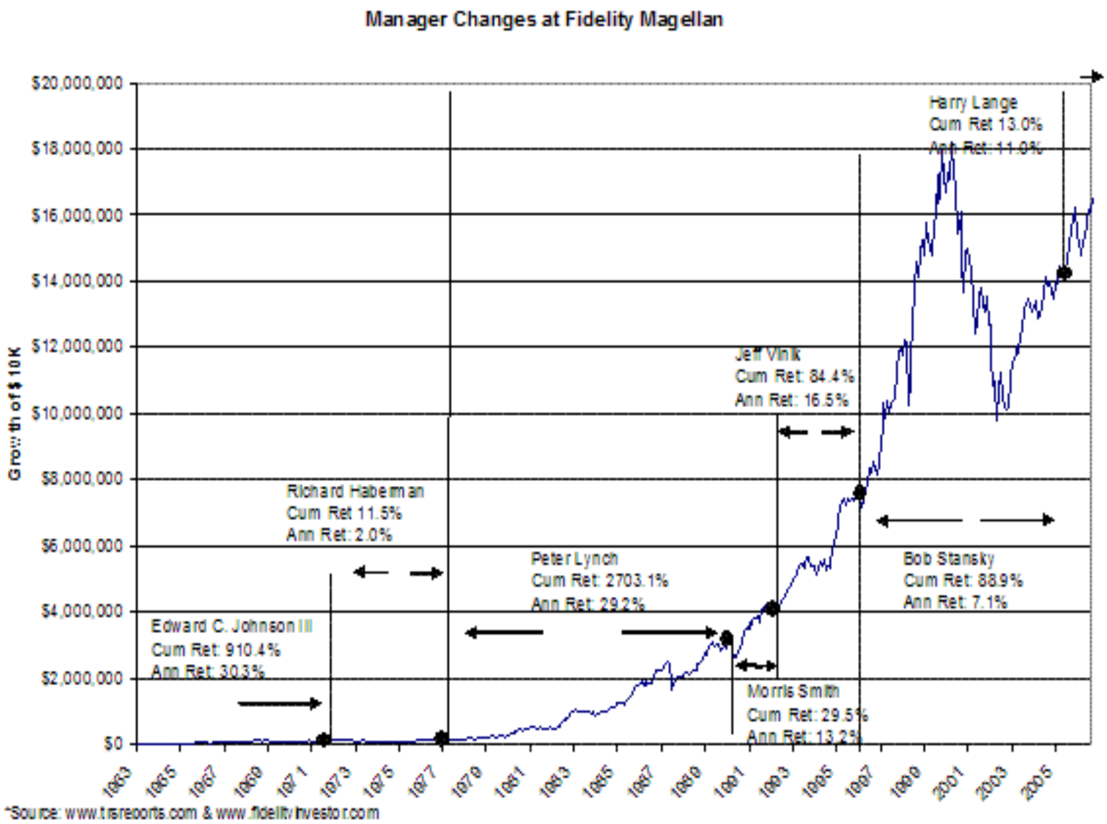
Peter Lynch: Father Of Growth Investing

Peter Lynch is an American businessman and stock investor, who was the manager of the Magellan Fund at Fidelity Investments between 1977 and 1990.

Peter Lynch's Track Record: 29 Percent Per Year!

Perhaps one of the greatest mutual fund manager of all-time, investment guru Peter Lynch managed to achieve an average return of 29 percent per year during the 13 years he ran the Fidelity Magellan Fund, from 1977 to 1990.

During the same period, the S&P 500 only managed to return 15.8 percent. Peter Lynch managed to almost return twice as much as the market returns! If you had put $1000 with Peter Lynch when he first managed Magellan Fund, you would have earned close to $5000 on your initial investment!



Peter Lynch's Key To Success: GARP

But how did Peter Lynch managed to put in such a stellar performance consistently for 13 years?

The key concept behind Peter Lynch's investment strategy is summed up by a cute acronym: GARP. Growth At Reasonable Price (GARP) is an investment strategy that seeks to combine the essence of both growth investing and value investing. GARP aims to screen out companies that are showing consistent earnings growth above market levels that are, at the same time, slightly undervalued.

GARP Criteria

Peter Lynch has a set of investment criteria that he employs which he lists out in his books (One Up On Wall Street, Beating The Street).

Classified As Fast Growers

Peter Lynch classifies the companies into six different classifications:

1. Slow Growers

   Slow Growers are generally large cap companies (although not always), that are saturated or aging. While they generate large amount of cash, the rate of growth is slow.

2. Stalwarts

   Stalwarts are the in-between of slow and fast growers. Stalwarts can provide outstanding opportunities when it is cheap enough because the company has already established itself yet still has growth potential remaining.

3. **Fast Growers**

   Companies that are in the early stage of business which tend to grow quickly and aggressively. These companies often have little debt, growing earnings at 20-50 percent a year, and have a stock price-to-earnings ratio below the company's earnings growth rate.

4. Cyclicals

   Companies that have seasonality, with a predictable pattern of high and low sales

5. Turnarounds

   Depressed, beaten and oversold companies that rebound back to its intrinsic value (and beyond) very quickly once people realize that the company has been successful in turning itself around.

6. Asset Plays

   An asset play is categorized as companies that own something much more valuable than just its business.

Peter Lynch invests in fast growers, which has the highest growth and return potential, by analysing the industry and stage of business the company is currently in.

I. EPS Growth Rate

Peter Lynch believes that fast growing companies should experience EPS growth between 20 and 50 percent as he foresees that anything above 50 percent is unlikely to be sustainable.

Criterion 1 – EPS Growth (20 to 50 percent)

II. Sales And P/E Ratio

Peter Lynch categorize companies into two groups to determine its relative size: sales below $1B and above $1B. If sales is greater than $1B, the PE should be below 40 as large companies may not be able to support growth higher than a PE of 40.

Criterion 2 – PE Below 40 If Sales Exceed $1B

III. PEG Ratio

P/E ratio ÷ Annual EPS Growth (in terms of ratio)

Price-Earnings Growth Ratio (PEG) is one of the most famous ratio used in screening stocks today. This ratio was popularized by Peter Lynch. PEG states that the P/E ratio of any company that's fairly priced will equal its growth rate, i.e., a fairly valued company will have its PEG equal to 1.

Thus, companies that have PEG that is lower than one are either growing at a much faster pace than indicated by its price, or undervalued based on its current growth rate.

Criterion 3 – PEG Lower Than 1

IV. Debt Level (Debt-Equity Ratio)

As a fast grower, these companies should not carry too much debt as there is no need for such level of debt to support its growth. The acceptable scenario is for companies to have less than half its balance sheet made up of debt.

Criterion 4 – D/E Ratio Below 0.5

- **Above 80 percent – High**
- **Above 60 percent – Mediocre (needs to have very good ratios to substantiate an investment)**
- **Below 50 percent – Acceptable**
- **Below 20 percent – Ideal**

Bonus: Free Cash Flow Yield

Free Cash Flow Yield = Total Free Cash Flow ÷ Market Capitalization.

While this is not a must-have criterion, Peter Lynch believes that this is a very good bonus criterion to have. If the FCF yield (FCF/Price) is above 20 percent, it is a sign that the company is very cheap.

The Dow Theory

Who Is Charles Dow?

Charles Henry Dow was an American journalist who co-founded Dow Jones & Company with Edward Jones and Charles Bergstresser. In the 1890s, Dow saw that the recession was ending. After which, many mergers began taking place, resulting in the formation of huge corporations. These corporations sought markets for their stock shares. The wildly speculative market meant investors needed information about stock activity. Dow took this opportunity to devise the Dow Jones Industrial Average in 1896. The Dow Jones Industrial Average was part of his research into market movements.

What Is Dow Jones Industrial Average?

The Dow Jones Industrial Average currently tracks the closing stock prices of 30 companies with the average being price-weighted. And to compensate for the effects of stock splits and other adjustments, it is currently a scaled average.

The value of the Dow is the sum of the component prices divided by a divisor, which changes whenever one of the component stocks has a stock split or stock dividend, so as to generate a consistent value for the index. Thus, it is not the actual average of the prices of its component stocks.

The index is now seen as the leading market indicator for US economy. The index's performance continues to be influenced by, not only corporate and economic reports, but also by natural disasters and domestic and foreign political events such as war and terrorism.

6 Things We Need To Know About Dow Theory

1. Primary, Secondary And Minor Movements

According to Charles Dow, the market has three different movements: primary, secondary, minor.

> The primary movement is known as the ‘main movement’. This is also termed as the major trend. Generally, the major trend may last from less than a year to several years. For example, the Dow Jones Industrial Average was in a major bull market trend from 2009 to 2015.
>
> The secondary movement is known as the ‘medium swing’, or secondary reaction. The secondary trend can last between ten days to three months. Charles Dow observes that during the secondary movement, Dow Jones Industrial Average generally retraces from 33 to 66 percent of the primary price change.

The last movement is known as the 'short swing' or minor movement. The duration of such movement varies from few hours to a month or more. This is what we usually define as intraday movements.

The three movements may be simultaneous, for instance, a daily minor movement in a bearish secondary reaction in a bullish primary movement. As an investor, we want to be in the same direction as the primary and secondary movements. We should pay less attention to the minor movements.

2. Trends Have 3 Phases

Dow theory asserts that a primary market movement is composed of three phases: an accumulation phase, a public participation (or absorption) phase, and a distribution phase.

The accumulation phase (phase 1) is a period when investors "in the know" are actively buying (selling) stock against the general opinion of the market. During this phase, the stock price does not change much because these investors are in the minority demanding (absorbing) stock that the market at large is supplying (releasing).

The market will then catch on to these astute investors and a rapid price change occurs (phase 2). This occurs when trend followers and other technically oriented investors participate. This phase continues until rampant speculation occurs.

At this point, the astute investors begin to divest (cover) their holdings to the market (phase 3).

3. Trends Are Confirmed By Volume

When prices move on low volume, there could be many different explanations. For example, this could be due to an overly aggressive seller. However, when price movements are accompanied by high volume, it represents the 'true' market view.

Thus, if many participants are active, and the price moves significantly in a single direction, Charles Dow maintained that this was the direction in which the market anticipated continued movement. This signals that a trend is developing.

4. Trends Exist Until Signals Prove That They Have Ended

Charles Dow believes that markets do not trend in a single direction. There will be up and down movements in a bull/bear market phase. These are what he termed as 'noise': Markets might temporarily move in the direction opposite to the trend, but they will soon resume the prior move.

Some investors might interpret these opposite movements as a reversal rather than a short retracement. Determining whether a reversal is the start of a new trend or a temporary movement in the current trend is not easy. Thus, the trend should be given the benefit of the doubt during these opposite movements.

5. DJIA And DJT Must Confirm Each Other

During Charles Dow's time, US was a growing industrial power. The US had population centers but factories were scattered throughout the country. Factories had to ship their goods to market, usually by rail.

Thus, other than the Dow Jones Industrials Average (DJIA), he also invented the Dow Jones Transportation Average (DJT). Dow Jones Transportation Average is a running average of the stock prices of twenty transportation corporations which includes freight carriers, delivery services, marine transportation and rail companies.

This is because if manufacturers' profits are rising, it is likely that they will produce more goods. If they produce more, they will require more shipping services to deliver goods to consumers. Hence, if an investor is looking for signs of health in manufacturers, he or she should look at the performance of the companies that ship their output to market, the railroads.

A bull market in industrials could not occur unless the railway average rallied as well. In fact, DJT should rally ahead of DJIA. But the two averages should be moving in the same direction. When the performance of the averages diverges, it is a warning that economic condition is changing.

6. Market Is Efficient

Stock prices quickly incorporate new information as soon as it becomes available. Once news is released, stock prices will change to reflect this new information. This is widely known as the efficient-market hypothesis; which Charles Dow is a believer.

<u>3 Improvements To Dow Theory</u>

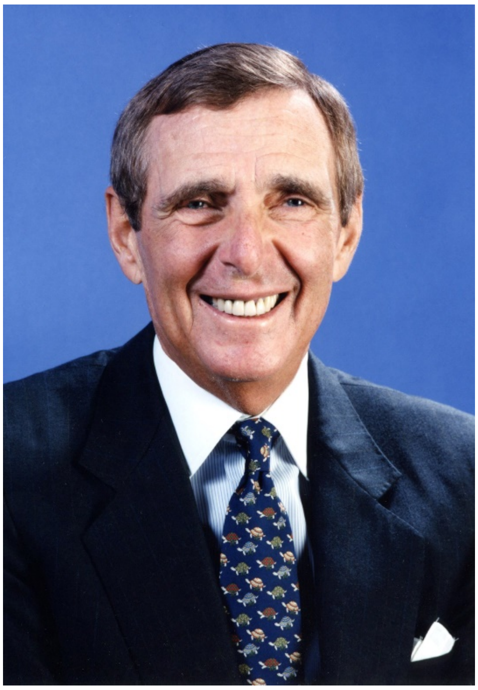
Over the years, there have been changes to the US economy. It is no longer the growing industrial economy it used to be. Some of Dow's original theory is no longer applicable. There are three improvements to the Original Dow Theory to make it the "Dow Theory for the 21st century."

> The first enhancement is to shorten the time frame of a secondary reaction to 10 to 60 days rather than the widely accepted 'from three weeks to as many months'. This is because changes in the market occur much faster in the 21st century than during Charles Dow's time.
>
> Another improvement is to add the S&P 500 Index rather than looking at the Dow Jones Industrials Average. The S&P 500 index is a broader index that consists of the 500 largest corporations in US.

The last update is the redefinition of a bear market. Previously, Charles Dow defined a bear market to be 20 percent. Rather than keeping it at the widely accepted 20 percent, historical have shown that when the market drops 16 percent on both the Dow Industrials and the S&P 500, it then tends to fall by as much as 24 percent for 69 percent of the time, with a recession following 67 percent of the time.

David Dreman: Contrarian Investing

Who Is David Dreman?



Unlike Charles Dow, Canadian-born David Dreman was a true bred investor. He founded his first investment firm in 1977 and is currently the founder, chairman and chief investment officer of Dreman Value Management LLC.

When Dreman first started investing, he lost 75 percent of his net worth simply by following popular stocks in the late 1960s. This prompted him to seek other methodology that was a better fit for him.

A subsequent interest in analysing the psychology of the market helped him to uncover how emotions can distort the valuations of fashionable stocks. This spurred him to forge his famous contrarian approach which seeks to take advantage of the misjudgements of other investors. Dreman invests in out-of-favour stocks, often in out-of-favour industries, that he identifies using relatively straightforward metric criteria.

4 Straightforward Metric For David Dreman's Contrarian Investing

1. Reasonable Price: P/E Ratio Below Industry Average.

Dreman opines that investors put too much emphasis on P/E ratio. As a result, they overvalue stocks that have strong earnings visibility. In comparison, low P/E stocks with a perceived weakness in visibility are often ignored by rational investors.

Dreman believes that there is an inherent vulnerability in assessing stocks on a P/E basis. He asserts that fondness for particular stocks and sectors can change rapidly. This gives the contrarian investor the opportunity to take advantage of a market correction.

2. Earnings Growth: Growth Potential Outperforms S&P 500

Although Dreman avoids relying too much on forward earnings estimates, he is still a believer of growth stocks.

His focus on targeting low P/E ratios should not be confused with the importance of seeking growth stories. The contrarian investment approach seeks to identify companies that are incorrectly priced by the market but nevertheless offer the prospect of longer-term growth.

Dreman's screening requires companies to deliver historical and future earnings growth that outperforms the S&P 500.

3. Large Size: Above Average Market Cap

Dreman generally targets large and medium-sized companies. He believes that these companies are less likely to suffer badly from operational and/or financial setbacks. In other words, they have the financial capabilities to turnaround. Furthermore, larger companies naturally have a higher market profile that attracts wider attention in better times. In addition, the accounts of larger companies tend to offer more reliable growth indicators because of greater transparency.

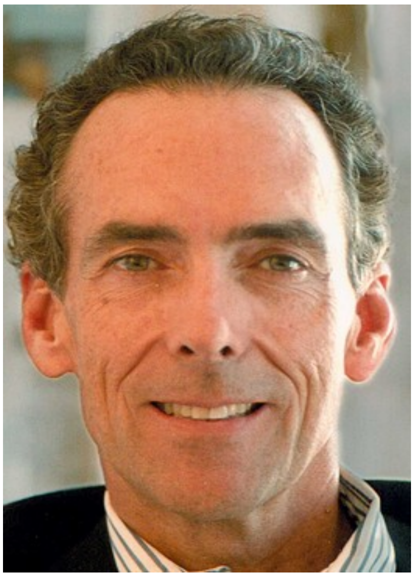
4. Financial Strength: Low Than Average D/E Ratio

Dreman feels that it is important to consider the financial strength of a company when pursuing a contrarian investment strategy. Companies with poor financial health are less likely to turn out to be the overlooked stock with strong growth potential. A strong financial position helps absorb the operational pressures encountered by companies in (temporarily) unloved sectors.

Don't Put All Your Eggs Into One Basket

On top of the four metrics, Dreman recommends that investors establish a portfolio of 15 to 20 stocks in 10 to 12 industries with equal investment in each company in order to offset the likelihood of significant variation in the rate of return among the stocks. This is commonly known as diversification. And just like any other investment approaches, the contrarian investment approach should be applied rigorously and patiently for a good chance of success.

Michael O'Higgins: Dogs Of The Dow



The Dogs of the Dow investment strategy was popularized by Michael B. O'Higgins in 'Beating the Dow'. This was written with John Downes in 1991. O'Higgins is currently the president and chief investment officer of O'Higgins Asset Management. He was widely considered one of the top money managers when he came out with the book.

How Does It Work?

The 'Dogs of the Dow' theory is a classic investment strategy where one invests in the 10 Dow Jones Industrial Average stocks with the highest dividend yield at the end of each year and hold those stocks for exactly one year.

There are only three simple steps. We just have to follow the three steps religiously each year:

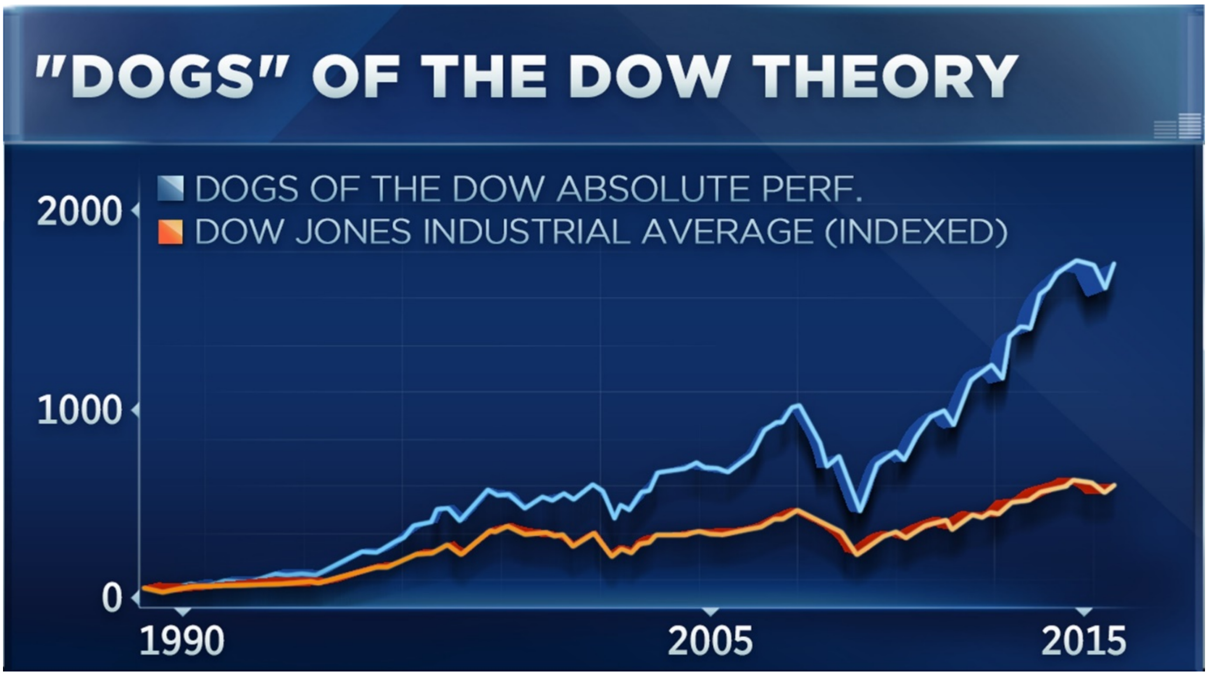
1. Find the dividend yields of all Dow Jones Industrial stocks.
2. Invest 10 percent of the whole portfolio in 10 of the highest-yielding companies.
3. Liquidate and select new positions on 1st January of the following year, using the same methodology, i.e. repeat steps 1-3.

Simplicity Is Its Strength

Yes, this strategy really is as simple as it sounds. The strategy's simplicity is one of its most attractive attributes. That being said, investors need to remember that this is a long-term strategy, requiring a long period to see results. There have been a few years in which the Dow has outperformed the Dogs, so it is the long-term averages that proponents of the strategy rely on.

Historical Performance

The strategy has yielded strong gains through the years. In 10 of the last 15 years, the dogs of the Dow have outperformed the market, according to Worth.



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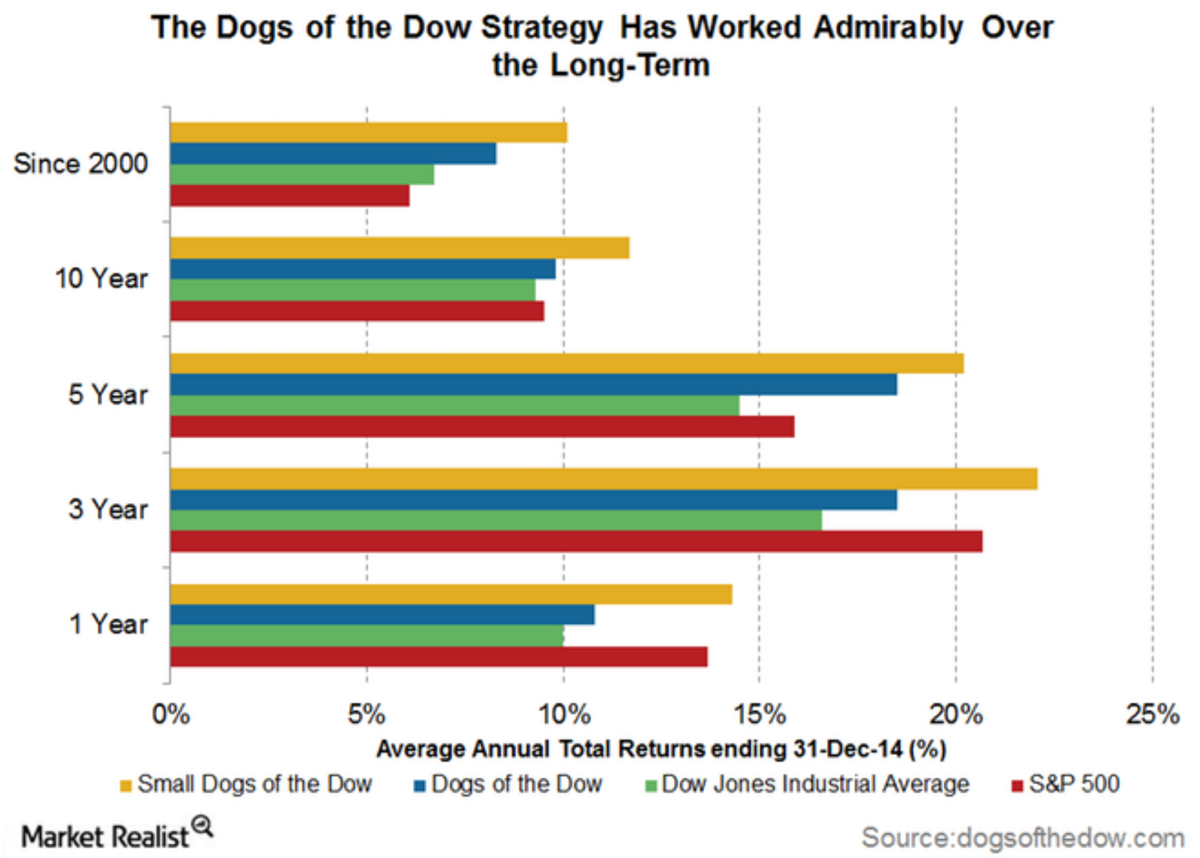


Why 'Dogs Of The Dow' Works?

The rationale behind the Dogs of the Dow investment strategy is simple. The universe of selection is limited to the 30 stocks comprising the Dow Jones Industrial Average. These stocks are of well known, large companies with vast financial resources and robust track records. They are considered as resilient stocks even during down times and economic stress, making them solid investments.

Dividend yields, compared to price-to-earnings ratio, tend to remain stable and are thus a more appropriate measure. O'Higgins considers stocks with increase in dividend yields over the short term to be oversold and the market doubts the immediate prospects of the company. However, he believes that over the long term, prices will be driven back up if the dividend stream remains robust and the companies start recovering from their down times.

Jesse Livermore's Money Management Rules

Having a trading system and methodology is important. But there is something else that matters as much, if not more: Money Management. Let's face it. We will never be 100 percent accurate in the stock market. There will be gains and losses. But without good money management, we will not be able to withstand 'mistakes' that we make.

Jesse Livermore, one of the most consistently successful traders in history, believes that making profits consistently is a more sustainable form of investing rather than 'get-rich-quick'. A good investor needs to have strong mental discipline. But the prevailing human tendency today is to look for quick wins and to avoid hard graft or any form of psychological pain, or effort. For example, it is difficult to follow a strategy that tells you to initiate a trade when the last ten trading signals from that strategy have caused you to lose money.

6 Simple Money Management Rules That Are Hard To Live By:

Here are six simple tips that you can take from Jesse Livermore to make yourself a better investor:

1. Don't Buy Entire Positions At Once

Livermore believes that it is dangerous to take full stock position at only one price. Instead, he advocates going in at a range of prices to ensure that the trade is going your predicted direction.

He always bought in round lots and used his probing technique to buy:

1. An initial position of 20 percent,
2. A second position of 20 percent,
3. A third at position of 20 percent, and
4. A final purchase of 40 percent, with all purchases being at a higher price and therefore higher cost.

   For example, if you want to buy 1000 shares, start with buying 200 shares. If the stock keeps rising, then continue to buy another 200 shares. Let it sit and see how it reacts. If it continues rising or corrects and then rises, you can go ahead and purchase the final 400 shares.

A trade going in the expected direction is the proof that your judgement about the price movement is correct. Conversely, if it goes against it means the judgment was wrong and you will lose the minimum when you are wrong. Interestingly, Livermore always made additional purchase at a higher price when on the long side and additional short selling at the lower price when on the short side.

2. Never Lose More Than 10% Of Any Investment

As soon as the stock falls 10%, Livermore would liquidate his position. To Livermore, capital protection is key in surviving in the market. He understands that the consequences of big losses are drastic. In order to cover a loss of 50 percent, you have gain back 100 percent from your remaining capital. The more money you lose, the more you have to earn in the consecutive trades to recover it.

3. Always Jeep A Cash Reserve

Like how a good general always keeps troops in reserve for right opportunity, a successful investor must always have some cash in reserve. Markets will always provide new opportunities for us to take advantage of. But we can take advantage of those opportunities only if and when we have more capital. And even if you miss a good opportunity, don't chase it because another opportunity will come.

4. Don't buy Or Sell Without Any Reason

Every time you enter or exit a trade, do it with a strong justification. Just because the price has appreciated few points is not the reason to sell it. We do not want to sell too early, or hold onto losers. Continue holding on to the winners as long as the stock is acting right. As long as the action of the overall market and the stock does not give you cause to worry have the courage to continue your positions, let it run. The golden money management rule is cut your losses, let your profits run.

5. Put Half Of Your Profit In Bank

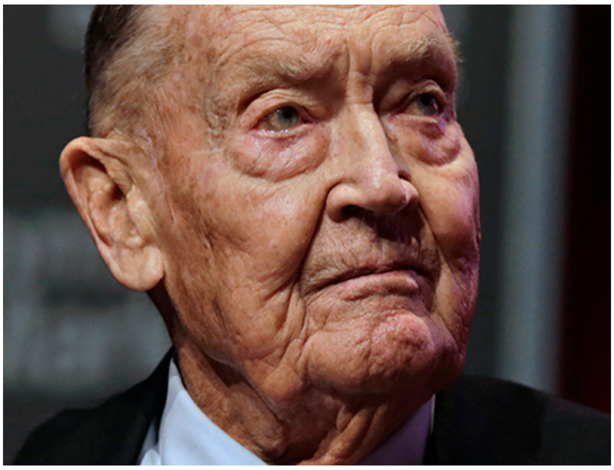
Livermore recommends parking 50 percent of your profits from successful trade, especially when your capital is doubled. Take out the cost to put it in the bank, safe assets (e.g. bonds, REITs) or hold it in reserve. Cash is one of the tricks you have up your sleeves.

6. Pay Special Attention To Risk/Reward Ratio

It doesn't matter how good you are as an investor; you can't avoid losses. Risk to reward ratio is important because it disciplines you to take on calculated risk for a good reward ratio. For example, if you risk $100 for a potential return of $300, this gives you a risk-to-reward ratio of three. For every good trade you make, you can afford to make up to three 'bad trades'. Of course, nobody wants to make losses. But it's the part of the game. We can only increase our odds of succeeding.

John Bogle: Active Investing Vs Passive Investing

Who Is John Bogle?



John Clifton "Jack" Bogle is the founder and retired CEO of The Vanguard Group. Vanguard Group founder John Bogle is a clear fan of passive investing through index funds or Exchange Traded Funds (ETFs).

The Case For Passive Management

Vanguard Group of mutual funds is the first firm to introduce "indexed" mutual fund to track the market's return in 1976.

Bogle's innovative idea was creating the world's first index mutual fund. The Vanguard Index Trust, later renamed the Vanguard 500 Index Fund (ticker: VFINX), tracks the performance of the S&P 500 Index benchmark index.

Bogle's idea was that instead of beating the index and charging high costs, the index fund would mimic the index performance over the long run. Thus, achieving higher returns with lower costs than actively managed funds.

Bogle's innovative idea of index investing offers a clear yet a prominent distinction between investment and speculations. Bogle lauded the benefits of active management and shunned the idea that an unmanaged portfolio of stocks would do better.

Active Investing Vs Passive Investing

Investing takes on two main forms: Active and Passive investing. In determining investment style, an investor should first consider the degree to which they believe that fund managers can create greater than normal returns.

Active Investing

Investors who want to have professional money managers carefully select their holdings will be interested in active management. Actively managed funds typically have a full time staff of financial researchers and portfolio managers who are constantly seeking to gain larger returns for investors. Since investors must pay for the expertise of this staff, actively managed funds typically charge higher expenses than passively managed funds.

Active managers are constantly searching out information and gathering insights to help them make their investment decisions. The aim is to beat the market return and create alpha return for investors. Each fund has its own complex security selection and trading systems to implement their investment ideas, with the ultimate goal of outperforming the market.

Active Investing: Non-Zero Odds Of Outperformance

The main advantage of active management is the possibility that the managers will be able to outperform the index due to their superior skills. They can make informed investment decisions based on their experiences, insights, knowledge and ability to identify opportunities that can translate into superior performance.

Active Investing: Cost And Portfolio Concentration Weakness

However, active investing is costlier, resulting in higher fees and operating expenses. Having higher fees is a significant impediment to consistently outperforming over the long term.

Furthermore, to beat the market, active managers tend to have a more concentrated portfolio with fewer securities. However, when active managers are wrong, they may significantly under-perform the market.

<u>Passive Investing</u>

Some investors doubt the abilities of active managers in their quest for outsized returns. This position rest primarily on empirical research shows that, over the long run, many passive funds earn better returns for their investors than do similar actively managed funds. Passively managed funds have a built-in advantage – since they do not require researchers, fund expenses are often very low.

Passive Investing: Its Biggest Strength Is Its Greatest Weakness

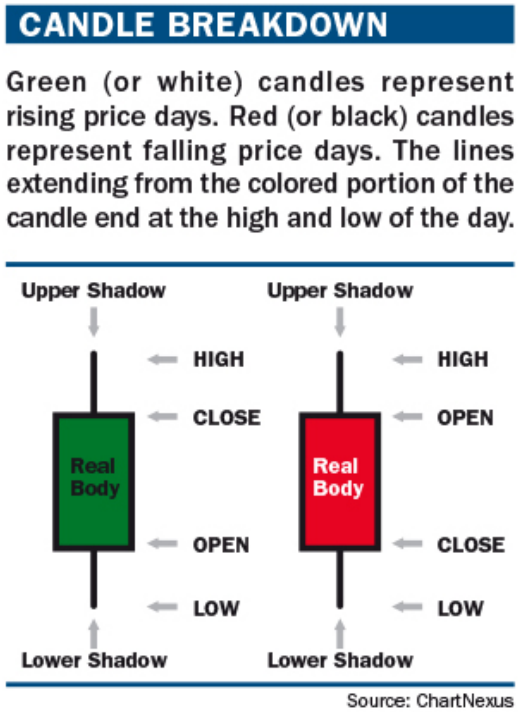
Passive investing is an investment management approach based on investing in exactly the same securities, and in the same proportions, as an index such Dow Jones Industrial Average or the S&P 500. Passive managers do not try to beat the market, but only to match its performance.

Portfolio managers do not make decisions about which securities to buy and sell; the managers merely follow the same methodology of constructing a portfolio as the index uses. The managers' goal is to replicate the performance of an index as closely as possible.

As a result, a passively managed investment will never outperform the underlying index it is meant to track. The performance is dictated by the underlying index and the investor must be satisfied with the performance of that index. Managers are also unable to take action if they believe the overall market will decline or they believe individual securities should be sold.

Steve Nison: Japanese Candlesticks

While candlesticks have been a mainstay among Japanese, it was popularized in the west by Steve Nison. Steve Nison brought candlestick patterns to the Western world in his popular 1991 book, "Japanese Candlestick Charting Techniques."

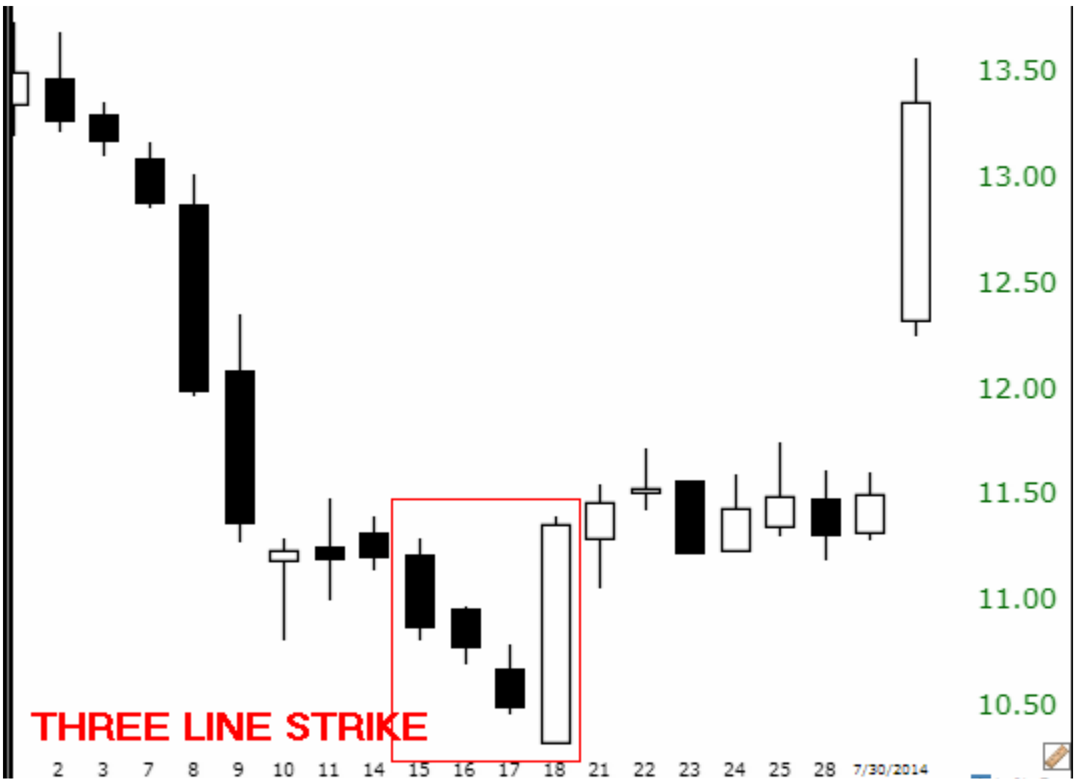


Candlesticks build patterns that predict price direction once completed. Proper colour coding adds depth to this colourful technical tool, which dates back to 18th century Japanese rice traders. While not all candlestick patterns work equally well, their huge popularity has lowered reliability in a self-fulfilling prophecy.

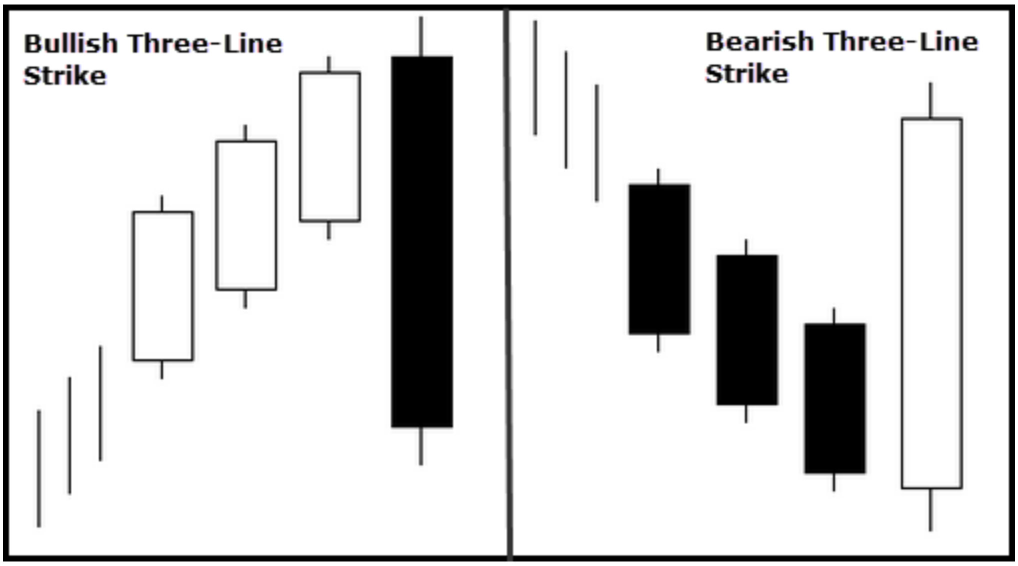
Hedge funds and traditional fund managers are increasing their reliance on lightning speed execution to seek alpha returns. In other words, they use software to trap participants looking for the high odds bullish or bearish outcomes.

<u>3 Candlestick Patterns You Need To Know</u>

1. Three Line Strike



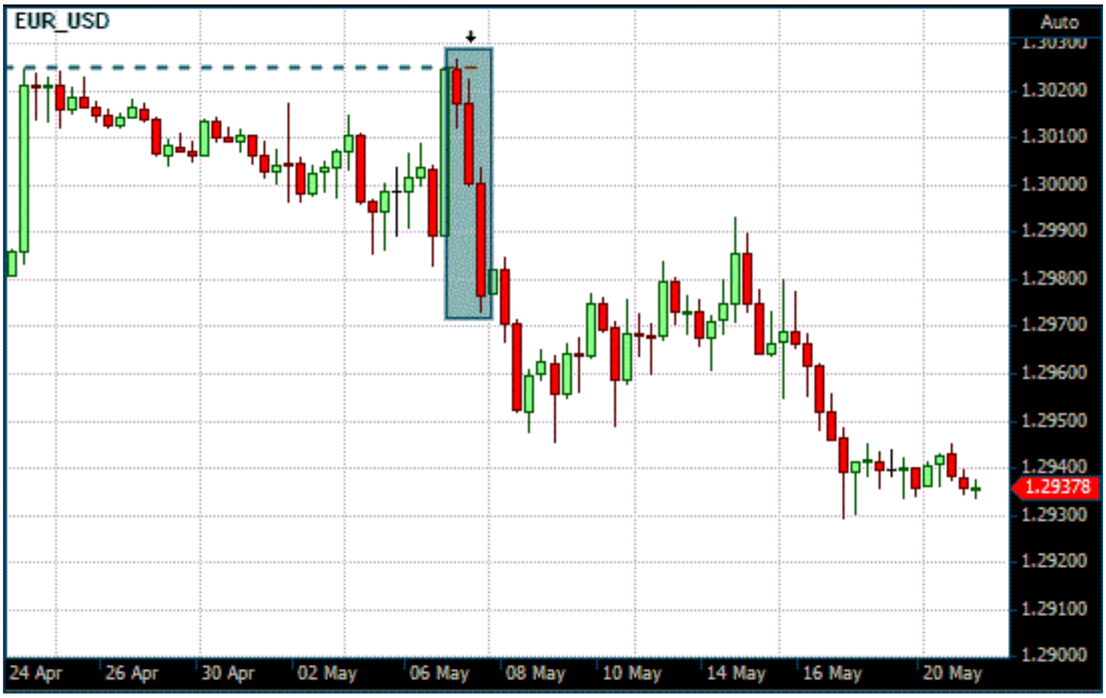
Source: Investopedia



The bullish three-line strike reversal pattern carves out three black candles within a downtrend. Each bar posts a lower low and closes near the intraday low. The fourth bar opens even lower but reverses in a wide-range outside bar that closes above the high of the first candle in the series.

Accuracy: 84 percent

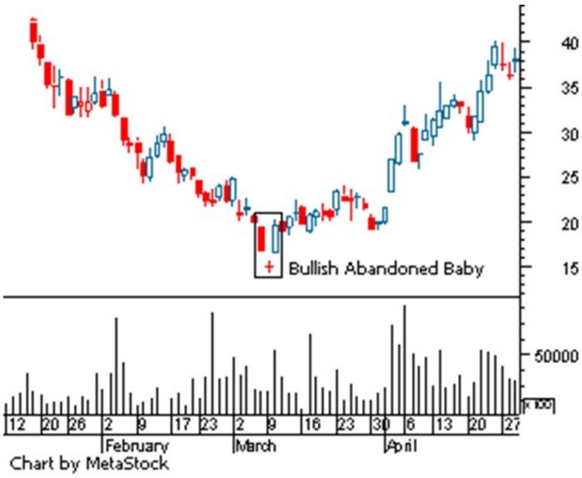
2. Three Black Crows



Source: Chart-Formations.com

The bearish 'three black crows' reversal pattern starts at or near the high of an uptrend, with three black bars posting lower lows that close near intraday lows. This pattern predicts the decline will continue to even lower lows, perhaps triggering a broader scale downtrend. The most bearish version starts at a new high because it traps buyers entering momentum plays.
Accuracy: 72 percent

3. Abandoned Baby



Source: Investopedia, MetaStock

The bullish abandoned baby reversal pattern appears at the low of a downtrend, after a series of black candles print lower lows. The market gaps lower on the next bar but fresh sellers fail to appear, yielding a narrow range doji candlestick with opening and closing prints at the same price. A bullish gap on the third bar completes the pattern, which predicts the recovery will continue to even higher highs, perhaps triggering a broader scale uptrend.

Accuracy: 70 percent