# Lessons On Buying Stocks

1. **Earnings: The Indispensable Element Of Great Stocks**

- Insist on the best earnings performance, not just a promise of earnings. This way, you will pick stocks with the best probability of making substantial gains.
- Look for companies reporting earnings growth of at least 25% in the most recent quarter.
- Find companies with earnings that have accelerated in the three or four most recent quarters.
- Identify stocks with annual earnings growth of at least 25% over each of the previous three years
- Don't overemphasize the price/earnings ratio as a way to compare a company's stock relative to its earnings.

2. **Sales, Margins & ROE**

- Strong sales growth is one key indicator of a company's success. Quarterly sales growth should be up at least 25% in the most recent quarter. Otherwise, they should be accelerating.
- Profit margins tell you how much of a company's sales end up as earnings after expenses. Generally, the higher profit margins, the better. The rule of thumb for all companies except retailers: seek companies with annual pretax profit margins of at least 15%. After-tax margins should be at all-time highs for the company or within 10% of the high.
- Return on equity measures how well a growth company can produce earnings with shareholders' capital. Look for ROEs of at least 17%. In most industries, the top-performing companies tend to have ROEs of 20% to 30%. Occasionally, companies will boast ROEs of 40% or even higher. The higher the percentage, the more efficient a company is in utilizing its capital.

3. **Sponsorship**

- Institutional investors represent the bulk of trading activity in the market. As such, their buying and selling power can move a stock's price up or down dramatically.
- You can learn to spot which stocks institutions are buying and selling by watching for surges in trading volume.
- Look for stocks with an increasing total number of institutional owners in recent quarters. Look for those stocks that are owned by more funds each quarter.

4. **Industry Groups**

- Much of a stock's move is due to the strength of its industry. You want to own stocks in industries that are displaying strength and market leadership.

- Different industries move to market leadership as economic conditions and consumer trends change. You can identify the new leaders by watching the top five industry sectors with stocks making the most new price highs.

5. **Leaders**

- Relative Price Strength Rating measures a stock's price move over the last 12 months compared to all other stocks.
- Look for stocks with high Relative Strength. The better-performing stocks tend to go higher, while the lagging stocks tend to lag even more.
- The Relative Strength line helps confirm a stock's upward price movement. You want to see the RS line moving in a strong uptrend.

6. **New Highs**

- Quality stocks making new price highs just as they emerge from sound bases on higher volume are often likely to continue climbing, while stocks making new lows are probably headed even lower. Therefore, focus on the new price highs list for the best potential opportunities.
- The great paradox of the stock market is that what seems too high and risky to most investors is likely to continue rising. And what seems low and cheap usually goes down.
- You can think of a stock's price as a measure of its quality and, consequently, its potential. Typically, stocks higher in price reflect higher quality.

## Lessons On Selling Stocks

### Lesson 1. Cutting Losses

- The first sell rule is to get rid of any stock that falls 8% below your purchase price.
- It's critical to follow this loss-cutting rule regardless of how highly you value a stock. Personal opinions get in the way of smart selling decisions.
- The larger the loss, the higher the recovery you need to get back to the break-even level. (A 50% loss requires a 100% gain to break even.)
- Strong stocks sometimes initially retreat close to their buy point (as determined by the stock's chart pattern). This doesn't necessarily mean you have to sell, unless the stock goes 8% below the purchase price.
- Avoid making sell decisions based on tax concerns or commission rates.

### Lesson 2. Taking Profits

- A simple, clear-cut strategy is to sell after your stock has gained 25%, unless the stock has gone up 20% in just one to three weeks.

- Stock charts are especially helpful in spotting signs of weakness in stocks, often providing clues much earlier than any fundamental indicators show.
- Look for climax runs, exhaustion gaps, failed breakouts, significant violations of the 50-day moving average and other characteristics of a weakening stock.
- Remember to check the market direction daily. If the market comes under distribution and weakens, your stocks will have a hard time making any further advances.

### Lesson 3. Selling Indicators

- Consider selling a stock if it shows fundamental signs of weakness, such as a steady deceleration in earnings or sales.
- Watch for weakness in the stock's industry group. When the leading stocks in an industry decline, the other stocks in the group may typically go down, too.
- If there are signs that mutual funds are consistently selling the stock, you should consider selling.
- Too many stock splits close together in time can push a stock lower.

## Rules For Stock Market Success

**Rule 1.**
Consider buying stocks with each of the last three years' earnings up 25%+, return on equity of 17%+ and recent earnings and sales accelerating.

**Rule 2.**
Recent quarterly earnings and sales should be up 25% or more.

**Rule 3.**
Never buy or sell stocks on Tips or Rumours, no exception.

**Rule 4.**
Cut every loss when it’s 8% below your cost. Make no exceptions so you can always avoid huge, damaging losses. Never average down in price. In a bear market, average decline of a leading stock is 72%.

**Rule 5.**
Follow selling rules on when to sell and take profit on the way up.

**Rule 6.**
Buy when market indexes are in an uptrend. Three out of every four stocks follow the market, either up or down. Reduce investments and raise cash when general market indexes show five or more days of volume distribution.

**Rule 7.**
Buy leading stocks in the leading industry groups. 50% of any stocks move either up or down is because of the strength or weakness of its Industry Group & its overall sector.

**Rule 8.**
Pick companies with management ownership of stock.

**Rule 9.**
Buy stocks breaking out in heavy volume from chart patterns like cup with a handle, flat base, double bottom, etc.

**Rule 10.**
Select stocks with increasing institutional sponsorship in recent quarters.

**Rule 11.**
Current quarterly after-tax profit margins should be improving, near their peak and among the best in the stock's industry.

**Rule 12.**
Don’t buy because of dividends or PE ratios.

**Rule 13.**
Pick companies with a superior new product or service.

**Rule 14.**
Invest mainly in entrepreneurial companies. Pay close attention to those with an IPO in the past 8 years.

**Rule 15.**
Check into companies buying back 5% to 10% of their stock and those with new management.

**Rule 16.**
Don’t try to bottom guess or buy on the way down. Never argue with the market. Forget your pride and ego. Dont back your judgements until the action of the market itself confirms your opinion.
"Markets are never wrong - opinions often are". Dont let emotions take over, thats one of the biggest dangers of Investing.

**Rule 17.**
Find out if the market currently favors big-cap or small-cap stocks.

**Rule 18.**
Do a post-analysis of all your buys and sells. Post on charts where you bought and sold each stock. Evaluate and develop rules to correct your major past mistakes.

# Common Mistakes Most Investors Make

These are the mistakes you must avoid.

1. Stubbornly holding onto losses when they are very small & reasonable.

2. Buying On The Way Down In Price, Thus Ensuring Miserable Results.

3. Averaging Down In Price Rather Than Up When Buying.

4. Buying Large Amounts Of Low Priced Stocks Rather Than Smaller Amounts Of Higher Priced Stocks.

5. Wanting To Make A Quick & Easy Buck.

6. Buying On Tips, Rumours, Split Announcements & Other News Events, Stories Advisory Service Recommendations, Or Opinions You Hear From Supposed Market Experts On TV.

7. Selecting Second Rate Stocks Because Of Dividends Or Low Price-Earnings (P/E) Ratios.

8. Never Getting Out Of The Starting Gate Properly Due To Poor Selection Criteria & Not Knowing Exactly What To Look For In A Successful Company.

9. Buying Old Names You Are Familiar With.

10. Not Using Charts & Being Afraid Of Buying Stocks That Are Going Into New High Ground In Price.

11. Cashing In Small Profits Early While Holding The Losers.

12. Worrying Too Much About Taxes, Commission & Brokerage.

13. Speculating Too Heavily In Futures Because They Are Thought To Be a Way To Get Rich Quick.