

Hoosier Dispatch: Getting Started at Stock-Picking, Part III

By Andrew Greta
2/4/98 10:46 AM ET

We began this three-part series talking about how investing was a lot like raising kids. Now we'll continue the analogy beyond the nitty gritty. After two scrappers of her own, my sister gave me an interesting insight that relates to the world of investing. She told me it's really not that hard, you just have to rely on a few proven principles and use common sense.

I'm not claiming to have the definitive word on anything here, but I've collected a batch of seven basic maxims from my four years as a broker that may prove helpful to those just staring down the yellow brick road.

Principle No. 1: You don't have to be right all of the time to make a ton of money. The casino operators know this one by heart. On a given roulette, the house wins just over half of the time. Most investors would probably call a 51% hit rate pretty abysmal performance, but not the manager of Harrah's. He's too busy in the back room counting the 1 or 2 cents on every single dollar that passes through each station and piling up the pennies by the millions.

You'll never be right about every stock you pick, so don't get too worked up about it (sure takes the pressure off, doesn't it?). Instead, focus on getting the best odds you can using a system like the one I've described in this series, and try to gain more on your winners than you lose on your losers, which brings us to...

Principle No. 2: Pull the weeds, not the flowers. Be quick to sell the stocks that don't work out and slow to take profits on the winners. Too many clients I know lock in small gains and take huge losses due to some quirk in their primal greed response.

If you can turn the tables by, say limiting losses to 10% and averaging 30% on your winners, you only have to be right one time out of three to make money. But how do you bring yourself to cut loose the trophy fish of a lifetime that's heading straight for the bottom, dragging you and your boat with it?

Principle No. 3: Act on facts, not emotions. Parents always think that their kids are the cutest in the world, but an ugly baby is still ugly. Don't get blinded by your own prejudices into making a prince out of the frog next door.

Realize that just because you feel a certain way about a stock, industry, product or service, that doesn't mean that anyone else feels the same way. Check it out with the objective shades on, and remember: The market is never wrong, it just "is."

Principle No. 4: Use a disciplined approach. You don't change your golf swing every time you tee up, right? Then why use different criteria every time you pick a stock? Stick with a system that fits your style and use it every time you make a move – for, say, 20 round-trip trades or more. Then, if you see some areas to change for better performance, do it, but stay with the system and don't second-guess yourself.

Principle No. 5: In the long run, earnings drive stock prices, period. On any given day, stock prices jump around like a bunch of Ritalin-deprived 8-year-olds due to all kinds of factors beyond your control.

However, as a beginning investor who's brain isn't hard-wired into the market's nerve center like the 900-pound gorilla on some trading desk in Manhattan or Chicago, forget about trying to take advantage of those gyrations.

Face the facts that you'll probably be the last to know about any information that drives prices in the short run and focus on hitting consistent singles over months and years instead of trying to blast a home run once a decade.

The way to do that is by focusing on a company's earnings growth and the factors that contribute to that growth as a primary factor in picking your stocks. It's really pretty simple: If the company is making money, you, as part owner, will make money too.

Principle No. 6: Buy high and sell higher. In other words, don't rule out a stock just because it's at the top of its trading range. The laws of Newton do not necessarily apply to the stock market. For example, an investor that picked up Gillette any time over the last decade would have probably been buying at an all-time high. Yet \$10,000 invested over that same time frame would have grown to nearly \$200,000 today. What went up, kept going up.

Put another way, don't go bottom-fishing unless you're trying to hook some sickly looking carp that's probably down there for a reason. That's not to say that you should buy the latest Net-Hype IPO on opening day at a 50-point premium. Just use your head and follow the process in parts I and II, which should keep you safe from fits of recklessness.

Principle No. 7: Never force a trade. If nothing looks good, sit tight; there's probably a reason. New opportunities come up all

the time, so there's nothing wrong with picking your shots instead of randomly blasting through the woods. On the other hand, if a stock pops up that passes all of your screens, pull the trigger. Don't wait around for something better to saunter by.

By following these principles, you'll hopefully wind up with a dose of added confidence as you head into the wilds looking for your first kill. Or at least you'll keep you from shooting yourself in the head by accident.

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