Tips for Success in the Stock Market

ARE YOU A TRADER OR INVESTOR?

There is no singular way to approach investing in the stock market. Equity markets provide a myriad of ways to make and lose money. However, it is useful to identify a process, philosophy and strategy that can create a framework for decision making. In times of stress such as during the harsh correction of early October 2014, a philosophical foundation can alleviate panic and eliminate poor decisions based on emotion. The first question to ask is "Am I a TRADER or INVESTOR"?

TRADING stocks will tend to be opportunistic and exciting. However, there is a downside in the realization of short term gains that can siphon off significant capital to the government in taxes. Also, without sufficient time a good business cannot effectively compound its earnings and dividends. Very few great investors and scarcely any of the wealthiest people in the Forbes 400 reached that level of success from trading. They almost all own a business or a portfolio of businesses.

There are some recommended TRADING strategies that have stood the test of time:

- Buy relative strength by moving capital from weak performers to stronger price action.
- Accumulate positions in stocks that are trading above their 200 or 50 day moving averages.
- Keep tight stop losses and never add to losing positions.

INVESTING in equities tends to be more intellectually rigorous and requires patience and judgment. The investor is generally looking for wealth creating businesses that can be held for long periods of time to benefit from the internal compounding of its earnings and dividends.

The most important characteristics of a wealth creating business are as follows:

- Attractive revenue growth.
- High profit margins and high ROE.
- Substantial free cash flow.
- A brand or sustainable competitive advantage.
- Management committed to stock buybacks and increasing dividends.

These kinds of companies have made Warren Buffett very wealthy and can be held for long periods of time - throughout short term volatility and longer market cycles. Holding these positions can also defer capital gains payable to the government indefinitely. This is no small feature when trying to compound wealth. If an investor can add a price discipline and accumulate more shares of a great business during market sell-offs this strategy is even more effective.

Suggestions on what to avoid:

No mining or extractive commodities such as gold, silver, copper, uranium, coal, oil, natural gas or rare earths should be considered as investments – only trades. They are difficult businesses with high demands for capital and a boom and bust economic cycle. Enormous profits can be made in these industries during cyclical periods but they tend to be a zero sum game over time – just as much money is lost as gained over a cycle.

Only use leverage on income producing investments. Margin expense should be covered with dividend or distribution income.

Conclusion:

Approaching the stock market with a steady, rational and unemotional process can lead to success. By investing in great businesses that consistently raise their dividends, your portfolio will generate increasing cash flow, as well as improve the chances of capital appreciation.

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