**DECEMBER 2011 e-NEWSLETTER**

## COMING EVENTS

>**StockTalk:** February 11th, March 10th, and April 14th at Christ Church United Methodist.

> **Introduction to Investing:** January 14th, 9 to 11am

> **Stock Selection Guide (SSG) – Learning the Basics:** January 28th, 9am to 4pm

> **NEW: ToolKit Mechanics** – Applied ToolKit with "Hands-On" Computer Lab, February 25th,

> **ToolKit – Beyond the Basics:** March 17th, 9am to noon

> **Supercharge Your SSG With Sound Judgment:** March 17th, 1 to 4pm

> **Spring Investors' Forum:** April 28th, 8:30am to 4pm

## FIND-A-CLUB

We now have 15 clubs listed in our Find-A-Club program who are open to visits by those looking for an investment club to join or just curious about the investment club experience and want to learn more. Nine of those clubs are "women only" while the remainder are mixed (men and women). To increase the success of this program, we need to have as many clubs as possible to open their doors to visitors. We need more men and mixed clubs, **so register your club today.**

## TALES FROM THE BRIGHT SIDE

Day traders and short term speculators are gamblers whose goal is to make fast money which can only be done at the expense of another trader. For a trader to make a buck, someone must lose a buck since the idea of wealth creation through business activity is a foreign concept to these folks. They care nothing for the company whose stock they trade. They play a "zero sum game".

We are in the camp of **investors** as distinct from traders in that we look for a

- great company with a record of growth and performance, with a
- sound business model meeting basic human needs and desires far into the future, run by a
- savvy management team.

Then we patiently wait for the market to temporarily misprice the stock and we use that opportunity to buy into that business at an attractive price. **We are then co-owners of that company and share in the wealth created by the company's business activity.** This approach is aligned with successful investors like Warren Buffett.

No company can generate wealth in an hour, or a day, or a week, or even a month. It requires many months and years of hard work, manufacturing, selling, and managing to do so. Therefore we expect to hold the stock for the long term to give the company time to generate new wealth in the form of earnings in which we will share through dividends and stock price appreciation. Stock price follows earnings over time even while gyrating wildly short term due to the frenetic activity of the traders and speculators. Dividends are much steadier and can be re-invested regularly to take advantage of the miracle of compounding.

We will sell the stock should the business model sour or business activity be compromised or management fails for whatever reason. We will also sell should the stock become seriously overpriced. (e.g., when the P/E ratio exceeds 150% of the average P/E or some other criteria well understood and agreed to by the membership) This approach is the only sure, low risk way to personal wealth over time.

But it isn't all that simple. When we elect to buy or sell a stock we must enter the market jungle at a given time to make our transaction. We must enter the frantic world of the trader where momentum rules. Some characterize the short term market as a manic/depressive personality swinging unpredictably between euphoria and depression. How can one deal with this highly volatile market? Traditionally, clubs make the buy/sell decision at a club meeting and then enter the buy/sell order the next morning "at the market". In a volatile market, a month is a long time and even a market order can miss the target the next morning. Is there a better way? Here are some ideas for your consideration.


As part of the overall analysis process, you might specify the selling price under two conditions. **First**, if the price falls below your projected low price, the stock monitor should review the situation. If it looks like the company business is permanently impaired then the monitor should be empowered to authorize the treasurer to sell immediately at the market or enter a **stop loss order**. The order will become a market sell at the stop price. Or the monitor might initiate an email vote of the membership based on the monitor's recommendation and supporting rationale. In any case, the critical decision doesn't have to wait a month for the next club meeting. **Second**, the club should know when the stock becomes overpriced with little upside potential remaining. This is easily done by taking 150% of your average P/E and multiplying by the TTM EPS. When the current price is within 10% of that price, a **sell limit order** should be entered. For example, suppose the average P/E is 18, the TTM EPS is $5, the overpriced point is 1.5*18*5 = $135. So a sell limit order should be entered with a limit of $135. Should the stock price exceed $135, the stock is sold. If not, nothing happens.

Many clubs have tried using the stop loss order to prevent holding a stock whose price falls precipitously. However, if the company is still sound, the price will surely rebound and the club is "stopped out" of a position that really should be held. For example, you enter a stop at $30 and the stock falls to $26, is sold and then pops back up to $31. A cruel trick of the volatile market. Furthermore, the stock monitor hasn't the opportunity to evaluate the reason for the price drop and determine if reflective of a permanent problem, a temporary event, or just the mood swing of the market.

**WORDS OF WISDOM**

"Good judgment comes from experience, and a lot of that comes from bad judgment." - Will Rogers