

>: The Most Dangerous Place to Get Investing Advice Today

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[Editor's Note: Got questions? The market is up, down, and just plain crazy. Teeka Tiwari, hedge fund manager and Fox Business New contributor, has agreed to answer Tycoon Reader's questions in a free webinar next week. This will be one of the most significant web events you will ever attend. But hurry, because we can only accept your questions for one more day. [Submit your questions by Friday and register for this exclusive webinar now.](#)]

Regardless of which candidate you vote for in three weeks, our economic reality will not be washed away with the tide of the elections. Grotesquely high budget and trade deficits, obscene debt-levels led by off-the-chart consumer spending, low savings and impossible-to-obtain loans have all finally caught the attention of investors.

Whether in the short-term the market ends up trading higher or lower from this point, one thing is for certain: you have to be more careful than ever with how you invest your money. The market will not "save you" from a bad investment. Only your wits and a fair amount of patience will.

This does not mean you should avoid stocks - I still think there is no other place to put your money. Bond yields simply don't compensate you for the risk of inflation. Real estate prices are still abnormally high and will remain so until people stop pricing their property based on what they owe on their mortgage. And until the government offers a bail out plan to homeowners who are underwater, they'll have little incentive to sell at prices that assure them huge losses.

What does that mean?

In my circle of friends we're hunting for profitable game as hard as ever. It's times like these - big game situations - that we want the ball in our hands.

Experience has taught me that the flip side of the panic coin is "opportunity." That's why, whenever I hear the word "**crisis**," I replace it with "**opportunity**": As in the "**Greatest Opportunity Since the Great Depression.**"

In any market environment - but especially a market like this - the best offense is a good defense. That means that you have to work extra hard to protect your capital first, while you hunt for investing opportunities second.

A Fool and His Money Are Soon Invited Everywhere

If you're like me, every week you get solicited by seemingly dozens of people that want you to invest in something.

I used to think it was flattering. It didn't take long, however, before I learned the age-old lesson that "a fool and his money are soon invited everywhere."

A stockbroker whose been trying hard to get your business calls and wants to discuss a tech stock he or she thinks is going to "break out" of a range and trade higher...you see Jim Cramer yelling about some new stock nobody's ever heard of on TV...you hear that some large investor just bought a gazillion shares of the next best stock since **Microsoft (MSFT)**.

It's easy to keep your guard up when you hear investing ideas from people you don't know personally.

It's much harder, however, to keep your guard up when you're getting advice from people you do know...

Like the stockbroker you've been doing business with for several years whose telling you that now may be the time to dip your toes back in the market...Or your doctor friend casually told you about a biotech company that has a promising new drug that should be approved by the FDA...Or your neighbor opens up to you after a couple at the backyard BBQ and tells you he and his buddies just bought 50,000 shares of "the next Microsoft" for only twenty cents per share.

Because these people aren't the ones out to get you, it's easy to let your guard down. Why on earth would you not trust a stockbroker you've been doing business with for five years?

But there's a lot of innocent money out there. And innocent money can be just as destructive as dangerous money. Before you know it, a well-meaning advisor could offer an ill-timed recommendation that sets you back five years.

So today I'd like to talk about how to create a filtering system that protects you from the innocent money that may be advising you.

If you walk away from this with a better system for filtering the good ideas from the bad, then I've done my job. Once you find yourself saying

"no" a heck of a lot more than you say "yes" you'll have realized one of the most important keys to becoming a successful investor: knowing when exactly to pick up the bat, step to the plate and take a real swing and knowing when not to.

(One quick comment before we begin. Countless articles have been written about how to avoid doing business with a crooked broker. That is not the focus of the article. Having worked on Wall Street for years I can say without a doubt that most stockbrokers are decent, hardworking people. But if you need to check the disciplinary and employment history of your broker go to www.nasdr.com.)

Question #1: Are You Recommending this Stock Based on the "Squiggly-Line Theory"?

Chris Rowe calls it the Squiggly-Line Theory. Most people refer to it as basic "Technical Analysis" - the art of looking at a chart or two and deciding whether or not to buy a stock.

It seems that almost every investor, whether professional or not, starts investing by using technical analysis. I'm no different: I spent the first two years of my career trying to predict the direction of stock prices by reading charts.

It's clear now in hindsight to see why I, as most others, start that way: learning technical analysis is easy. In fact, that's why most people get into it. I can't tell you how many new investors I've met in my career who are fascinated by the visual appeal of a graph with squiggly lines and arrows.

And when you see how much you could have made had you bought at one of the past "buy points" on the chart then it almost seems foolproof. Who in their right mind wouldn't want to make what looks like easy money by reading something as simple as a chart?

But let's look at the cold hard facts. Investing is about making money. And the way investors "keep score" is by how much money they make investing. Thus it was disturbing when, two years into my career, I realized that there isn't one technical stock analyst on the Forbes 400 list. Not one. I know it's hard to believe, but it's true: even William O'Neil, owner of Investors Business Daily and the biggest proponent of the craft, is nowhere to be found. Neither are any of his most famous "students" that he mentions in his book.

Perhaps even more disturbing when you really think about it, is that technical analysts propose using pricing and volume to determine whether you should buy a stock. If a stock breaks out to a higher price on heavy volume, it often means that you should purchase it. If a stock drops in price, it means you should sell it.

This is the height of absurdity to me. Let me explain. When you purchase stock you are buying shares of an actual business not a floating piece of paper. And technical analysts believe it is better to buy a piece of a business at a higher price than it is at a lower price!

Imagine you took that approach to buying a new house or a car or a watch.

Would you run out to buy a new home just because its price was 20% higher today than it was yesterday? Would you avoid your dream home just because its price was 20% lower today than it was yesterday?

No wonder they're not on the Forbes 400 list: the art of financial suicide doesn't pay over the long-term. I prefer to buy my assets cheap.

Thus, the reason I place this question first is because you first need to make sure the person giving you that stock recommendation is even playing in the right ballpark. The right ballpark is not where little leaguers play. It's where the big money is made.

Question #2: Are You Recommending this Stock Based on the Direction of the Economy, Stock Market or Interest Rates?

Trying to predict the direction of interest rates, the stock market or the economy is Wall Street's great mental game - and its great distraction.

It's a game because nobody in history has ever predicted the future of any of these on a consistent basis. Nobody. Sure, I've seen certain analysts make high-profile calls and be right. I've even seen it twice. In fact, when I started working on Wall Street, analyst Elaine Garzarelli was all the rage because she had correctly predicted the 1987 crash. But her next five calls were wrong and she faded into relative obscurity. The fact that somebody who was so well respected when I started and fell so quickly made a big impression on me: I realized that there are far too many variables for anybody to consistently predict the direction of economy, interest rates or the market. My own experience and my study of history has not disappointed me since.

Furthermore, trying to predict them is a distraction because it takes your mind as an investor away from far more profitable thoughts. We all know how easy it is to start discussing the economy over dinner. You can sit with your friends for five hours, discuss everything under the sun, and still not have solid enough evidence to start making big bets investments. Add ten economists to the discussion and you will all walk away just as confused.

Anybody who tells you that they know the direction of the economy, interest rates or the stock market is either a) inexperienced or b) selling you something you don't want.

This doesn't mean that I don't watch the financial news on the television. Nor does it mean that I don't enjoy it. I like financial gossip just as much

as the next guy. I just don't take it seriously.

Question #3: What Does The Company Do?

Sure, this sounds asinine commonplace ? but it is, without a doubt, the least understood question I hear investors ask. Sure, many people know that **Cisco (CSCO)** is the largest router dealer in the country. But what exactly is a router? Who are Cisco's customers? How do they buy their routers? How much does it cost to make one? What do they sell them for? Who does Cisco compete with? These questions are critical to really understanding what the company does to earn money.

Think about it in relation to your profession. You may be a doctor of oncology or an advertising executive. But does your old friend from college who became a web designer really know what you do for a living because he goes to the doctor each year for a check-up? Not likely.

But people invest in companies like Cisco just because they have a router in their house and it works. Personally, I only invest in company's that make products I can touch, see, feel or understand.

One of the reasons I like companies like **Procter and Gamble (PG)**

is because finding out if their razors, for example, are selling well is easy. All I have to do is walk into **Wal-Mart (WMT)**.

Perhaps I'm a simpleton, but I simply refuse to buy companies I don't understand. That's why I won't buy a company that made the latest transistor that helps keep the temperature inside of a router cool enough to get more processing speed.

I'm not even sure if what I just said about routers makes any sense. And that's my entire point ? if I can't see it, understand it and feel it then I really don't know it. And if I don't really "know" it then I'm just gambling.

But that's just me. If you want to buy a stock, make sure you understand the business first. Or do what I do and ask the person to "explain it to me like I'm two years old."

My general rule is to invest in companies whose products are as tangible to you as a rental property you own. You'll gain a big comfort level when you're able to "see" the property/product each and every day.

Question #4: What Is Management's Track Record?

First let me state the obvious: you have to be able to trust management with the cash register. For private companies it's literal. For public companies it's compensation and perks. But there are other areas that are not so obvious that you must consider as well.

- How long has present management been running the company? If less than one year, don't buy it yet.
- How much have they increased sales, earnings and profits during the past five years? If less than 10 percent per year, avoid it.
- Have there been any restructurings? If more than one in the past five years, avoid it.
- Does management have a significant portion of their net worth in the company (not in unexercised options)? If not, forget it.
- Does management announce ?pro forma? earnings with their regular earnings announcement? If so, stay far away.
- Does the company have more than 40% of its capital in debt? Say goodbye.
- Does management constantly make acquisitions? Probably not a good bet.
- When management has a bad year do they admit it honestly on the conference call or in the annual report? If not avoid them.

These questions are a good starting point, not an ending point.

Question #5: What is The Business Worth?

Not knowing what a business is worth when you buy its stock would be akin to not knowing what a car is worth before you went car shopping. You leave yourself open to danger.

Let me start with a simplified but revealing example. Let's say that you went to the local Toyota dealership to look for a new Camry. What would you do if the dealer tried to sell you the car for \$250,000?

You'd probably run right out of the shop. Why? Because the car is not worth \$250,000. It's worth closer to \$30,000.

Conversely, let's say that you were shopping for the same Camry and you saw an ad in the paper that said, "Brand New Toyota Camry's On Sale for \$5,000."

You probably run to the dealership as soon as possible to buy the car. Why? Because you would be buying the car for less than it is worth.

Yet when people purchase stocks, they often buy Toyota Camry's for Rolls Royce prices.

separately from the quality of the business.

For example, I have a good friend of mine who called me and told me that he wanted to buy shares in **Google (GOOG)** and **Sirius (SIRI)** because he thinks they're two of the greatest companies in the world.

Although I agree with him, I wouldn't buy the stock. Why? Because having a great company says nothing about the value of the company. They are two separate issues.

That would be like buying the Toyota Camry for \$250,000 just because you feel it's a great car. Nobody is saying it isn't a great car. It's just a question of what it's worth.

An easy short-hand method is to look at the past recession the company went through. How much did their earnings decline from the prior year?

Now estimate how much you expect earnings to decline during this recession. If earnings decline by 20%, what P/E would that give the stock? How does it compare with the stock's historical P/E during expansions and recessions?

If the stock is trading at a reasonable discount to that, you may want to consider buying some. If not, just be patient and wait for the price to come to you.

Now that you have some guidance on what the company is worth, you can determine if you should be buying it.

Question #6: Is It Selling for a Discount to What It's Worth?

The goal of any great investor is to buy a stock for less than it's worth. That's how investors, whether in stocks or real estate, make money.

That's why determining the value, as discussed above, is so important. You have to first know what a stock is worth before you can tell whether to buy it or not.

To borrow from the example above: If you determine that XYZ trades at 15 - 20 times earnings during an expansion and 8 - 12 times those earnings during a contraction, you can wait for the stock to hit 8 times earnings before you buy it.

Of course, it's very likely that this recession will be more severe than the last one. But if you're sticking with companies that (a) dominate one niche, (b) have little debt and (c) have lived through many economic cycles, then even a simple rule like this will serve you well.

So wait for that stock to hit 12, 10 or 8 times earnings and buy when you are comfortable buying it.

As I've said many times before, George Soros, the famed investor, is fond of saying that he's an "insecurity" analyst not a security analyst. Keep that in mind when you begin to ask these questions about potential investments ? they're a starting point, not an ending point.

In the meantime, during times like these you have to keep a wary eye even on people you trust for advice. They may be great during expansions but unless you've tested them through markets like these, then you have to use your own judgment to filter the good, the bad and the ugly.

Best Regards & Good Luck This Month,



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