

## >: Q&As, Investment Book Suggestions, & More...

Thursday, February 15, 2007 | Chris Rowe

Good Morning!

I recently wrote an article titled [How Can We Help You](#)

asking you to submit questions or requests that you would like us to write about. Today I'm going to keep the article short and sweet, as it is merely an extended answer to one of the questions submitted a couple of weeks ago. On the second half of the page, you'll find some shorter answers to some of your submitted questions. (As a quick reminder, all questions are saved in our database, and if you do not see one of your questions answered in either the Q&A or through an entire article, it doesn't mean that we haven't read it. We will use most of what we read from you in one way or another in the future.)

**QUESTION:**I'm just an average Joe, with a decent inheritance. I'm a rookie stock broker and I wait tables on the side, but I've been trading for 4 years. I need work on my timing when it comes to trading because sometimes it's way off. I consider using the buy and hold approach (long-term,) but it has been said that the buy and hold approach is a myth (1970s-early 80s, NASDAQ 5,000 - Today, we just recently started breaking 7 year highs on major indices etc.) So now I'm considering stocks with high volatility/risk to hold for higher long-term returns, but I'm considering trading them too. What do you think about this and how do I learn more about stock timing? David O. Queens Village, New York.

**ANSWER:**Well Dave, this may not be the answer that you were looking for, but, it all comes down to the skill set that you have. In other words, the "buy and hold theory" is indeed a valid one, but does the investor have the ability to know what companies will remain superior or at least average for the next decade or two? Because the "buy and hold theory" is usually backed up by the argument that the Dow Jones 30, or in more recent times the S&P500 (which more accurately reflects the general market), has achieved 11% average returns over the last 50 or 100 years. It's also incredibly important to understand that these returns would only have been achieved if you had reinvested your dividends. Most of all, the tax benefits are obviously much, much better when you hold for the long term so your real return is much greater. (You can read more about this in Dylan Jovine's article "[How Taxes Kill Your Investment Returns.](#)")

So to take advantage of that concept, you have to buy your own basket of stocks that remain superior over time on average, you have to have a very long time horizon for your investments to work out, and most importantly you have to reinvest those dividends (which impacts your portfolio in a way that is greatly underestimated by most.) KEEP IN MIND that you can request that all dividends be automatically reinvested when you fill out your brokerage account form, or by having your broker change your existing account to do so. (Have your firm send you proof of that change.) If you start automatically reinvesting your dividends after reading this today, then look me up in 10 years and thank me.

I believe that the best way to "buy and hold" (and again, this is with a 20 year time horizon,) if you don't believe that you can beat the performance of the general market or 97% of the mutual fund managers, is to simply buy the S&P SPDR's (symbol SPY). This exchange-traded fund, which is commonly referred to as "spydys" or "spiders," tracks (mimics) the performance of the S&P 500, sports an extremely low 0.12% expense ratio. You can request that dividends be reinvested into this one too.

Now what if your time horizon is not that long? What if you simply want more action than that? Maybe you think that you can do better than 11%/year by trading like I do? What if you're one of those people who start out saying that they are investors but they are really "closet traders." They may buy something and sell it later in the year, or only 1 or 2 years later.

Well there is one part of your question that everyone reading this needs to know the answer to, and before you learn more about timing the movement of a stock, we have to consider this important principle which might help you select the right vehicles to invest in...

You mention that you are considering stocks with high volatility/risk to hold for long-term returns. But higher volatility/risk giving higher returns over the long haul is a complete myth.

**To prove this fact:** A study was conducted by Signalert using mutual fund data from 1983 to 2003 using 3,000 mutual funds (with the number increasing over years as more mutual funds have been created.) Mutual funds are ranked by volatility, the amount of price fluctuation that takes place in that fund usually compared to the S&P500. "Drawdown" represents the maximum loss taken from a peak in portfolio value to a subsequent low before a new peak in value is achieved. The study shows 9 mutual fund groups ranking in terms of volatility. The highest volatility group (group 9) incurred losses (drawdown) of as much as 68% during the 20 year period, whereas the lowest volatility group (Group 1) had a maximum drawdown of just 15%. This simply shows that in the good years, the high volatility will move higher, and in bear markets they move much lower. But over time, investors gain little, if anything by investing in higher risk holdings.

The study shows us that with the lower volatility group of mutual funds, the profit:loss ratio is actually higher. "Group 9" which was the *most volatile* portfolio segment had a gain:loss ratio of 1.5 (gained on average 3% in gaining months and lost on average 2% in declining months.) "Group 1" which was the *least volatile* portfolio segment had a gain:loss ratio of approximately 2.7 (gained 2.7% per winning month for every percent of assets lost during losing months.)

want to die of old age or of a stress related problem, but that's pretty much the difference.

Finally, in answer to your *trading* higher volatility stocks, I urge you to study technical analysis. Before you crack one book just take this rule with you: *80% of a stocks move has to do with the sector that it is in.*

Also, remember that "charting" is only one part of "technical analysis." This brings me to the Q&A's that I promised you earlier. Here are some questions from our readers:

- "Technical Analysis" - Power Tools for Active Investors ~ By Gerald Appel (Discusses many aspects of technical analysis including charting, political cycles, seasonality, moving averages etc.)
  - "Japanese Candlestick Charting Techniques" ~ By Steve Nison (A book on the charting style called "Candlesticks" used by many traders especially for short-term trading.)
  - "Technical Analysis and Stock Market Profits" ~ The Real Bible of Technical Analysis ~ Richard W. Schabacker (This is an old book on technical analysis, almost 100% charting. This book was written a gazillion years ago, but if you complete this one, you will realize that human nature doesn't change, so it's just as good, if not better than most of what you will find out there.)
- QUESTION:** Chris, two more requests... 1) Would each of you Tycoon writers please give your recommendations on the best financial books, articles, etc. in priority order? 2) Would you give more in-depth analysis on the 200-day moving average, in addition to what Peeka has already given. (This article on this subject was excellent!) I've read some stuff on the internet about how they take the analysis even further to 1-day, 2-days, 1 week after a stock has risen above or below the 200 moving average line, making the exact time to buy or sell even more precise to yield higher gains. As always, thank you! Andrea C. (one of our loyal members.)
- ANSWER:** Hi Andrea. I'll answer with what I was hired to do. I'll also give you the technical analysis, if you'd pay for some great starting points are throughout the year. Explains a lot about seasonal investing real time.

These are a few great starting points for Technical Analysis. But there are other essential reads that I know the other Tycoon Editors would agree with me on.

- "The Warren Buffett Stock" ~ By Robert Ky. Elmsroth
- "The Intelligent Investor": By Benjamin Graham and Jason Zweig
- "The Essays of Warren Buffett" ~ By Warren E. Buffett and Lawrence A. Cunningham

A stock market book that I would literally be made fun of by the entire Tycoon staff if I didn't include:

I hope that this helps!

#### GENERAL COMMENT:

Chris, please stick to stock/option information and recommendations, and leave out all the personal stuff; wife, kid, ... Who else cares? That's not what I paid for. Thanks, Joe

**ANSWER:** Ha! Joe, you know something, you are right. I know you're right, you know you're right. And I'm all about business. Being all about business means I'm all about the customer (sounds like you are a paying member to my options trading service [The Trend Rider](#))

But although we built this from scratch, and although I know that this is all about making people like you profits, and knowing everything else that would normally prevent me from letting my personal life spill out into [TheTycoonReport.com](#) or [TheTrendRider.com](#), I STILL talk about it sometimes for this reason: I have never experienced the level of happiness that I have been experiencing over the last 2 years between the birth of Tycoon, my marriage, and my baby daughter. I know that these things don't get you paid (at least \$s 2 & 3) so I really do hold back. But my happiness sometimes seeps through my pores, and the truth is that ALL I do is research stocks and type out what's on my mind to our readers. It's the only world that I live in. Because if this, I feel a personal connect with all of our readers (as strange as it sounds) so who else am I going to tell about these feelings besides my "real" family and YOU?

You are 100% right man. I know. I'll keep it to a minimum.

**This next question** pertains to last week's article "[6 Ways to Make Money Just as Easily - Synthetic Positions](#)" where I talk about the strategy "Buy Writes" and "Selling Covered Calls." I was talking about the fact that "selling naked puts" gives you the exact same risk and reward on a stock that covered calls have. You just have to commit less money to the trade

**QUESTION:** Why would you want to do a trade with a maximum profit of \$180 and a risk of \$7320?

**ANSWER:** Many people enjoy doing this when their outlook on a stock is neutral to bullish. The risk compared to the reward seems big when you put it the

way that you have. But keep in mind that the risk of \$7,320.00 is incurred because it is possible that the stock trades to zero. If that stock - 100 shares of XOM - in the example that I used traded from \$75.00 down to \$70.00 then the loss would have been \$320.00. (\$500.00 - the \$180.00 that you received when you either sold the covered call or the naked put.)

The idea is that the likelihood of success is greater with this strategy.

When you implement either one of the strategies, there is a higher probability that the average stock either trades flat, or slightly up, or slightly down which gives the trader who has sold the covered call or the naked put the advantage. In my example, when the stock was at \$75.00, you're profitable as long as the stock trades above \$73.20. The flexibility is what attracts traders to these strategies.

**QUESTION:** I recently started trading options and I was told that I should absolutely learn about "delta". Where can I learn more about this?

**ANSWER:** OOOOO! That's easy! I wrote a 3 part series on this. And yes, you absolutely must understand Delta. Just go to the website which archives all of these daily articles: [www.thetycoonreport.com](http://www.thetycoonreport.com)

(stick it in your "favorites" folder) and go to the "past articles" section. In the search box, just type the word delta. You'll find all 3 articles.

Okay everyone, I hope this helps. I have a billion more questions and a gazillion more answers. Other editors will base much of what they write about on what we hear (see) you asking or requesting. It may not show up today, it may not show up tomorrow, but at some point, we will get to your inquiry. All you have to do is click the "Rate This Article" link below.

Until next week!

?Profit from the Trend?



Chris Rowe

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