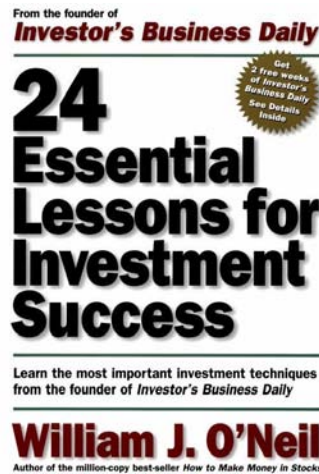


BusinessSummaries

WISDOM IN A NUTSHELL

24 Essential Lessons for Investment Success

Learn the most important investment techniques from the founder of Investor's Business Daily



By

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Author of the million copy bestseller How to Make Money in Stocks

Published by McGraw-Hill Books, 2000

ISBN 0-07-136033-6 (IBD Edition)

ISBN 0-07-135754-8

173 pages

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The Big Idea

Take investment lessons from the expert. O'Neil started out with \$500 just out of college, and by age 30 had purchased a seat on the New York Stock Exchange and opened his own investment management research firm. In 1963, he was the first to create a computerized database for stock market research that is used today by 400 major US institutions. With decades of investing experience, the author shares the lessons he has learned in a simple question-and-answer format, for those who may be first-time investors getting their feet wet, and to improve the performance of those who may have been playing the market for some time. Learn common-sense strategies, know when to buy and sell at the right time, and successfully manage your own portfolio. Your journey to financial security and freedom begins here.

Lesson 1. What Every Investor Should Know Going In

- Cut your losses early. It's like buying fire insurance.
- Always cut your losses at 8% below your purchase price.
- Be persistent. Learning to invest doesn't happen overnight. It takes time, effort, and experience.
- Always sell your worst performing stock first, not your best-performing stock.
- Do not make emotional decisions. We tend to get attached to our trading decisions and cannot admit our mistakes.

Lesson 2. Getting Started: There's no time like the present!

- You don't have to wait until you have the right job or reach the right age, start now and gain experience over the years.
- Decide whether you want a full-service broker or a discount firm.
- Research on the stockbroker you're considering. Where do they get their information? Are they truly interested in products that are right for you? How much commission do they get if they are a discount brokerage? Do not go with low commission firms.
- Open a cash account first, and then after a few years' experience, consider a margin account that lets you borrow money from your broker.
- Each week you must spend time tracking your investments. Learn to read charts so you get the facts, not opinions.
- As a beginner, avoid volatile investments, such as low-priced stocks, futures, options, and foreign stocks. Most of the outstanding companies to invest in should be between \$15 to \$150 a share.
- It only takes \$500 to \$1000 to get started. Add to your investment account from savings from your salary.
- If you have \$5,000 concentrate on owning up to two high-quality stocks. You should own no more than six to ten stocks if you are in the \$100,000 up range. There's no reason to own more than 20 stocks because you simply can't keep track of all their progress.
- Recommended reading would be the Investor's Business Daily Guide to the Markets, Gerald Loeb's Battle for Investment Survival, Edwin Lefevre's Reminiscences of a Stock Operator, Bernard Baruch's My Own Story, and How to Make Money in Stocks by William O'Neil.

Lesson 3. Follow a system rather than your emotions

- Do not get emotionally involved with your stocks. Follow a set of buying and selling rules.
- Do not buy a stock under \$15 a share. The best companies that are leaders in their fields simply do not come at \$5 or \$10 per share.

- Learn from history and study the best stock market winners.
- Always conduct a post-analysis of your stock market trades so you learn from successes and mistakes.
- Of the best-performing stocks of the last 45 years, the average share price before they went on to double or triple was \$28 a share. This is a historical fact. Cheap stocks involve far greater risk. You get what you pay for.

Lesson 4. Fundamental analysis or technical analysis?

- A combination of fundamental and technical investment styles is essential to picking winning stocks.
- Fundamental analysis looks at a company's earnings, earnings growth, sales, profit margins, and return on equity. It narrows down your choices so you are only dealing with quality stocks.
- Technical analysis involves learning to read a stock's price and volume chart and timing your decisions properly.
- Volume, or the number of shares of stock trades per day or per week is a key to interpreting supply and demand correctly. It is a signal that big institutions may be buying or selling your stock, which could impact price positively or negatively. The best institutional investors use both fundamental and technical analysis in their purchase decisions.
- Most of the big winners have Return on Equity ROE (an indicator of financial performance) of 20% or more. Most have management ownership or the management owns a percentage of the stock.

Lesson 5. First among fundamentals: Earnings and Sales

- Microsoft, Home Depot, and Cisco Systems were among the big winners in the 80's. All their stocks had enormous gains after posting their sales and earnings figures.
- The ROE's of Microsoft, Home Depot, and Cisco were 40%, 28%, and 36% respectively.
- Rule of thumb: Look for stocks with annual earnings growth rates of 30% or more and ROE's of 17% or higher.
- To make big money, you have to buy the very best companies at the right time. Microsoft was up 266% in only 30 weeks in 1986, following the 6 months after its IPO or initial public offering. Home Depot was up 912% in less than 1 and ½ years from 1982, Cisco Systems and Price Co. advanced 2,000% and 750 % respectively since 1990 and 1982.
- Strong sales and earnings are among the most important characteristics of winning stocks.
- Buying a stock as it is coming out of a price consolidation area or base is crucial to making large gains.

Lesson 6. Relative Price Strength: a key technical tool

- Relative price strength is one key technical indicator that shows you what value the market itself places upon a stock.
- We calculate Relative Price Strength by taking a stock's price 1 year ago and its price today, calculating the percent change and then comparing it to all other stocks over the same time period. The result should be on a scale of 1 to 99 with 99 being the highest.
- When using Investor's Business Daily's SmartSelect Corporate Ratings, avoid stocks that have a Relative Price Strength Rating below 80. Always go with strength when picking stocks.
- If a stock's relative strength falls, do not buy any more shares. If the stock price drops 8% below your purchase price, sell all of your shares. This way you protect yourself from large losses.

Lesson 7. Know a stock by the company it keeps

- Always pick stocks from leading industry groups or sectors. The majority of past market leaders were in the top industry groups and sectors.
- Historically, the drugs, medical, computer, communications, technology, software, specialty retail, leisure, and entertainment groups have supplied more big winners than most other groups.
- When Microsoft was an outstanding winner, so was PeopleSoft, Dell was doing well at the time Compaq was too. Home Depot, Wal-Mart, and The Gap were all major retail winners. The same time Schering-Plough and Bristol-Meyers Squibb were leading, so were Warner Lambert and Pfizer. When buying stock, look at the group strength.
- The Industry Group Relative Strength Rating can help you identify stocks in top industries.

Lesson 8. The importance of volume and sponsorship

- Institutional investors account for 75% of the buying of better quality stocks. When you're selecting stocks, daily or weekly trading volume is how you measure demand.
- Volume is the actual number of shares traded daily and is available in most newspapers.
- Sponsorship is when large institutional investors buy into a stock.
- Stocks never go up by accident. There must be large buying, typically from big investors like mutual funds and pension funds.
- Investor's Business Daily's "Volume Percent Change" column tracks the average daily volume of every stock over the past 50 trading days and shows you how much stock traded above or below its average.
- Use Accumulation/Distribution rating to find out if stocks are being bought or sold by big institutional investors. It is available for every stock, every day and the Acc/Dist Rating tracks the last 13 weeks of trading volume for a stock and tells you whether it is under accumulation (institutional buying) or distribution (institutional selling). Provided on an A to E rating system, an A or B means stock is being bought, a D or E means stock is being sold and should probably be avoided for the time being, while C indicates a neutral amount of buying and selling.
- It's important to know what stocks the best mutual funds are buying and selling. Sponsorship Rating helps you determine whether your stock has quality institutional sponsorship.

Lesson 9. How to buy at just the right moment

- In studying the greatest stock market winners over the past 45 years, there can be found specific base patterns. These bases were formed just before the stocks broke out into high ground in price and went on to make big gains.
- The most common pattern is a "cup with a handle" named so because the chart shows a resemblance of the pattern to a coffee cup. The end of the handle signifies the buying point.
- The optimal buy point of any stock is its "pivot point" or the point at the end of a basing area when the stock price is breaking out into new high ground.
- On the day the stock breaks out, volume should increase 50% above its average.
- Buy a stock when it is breaking into new high ground. 98% of individual investors never buy this way, and that's why few will ever own big stock winners. The idea is not to "buy low, sell high" but "buy high and sell higher".
- Increased volume from the prior day/week with the price moving up is generally a positive sign.

- Increased volume from the prior day/week with the price moving down is generally a negative sign.
- A decrease in price on decreased volume indicates no significant selling.

Lesson 10. How chart patterns lead to big profits

- Aside from the “cup with the handle” pattern, a “double bottom” or a “W” pattern on a chart shows a potential good stock before it advances in a huge way. American Power Conversion’s 39 week pattern in 1990 resembled a letter W. The end point of the W or Point G was the correct buy point at \$22, the stock advanced 800% in the following 22 months from Point G.
- You want to buy a stock exactly at its pivot point as it breaks out of a sound pattern. Don’t chase it up more than 5% past its pivot.
- Short bases of 1 to 4 weeks in duration are very risky and usually fail. Avoid them.
- Patterns that are abnormally wide or loose in overall appearance are more risky. It is safer to buy tighter, better-contained patterns with less wild price fluctuations.
- Stocks that shoot up straight from the bottom of a pattern into new highs without any pullbacks or handles are risky and frequently have sharp sell-offs.
- A base breakout with no real increase in volume should be avoided.
- Laggard bases. The last stock in a group to break out to a new high is weak and a laggard and should be passed up.
- Handle areas that are too wide and loose (down 20% to 30%) or handles that wedge up along their lows rather than drift down along the lows are faulty and frequently fail.
- After a stock has had a long advance, the fourth time the stock forms a base (“fourth stage” base) is usually too obvious to everyone and will probably fail.
- When choosing stocks, look for “cup with the handle” patterns, “double bottom” patterns, and “flat base”.

Lesson 11. How to read stock charts like a pro

- Most successful stocks build a number of bases as they make their way up in price. Each one creates a different “stage” base. Third and fourth stage bases are prone to failure.
- Chart price and volume action frequently can help you recognize when a stock has reached its top and should be sold.
- Study chart patterns of past winning stocks. History always repeats itself in the market.
- Look for handles that form in the upper half of the base.
- A sound base should usually have more weeks where the price is up on greater-than-average volume than weeks down on greater-than-average volume.
- Most big stock market leaders breaking out of a sound base will go up 20% in 8 weeks or less from the pivot point. Never sell a stock that does this in 4 weeks or less.

Lesson 12. How to gauge the stock market’s health

- For an individual investor investing in common stocks, the key steps to follow are:
 1. Develop buying selection rules that let you pick the best stocks and use charts to determine the right time to buy.
 2. Have a set of selling rules that tell you when to sell and nail down a profit, or cut short a loss to avoid a possible larger loss.
 3. Have a specific method to tell you when the general market averages are topping and headed down, and when they’ve hit bottom and turned into a new uptrend.

When it comes to the stock market, remember:

- It's better to get off the elevator on one of the floors on the way up than to ride it all the way down.
- The general market is represented by leading market indices like the S&P 500, Dow Jones Industrials, and the Nasdaq Composite. Tracking the general market is key because most stocks follow the trend of the general market.
- Ignore personal opinions about the market. Study the day-to-day price and volume changes in leading indices instead.
- Investor's Business Daily's "General Market & Sectors" page will help you understand what is going on now in the general market. "The Big Picture" column helps unravel its complexity.
- A typical bear market will decline 20% to 25% from its peak price. A negative political or economic environment could cause a more severe decline.

Lesson 13. How to spot when the market hits a top

- Knowing when to buy or sell a stock is key.
- Because three out of four stocks, regardless of how "good" they are, will eventually follow the trend of the general market, it is important to learn how to spot when the market is hitting a top.
- After 4 or 5 days of distribution within a 2 to 3 week period, the general market will normally turn down.
- Distribution is indicated by the index closing down on increased volume or a day's attempted advance stalling on greater volume than the day before. At this time, review the stocks in your portfolio and look for individual selling signs that indicate you should cut back or sell them.

Lesson 14. How to spot when the market bottoms

- Bear markets create fear and uncertainty. When stocks hit bottom and turn up to begin the next bull market loaded with opportunities, most people simply don't believe it.
- At some point on the way down, the indices will attempt to rebound or rally. A rally is an attempt by a stock or the general market to turn up and advance in price after a period of decline.
- Bear markets normally come in two or three waves, interrupted by several attempted "false" rallies that usually fizzle out after one to three weeks and occasionally five to six weeks or more.
- Eventually, one of the rallies will "follow-through". A "follow-through" occurs when one of the indices closes up 1% or more with a jump in volume from the day before. This confirmation will usually happen on the fourth to tenth day of the attempted rally.
- The Dow, S&P 500, and Nasdaq indices, along with the IBD Mutual Fund Index are your best sources for analyzing the market's condition and determining if a top or bottom has occurred. Also, observing how leading stocks are acting can be another indicator of a market top.
- Most technical market indicators are of little value. Psychological indicators like the Put-Call Ratio can help confirm changes in the market's direction.

Lesson 15. Putting the stock-picking puzzle together

Once you determine that you are operating in an uptrending general market, here are the factors you need to consider:

- Is the company's current quarterly earnings per share up at least 25%?
- Are the percentage increases in profits accelerating compared to recent quarters?
- Does it have six to twelve quarters of significant earnings increases up 50%, 100%, even 200% or more?
- Is the next quarter's consensus earnings estimate up a worthwhile amount?
- Have earnings in the past few quarters been higher than expected?
- If it's a growth stock, is each of the last 3 years of earnings up an average of 25% or more per year?
- Is the company's Earnings Per Share Rating 80 or higher?
- If it's a turnaround stock, does it have two quarters of strong earnings increases or one quarter that is up so much that the 12 months earnings per share are back to their old peak?
- If 2 or more quarters have turned up, are the trailing 12-month earnings near or above the peak of the prior couple of years?
- How much are the consensus earnings estimates up for the next 2 years?
- Does the company have six to twelve quarters of strong sales growth?
- Has that growth rate accelerated in recent quarters?
- Is the current quarter's after-tax profit margin at or close to its peak?
- Has there been a general trend of profit-margin improvement over many quarters?
- Are the company's margins among the best in its industry?
- Is the annual pre-tax profit margin 18% or more? (For retailers it's alright to have lower margins)
- Is the return on equity 20% to 50% or more and is its ROE among the very best in its industry?
- Is its Sales+ Profit Margins + ROE Rating an A or B? That would place it among the top 40% of all stocks in terms of sales growth, pre-tax and after-tax profit margins, and return on equity.
- Does the company's management own the stock?
- Is the stock in a quality price range? Quality comes at 16\$ to 150\$ for Nasdaq stocks and 20\$ and above for NYSE stocks. Leaders like Cisco Systems, Wal-Mart, Microsoft, PeopleSoft and Amgen broke out of their beginning chart bases many years ago between 30\$ and 50\$ per share – before they had giant price advances. Price is a basic reflection of quality.
- Is the stock part of a historically winning industry group such as retail, computers, technology, drug and health care, or leisure and entertainment?
- Is it in one of the Top 5 groups? Check the "52-Week Highs and Lows" feature on the Industry Groups page for the top 5 performing groups.
- Do Investor's Business Daily's small index charts on the Industry Groups page show the current market favors big-cap or small-cap stocks? Go with the flow and do not fight current market trends.
- What broad economic sector is the market favoring? Consumer or high-tech? Growth or cyclical? Defensive (food, utilities)? New or older more established companies?
- Does the company's product save money, solve a problem, or save time with new technology?
- Is it a new drug or medical technique?
- Is it widely needed or liked?
- Is it a product that encourages repeat sales?
- Is the company's backlog of unfilled orders expanding?
- At what percent capacity is the company operating?
- What is the company's expected rate of future expansion?
- Have one or two of the smarter, better-performing mutual funds bought the stock recently? Better institutions do extensive research before buying.
- Do you really understand and believe in the company's business? Have you seen or used its product or service?

- Potential winners will have strong earnings and sales growth, increasing profit margins and high return on equity (17% or more) and will be part of a leading industry group.
- Investor's Business Daily's proprietary data and the IBD SmartSelect Corporate Ratings will help you pick winning stocks.
- Check Daily Graphs Online to spot which of your prospects are forming a sound pattern and are under accumulation or professional buying. They must be near a proper buy point.
- Analyze the week-by-week price and volume action. Write down the price at which you will begin buying the stock. After your initial purchase, identify a price area (maybe when it goes up 2.5 to 3%) at which you will add a small amount as a follow-up buy if it continues to perform well.
- If the stock drops 8% below your exact initial buy point, protect yourself against a possible larger loss by selling at the current market price.
- You want an increase of 50% or more in trading volume on the day you begin buying with the stock breaking out of a sound base.
- Is the chart pattern a "cup with a handle", "double bottom" or "flat base"? If it is not any of these, it may be faulty and failure-prone.
- Is its Relative Price Strength Rating 80 or more? Is the relative strength line on the chart in a definite uptrend?
- Keep adding to your best-performing stocks and reduce or sell your worst performing ones.
- Check a long-term monthly chart to see if stock is also emerging out of a long-term base over a number of years.

Lesson 16. How to find new investment ideas in Investor's Business Daily

- Scan "The Markets" summary for the prior day's closing prices of the S&P 500 and the Dow Jones Industrials, the Nasdaq and the NYSE volume, all can be found on the front page of IBD
- "To the Point" gives the busy reader a quick, time-saving review of all key business news of the day.
- Check out "The New America" page for new companies. Study How to use IBD SmartSelect Corporate Ratings box found at the beginning of the main NYSE and Nasdaq stock tables.
- Avoid companies where the EPS (Earnings per share) Rating and RS (Relative Price Strength Rating) are less than 70. The best companies should have at least a B on all three ratings.
- Stick to stock purchases among leading groups or sectors by checking their Industry Group Relative Strength Rating.
- Sales + Profit Margins + ROE (SMR) Rating combines 4 fundamental measurements (sales growth, before and after-tax profit margins, and return on equity) into one easy rating.
- The Accumulation/Distribution Rating identifies whether a stock is under professional buying or selling over the last 13 weeks. A = heavy buying, B = moderate, C = equal amounts of buying and selling, D = moderate selling, E = heavy selling
- Look for stocks in the stock tables with boldfaced type. This indicates that a stock is up 1\$ or more for the day or is making a new price high. This is a good starting point for more research
- Using a chart service helps you determine if the timing is right to buy any of the prospects found in Investor's Business Daily

Lesson 17. Growth vs. Value Investing

- There are two kinds of investors: growth stock investors and value investors.

- Growth stock investors seek companies that show consistent earnings and sales growth, usually 20% or more each year for the past 3 years or 5 years. Companies such as Schering-Plough, Paychex, Cisco Systems, and Microsoft would be considered growth stocks in the 1990s.
- Growth stocks have a high-quality, repeat-type product or service that generates superior profit margins and return on equity of at least 17% to 50%.
- Value investors search for stocks they believe to be undervalued. They evaluate a company's balance sheet and profit-and-loss statement, looking for hidden value like an unusually large amount of cash in the company or property carried on the books at cost, which is below the current market value, etc.
- Value investors look for a bargain and like to buy stocks with a low P/E ratio (Price/earnings) or low price-to-book value. They look to buy a business franchise at a low price. Value investors wait for the market to recognize their stock's value for it to go up in price. This takes a long time, and sometimes does not happen at all.
- Studies have shown the new market leaders had P/Es that significantly exceeded the rest of the market (31 times the average) before they made their big advance.
- Mutual funds are a great investment as well. Pick strong performing funds from Investor's Business Daily's "Mutual Funds" page, and remember the key to success with mutuals is to buy and hold forever.

Lesson 18. Don't try to be a Jack-of-all-trades

- Keep it simple. Concentrate on a few good high-quality common US stocks. Domestic stocks or mutual funds are best. The more types of investments you own, the harder it is to keep track.
- You get what you pay for on the market. Low-priced stocks are usually cheap for a good reason. They may be performing poorly.
- Options are risky because investors do not only have to be right about the direction of the stock but also about the time frame in which they believe the price will go up or down.
- Futures, due to their highly speculative nature, should be attempted only by people with several years of successful investment experience.
- The US has the greatest stock market in the world. There are more than 10,000 common stocks to choose from. If you can't learn to profit investing in US stocks, you aren't likely to profit in the commodity market or buying foreign stocks.
- Many foreign stocks are unstable due to their government's history, corruption, and unsound systems. Most individual investors do not know all they need to know about foreign countries.

Lesson 19. What's the right mix for your portfolio?

- Concentrate your eggs in fewer baskets, know them well and watch them carefully.
- With \$5,000 invested, you may own no more than 2 stocks.
- With \$10,000 invested, 2 or 3 stocks is appropriate.
- With \$25,000 invested, 3 to 4 stocks is appropriate.
- With \$50,000, 4 to 5 stocks
- With \$100,000 5 to 6 stocks
- It is not advisable to hold more than 20 stocks. You cannot keep track of all these investments properly.

- Stagger your buying over time. Never buy all five stocks at once. Let your stocks make some progress before you get 100% invested.
- Buy only half of your \$20,000 position (\$10,000) in one stock as your initial buy. If the stock goes down in price, don't buy any more. If it goes down 8% from your buy price, sell all of the stock at once to cut your loss. If the stock moves up 2 to 3% in price from your initial buy and if it still looks like it is performing well, follow up and buy \$6,500 more. Buy another \$3,500 worth if it makes another 2 to 3% advance, and then stop. Sit back and give it time and room to grow.
- If you already own the maximum number of stocks but want to add a new stock to your portfolio, sell the least profitable stock to get money for the new one.

Lesson 20. Sell rules every investor should master

- Cut your losses short and do it early. We repeat the old 8% rule. If a stock falls 8% below your purchase price, sell it.
- Don't sell and take a profit if your market leading stock is up 20% to 25% in only 2 or 3 weeks. That's a sign of real power, and you may be holding a big winner.
- Don't let yourself lose money on a stock you had a reasonable profit in.
- 40% of stocks will pull back near the initial buy point, sometimes in big volume, for 1 or 2 days. Don't let this shake you out of your stock.
- 30% of market leaders will peak after many months of advance by having what is called a "climax top". The stock will run up at a much faster rate than in prior weeks. Look for the stock's greatest 1-day price advance since the beginning of the move up. This usually means that everyone is excited about the stock, which makes its price rise dramatically. Because the market often moves contrary to mass opinion, it is a good idea to sell your stock when this happens.

Lesson 21. More sell rules every investor should master

- Sell a stock if the earnings per share shows a major deceleration in growth for two quarters in a row.
- If your stock advances a significant distance over many months and has formed several bases during the process, the fourth time the stock breaks out of a base ("fourth stage" base) it probably should be sold.
- Sometimes you should sell a stock because it consistently moves up in price less than another good stock you're holding. The money can be used in the better performing stock.

Lesson 22. How to make a million with mutuals

- A diversified US stock fund, whether growth or value, is your best choice.
- Choose funds with an A or A+ rating from Investor's Business Daily. They are the best performers over a 36-month period.
- Never sell a domestic growth stock mutual fund. Hold it and watch its growth compound over the years ahead. If you need income, just set up a monthly or quarterly withdrawal plan to take out 7 or 8% each year.
- Don't buy too many funds. Extensive asset allocation will just dilute your overall returns.
- Compounding over long-term is the key to making a million in mutual funds.

Lesson 23. Too busy? How to use Investor's Business Daily in 20 Minutes

- Scan IBD's Top 10 new stories and "The Markets" summary box, "To the Point" and read only the brief summaries you find important.

- Scan “The New America” for dynamic entrepreneurial companies with new concepts and products, “Leaders & Success”, “Business & the Economy”, “Computers & Technology”.
- IBD is really a daily computer printout and evaluation of the entire market. It provides relative scores, ratings, and special screens, based on extensive stock market research, of the most relevant factors in winning stocks.
- IBD stock tables do 80% of your research for you in a lot less time.
- Before selecting your stocks, you must be able to gauge the general market. “The Big Picture” on the “General Market & Sectors” page will show you what is going on in the market now.

Lesson 24. How to make the most of Investor’s Business Daily, Investors.com, and other online resources

- The Internet is a convenient and time-saving research tool and can help you when you know exactly what you’re looking for, but it can also overwhelm you and you can easily get lost in cyberspace if you are just randomly surfing for ideas and looking for huge amounts of data.
- Use Investor’s Business Daily to find the very best stocks before you visit the Internet for further information.
- Consider that information providers on the Internet are potentially biased.