

Tutorial 3

Investing Strategies

How to find
the trading style
that suits you



Tutorial 3: Investing Strategies

There Are No Guarantees

The first thing you need to know about investing is whenever you invest there's no guarantee you'll make a profit. You could lose money and end up with less than you started with. But armed with the right knowledge, you can improve your odds of success, balancing the risks of investing with the potential rewards.

Topics covered:

- Investing Strategies
- The Disciplined Investor
- The Right Approach for You

Millions of people are investing their hard-earned cash in the stock market with the objective of meeting their future financial needs. There are many different approaches to investing in stocks and shares, each of them designed to reduce some of the risk of investing while increasing returns. Below, we outline a few of these strategies. Each comes with advantages and disadvantages, so you should try to find the best approach to suit your own financial situation and goals.

Investing Strategies and Styles

Investing strategies can be broken down into two broad categories: technical analysis and fundamental analysis. They are as different as night and day, but each camp has its followers and its critics.

Technical Analysis

Technical analysis is an attempt to use price charts and other mathematical indicators to predict future share price movements. The method doesn't look at any outside factors, such as the company's financial statements or the overall economic outlook. It's strictly by the charts. Market technicians believe that the market price of a share reflects all known information about that share.

The downside of technical analysis is that it's very - well - technical. Although there are some excellent software programs specifically for technical analysis, the learning curve to just get started using these techniques can be frightening. Another disadvantage of technical analysis is that it requires you to actively follow current and potential holdings, reviewing charts and indicators each day or week. This means being glued to your computer screen for hours at a time, and can require ample number-crunching skills. Finally, technical analysis is often a short-term strategy, requiring you to make frequent deals and to pay the commissions and short-term capital gains taxes that result - that is, if you have any gains!

Opponents of technical analysis believe there's no direct cause-and-effect relationship between a share's past price performance and its future performance and that relying on chart patterns is a bit like expecting it to rain on June 21st if June 10th is sunny just because that's what happened last year.

Market timers use technical analysis to try to determine when to buy or sell a particular share, or to get in or out of the market in general. Market-timing systems usually examine reams of data and try to find the best signals indicating when to buy or sell. Unfortunately, short of gazing into a crystal ball, there's no reliable way of knowing when the market will turn in any direction, at least in the short term. In 1987, only a handful of the experts predicted the impending crash of the world stock markets.

Fundamental Analysis

On the opposite side of the coin from technical analysis is fundamental analysis. Fundamental analysis can be described as the study and purchase of companies, rather than shares. Factors such as a company's growth rates, balance sheet, and quality of management are analysed to work out the true value of a share.

Fundamentalists aren't concerned with price patterns on a chart, but with indicators of a company's underlying financial strength.

When you go shopping for a new car, you probably try to buy the best car you can for the best price. You want a vehicle that will run for a long time without breaking down, and doesn't leave you wondering whether you'll make it to work each morning. You want a car that will require as little maintenance as possible, not one that needs a tune-up every few thousand miles. And you want to get it for a good price. If you can get a well-made car that fits all your needs, at an affordable cost, you'll be one happy car-owner.

Investing in shares isn't much different. You can buy a share of a high-quality company at a good price, put it away in your portfolio and not worry about it except during your occasional portfolio check up. Over the long-term, that company can grow and see its price increase as a result and your portfolio will become all the richer.

Just like shopping for a car, however, you'll need to do your homework first to make sure you're getting a good deal on a good company. By investing in quality companies at reasonable prices you can minimise your risks and increase your returns.

There are many related strategies investors use to select stocks within the spectrum of fundamental analysis.

Value Investing

Value investors look at how much a company is worth based on the value of all its assets and at how well the company uses its assets to grow its business. If the company's share price doesn't reflect the full value of its assets the stock is considered undervalued. If the share price increases to reflect the company's underlying worth, perhaps over a period of years the shareholder is rewarded.

Growth Strategy

Growth investors look at how quickly companies have been able to grow their sales and earnings in the past and how that growth is likely to continue in the future. Then they look at the current price and determine if it reflects the potential future growth of the company's business. By buying companies that are growing faster than other similar companies, these investors hope to see their investment grow over the years.

Many long-term investors combine aspects of growth and value investing in their personal strategy, looking to identify undervalued stocks that have the potential to grow in the years ahead. In addition, you can use pound-cost averaging to add more shares to your portfolio on a regular basis.

Finding the Right Approach for You

Not every investing strategy is right for everyone - but you can work out which strategy will work for you, by asking yourself a few questions:

- How much time do you have to invest in your investments? Your time itself is an investment, since it can pay off later when your portfolio begins to bloom as a result of your efforts. If you're just getting started in stocks and shares, you can expect to spend some extra time up front on your investment education as well as investigating possible candidates for your portfolio. But once you get the hang of it, you won't need to make an enormous time commitment. Typically you'll only need a couple of hours a month to manage your portfolio.
- How much money do you have to start building your portfolio? A benefit of long-term investing is that you can start small and build a portfolio of quality shares over time, but the choice is yours.
- Can you identify quality growth companies for your portfolio? You can reduce your risk by buying quality growth companies at good prices.

The majority of investors find that a growth and value strategy works well for them. By using pound-cost averaging to buy and hold shares for the long-term, your portfolio can grow through the years.

Become a Disciplined Investor

Once you've found your investing style, stick with it. Over time you'll develop your own set of criteria to pick shares. If you try mixing approaches, you could end up diluting the effectiveness of your chosen strategy and reducing your returns.

Sometimes this means ignoring the talking heads on television with their advice to buy, sell, or hold a particular share. Just remember that these analysts aren't managing your portfolio. They may have a very different outlook and time frame than you do and their advice may not be suitable for your circumstances. You'll have to learn to avoid the hype.

Sometimes this means remembering you shouldn't buy a share just because you have a good feeling about its chances. You shouldn't be an emotional investor, buying or selling on a whim or because of gut instinct. The most successful investors are usually those who have a system that works - and they stick to it.

It's important to remember, the value of your investments and the income from them can go down as well as up. You may not get back the full amount you have invested. If you're in any doubt about whether to buy or sell shares, you should consult an appropriate Financial Adviser.

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