

Key Points

- ◆ Bulls and Bears make money, Pigs get Slaughtered
- ◆ They don't ring a bell at the top
- ◆ Bull markets begin in bad times, Bear markets begin in good times
- ◆ Don't fight the Fed



As Seen in

Forbes

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Investment Rules

John Riley
Chief Strategist

It has been our observation that over the past 10 years, investors have been ignoring some of the basic rules of investing. We would expect that after the market volatility of 2008, investors would be returning to some of the essential rules. While there are no real rules, (Except for the rules the regulators enforce), below are some of the basic rules investors should be aware of and adhere to.

Time and patience are an investors best friends – It has been our experience that impatience has caused just as much under performance as market declines. We have watched investors jump from strategy to strategy, and investment to investment before ever giving them time to work. If proper fundamental research has been done and the appropriate strategy has been deployed, an investor should be patient and let the fundamentals come through. It has been our experience that fundamentals always win (See Fundamentals always win)

A bull market is born amid pessimism, grows up under skepticism, matures with optimism and dies with euphoria – An addendum to this rule would be that many investors don't start investing until the Euphoria hits, which means they catch the end of the move.

Notice none of the phases of the bull market are based on economic data or fundamentals. They are defined by emotions. Unfortunately, many investors choose to ignore fundamentals in favor of emotionally based decisions.

A rising tide raises all ships, and vice versa. So assess the tide, not the ships. – Many investors get this wrong. What it means is that the cycle is more important than the specific investment. Getting the direction of the trend right is half the battle. Too many times, investors start with the investments and then try to make them work. Determine the direction of the market cycle first, then the sector or industry and then select the specific investments.

Avoid popular stocks, fad industries and new ventures – Billions have been lost on internet supermarkets, hot new sneakers and the latest electronic gizmo. While they are exciting and fun, they are also usually speculations and based on nothing more than air. The lure of fast, easy money attracts even the most conservative investors. Unfortunately, it has been my experience that few ever get in early enough or get out in time. Fads and hot stocks are best suited for cocktail parties and not investment portfolios.

Bear markets begin in good times. Bull markets begin in bad times. – This seems logical on paper, but in real life, it is almost impossible to convince an

investor that the market is headed for bad times when it is hitting new highs.

Bulls and Bears Make Money. Pigs Get Slaughtered – Too many times investors hold out for the last penny on an investment before they will sell. Unfortunately, many times, the investment never hits the target, reverses downward and the investor stubbornly keeps holding all the way down.

The other side of the coin is the investor that doesn't get into a good investment because it hasn't gone down far enough.

Either way, these are investors that don't understand the point of investing is not to get in at the bottom and out at the top, but to get the trend right and invest accordingly. A wise old broker once said I buy late and sell early. All I want is the middle 80% of the move.

Buy the Rumor, Sell the News – Many times, by the time news about a company hits the media, the market has the news priced into the stock. This is because those that follow the company closely anticipate the news and buy early, well ahead of the news announcement. So when the news is announced, they are selling while the amateurs are buying.

Buy low, sell high – As obvious as this sounds, investors were buying high hoping to sell higher during the Dot Com mania and Recent market rallies. This takes patience and research. Neither are attributes of most investors.

Don't Try to Catch a Falling Knife – When a famous stock drops, the amateurs jump in. This is usually a mistake. When a stock drops quickly, there is usually a reason, and many times there are more shoes to drop. It is usually best to wait to see where things end up before getting into a stock that has crashed.

They don't ring a bell at the top – If I've heard it once I've heard it a hundred times – investors saying they will know when to get out of the market. And time and time again, they don't. The market gives warning signs ahead of a market top. Wise investors heed those warnings.

Don't fall in love with your stock - Too many times investors say they don't want to sell a stock because it has been "good to them." Emotions and investing are a toxic mix. Sometimes investors hold onto investments well after they should have been sold because of an emotional attachment or that they have made a lot of money on the stock and they feel it would be turning their back on something that did them so much good.

Don't Fight the Fed – The Federal Reserve controls short term interest rates. They can raise or lower liquidity within the system through their control of

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- ◆ Expert investors care about risk, Novices shop for returns
- ◆ The Market is driven by Greed and Fear
- ◆ If it sounds too good to be true, it is

Questions, comments, further information, to set up an appointment or request forms, call: Toll Free:

1-888-277-5968

(outside Rhode Island)

Providence Office:

(401) 453-5550

Dallas Office:

(972) 563-8990

Email:

johnr@cornerstoneri.com

**Cornerstone
Investment**

Services, LLC

**245 Waterman St,
Ste 301**

Providence, RI 02906

www.cornerstoneri.com

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rates. They also impact inflation through their control of rates. The Fed actions can be tracked and the results can be predictable.

Expert investors care about risk; novices shop for returns – This is a constant battle for novice investors. They are always looking for a ¼ point more yield or having every penny of their portfolio invested. Experts understand that they need to give up a little to reduce their potential risks. Novice investors are very short term oriented in their thinking and investment strategy while expert investors usually take a much longer term view and know that they may have to give up a little today to get the bigger payoff tomorrow.

If the investment sounds too good to be true, it is – Investors fall for investment scams because they want to make money fast, easy and risk-free. That type of investment doesn't exist, but that doesn't stop some investors. This is why billions are lost each year by investors that get involved in get rich quick schemes or even some hot stock that doesn't pan out.

If you are going to panic, panic early – It is usually better to get out before everybody else. So what if you don't get the top. (See Pigs Get Slaughtered) It is better to get out before things get worse.

If you don't understand the investment, don't buy it – I can't tell you how many times investors will tell us they have no idea what some of the investments in their portfolio are. I had one retired woman tell me she owned the Green fund at her bank, because the Blue fund was too conservative and the Red fund was too aggressive. With analysis like that, Morningstar has nothing to worry about.

Stocks Climb a Wall of Worry – Remembering that bull markets start during bad economic times, that information can be extrapolated forward to explain how stocks go up in the face of problems and worries. The key is that fundamentals are improving. This is vastly different than poor or deteriorating fundamentals which characterizes a bear market.

The Market is Driven by Fear and Greed – Investors can take markets well beyond fair value on both the upside and downside. This is when greed and fear take over. Greed drives markets to extreme overvaluations and fear crushes markets. Investors need to be able to recognize the emotions of the market and how their own emotions may impact their investment decisions.

You won't go broke taking profits – This goes against much of what investors hear from Wall Street and the mainstream since they push buy and hold. I'm not sure how happy people are that have maintained a buy and hold strategy over the past 10 years.

Taking profits along the way would have been a good way to reduce exposure to a market that was overvalued and ready to rollover into a bear market.

Taking a profit banks that profit and eliminates the possibility of loss on that investment. As long as an investment is held in the account, there is the possibility of loss. Once it is sold, and the profit is taken, that profit is yours. Nobody goes broke taking profits.

Will these rules guarantee a profit? No, but they may help you avoid the occasional collapse and keep you from getting involved in scams.

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