7 Golden Rules of Investing

Golden Rule #1: Develop your own Investment System

Before you put any cash to work, you must know what you are investing for. This will condition your target return, time horizon and risk appetite. In turn, you will find the right asset class and strategy best suited for your objectives.

You would also have found an excel workbook titled *"DIY Investing Checklist"* attached with this report.

Once you go through the 10 steps rigorously, you will be ahead of the other 80% of investors who don't know what to buy, when to sell or how much to buy.

1	**Personality + Philosophy**	Goals, Knowledge, Experience, Skills, Interests & Current Financial Background
2	**Portfolio Structure**	90% Stocks, 10% Cash; Diversified across various industries.
3	**Where to Search**	Investor Newsletters, Finance News, Analyst Reports etc.
4	**What to Buy/Criteria**	Filter for Stocks with >15% Earnings Growth, Low Debt & Good Prospects
5	**When to Buy**	Form a Thesis (e.g. O&G recovery) + Margin of Safety (e.g. Price < Intrinsic Value)
6	**How Much to Buy**	Each Investment capped at 10% of Portfolio OR when $5K Savings accumulated
7	**Monitor Progress**	Does the Biz Still Meet My Citeria or Hypothesis? Is it Fundamentally Flawed?
8	**When to Sell**	When Stock has failed Criteria or Hypothesis; Not Based on Price Movement!
9	**Handling Mistakes**	Admit It & Find Out Root Cause. Treat it as Valuable Learning Experience.
10	**When System Fails**	Stop Investing. Do an Overhaul of your Investing Strategy or Consult Mentors.

If you require a sample for a clearer picture, we will go through a scenario and use a fictious name called **Jackie**.

An example of his **investment plan** is as follows:

**** Jackie is a working professional in his early 20s and has no commitments yet. Being able to save $1k monthly, he is interested in active investing and wants to grow his wealth more aggressively through value-growth stocks.*

In addition, he regularly searches for ideas by subscribing to our newsletter and read the business times. Screening criteria include >15% Earnings Growth, Low Debt & Good Prospects. A thesis on how the stock will fare is formed and he calculates the intrinsic value by a Discounted Cash Flow model.

He finds a stock and intends to buy into it once he gathers $5K of savings. After forming a portfolio, he evaluates the portfolio periodically and will sell those stocks that fall out from his initial thesis. Any mistakes are dealt with scrutiny to ensure no repeat of such going forward.

*Finally, he reviews his financial circumstances and found out that it's time to save up for his wedding and house renovation. He cuts his monthly savings from $1k to $500 and sell off some stocks and do a rebalancing to prepare for his next phase of life. ****

In a nutshell, you plan to fail if you fail to plan. So start crafting your own Investment Plan today!

Golden Rule #2: Don’t try and time the markets

Oh… the temptation is soooo strong. Think that the markets will crash when Donald Trump becomes President on 21 Jan 2017?

At the time of writing, the U.S. Dow Jones Index is trading at 25,669 – around 29% higher, a far cry from the mass predictions from the economists and fund managers who screamed “SELL!”.

Then, there is also the natural thinking that it’s best to sell when things are going badly and buy only when they pick up again. However, history has shown that when markets rebound, they can do so quickly and dramatically.

There’s a higher chance that you’ll end up buying when stocks are most expensive and selling when they’re at their cheapest. And yes – its proven.

For the twenty years ending 12/31/2015, the S&P 500 Index averaged 9.85% a year. The average equity fund investor earned a market return of only 5.19% annually. A $100,000 portfolio in S&P 500 Index will grow to $654,638 while the retail investor will get $275,099 – a whooping difference of almost $400K. Talk about a 4.5% return difference…

The next time you want to time the markets again, check back your past few trades where you ‘try to time the market’. What happened? Did the things work out as planned? If not, you are probably better off being invested over the long haul.

Either that or you can also invest regularly over a long period, or what we call **“Dollar-cost Averaging”**.

According to Investopedia, Dollar-cost averaging (DCA) is an investment technique of buying a fixed dollar amount of a particular investment on a regular basis, regardless of the share price. The investor purchases more shares when prices are low and fewer shares when prices are high.

By investing regularly, you can dampen the need to predict where the market is heading next and also ‘smooth out’ the highs and lows when stock markets are volatile.

Golden Rule #3: Optimal Diversification

Diversification is the practice of spreading your investments around so that your exposure to any one type of asset is limited. As such, it can help mitigate the risk and volatility in your portfolio over time. There are **2 different camps** when it comes to diversification.

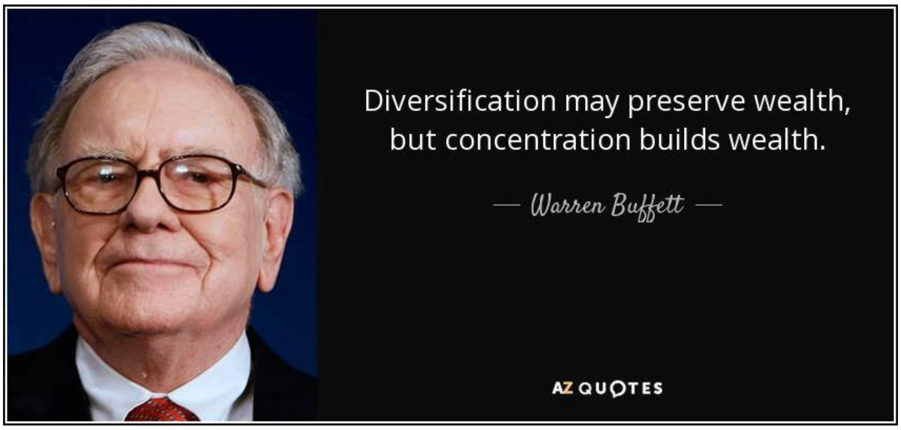
On 1 end, many financial advisers and even the academic studies have touted on the importance of diversification. They say that when you diversify properly, you would be less likely to lose everything in the event of a market downturn or even crash.

On the other end, investment gurus like Warren Buffett are in favour of ***focus investing*** said this:

"Pure diversification is protection against ignorance. It makes little sense for those who know what they're doing."

So… what is going on here? Who should you listen to?

After investing for many years and studying the pros and cons of diversification, we got the knack of it – and it is also surmised by Warren Buffett's quote below:



We believe in building an optimally diversified portfolio of around 15-20 stocks. While it will help us get higher returns from focus investing, the risks are also relatively spread out to protect us from the inevitable blips — and allows us to sleep well at night.

While we're at that, we will not venture into copious asset classes like bonds or gold just for the sake of diversification too. This is because stocks remain the best long term bet an investor can have. Not to mention the fees you can save from just staying invested in stocks for the long term.

Golden Rule #4: Know When to Sell

Despite knowing what to buy, the more important question is actually when to sell them.

Contrary to Warren Buffett's Buy-and-Hold approach, he does sell off stocks that no longer meet his criteria or hypothesis. So should You.

Below, we highlight 5 key reasons on when to sell and 3 crucial reasons when NOT to sell:

5 Key Reasons on When to Sell

#1 Better opportunities

Sometimes, there's nothing wrong at all with a company or its shares: There are simply better opportunities elsewhere that will bring us more bang for our bucks. We will consider selling a less attractive share (even at a loss!) if we think we can get a better deal elsewhere.

#2 Business changes

There's no way around it: Businesses change — sometimes significantly. We could be talking about a major acquisition, a change in management, or a shift in the competitive landscape. When this occurs, we incorporate the new information and re-evaluate to see if the reasons we bought the company in the first place still hold true.

We will consider selling if:

- The company's ability to crank out profits is crippled or clearly fading.
- Management undergoes significant changes or makes questionable decisions.
- A new competitive threat emerges or competitors perform better than expected.

- We'll also take into account unfavourable developments in a company's industry.

Here, it's important to delineate between temporary and permanent changes. In a downturn, financial figures may suffer even for the best-run companies. What's important is how these businesses take advantage of the effects on their industry to improve their competitive position.

#3 Valuation

We're all for the long-term here, but sometimes our shares have seen too much love from the market. We will consider selling if a share price has run up to a point where it no longer reflects the underlying value of the business.

#4 Faulty investment thesis

Everyone makes mistakes. Yes, everyone. Sometimes, you'll just plain miss something. You should seriously consider selling if it turns out your rationale for buying the share was flawed, if your valuation was too optimistic, or if you underestimated the risks.

#5 It keeps you up at night

It is tough to put a dollar value on peace of mind. If you have an investment whose fate has changed such that it now causes you to lose sleep, that could be a great cue to move your dollars elsewhere.

We save and invest to improve our quality of life, after all, not to have our spouse grumble at us for tossing and turning all night long. Adding insult to injury, stressing about a share might cause you to lose focus and make rash decisions elsewhere in your portfolio.

Remember, there's no trophy or prize for taking on risk in investing. Stick with what you're comfy with.

With that said, we move on to why and when you SHOULD NOT sell…

3 crucial reasons when NOT to sell

#1 Due to increase in share price

The story of the investor who sold his shares because of a 100% gain in the share price is the perfect example of selling resulting in a missed opportunity. Investors tend to want to lock in profit on their investment after a strong price surge. However, this investment "strategy" can prevent you from profiting even more.

Legendary investor, Peter Lynch, always looked out for companies that had the potential to be a ten-bagger (companies that can appreciate 10-fold). If we base our investment decisions on taking a profit simply because the company has increased by 100%, we will never be able to reap the potential returns of wonderful investments.

Instead of simply selling investments that have appreciated, we should relook at what had caused the price surge and see if it is warranted. If so, we should be happy to continue holding on to the investment.

#2 Because you read in the news that a bear market is coming

Almost every day in the news, you will find headlines that go something like, “Market expert predicts downturn this year”.

This is obviously very worrying for investors who are involved in the stock market. But if you look back through the years, there will, in fact, always be “market experts” or “gurus” who are predicting doom-and-gloom.

Bear markets are bound to happen because of investors’ insecurities or short-term government policies. However, if we always get cold feet because of a prediction that most of the time is inaccurate, we will not be able to benefit much from the overall upward nature of the stock market.

#3 Because of speculative world news

There is constant bad news occurring around the world. Terrorist attacks, Middle East crisis, North Korea nuclear threat, and shootings in the United States just to name a few.

All of which can have an impact on short-term share prices but are unlikely to have any long-lasting impact on businesses in general. Investors should not be overly concerned with world news that has little impact on their current investments.

A terrible mistake would be to sell your stocks because you think a particular world news will affect share prices in the near-term. Price volatility in the market is almost impossible to predict and selling because of world news can lead to potential loss of profit down the road.

Golden Rule #5: Keep Your Emotions in Check

If there is one thing that wreak havoc in an investor's portfolio performance, it would be due to **Emotions**.

According to Investopedia, investors have a knack for piling into investments at the top and selling at the bottom. Many investors get caught up in media hype or fear and buy or sell investments at the peaks and valleys of the cycle.

Look at the tell-tale stock market's cycle below:

The above picture shows that most often than not, our emotions get into our way of investing successfully. This is also what brought light to Warren Buffett's famous quote:

*"**Fearful** when **others** are **greedy** & **Greedy when others are fearful**."*

Don't panic over the daily fluctuations which can get crazy too. Just look back at all the huge events like the Brexit, Euro Crisis, Donald Trump Presidential Election. The U.S. markets have continued to punch higher after swiping away these "dangerous" events.

Lastly, learn to embrace and take advantage of the uncertainty instead. Just like Mark Gordon, Chief Investment Officer at Wealth Architects, LLC, with $1 billion under management said,

"Rebalancing back to a long-term strategic plan forces us to buy low and sell high. There's no need to stress out over market swings and the headlines they create. Market volatility means increased opportunity for disciplined investors."

Golden Rule #6: Keep Score

There is 1 simple reason that separate successful investors and those that are not is this:

Master Investors are accountable for their results.

Most often than not, many retail investors have their investing funds all over the place, some in Government Bonds (i.e. SGS), some in stocks and some in unit trusts. As a result, they do not know how much their portfolio has performed whether to their expectations.

Imagine having $100k as investment capital and you invested $20k in stocks and $80k in bonds over the past year (we will disregard the commission and fees here).

Your stocks performed well, giving a return of 10 and your bonds provided a fixed return of 3%. How much do you think your portfolio has fared? It went from $100k to $104.4k, up 4.4%.

On the other hand, the STI Index was up 8% over the same period. You may think that your stocks have out-performed the market, but on an overall basis, you are underperforming the market.

To conclude, there are **3 big reasons** to keep score of your portfolio performance.

1. To evaluate your portfolio's performance

Research shows that an investor's perception of their own performance has zero correlation to their actual results.

Take for example a trader who buys and sells stock on a whim. He may think that his few big wins have made him lots of money. However, if he were to tabulate the small losses and hefty trading expenses along the way, he may not have out-performed the index.

Worse still, he may have lost a big sum of money which he can shrug it off as "paying for school fees"or "unlucky streak which will get better".

2. To know what you're paying in fees

To add on to the above, your account statements will also tell you about your costs and fees. Any fees you pay will lower the return you make on your investments.

Personally, I used to stick to the traditional brokerage firms while I was starting out as an investor. However, after my average trade size gets bigger, the commissions were increasing in tandem as well. That was when I think that I am paying too much in fees and search for other lower-cost alternatives such as fundsupermart.com and going for pre-funded accounts.

3. Make Portfolio Adjustments (if any)

By keeping tab of your portfolio periodically, you can measure its progress against your goals.

Are you too conservative and not achieving a higher return necessary to attain your retirement amount of $1 million by age 65?

Or are your portfolio too volatile and causing you to lose sleep at night?

Through monitoring your investments and asking yourself questions, you get a clearer picture of where you stand. It also allows you to stay committed to your own investment strategy and avoid leaning to the next “holy grail of investing” as people talks about it.

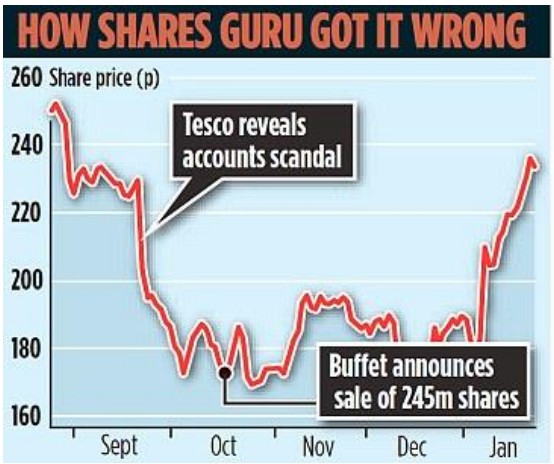
Golden Rule #7: Learn from Your Mistakes

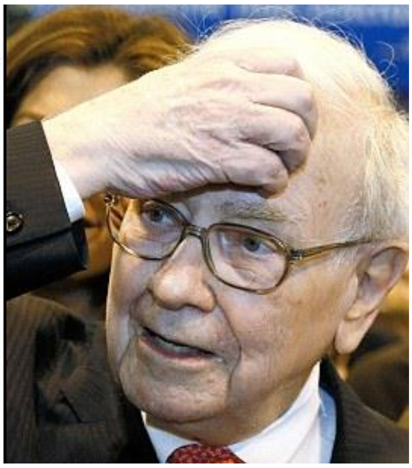
Everyone makes mistakes when it comes to investing. Not even investment legends like Warren Buffett and Ray Dalio, founder of investment firm Bridgewater Associates, one of the world's largest hedge funds can escape from the fact.

They make mistakes - Humongous ones at that.

- **Warren Buffett's mistake**

In 2013, *Tesco* was listed among Berkshire Hathaway's largest holdings. A year later, the food retailer wasn't on the list at all.





Buffett confessed to making a mistake with *Tesco* by procrastinating whether he should have sold earlier when he saw that Tesco had management and accounting problems that seemed to worsen every month.

The mistake costed him **US$444 million dollar – Ouch!**

- **Ray Dalio's mistake**

During the year 1982, Dalio calculated that American banks had lent too much money to emerging countries and deduced that they weren't going to be able to pay it back. In turn, the economy and stock markets would plummet.

However, just the opposite happened and both the stock markets and economy soared upwards. With that, he lost his clients' substantial amounts of money and his own money. He even had to borrow $4,000 from his dad.

Takeaway

The key takeaway here is that investing mistakes are inevitable but ideally, you should be always bettering yourself and not continually committing the same common mistakes as before – we have highlighted 5 of them in our other *Special Issue*.

We also want to take a page out from Peter Lynch's greatest investing mistake:

> *"Selling your winners and holding your losers is like cutting the flowers and watering the weeds."*

In a nutshell, always be aware of your own fallibility and treat mistakes as learning experiences.