CHAPTER 1

GETTING STARTED

SETTING GOALS, CHOOSING INVESTMENTS, GETTING INFORMATION

To get started as your own portfolio manager, first realize that there is no perfect way or time for you to start. And there is no perfect product for you to start investing in. The best investment choices for your portfolio are the ones you are comfortable with and the ones you have researched for yourself and understand. With that said, you can always choose better investments as you become more experienced. So once you get started as your own portfolio manager, keep practicing. The more you do it yourself, the more experience you'll gain.

As your portfolio grows, so will your knowledge of portfolio management. Start simple (with concepts you can easily understand), try your ideas on paper first, not using real money, and as you learn and your portfolio increases in value, expand and diversify the types of investments you have. There are thousands of choices that you can make but the important thing is to get started now! It really is never too late.

Before You Even Begin Investing

As an individual investor, it is paramount that you learn to manage *your own* money and control *your own* financial destiny. Drawing on my experience as a financial analyst and professional money manager (managing both institutional and individual money), I intend to teach you the skills used by professional money managers, the people responsible for investing a fund's assets, implementing its investment strategy, making the investment decisions, picking the investments in the fund, and managing the day-to-day portfolio trading.

Investing, like most other things, requires that you have a general philosophy about how to do things in order to succeed, achieve your goals, and avoid careless errors. To think like a professional money manager or portfolio manager, you need to understand the time value and compounding effect of money, determine your goals and needs, and develop an investment strategy.

THE TIME VALUE OF MONEY

The most basic concept in finance, the time value of money states that a dollar today is worth more than a dollar at some time in the future. For example, if you invest $1,000 in a 5 percent savings account today, it will be worth $1,050 in one year. Therefore, if you can have $1,000 today or choose to have $1,000 one year from now, it is always better to have the money now because of its potential to grow. By saving and investing today, you make the time value of money work for you.

Let's look at the reverse of this situation, to see how the time value of money can work against you. Suppose instead of receiving $1,000, you spent $1,000 by purchasing merchandise on your credit card. Remember that a dollar today is worth more than a dollar tomorrow, so in this case, you will have *lost* money because you will need to pay off your credit card account with money from the future (which is worth *less* than money today). In addition to having to pay with future money, you will also have to pay interest expense. So, in this case, if you paid off the credit card in one year (assuming 15 percent interest), you'd have to pay $1,150.

You should think about the time value of money before making any financial decisions.

THE COMPOUNDING EFFECT OF MONEY

A concept related to, and maybe even more important than, the time value of money is the compounding effect of money. This concept is often overlooked or underestimated by people when making financial decisions. When applied to all of your financial decisions, this effect is the key to long-term success! To illustrate the compounding effect of money, let me use some financial examples.

Suppose you have $1,000 in a 5 percent savings account today. Here's what happens to your money:

- In one year, that account would be worth $1,050 [$1,000 + ($1,000 × 5%)], yielding a $50 gain.
- However, in year two, that same initial investment would be worth $1,102.50 [$1,000 + ($1,000 × 5%) + ($1,050 × 5%)], yielding a $52.50 gain.
- And in year three, the same $1,000 would be worth $1,157.63, yielding a $55.13 gain.
- By year ten, the initial $1,000 investment would be worth $1,629, and by year 25 it would be worth $3,386.

From this example, you can see that investing $1,000 today is much more valuable than investing $1,000 even a couple of years from now.

This second example shows how the compounding effect can work against you. Suppose you borrow $20,000 to purchase a car at a 10 percent interest rate (for five years). Your monthly payments are $424.94. Because the $20,000 loan continues to compound over the life of the loan, you actually pay $25,496.45 over the five-year period, meaning that you have in essence paid $5,496.45 because you spent the money before you had it. In fact, in your initial payments, the interest alone will account for almost 40 percent of your monthly payments. In this case, the bank or lender that gave you the loan uses the time value of money to its advantage.

Now suppose instead of making the $424.94 car payment, you invest that payment at the same rate as what your car loan was (granted it's a little high for a savings rate, but not unreasonable for other investments). Now instead of paying the bank, you are actually earning interest and compounding the benefit yourself:

- After one year, you will have saved $5,340 and have earned $240 in interest.
- After two years, you will have saved $11,239 and have earned $1,039 in interest.
- By the third year, your investment will be worth almost $18,000 and you will have earned $2,457 in interest.
- By month 40, you will have enough money to purchase a $20,000 car in cash!

So let's weigh the differences between the two preceding scenarios. In the first case, you *paid* the bank $5,496 to borrow the money; in the second case, you *earned* $2,457 and could buy the car in cash after just 40 months (just over 3 years)! The opportunity cost of the first alternative versus the second alternative results in a net difference of $7,953 (a $2,457 gain versus a $5,496 loss). Thus, by making a simple deferral decision (buying the car in 3 years versus today), you can get ahead by almost $8,000!

To achieve the most benefit from the compounding effect of money, start young! Many investors do not start saving early enough to enjoy the extraordinary power of compound interest. Albert Einstein, when asked what was the most powerful force in the world, is said to have answered: "the power of compound interest." Table 1.1 shows you why. We assume a return of 11 percent a year on $10,000 lump-sum invested at the ages listed. The assumption doesn't take taxes into account. So unless you can find a tax-exempt or tax-deferred investment plan, be assured that taxes will greatly reduce the totals. Of course, you don't need to start off with a $10,000 lump sum. You can set aside a small amount each month in most mutual funds to get you started. The key point here is (I'll say it again), "Start saving early!" A good start would be in an individual retirement account (IRA) or other retirement plan as early as possible.

Table 1.2 illustrates how investing a fixed dollar amount ($100) each month (also known as *dollar cost averaging*) can build up a substantial sum over time. Note again that this chart does not include income taxes.

Table 1.3 shows how long it takes to become a millionaire based on (1) how much you can save and (2) how well you invest. Obviously, the more you invest and the more you make on your investments, the faster you reach your goals.

Table 1.1 The Benefits of Investing Early

Age of Investor	Amount Invested	Total Amount When Investor Reaches 65
25 years old	$10,000	$650,010
35 years old	10,000	228,920

Table 1.2 How $100 Can Grow at Different Interest Rates Over Time

	Interest Rate					
Year	6%	8%	10%	12%	14%	16%
1	$ 1,272	$ 1,296	$ 1,320	$ 1,344	$ 1,368	$ 1,392
3	3,281	3,858	3,972	4,049	4,128	4,207
5	6,765	7,040	7,326	7,624	7,920	8,252
7	10,073	10,708	11,384	12,107	12,876	13,697
10	15,817	17,384	19,124	21,059	23,204	25,585
20	44,143	54,914	68,730	86,462	109,230	138,546
25	65,838	87,727	118,016	159,996	218,244	299,052
30	94,870	135,936	197,388	289,586	428,148	636,372

Table 1.3 How Many Years to Reach $1 Million

Monthly Savings ($)	Interest Rates							
	2%	4%	6%	8%	10%	12%	14%	16%
50	177	105	77	61	51	44	39	35
100	144	88	66	53	44	39	34	31
150	125	79	59	48	40	35	31	28
200	112	72	54	44	38	33	29	26
250	102	67	51	42	35	31	28	25
300	94	62	48	39	34	30	26	24
400	82	56	43	36	31	27	24	22
500	73	51	40	33	29	25	23	21
750	58	42	34	29	25	22	20	18
1,000	49	37	30	25	22	20	18	17
1,250	42	32	27	23	20	18	17	15
1,500	37	29	24	21	19	17	16	14
2,000	30	25	21	18	16	15	14	13
2,500	26	21	18	16	15	13	12	12
3,000	22	19	16	15	13	12	11	11
4,000	17	15	14	12	11	10	10	9
5,000	14	13	12	11	10	9	9	8

Table 1.3 can be used in many different ways. One way is to determine the time you have until retirement, choose your estimated investment rate of return (depending on your risk profile), and then find the monthly savings rate that matches your investment return and years until retirement. The table will show you how much you need to save each month to reach a million dollars. If you need $2 million to retire, you can multiply the monthly savings rate by 2 to find the amount you need to invest each month to reach your goal.

A second, and more obvious way, to read Table 1.3 is to find the amount of money you save or invest each month, find the estimated return you expect on your savings or investments, and then find the corresponding number of years until you reach $1 million. No matter how much you will need to retire, Table 1.3 can be useful for determining both how long it will take to reach your goal and how much you need to save to reach your goal.

To build your portfolio and accumulate wealth, you must use the time value of money and the compounding effect of money to your advantage.

YOUR GOALS AND NEEDS

While this isn't a book on financial planning, as you begin to formalize your particular investing strategy, there are some aspects of financial planning that you should consider.

Depending on what your goals are, you will utilize different investment tools and products for that particular portfolio. It's okay to have more than one portfolio. For instance, if you are saving for one or more financial goals, then prioritize them and allocate your investment strategies among the various portfolios. Most money management firms, especially mutual fund companies, have multiple investment portfolios and strategies at their firms (small-cap growth, bio tech, fixed-income, large-cap value, and so on). You should be no different.

You should have a retirement portfolio, a portfolio for short-term needs in case of emergency, a portfolio for that business you want to start or buy one day, a portfolio that will finance a future educational need, and so on. Your portfolio should have strategies as well; for example, if you are in your 20s, then your retirement portfolio should be classified as "long-term growth," possibly with a large-, mid-, and small-cap growth stock emphasis. (I discuss these portfolio strategies in the final chapter of this book.)

The following paragraphs discuss the first questions to answer as you develop your portfolio strategy according to your goals and needs.

- *Is your portfolio investing for the short, medium, or long term?* If you are investing for the short-term (less than a year), then your best choice is probably to purchase a certificate of deposit (CD) at your local bank or park your money in a money market savings account at a brokerage firm. If you are investing for the medium-term or long-term, you'll want to open a brokerage account. Opening a brokerage account is as easy as filling out and mailing in an online form, and it can be done by almost anyone. (I discuss strategies, products, and brokerage accounts in the next section of this chapter.)
- *Are you investing money that you will want access to before retirement?* If so, do not invest the money in a tax-deferred account.
- *Is your portfolio for retirement?* If so, you'll want to utilize as many tax-deferred investments as possible, including any 401(k), 403(b), IRA, or Roth IRA accounts that you qualify for. The 401(k) and 403(b) plans are only available through your employer. If you are self-employed or a business owner, then consider starting an SEP-IRA for yourself and your employees (a brokerage firm can assist you in setting up one). These are the most beneficial tax-deferred plans available. If you are eligible for these plans, you should start investing in them immediately, and contribute as much as you can each paycheck and each year.

The difference between an IRA and a Roth IRA is that an IRA is tax deductible the year that you create it. Also, if you already participate in a 401(k) or 403(b) plan, you are usually unable to contribute to a traditional IRA. In a traditional IRA, your money grows at a tax-deferred rate but when you sell it you'll have to pay taxes on the full amount. With a Roth IRA you are taxed on your contribution the year you make the deposit, but you will never have to pay taxes on the money when you take money out.

- *Is your portfolio for your children's college education?* If this is one of your specific goals, then you can invest money in a 529 plan (either a prepaid tuition plan or a savings plan) or a Coverdell IRA (formerly know as Educational IRA). See www.collegesavings.org to find out what plans your state offers.

Opening an Account

Once you know what type of portfolio you want to develop according to your goals and you determine your investment strategy, the next step is to open up an account to manage your portfolio. Here are the basics of each type of account:

- *Banks.* You can buy CDs through your local bank.
- *Discount Brokerage.* The fastest, easiest, and cheapest way to open a brokerage account is to open it through a discount brokerage. Even better, open it at an online discount brokerage. My favorites are E*TRADE, Schwab.com, and Ameritrade. Ameritrade is the cheapest; E*TRADE is inexpensive but offers lots of options, Schwab.com is the most expensive but offers you additional services like advice, research reports, and other full-service options.
- *Full-Service Brokerage.* Morgan Stanley, Merrill Lynch, and Prudential Financial, to name just a few, are examples of full-service brokerages. These brokerages provide you guidance, advice, and research reports, but they are expensive and their brokers can often push you toward investments you may not be comfortable with. Instead of charging a flat fee for trades, they usually charge a commission-based fee. They also charge annual maintenance fees on your account of sometimes hundreds of dollars. Consider these accounts only if you really need the extra guidance.
- *Your Employer.* You can invest in your employer's 401(k) or 403(b) plan; these plans are offered *only* through your employer. Find out if your employer offers one of these plans (or any other tax-deferred, stock investment or other plan) by contacting your human resources department.

WHAT IS A BROKER?

If you are going to buy shares of stock for your portfolio, you need a stockbroker (broker) to help you with the transaction. In the same way that CompUSA or Best Buy is the middleman between you and computer manufacturers, the broker is the link between you and the stock exchange. To better understand what a broker is and how one operates, let's define the broker's role:

- A stockbroker is a salesperson.
- Stockbrokers work for a stock brokerage firm (like Merrill Lynch).
- The broker's job is to carry out your transactions.
- At full-service brokerages, the broker can advise you about your investment decisions.

Stockbrokers get paid by salary, commissions on sales, or a mix of both. Commissions can range from as low as $5 or $10 dollars to upwards of several hundred dollars. The price difference arises when you choose between either a discount or traditional full-service broker.

To become a stockbroker, a person must pass two licensing examinations called the Series 7 and Series 63. Successfully completing these exams allows the broker to advise you, to solicit business from you, and to execute transactions on your behalf.

WHAT A BROKER IS NOT

Although a broker may do his or her own research, he or she is *not* a (sell-side) research analyst. He is not one of the people about whom you might read, "John Doe Smith III of XYZ Investment Bank & Associates has issued a 'strong buy' rating and raised his estimate for Bootleg and Copy Records fiscal year 2005 earnings from 19 to 35 cents per share, citing resurgence in demand for bootleg CDs and DVDs." Research analysts are other folks who work for investment banks and brokerages, and it is they who do that sort of enlightening, in-depth research of a company's business and industry.

FULL-SERVICE VERSUS DISCOUNT BROKERAGES: HOW TO CHOOSE

Investors today have the luxury of deciding whether to use a traditional full-service broker or a discount broker. Which one is right for you? It all depends on your goals and circumstances. While you ponder this important decision, think about how managing your own portfolio will benefit you versus how a live broker from a full-service firm will benefit you. After all, it's your money, and you should have it managed the way you see fit. So, the first step is to take stock (no pun intended) of what you want your investing experience to be like.

Before we get too deep into the details, I want to emphasize that the decision between using a full-service broker and a discount broker isn't necessarily exclusive; you can get the best of both worlds if you want. Many discount brokerage firms are offering the services that a traditional full-service broker provides (such as access to investment research).

Some important questions to ask yourself when choosing between full-service and discount brokerages are:

- What are your investment goals?
- Do you have any investment experience?
- Is that experience in the area of which you want to manage your portfolio?
- Was your experience in this area a rewarding one?
- How much time and money will you devote to investing and managing your portfolio?
- Do you like to do it yourself or do you prefer to delegate responsibility?
- Do you have computer and Internet access to monitor your portfolio?

Just keep these questions in the back of your mind as you look at the pros and cons of each choice. There are many discount brokerage houses and many, many full-service brokerage houses.

Full-Service Brokers. Full-service brokers work for large national and regional brokerage firms. They earn a commission on stocks and other financial products that they buy and sell for their clients. Some firms also pay their brokers a bonus based on the size of their clients' accounts, but most of a broker's compensation is derived from commissions.

If you decide to open an account with a traditional brokerage firm, you will work one-on-one with a personal stockbroker who is assigned to you. He or she will offer investment ideas, prepare reports about your portfolio, give you a rundown of how well your investments are doing, and generally be available with a single phone call or e-mail to buy or sell stock for your account. In addition, traditional brokers offer a variety of different research sources to their customers. In exchange for this one-on-one service and guidance, you will be charged a significantly higher commission than if you work with a discount broker.

Although most brokers are honest, hard-working people, you can already see that your goals and the goals of your broker are not the same. He or she makes money when you buy or sell, whereas you want to *minimize* transaction costs. A broker who "churns" your account (i.e., engages in excessive trading) can cost you a lot of money. Further, you may pay more capital gains tax with short-term buying and selling.

Brokerage firms are like retail stores. They are in business to sell products. Investment and insurance companies send sales reps to brokerage firms to encourage brokers to sell their products: mutual funds, REITs, trusts, insurance, annuities, limited partnerships, bonds, closed-end funds, bond funds, new issue stocks—the list goes on. They offer brokers special incentives (i.e., higher commissions, trips, free meals) to sell these products. Too often, the new products are junk: complex, confusing, and lower-yielding than good stocks and good no-load mutual funds.

Full-service brokers usually charge full commissions, but their fees may be negotiable. So if your business merits it, ask your broker for a discount. Depending on the size of your account, you may be able to get commissions down to levels comparable to a discount brokerage. Discount brokers charge lower commissions, but full-service brokers, backed up by their service departments and analysts, may give you more recommendations on a wide variety of investments. Full-service brokers are under constant pressure from their brokerage firms to acquire more clients, service their present clients, try to understand a constantly changing array of financial products (some of which are quite sophisticated), and grow their asset base. Remember, brokers are *salespeople*, not financial analysts.

Also, most full-service brokers push what their firm's research department recommends. The problem is that about a thousand other brokers in the firm have called their clients to tell them about the same stocks in the analysts' reports. Brokers naturally call their best clients first . . . so by the time they get around to smaller clients, the price may be bid up to overvalued levels (and the research department's recommendation may not have been all that great from the outset).

Selecting a Brokerage Firm

Need a list of the leading brokers? Gomez' Discount Broker Scorecard is the place to go: check out http://www.gomez.com. Also, check out http://www.brokercomparison.com. It's a great site for comparisons for online and direct access brokerage firms, with details about commissions and minimum requirements. It also provides information about various account rules and services.

Discount Brokers. Discount brokers are companies that cater to more self-directed, do-it-yourself investors; they don't offer advice or research as to what to put your money into, leaving you to make your own financial decisions and charging you much less than their traditional counterparts. They simply transact your trades with no frills. With most discount brokers, you can purchase stocks and bonds, trade options, open money market accounts, set up margin accounts, and IRAs, and invest in most of the financial instruments offered by full-service brokers. Remember that with most no-load mutual funds you can buy directly from the fund and avoid any commissions.

Instead of working with the same stockbroker, you will do most of your trading either online, or if you decide to call in your order, with the first available broker. Live brokers at these brokerages are usually paid a fixed salary to execute your trades. They don't solicit, and they aren't paid commissions. Discount brokerages make money by doing business in volume, competing mostly on price and reliability of the service: If they have the lowest prices and the best service, they get the most trades.

Recently, discount firms have been offering research that is on par with that offered at the traditional brokerage firms. In exchange for giving up the guidance of a stockbroker, you'll be charged significantly less because most discount brokers are on salary and charge lower commissions. You get less support, but you can enjoy substantial savings.

Among the best discount brokers are Charles Schwab, E*TRADE, Ameritrade, and TD Waterhouse. Each offers commissions of $8 to $30 and have easy to navigate Web sites. Almost all allow you to invest in mutual funds as easily as in common stocks, which can be advantageous for those who are just getting involved in managing their own finances.

Hybrids. Some firms, such as Charles Schwab and Merrill Lynch, offer both traditional and discount services to their customers, allowing them to choose between the two formats.

DO IT YOURSELF, OR NOT, BUT DO IT!

Personally, I advocate do-it-yourself investing (that's why I wrote this book). Because I want investors to do their own research and make their own investment decisions and manage their own portfolios, I think discount brokers are the way to go. I think you're capable of learning whatever you need to know to invest successfully, manage your own portfolio and save big commission dollars in the process. However, I know that not everyone wants to use a discount broker. Some people will want the advice and services of a full-service firm, and if that's you—that's okay, too! Just know what you are getting when you use a full-service firm.

When opening a new account with either a discount or full-service firm, the minimum investment amount can vary. The minimum is usually around $5,000 to $10,000 (again, check with the individual firm because the amount will vary). The amounts are even lower for IRAs and other retirement and education accounts or if you are buying a mutual fund. Most offer the option of either having an application form sent to you or allowing you to fill it out online, print it, and mail it in with a check. The process is easy and can be done fairly quickly at almost all financial institutions.

Once you have opened an account, you can start investing your money. All brokerages give you the option of setting up automatic monthly withdrawals, which will transfer an amount you specify each month from your savings or checking account to your brokerage account. This arrangement can be an easy way to start building up your equity; if you don't see it, you won't spend it. Since you won't notice the money that is missing each month, saving will be relatively painless.

Getting Started

Once you've chosen whether you want to work with a traditional broker or a discount broker, or simply trade online, and once your account is open and funded (follow the instructions from your broker to learn how to fund your account), it is time for you to set up your portfolio(s) and make your first investment(s). While the amount of money you have to invest plays an important role in what investments you can purchase (some investments require minimum amounts), whatever your dollar amount, start with what you have—whether it's $500 or $500,000. (You can start with $500 by putting it into a mutual fund—again, just start!)

CHOOSE YOUR RISK LEVEL

Decide on how much risk you are comfortable with and willing to take. The longer your time horizon, the more risk you should take. The more risk you take, the higher your return *should* be. (On the high end of risk are private equity and hedge funds; on the low end are CDs and money market instruments.)

Make sure you try to diversify within your risk level. For example, if you are investing in medium-risk, large-cap investments (such as Fortune 500 companies or S&P 500 companies), either buy several stocks or buy a mutual fund that invests in a broad array of these companies. Figure 1.1 compares different investment vehicles according to their risk levels and return rates.

CHOOSE YOUR ASSET CLASS (OR CLASSES)

Do you want to buy money market accounts (or CDs), stocks (large cap, small cap, value, growth, etc.), stock market tracking stocks (like the QQQ or SPiDERs), or, of course, mutual funds or bonds? How about short selling? Do you want to do option trading? Or invest in real estate or alternative investment categories, such as private equity and hedge funds? As a portfolio manager, you need to choose an asset class for your portfolio. And remember, you can choose more

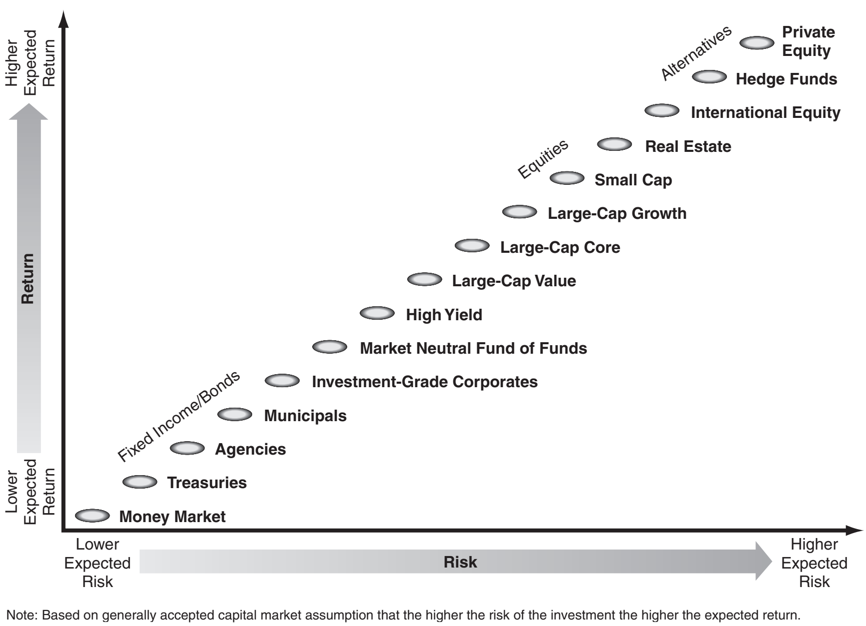

Figure 1.1 Comparison of Different Investment Vehicles by Risk and Return Rates

than one asset class for a particular investment objective for your portfolio.

If you are starting out with only a small amount of money (say, $500), don't worry too much about diversifying your portfolio. Start by buying a single mutual fund investment in the risk category you are interested in and understand. To find a suitable mutual fund, check with your brokerage firm to see what it offers. Most brokerage firms give you access to thousands of mutual funds usually without charging a fee. Or you can just contact the mutual fund company directly.

Another option when you have only a small amount of money to invest are dividend reinvestment plans, commonly referred to as DRIPs. These allow you to purchase stock in companies without the need of a broker, and most DRIP plans allow you direct access to ownership in the companies stock for under $500. Hundreds of well-know publicly traded companies have DRIPs. I discuss DRIPs in greater detail in Chapter 6.

As your investments grow and you invest more and more money, start to diversify your investments to include investments from multiple risk categories (capital preservation, income, growth, aggressive growth) and asset classes (money markets/CDs, small-cap stocks, large-cap stocks, bonds, and alternative investments such as hedge funds and private equity).

SELECT THE RIGHT INVESTMENTS FOR YOUR PORTFOLIO

There are many investment options out there. Here are some of them and some basic tips on how to narrow down your selection of investments.

CDs. Choose your time horizon. Then find the CD closest to that time horizon with the highest rate. Shop around at your local banks or through your brokerage account.

Money Market Accounts. Offered by banks and brokerages, you can choose between tax-free and traditional money market accounts. Then look for the highest rate. Tax-free accounts are more beneficial if you are in a very high tax bracket, but they pay a lower interest rate.

Stocks. You can buy stocks through either a full-service broker or a discount brokerage. Picking individual stocks is the riskiest method of investing.

If you are just starting to invest, you should probably start with stock mutual funds. However, it doesn't hurt to add a small percentage (never more than 10 percent of your portfolio per single stock) of individual stocks to your account. Doing so will likely increase your participation level and interest in the stock market.

To pick individual stocks, you can use a variety of tools, many of which are offered through your broker and online via the Internet. Find companies and industries that you know something about. Then, read about the company and learn about its business. Try to get your hands on some research reports to learn what other people think (but remember that research reports are wrong as often as they are right). A later section of this chapter discusses how to find companies to research for potential investment.

Look for long-term trends that will benefit the company you like. Always invest for long-term reasons and don't ever buy a stock simply because it is popular or because you think you know something others don't. As a research analyst and portfolio manager, I'm saying that you can't predict the short-term fluctuations of the stock market or of individual stocks. The best way to invest is to find long-term, sustainable business trends that you can invest in, and then to hold your investment until you think those trends are changing.

Mutual Funds. Mutual funds can also be bought from either discount brokerages or full-service brokerage firms or directly from the mutual fund company. Use the tools from your brokerage firm or the mutual fund company itself, or other Web sites like Yahoo! Finance, or even magazines like *Money* to learn about and compare different funds. As the portfolio manager for a mutual fund company, I would have to say that the industry standard for mutual fund information for retail investors like you is Morningstar. More information can be found at www.Morningstar.com.

Your job in your new role as portfolio manager is to manage a fund in the risk category you are comfortable with (whether it's for capital preservation, income, growth, or aggressive growth). If you are investing directly in mutual funds, it also makes sense to go with funds from companies that you've heard of before (such as T. Rowe Price, Janus, Putnam, and Fidelity). These companies will likely be in business longer and often attract better portfolio managers than other funds—though not always.

Keep in mind that previous results are not indicative of future results. High-flying funds often falter for years afterwards, and the topperforming funds often come from previously underperforming managers. To find out if a fund is right for you, read its prospectus, which can be found on the Web site of your online brokerage, on the Web site of the fund company, or through request from your broker or the fund company itself. Look at the quality and experience of the managers of the fund, their investment philosophy, and the list of the top stocks held in their fund (all of these are required to be reported in the prospectus).

Also, look at the fee structure of the fund. An average management fee shouldn't exceed a few percent a year. Be aware that some funds charge you extra fees to purchase or sell shares. Stay away from these funds. And, most importantly, don't worry too much about which fund you are buying, and when you buy it, and try not to be too critical of its performance. Give it some time before you judge its results.

Bond Funds. Search for a bond fund the same way you search for a stock mutual fund. I wouldn't recommend buying bond funds unless you are nearing retirement or using the money for some short-term need (such as buying a home) or unless you have a very large portfolio that you need to diversify.

When buying bond funds, look at the duration of each fund. Find out whether it invests in long-term, short-term, or medium-term bonds. Use your online broker's tools (or Yahoo! Finance) to look at its historical returns versus other funds. Look for good brand names and read the fund's prospectus to determine if it is right for you.

Traditional IRA. You can open a traditional IRA with almost any brokerage or discount brokerage. I recommend doing it yourself with a discount broker like Charles Schwab, E*TRADE, or Ameritrade. E*TRADE doesn't charge a monthly fee and offers decent tools to help you choose your investments. If you want a little more help, you can open a discount brokerage account with Charles Schwab and get personal guidance.

Roth IRA. A Roth IRA can be opened the same way as a traditional IRA.

Coverdell IRA (Educational IRA). You can open a Coverdell IRA at many brokerages, including E*TRADE or Charles Schwab.

Self-Directed IRAs. Self-directed IRAs allow you substantial freedom and flexibility in your choice of investment options. See www.pensco.com for additional information about self-directed IRAs.

529 Plan. Check with your state to see which plans are offered. Go to http://www.collegesavings.org for more information about the plans in your state. Some of these accounts are also offered by online brokers including E*TRADE and Charles Schwab.

Other Retirement Plans. Many other specialized, small-business or self-employed plans also exist, such as SEP-IRAs, rollover IRAs, custodial IRAs, self-directed IRAs, QRP/Keogh, simple 401(k), profit sharing, money purchase, and others.

Privately Held Companies. You might be an accredited investor, someone who has room in your portfolio for investment in a private company. As an angel investor, who has the sufficient capital to do so, investment in private companies either directly or as a limited partner in a private equity or venture capital fund might further diversify your portfolio.

Options, Futures, Short Selling, Hedge Funds, Private Equity, and Other Forms of Alternative Investing. Alternative investments should be part of your portfolio only after you've learned the basics of more traditional investing in stocks and bonds.

WHAT IS A STOCK?

Dating back to the Dutch mutual stock corporations of the 16th century, the modern stock market exists as a way for entrepreneurs and business owners to finance businesses using money collected from investors. In return for money to finance the company, the investor becomes a part owner of the company. That ownership is represented by stock—specialized financial securities or financial instruments—that are secured by a claim on the assets and profits of a company.

Common Stock. Common stock is aptly named because it is the most common form of stock an investor will encounter. It is an ideal investment vehicle for individuals because anyone can own it; there are absolutely no restrictions on who can purchase it, young, old, poor, rich. Common stock is more than just a piece of paper. It represents a proportional share of ownership in a company—a stake in a real business. By owning stock, you are a part owner of a business.

Shareholders own a part of the assets of the company and part of the stream of cash those assets generate. As the company acquires more assets and the stream of cash it generates gets larger, the value of the business increases. This increase in the value of the business is what drives up the value of the stock in that business.

Because they own a part of the business, shareholders get one vote per share of stock to elect the board of directors. The board is a group of individuals who oversee major decisions made by the company. Far from being a perfunctory collection of do-nothings, the board wields a lot of power in corporate America. Boards decide how the money the company makes is spent. Decisions on whether a company will invest in itself, buy other companies, pay a dividend, or repurchase stock are all the purview of the board of directors. Top company management—whom the board hires and fires—will give some advice, but in the end the board makes the final decisions.

As with most things in life, the potential reward from owning stock in a growing business has some possible pitfalls. Shareholders also get a full share of the risk inherent in operating the business. If things go bad, their shares of stock may decrease in value—or even end up being worthless if the company goes bankrupt.

Different Classes of Stock. Occasionally, companies find it necessary for various reasons to concentrate the voting power of a company into a specific class of stock where the majority is owned by a certain set of people. For instance, if a family business needs to raise money by selling equity, sometimes the owners will create a second class of stock that they control that has 10 votes per share of stock and sell a class of stock that only has one vote per share to others. Does this sound like a bad deal? Many investors believe it is and routinely avoid companies where there are multiple classes of voting stock. This kind of structure is most common in media companies and has been around only since 1987.

When there is more than one kind of stock, they are often designated as Class A or Class B shares. This distinction is signified on the New York Stock Exchange and American Stock Exchange by a period and then a letter following the ticker symbol, a shorthand name for the company's shares that brokerages use to facilitate transactions. For instance, Warren Buffett's Berkshire Hathaway Class A shares trade as BRK.A, whereas Berkshire Class B shares trade as BRK.B. On the Nasdaq stock market, the class of stock becomes a fifth letter in the ticker symbol. For example, Bel Fuse trades under the tickers BELFA (the Class A shares) and BELFB (the Class B shares).

HOW STOCKS TRADE

Probably one of the most confusing aspects of investing is understanding how stocks actually trade. Words such as “bid,” “ask,” “volume,” and “spread” can be quite confusing.

Listed Exchange. The New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX, composed of the Boston, Philadelphia, Chicago, and San Francisco Exchanges and now merged with the Nasdaq stock market) are both listed exchanges, meaning that brokerage firms contribute individuals known as *specialists* who are responsible for all of the trading in a specific stock. Volume, or the number of shares that trade on a given day, is counted by the specialist and reported to the exchange along with information on the price and size of each trade.

NYSE trades still take place face-to-face in the trading pit (yes, just like in the movies) where buyers and sellers physically converge on the specialist who matches buyers with sellers, but computers play a big part in the process these days. All trades are auctions. There is no set price, although the last trade is often considered to be the price of a stock. In reality, the price is the highest amount any buyer is willing to pay at any given moment. When demand for a certain stock is high, the various buyers bid the price higher to induce sellers to sell. When demand for a stock is low, sellers must sell at lower prices to attract buyers and the price drops.

Over-the-Counter Market. The Nasdaq stock market, the Nasdaq Small-Cap, and the OTC Bulletin Board are the three main over-the-counter markets. In an over-the-counter market, brokerages (also known as broker-dealers) act as market makers for various stocks. The brokerages interact over a centralized computer system managed by the Nasdaq.

Market makers may match up buyers and sellers directly, but mostly they maintain an inventory of shares to meet the demands of the market. So when you want to sell 100 shares of ABC stock, you don’t have to wait for someone else to place an order to buy 100 shares of ABC; the market maker steps in, buys them from you immediately, then sells them when a buyer comes along. Market makers and specialists keep the markets liquid each in their own way. You are assured that, except in extraordinary circumstances, you can always buy or sell your shares if the market is open.

Volume numbers under the Nasdaq system are often inaccurate. Because most trades are in and out of the market makers' accounts, what would be one trade on the NYSE (where buyers and sellers are matched directly) is usually two trades on the Nasdaq.

BID, ASK, SPREAD

Handling all those orders is a very valuable service, and market makers (and specialists) are appropriately rewarded. Suppose you want to sell ABC and the last trade was at $6.25. When your market order (an order to sell at the going price) goes out on the Nasdaq system, the companies that make a market in ABC will bid for the right to buy your shares. If they see a lot of orders for ABC, they might bid $6.50 for your shares, because they know that they can turn around and ask $6.60 to sell them. If they see a slackening of demand for ABC, they might only bid $6.00 and ask $6.10. On the NYSE, specialists won't match orders for the exact same price; they will match buy orders for slightly more than the seller is asking.

The difference between the bid and ask price is the *spread* and it goes into the pockets of the market makers and specialists. The amount of spread will vary depending on the volume of shares traded. For very heavily traded stocks, market makers will compete vigorously for the business and the spread will be quite small. For thinly traded stock, market makers may demand a very large spread because they may have to hold the stock for a long time before a buyer comes along, increasing the risk that they won't be able to sell it for as much as they paid.

Investors can set their own bid or ask prices, too, by placing orders to sell or buy only at a specific price. Market makers and specialists keep a close eye on these open orders, executing them when conditions are met, and using them to gauge demand for the stock.

Finding Profitable Investment Opportunities

Now let's get down to business. Profitable investment opportunities are all around you. Finding them is easy, but finding the right one for you is a challenge.

FIND OUT WHETHER A COMPANY IS PUBLIC OR PRIVATE

Before you can invest in a business, you must discover if it is public or private. A publicly traded company is one that has shares of stock traded on the open market (stock market). Private companies do not have shares available for public purchase and may be owned by an individual, a family, a partnership, employees, or a small group of investors.

To illustrate the difference, consider Hershey and Mars, two of the largest candy companies in the world. The late Milton Hershey's chocolate business is publicly traded on the New York Stock Exchange as Hershey Foods Corporation (NYSE: HSY). An individual investor could take his paycheck and acquire shares in the company, profiting from every Hershey bar or Reese's peanut butter cup sold.

The multibillion dollar Mars company, however, is still privately owned by the Mars family. An investor could not buy shares unless the members of the family allowed him to acquire some of their closely held, personal stock or he invested in a private equity or venture capital fund that was invested in Mars.

How does one determine if a company is public or private? The simplest, most effective way to answer this question is to call the company and ask. At the same time, many corporate Web sites offer information on their ownership status; rest assured, if you see an "investor relations" section, the company is public.

INVEST IN COMPANIES YOU KNOW

In his lectures and writings, the legendary investor and chairman of Berkshire Hathaway, Warren Buffett, often discusses the concept of a "circle of competence." This circle of competence consists of all the businesses with which the investor is familiar and thoroughly understands.

As a professional money manager, I believe it is possible to estimate a range of the intrinsic value for a company based on its financial statements and filings. This valuation cannot be done, however, if you do not understand how a company makes money. If, for example, you know nothing about biotechnology and infectious diseases, you shouldn't invest in Chiron (Nasdaq: CHIR) Why? Unless you understand the company's products, market, competitive strengths, and weaknesses, you won't be able to project the future cash flows.

For example, an investor who has spent 10 years as a checker at a supermarket would have an advantage when analyzing the financial statements of a grocery store chain; he or she would be able to pinpoint strengths and weaknesses of the business, evaluate the competitive climate of the industry, and compare the performance of a prospective investment against those of an excellent grocer.

The size of an investor's circle of competence isn't as important as clearly defining the borders. If you are unfamiliar with the insurance industry, don't even attempt to evaluate the performance of a property and casualty company. Likewise, if you don't understand the Internet, don't bother ordering the annual report of an Internet stock. Straying from the circle of competence leads a would-be investor into the land of speculation.

WHO IS . . .

WARREN BUFFETT

Warren Buffett is probably the most successful (and famous) investor of all time. Based solely on his investment acumen, on any given day, Buffett is either the richest man in America or one of the richest men in America. From 1957 to 2001, Buffett achieved an average annual return of more than 25 percent per year on his stock investments. However, Buffett does not achieve this enviable record using some complicated investment strategy. Instead, he buys stock in what he calls franchise companies and buys these stocks with the intent of never selling them. Buffett meticulously studies each business he is interested in, and only buys the stock of companies in sound financial condition that can be purchased well below his assessment of their intrinsic value. He also buys stocks of companies he understands. Some of his largest stock investment returns have been made in household names (in the United States) such as Capital Cities/ABC, Coca-Cola, and The Washington Post.

BENJAMIN GRAHAM

Benjamin Graham is known as the father of modern security analysis. He is commonly referred to as the founder of the value school of investing. Graham influenced such subsequent investment gurus as Warren Buffett, Mario Gabelli, Michael Price, and John Bogle. His timeless *Security Analysis* (1934) and *The Intelligent Investor* (1949) are still considered the bibles for both individual investors and Wall Street professionals to this day.

(*continues*)

Ben Graham had become well known during the 1920s. At a time when the rest of the world was approaching the investment arena as a giant game of roulette, he searched for stocks that were so inexpensive they were almost completely devoid of risk. One of his best-known calls was the Northern Pipe Line, an oil transportation company managed by the Rockefellers. The stock was trading at $65 a share, but after studying the balance sheet, Graham realized that the company had bond holdings worth $95 for every share. The value investor tried to convince management to sell the portfolio off, but they refused. Shortly thereafter, he waged a proxy war and secured a spot on the board of directors. The company sold its bonds off and paid a dividend in the amount of $70 per share.

When he was 40 years old, Ben Graham published *Security Analysis*, one of the greatest books ever written on the stock market. At the time, it was risky; investing in equities had become a joke (the Dow Jones had fallen from 381.17 to 41.22 over the course of three to four short years following the crash of 1929). It was around this time that Graham came up with the principle of "intrinsic" business value: a measure of a business's true worth that was completely and totally independent of the stock price. Using this intrinsic value, investors could decide what a company was worth paying for and make investment decisions accordingly. (Intrinsic value is discussed in more detail in Chapter 4.)

Graham was a pioneer in driving home to investors the importance of crunching numbers. After experiencing the devastation of the 1929 crash, he sought to develop resilient techniques that could be used by any investor. He popularized the examination of price-to-earnings (P/E) ratios, debt-to-equity ratios, dividend records, net current assets, book values, and earnings growth.

Graham's focus was on objective numbers rather than more subjective things such as management, trends, brand names, and new products. The data he tapped was publicly available, via corporate financial statements and the *Standard & Poor's Stock Guide* (available for free from many brokerages). Coauthored with David Dodd in 1934, Graham's hefty textbook on security analysis is still widely used in business schools. I recommend his more concise work, *The Intelligent Investor*, which Warren Buffett has called, "by far the best book about investing ever written."

PETER LYNCH

From 1977 to 1990, Peter Lynch managed the now famous Magellan Mutual Fund to an amazing 29 percent average annual return. He is also the author of several popular books and appears as a guest speaker and columnist in numerous television programs and magazines. His investment philosophy is simple: Invest in what you know, ignore market fluctuations, and look for companies undiscovered by professional investors.

How do you find companies you can understand? Well, for starters, consider these questions:

- Where do you work and what industry are you or your employer involved in?
- What is your particular area of expertise and what are you good at?
- Do you have hobbies?

There's an old saying: "go with what you know!"

LOOK IN PRACTICAL PLACES TO DISCOVER PROFITABLE OPPORTUNITIES

Many investors are interested in selecting individual common stocks (or if you are an angel investor, individual companies) for their portfolios. However, they aren't sure where to begin their search. Here are suggestions for some practical places to find investment opportunities for your portfolio.

Check Out Standard & Poor's (S&P) Large-Cap, Mid-Cap, and Small-Cap Guides. Each year, S&P releases three financial guides containing historical data on the selected companies making up its small-cap, mid-cap, and large-cap indexes. The reports are two pages and include the full company name, ticker symbol, industry, contact information (including phone numbers and Web addresses), dividend records, officer listing, and business summary. As an investor you might want to ignore the buy, sell, or hold recommendation S&P attaches to each of the reports; instead, begin your career as a research analyst and portfolio manager and do your own research. For starters, begin by looking at the growth in earnings, debt levels, and the return on equity rates for the past several years. (I discuss this more in Chapter 4, on fundamental analysis.)

Take out a scratch pad and write down the name and ticker symbol of all companies that look interesting to you. Your list of investment ideas will probably reveal a lot about your area of expertise and particular investment approach. Call each company's investor relations department and request information or order its annual report online from the company Web site. Combined, the three guides contain information on 1,500 companies, providing enough investment ideas to keep you busy for some time.

Browse the Value Line Investment Survey. The Value Line Investment Survey (see at www.valueline.com) is one of the most convenient ways to access data and historical figures on hundreds of companies in only a few minutes. Investors can purchase a subscription in either print or electronic form. If you can't afford the $500+ subscription price, take a trip to your local library. More likely than not, it maintains a subscription. You can read the reports for free and copy only the ones that meet your criteria.

For example, I am a native of Detroit, Michigan, and I discovered a little company in my own backyard (Kalamazoo, Michigan) a few hours from my hometown using Value Line. The company is Stryker Corporation (NYSE: SYK), which develops, manufactures, and markets specialty surgical and medical products that are sold primarily to hospitals throughout the world. However, Stryker is primarily known for making replacement parts for people. If you know anyone who has gotten a hip replaced, it probably came from Stryker. I used to tell people all the time that this business is recession-proof, bombproof and anything else -proof. Why? Because if your doctor tells you that you have to have your hip replaced, are you going to try to negotiate a deal to lower the cost on your new hip? Can I get *two* for the price of *one*? Of course not! You (or your insurance company) are going to pay whatever they tell you it's going to cost.

Stryker has a remarkably diverse product line. In addition to replacement parts, it also makes cement, nails, screws, implants, and more to help injury victims. Then there is its biotech division, which works on harnessing a naturally occurring protein to accelerate bone repair. It also has a line of what is best described as power tools for surgical procedures.

Stryker's management has a long track record of success. CEO John Brown has been running the company since 1977. Since 1984, the stock has only had three down years. Over that same time period, it has outperformed the S&P 500 by an average of 24 percent per year. These are all great things, but we are looking in the rearview mirror. Looking forward, Stryker is poised to continue benefiting from longer life expectancies due to generally healthier lifestyles and medical innovation. This clear demographic trend is fueling revenue growth and will benefit many health-care stocks, Stryker included.

Stryker distinguishes itself relative to both its peers and all publicly traded companies. Its earnings rank, according to the financial newspaper *Investor's Business Daily* (IBD), is 96 (out of 100). This ranking means that Stryker's three-year earnings growth rate of 26 percent is better than 96 percent of the IBD 6000 (an index of 6,000 publicly traded companies). The company is anticipated to grow earnings by 21 percent in 2004 and 20 percent in 2005. Its revenue growth, gross margins, and operating margins all exceed industry averages. Stryker also has cash equal to three times its debt.

All of this translates into superior returns for shareholders. Since 2004, shares climbed from a low of $62.95 to recent near-$90 levels. This stock has always been a core holding in my portfolios.

Take a Trip to the Mall or Grocery Store; Observe Your Everyday Surroundings. Why not take a trip to your local shopping mall and scout out the stores to see what is popular? Pay attention to where your kids want you to take them for back-to-school shopping. As you go about your daily life, take note of the products you see people using. Peter Lynch, the former portfolio manager of Fidelity Investments' Magellan Fund and one of the most successful money managers in history, got some of his best investing ideas from listening to his wife and kids after they came back from running errands. In fact, Lynch bought stock in Hanes after his wife brought home a new product the company introduced—L'eggs® pantyhose she discovered while in the checkout line at the grocery store. The investment made millions for Fidelity.

Grab a pad of paper and observe your everyday surroundings. Make a list of the name-brand products you come across—products such as Odwalla, Coca-Cola, Power Bar, Wrigley's gum, Starbucks, and Hershey's chocolate. I would even suggest making a list of brands that are popular and selling well in stores because these may be produced by private companies that might be public companies later. In recent times, such was the case with Starbucks, which was a privately held company that became a public company.

Consider each item a potential investing idea. Inspect the packaging to find the name and address of the manufacturer. Search the

Internet or call the number provided and ask if the company is publicly traded (meaning you can purchase shares of stock in it). If it is, tell them you would like to request an investor's package or kit that will include the annual report and other relevant information about the company. In most cases, they will transfer you to the investor relations department. Give them your name and address, and they will mail you a copy of the package free of charge.

For example, JAKKS Pacific is one such company I discovered a few years ago while looking for gifts during Christmas time. JAKKS Pacific, Inc. (Nasdaq: JAKK) is a multiline, multibrand toy company that designs, develops, produces, and markets toys and related products. JAKKS focuses its business on acquiring or licensing well-recognized trademarks and brand names with long product histories. Its products are toys and accessories that include action figures and accessories; craft, activity, and stationery products; child-guidance, infant, and preschool products; seasonal toys and leisure products; toy candy; electronics products; junior sports products; and fashion and minidolls and related accessories.

In addition to developing its own proprietary brands and marks, JAKKS licenses brands such as World Wrestling Entertainment (WWE), Nickelodeon, Rugrats, Dora the Explorer, Blue's Clues, SpongeBob SquarePants, Mickey Mouse, Winnie the Pooh, Kim Possible, Finding Nemo, and Hello Kitty. It also licenses technology produced by unaffiliated inventors and product developers to improve the design and functionality of its products.

JAKKS can be a very cyclical company—its price can move up or down depending on the success or failure of a company. That instability doesn't mean you don't consider the investment. You just need to know *when* to invest. When the stock is down, look to purchase and, possibly, sell later when the price is up. Or when the stock is up, look to do a short sale on the anticipation that the stock price will drop and you can profit on the decline of the stock. (I provide an example of a short sale in "More Than Just a Glossary" at the end of this book.)

Another company that tends to be very cyclical like this is Pixar (Nasdaq: PIXR), whose stock price tends to go up when a successful movie debuts and will drop once the movie has lost its excitement—a good thing to know whether you are a long or short investor.

Ask Your Friends and Family. Peter Lynch, one of the greatest mutual fund managers of all time, claims he got several of his best investment ideas from his wife and children. In addition to the aforementioned lucrative investment in Hanes, Lynch also investigated a particular store after his daughter furnished her entire back-to-school wardrobe with its clothes.

An example from my personal experience comes from when I was growing up in Detroit. There was an amusement park called Cedar Point, located on Lake Erie between Cleveland and Toledo in Sandusky, Ohio. It was only a few hours' drive from Detroit, and every summer we kids would always look forward to going because it consistently built taller and faster roller coasters. Sure, it had many other rides—but it was the roller coasters that kept us coming back. Cedar Point is world famous for its roller coasters. Its parent company is Cedar Fair, L.P.

Cedar Fair, L.P. (NYSE: FUN) owns and operates seven amusement parks: Cedar Point; Knott's Berry Farm, located near Los Angeles in Buena Park, California; Dorney Park & Wildwater Kingdom, located near Allentown in South Whitehall Township, Pennsylvania; Valleyfair, located near Minneapolis/St. Paul in Shakopee, Minnesota; Worlds of Fun in Kansas City, Missouri; Michigan's Adventure near Muskegon, Michigan, and Geauga Lake, located near Cleveland, Ohio. The parks are family oriented, with recreational facilities for people of all ages, and they provide clean and attractive environments with rides and entertainment. Cedar Fair also owns and operates separate-gated water parks near San Diego and in Palm Springs, California, and adjacent to Cedar Point, Knott's Berry Farm, and Worlds of Fun. The company also operates Camp Snoopy, a seven-acre indoor amusement park at the Mall of America in Bloomington, Minnesota.

For years, Cedar Fair has been a core portfolio holding of mine. Why? One of the main reasons is the consistent dividend it pays. It may seem odd to find consistency in an amusement park operator. Between the ups and downs of the cyclical travel industry and disposable income levels, one might expect a wild ride. We've all heard Disney (NYSE: DIS) cry "uncle" and Six Flags (NYSE: PKS) whine about its heavy debt burden when the economy isn't smiling just right. Why then, has fellow operator Cedar Fair seemed to move forward in good times and bad?

When Cedar Fair sees a wall of worry, it simply builds a new thrill ride with which to scale it (usually a "bigger, badder" roller coaster). This year it raised its quarterly distribution to $0.45 a unit. At the time of this writing, that gives the tax-advantaged limited partnership a yield of 5.2 percent—a winner in my book.

At this rate, Cedar Fair will have raised its distribution for 17 consecutive years. And readers of this book will know all about the beauty of buying into a company that perpetually hikes its payout. In fact, Cedar Fair has raised its quarterly payout 13 times over the past 10 years. Sure, the hikes appear petty at first glance; however, over that decade, the distributions have grown by 80 percent. Compare that to fixed income investments with flat payouts or money market funds with their paltry interest in recent years.

I never would have known about Cedar Point had it not been for family members who took me there as a child (thanks, Mom!) and let me ride the roller coasters. Because of its location (the Midwest), it was only open from April to September. But every day it was packed, and we would wait in long lines just to ride those roller coasters. I cannot remember what ticket prices where then, but they weren't cheap. So when I became a financial analyst, this was one of the first companies that I decided to research. In addition, during my research, I found that Cedar Fair had all the signs of a good investment—including great management. In addition to the dividend, as a stock this company has performed extremely well. Hey, with a ticker symbol like "FUN," you can't miss!

Attend Investment Conferences. All major investment banks have conferences that are open to many people. The investment community is invited, too, including financial analysts and portfolio managers. It's their way of introducing new client companies and keeping the investing public informed of the firm's current clients. You have to be a client of the firm to attend. So if you are not, ask a friend who is to invite you as a guest.

Investment conferences are not only great places to find ideas, but they are also great places to check up on the ones that you have already invested in. All of the major investment banks have them: Goldman Sachs, J. P. Morgan, Merrill Lynch, and so on. They put them on to highlight new companies and give current investment banking clients a chance to update the investment community. I attend these conferences regularly to find new ideas and stay on top of the ones that I currently own.

For example, Helix Technology (Nasdaq: HELX) was a company I discovered at an investment conference, though in an indirect way. One of the methods I use to discover new investment ideas is to ask other companies who their suppliers are and which ones they would invest in. Applied Materials (Nasdaq: AMAT) is a leading semiconductor capital equipment company and a mainstay at most technology conferences. At one such conference, one of its investor relations guys told me about one of its suppliers, Helix Technologies.

Helix Technology Corporation is a global leader in the development and application of innovative solutions in the field of vacuum technology. In addition to Applied, Helix is a major supplier to the semiconductor capital equipment, data storage, and flat panel display markets. At the time, it had little or no Wall Street following, but what stood out about this company was its being a technology company paying a dividend (that's what got my attention), something most technology companies don't do because the money usually goes back into the company for research and development. In addition to paying a dividend, the company has sound management and a product that has a niche in the marketplace, two more attractive features.

Helix falls under the classification of a small-cap stock, because its market cap is between $250 million and $1 billion. I have bought and sold this company several times over the past several years and I have been very successful in achieving positive returns each time.

Look at What Sell-Side Analysts Are Recommending. Most larger brokerage firms and investment banks have sell-side financial analysts who cover particular stocks and industries. Brokerage research departments publish monthly reports on many stocks, bonds, and other financial products. If you have an account with a firm, your broker can often provide you with copies of these research reports. Analysts are among the brightest people on Wall Street but they have difficult jobs. Their work, for the most part, is good. However, they too often are restricted to following only those larger companies that their own brokerage firms underwrote initially and are continuing to advise. The Internet is also a great place to find what sell-side analysts are recommending. I don't recommend buying a stock just because they recommend it, but again it's a good place to get ideas.

Why Analysts Rarely Give Sell Ratings

Think back a few years, and you'll remember some media hype about how a few stocks had been given "sell" ratings by Wall Street sell-side analysts. This discovery was part of a multifaceted scandal that led to some major reforms. One statistic shared was that fewer than 1 percent of stocks were rated "sell" by brokerage firm analysts. But surely 99 percent of stocks weren't that healthy, right? The widely accepted explanation was that the analysts were positive about most companies because either the firms were already clients of the brokerage's investment-banking division, or they someday might be.

That made sense at the time, and still does, at least to some degree. But recently, one former Wall Street sell-side analyst whistle-blower offered other explanations. He noted that both independent research firms and brokerages alike are still slapping few companies with "sell" ratings—significantly fewer than 10 percent, in many cases—for these reasons:

- First, selection bias. Because most investors invest long (i.e., they don't "short sell" companies) and most research houses cover only a subset of all the stocks in existence, it makes sense that analysts would focus on the healthier firms, which are less likely to command "sell" ratings.
- Next, sometimes ratings are relative. He opined that when an entire industry is ailing, it does little good to rate all the component firms "sells." Instead, it's helpful to give positive ratings to the healthier firms in the group.
- Analysts are, like many people, impressionable and psychologically predisposed to be influenced by the crowd. If their peers are positive, they may be as well.
- If the prevailing winds are positive, it can be extra risky to be negative. So even if you're wrong, it can be safer to stick with the popular opinions. (Wall Street is suddenly seeming a lot like high school, isn't it?)
- Being negative on a stock can lead to the company cutting off communications with the analyst, which can harm further analysis.

So what do you do now? Well, I said it before, and it still makes sense to me: Go ahead and read analysts' reports—but focus on all the words (and numbers) except "buy," "hold," or "sell." In other words, ignore the ratings, but consider the information.

And thanks to recent reforms and scandal settlements, there is more analyst research on stocks available than ever, much of it free from your brokerage. Brokerages such as Morgan Stanley (NYSE: MWD), Merrill Lynch (NYSE: MER), Ameritrade (Nasdaq: AMTD), and E*TRADE (NYSE: ET) offer plenty of free research to their customers. Contact your brokerage to see what it offers.

Read Newspapers and Magazines. Most investors use the newspaper to check on stock, bond, and mutual fund prices and other information. Most papers in large and mid-size cities have a financial page that reports prices on most financial products. The *Wall Street Journal*, *New York Times*, and *Investor's Business Daily* provide more detailed information on weekdays. *Barron's* (comes out Saturdays) gives an extensive end-of-the-week review of financial markets. *Barron's* is highly recommended for those who like to do weekend investment research.

Some major financial and business magazines investors can choose from are *Forbes*, *Financial World*, *Fortune*, *Bloomberg*, and *BusinessWeek*. *Bloomberg*, *Forbes*, and *Financial World* concentrate more on finance and investments. The other publications are geared for business information with fewer investing articles. Other publications for the mass market of investors include *Money* and *Kiplinger's*.

Watch Television. Television used to pay little attention to business, but this inclination changed in the 1980s. Now, investors can get Financial News Network (FNN) and CNBC, with price updates, interviews, and other financial topics. Avoid the commercials offering speculative "get rich schemes" in penny stocks, commodities, metals, art, and other high-risk stuff. Especially avoid coins that offer perhaps $10.00 worth of gold or silver at a "limited special one-time price of $100" and a limit of "only ten to a customer!" They will sell you $10.00 worth of gold for $100.00 for as long as some people are gullible enough to buy.

The *Wall Street Journal* offers an excellent program syndicated on cable TV; so does CBS Marketwatch. CNBC has *Wall Street Week with Louis Rukeyser*, a show that has outstanding guests. At the end of each weekday, the *Nightly Business Report* (*NBR*) carries an excellent synopsis of business news, the market, and global economics. Reuters news agency, which offers some of the finest financial information in the world, assists *NBR* in getting information for each show. I also like Bloomberg Television; Bloomberg is among the finest financial information sources in the world and if you are fortunate enough to have access to a Bloomberg terminal—they are costly but loaded with information for fundamental research and news—you can actually watch via your computer if you don't have the show in your area. Check out www.Bloomberg.com

Attend Angel Investor Group Meetings. In the San Francisco Bay Area where I live, there is an organization called the Keiretsu Forum.

(There are a few others as well: The Bay Area of San Francisco is a hotbed for angel investing groups.) It is an organization of wealthy accredited investors that meet regularly to interview private companies for potential investment. There are organizations like this all over the country. They provide an excellent way to see private companies up close and personal. There is usually a fee required to attend. These meetings are usually only for accredited investors who are interested in adding private companies to their portfolio. However, some of these private companies may one day become public.

Conclusion

Managing your money like a professional portfolio manager can be a daunting task. Yet it is an achievable goal. You are just getting started. I have covered some basics here in the first chapter to get you thinking like a professional money manager would; now, let's move on to learning how to read financial statements so you can make investing decisions like a pro.