CHAPTER 1

Introduction to Buy-and-Hold

I started dabbling in the markets by researching companies using their annual reports. I pored over the numbers and checked the ratios to make sure the company would not fold anytime soon.

In those days, I learned to love cash dividends and stock dividends as well. They added to the bulge in my wallet and slowly increased my net worth one share at a time. During the bull market of the 1980s, I had a win/loss ratio of 63 percent and made an average of 39 percent per trade. I achieved that without knowing what I was doing.

For example, I bought a stock called Sparton Corp. This was a wonderful stock that never heard of going up while I owned it, but it paid a huge dividend. That is, until they stopped paying it! I bought it three times and lost 23 percent, 39 percent, and 53 percent of my money.

I grew to mistrust the method of holding a stock forever (well, 3.6 years was my average hold time for stocks bought in the 1980s). I was tired of seeing a stock like ASA Holdings (acquired by Delta), which I bought four times in the late 1990s at an average price of 23.36, more than double to 51 and then drop to 34 before I sold it.

Nevertheless, I still like investing, which is a synonym for buy-and-hold. You can make a lot of money with little work. The hardest part is ignoring the daily rollercoaster movements of the market.

As I mentioned in *Trading Basics*, Chapter 2, under "Hold Time: My Trades," my best hold time is between three and four years. Research a company, buy the stock, and then hold it until it realizes its full potential. Then sell it.

WHAT IS BUY-AND-HOLD?

You probably know what buy-and-hold means, but let me tell you how I define it. If I buy a stock with the intention of holding it for years, then that is a buy-and-hold position. I expect bumps along the way, such as a quarter or two of weak earnings, but I am focusing on their long-term potential for growth.

Despite the name, I do not interpret it as buy-and-hold *forever*. Buy-and-wait is a better description. My guess is that I will never hold a stock as long as I did Michaels Stores. Some of those shares I bought in 1990 and sold in 2006 when the company went private. Now, my inner voice—call it the voice of experience—sees that I have doubled my money and will want to capture profits before a dead-cat bounce pattern takes away 70 percent of it in one session.

Often that voice speaks only after the stock has given back too much from a peak, such as in the case of Interface (IFSIA), where I sold 25 percent below the high, or Steelcase, down 26 percent. In fact, I thought we were sliding into a bear market in July 2010 and sold over half of my portfolio in a flight to cash.

I was wrong.

The market bottomed and then went on to new highs. I am more sensitive to price fluctuations because of the recent 2007 to 2009 bear market, especially when I have good gains.

I began concentrating on buy-and-hold positions because I found it more difficult to make money by short-term trading. That was in 2007, just months before the bear market started. Big mistake. Fortunately, it took only nine months after the bear market ended to recover my losses.

That brings up an important question: Who should buy and hold?

WHO SHOULD BUY AND HOLD?

Trading Basics, Chapter 2, "A Better Way? Portfolio Composition," discusses my thinking about diversification. Build a core portfolio of stocks from the buy-and-hold category and pepper it with other trading styles that fit your needs, such as swing trades or position trades. Diversify your holdings not only by industry, but trading style as well. That way, when the market favors swing trading over other styles, you will have positions ready to take the lead to greater wealth.

This guidance applies to day traders, too. I have heard that day traders tend to burn out after several years of trading (four years comes to mind, but I do not know if that is true). The constant pressure to perform each day coupled with lack of exercise and inability to relieve stress tends to fry the adrenal system. Having buy-and-hold positions available in which to place excess cash will create a cushion if the pressures of day trading become too much to bear. Swing and position trading can give the day trader a more relaxed ride in which to recover while still having the emotional feel of being in the game.

Regardless of your trading style, consider adding to your portfolio positions held for the long term. These are not buy-and-forget positions, but they need not require constant attention, either. Think long-term growth.

MY NUMBERS: BACKGROUND AND TERMS

In the pages that follow, I use almost a thousand stocks covering the period from 1992 to 2007. Not all stocks covered the entire period and dividends were not included unless noted otherwise. The test period includes the 2000 to 2002 bear market.

I refer to year 0 through year 5. Year 0 refers to the first year in which fundamental data and prices for a particular stock were available. It serves as the base year in which other years are compared. Year 5 is the last year. Year 0 through year 5 use the closing price at year's end.

Since I use 16 years worth of data but present only a five-year-wide window, the analysis uses data like a moving average. I use the fundamental number from the new year and drop off the old year. Year 1 becomes year 0, year 2 becomes year 1, and so on in a series of overlapping years as the five-year window slides from 1992 to 2007.

In this manner, each year 0 has the opportunity to see how price behaves during the next five years.

I am sure that none of this makes much sense and you may be asking, "Who cares?" but that is fine. When I start discussing tests, it will become clear and you will understand my thinking.

NOW WHAT?

If technical analysis tells you what will happen in the short term, fundamental analysis tells you what to expect in the long term. Both are useful tools for making money, but a brief review of important fundamentals will help when selecting companies to buy and hold. Those chapters follow.

Even if you are a day trader, some of the discoveries discussed in the coming chapters are worth learning. They may help you select stocks to trade. They may spark a new avenue of investigation that may well send you on a path to greater riches.