ADVFN Guide: A Beginner's Guide to Value Investing

by Clem Chambers

Sample Chapters:

Investing: How To Get Started

Most people think that investing in stocks and shares is a risky game only played by rich people and gamblers.

From the outside it seems it's hard to know how to make money investing in stocks. There are so many stories about people who lose their shirts.

This is true and false depending on what you set out to do.

Investing is not hard but trading shares is nigh on impossible.

Most people confuse the two things: trading is not investing and vice versa.

Trading is very close to gambling and, like betting on horses, it is extremely difficult to make a profit from that kind of activity.

Investing, on the other hand, is quite boring and the more boring you can make it, the better.

Investing is not hard. Making money by investing is not that difficult, but it takes effort.

There are many trading schemes, none of which I'm aware are much good at making money.

There are quite a few investing strategies and most will make you money. The simplest and the most tried and tested is value investing.

Value investing as a method was laid out clearly for the first time by an American professor called Benjamin Graham in the 1950s and one of his students, Warren Buffett, used it as the basis for his career in which he has become the richest man in the world.

Value investing is at its heart simple: buy cheap stocks then sell them when they are not cheap any more.

While value investing won't make you the richest person on the planet, it is a platform for good investment profits. The basics can be potted down into a set of simple straightforward methods.

I have followed the principles of value investing for many years and it has always given me excellent profits.

Apart from excellent profits, one key benefit of value investing is that it doesn't stress the investor out. Done properly it is a comfortable way to take risks with your cash.

Most stock market trading and investing ideas are packed with stress and even when these systems are doing well, anyone following such ideas can be put through the emotional wringer. This emotional price is simply not worth paying for most people; it burns them out and dulls their desire to be involved.

The low stress level of a sensible investing strategy is a sign that the investment style you are following is a solid one. Investing should not feel like war, it should just be a normal working endeavour that takes a certain amount of time and effort. It shouldn't be a battle that keeps you awake at night.

Value investing is and should be quite an easy-going way to make money from the stock market.

Being dull doesn't make value investing popular like trading, but it does mean that those that follow this idea make money year in and year out while traders come and go.

Why Value Investing?

If you wish to double your money very quickly in stocks and shares, you should stop reading this book right now. This book is about getting rich slowly, not quickly.

Over twenty years value investing will build wealth, but you will not be rich from it in a couple of years.

A lot of people that trade the markets want to get huge profits, 100% or more in a year. This is basically impossible even if it might seem on the face of it achievable.

You have as much chance of doubling your money every year for three years as hitting a jackpot at Vegas.

To the nearest percentage there is no chance of earning gains like 100% a year from shares and if someone does, they have been very lucky and are not responsible for their good luck. Anyone reading this who has achieved such gains should close their positions now, pile their money up on a table and count it out before putting it back into the market. It will be a good opportunity to kiss their money goodbye. Luck or 'one way' markets that provide such profits do not last.

Value investing is a technique that when combined with the simple basics of investment provides a basis for building up wealth, with a lot less anxiety than the other investment strategies out there.

Its sixty year history is alone a strong recommendation that value investing works and will keep on working.

Other ideas have come and gone, yet value investing keeps on going.

One of the reasons for this longevity is that value investing requires discipline and some work. It is rather boring and unflashy.

This is a benefit but for many it is a drawback. People are drawn to risky games—and the stock market is considered risky—and they like excitement and kudos. These 'punters' want to make quick money because they have a gambling streak.

Value investing does not satisfy the gambling urge very much as it is quite drab, rather unexciting and takes regular maintenance. Gamblers want minimal work and plenty of sensation.

Value investing is like gardening, just the sort of thing that gamblers aren't interested in.

Consequentially value investing is never in fashion. However, because it makes money, it is never out of fashion either.

Most investors know they should be value orientated but few can resist the enticing whirligig of trading and the glamour of go-go shares.

This is understandable.

People simply can't resist the lure of the casino either.

Why else would people pour their money away on simple games like roulette, when they have worked so very hard earning the money in the first place? It is because people love noise, thrills and flashing lights. They get hypnotised by them. Many shares in the stock market are like casino games and the city has learnt long ago that most of their potential customers don't want sensible profits; they want the lure of riches and a gambling high.

Sadly greedy gambling kills in the stock market—or at least costs the player a bundle.

Meanwhile, diligence pays.

This is why value investing works. The market has to pay investors a good return to own boring out-of-fashion shares. Prices of unloved companies fall until they are so cheap that smart investors can’t resist buying them. At some point this unpopularity goes into reverse and those that bought in cheaply make good returns.

If I turn that idea around you will quickly see why so many investors lose money.

The reverse situation is that people buy fashionable stocks that everyone loves. Clearly at some point the price of the share rises so high that people can’t resist taking their profits. At this point everyone who can buy has already bought and therefore the share price must fall. When the company’s share price falls it suddenly becomes less popular as holders start to lose money. Losses are made by everyone. As the price falls so the company gets more unpopular until no one wants to own it. After several rounds of this the share becomes ignored and cheap.

Enter the value investor.

The fundamental principle of value investing is the simplest: buy low, sell high. I like to say buy cheap and sell ‘not cheap.’

The rest of this book is about how to do just that. Value investing is not a great deal of fun, it is not very exciting, but it will make you money. You can spend the profits later on fun exciting things.

(NB. Actually I think value investing is great fun, but I am probably weird. Hunting out value is an amusing challenge. You feel like a bit of a Sherlock Holmes weighing all the evidence and once you are confident in your skills it’s amusing to note people unable to grasp simple facts that make the profit potential of a stock significant. However, I know as the CEO of ADVFN, one of the biggest share information websites in the world, that I am in a very small minority. It is like being a bird watcher rather than a football spectator. Market theory suggests this is yet another reason why value investment is so profitable. Few apply its rules.)

Searching for Companies

The key to value investing is finding companies that are cheap. That means looking for them. this might seem obvious but most people do not look for stocks, they listen to tips.

It is a mistake to take tips. Taking tips is the same as throwing your money down the drain.

Simply, never take notice of tips. At worst, use tips as a starting place for your research. If you will do that you will find that tips do not fit your criteria ninety-nine times out of a hundred.

It gets worse: if a tip makes you money—and few will—you won't have earned it and will have learnt nothing; it will be the financial equivalent of a snack on junk food. If you lose your money—and you very likely will—you will most likely lose a friend.

Just say no to tips and start looking for shares yourself.

Stock picking is all about developing the skill of searching for, identifying and monitoring stocks.

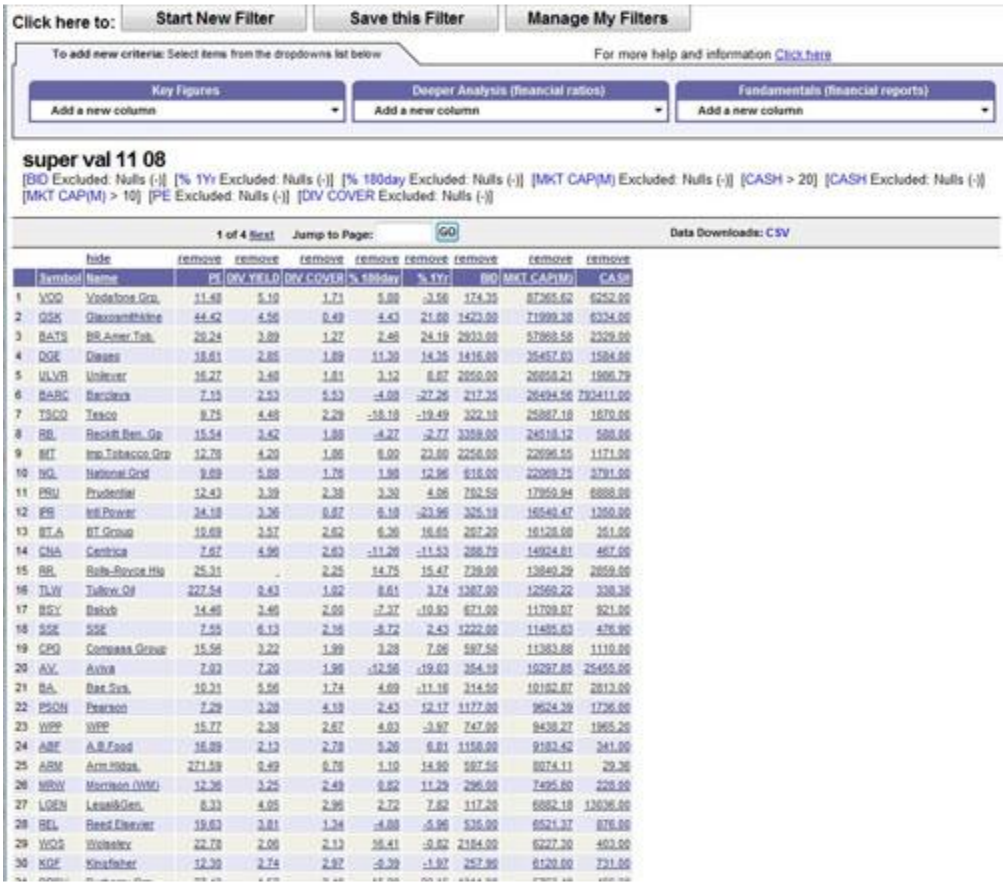
A few years back this would be a long, tedious and frustrating job. Good information on shares was really hard to find and when you found such data, it was expensive and after you bought it, it was very laborious to sieve through.

Thanks heaven for the internet and more particularly ADVFN.

I run ADVFN and I use it for all my investing. As such I'm not going to list all the many other places to go and find share information. ADVFN does the job for me.

Sites like ADVFN give you share information resources that in the 1990s would have cost you many thousands of pounds a year and in some cases tools that were simply not available.

This screenshot is for ADVFN's FilterX, which is an ultra-powerful tool to select, grade, sieve and separate shares on the stock market out of a universe of more than 2,000 in London alone.



Click here to: Start New Filter | Save this Filter | Manage My Filters

To add new criteria: Select items from the dropdowns list below — For more help and information Click here

Key Figures: Add a new column | Deeper Analysis (financial ratios): Add a new column | Fundamentals (financial reports): Add a new column

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[BID Excluded: Nulls (-)] [% 1Yr Excluded: Nulls (-)] [% 180day Excluded: Nulls (-)] [MKT CAP(M) Excluded: Nulls (-)] [CASH > 20] [CASH Excluded: Nulls (-)] [MKT CAP(M) > 10] [PE Excluded: Nulls (-)] [DIV COVER Excluded: Nulls (-)]

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	Symbol	Name	PE	DIV YIELD	DIV COVER	% 180day	% 1Yr	BID	MKT CAP(M)	CASH
1	VOD	Vodafone Grp.	11.48	5.10	1.71	5.88	-3.56	174.35	87365.62	6252.00
2	GSK	Glaxosmithkline	44.42	4.56	0.49	4.43	21.88	1423.00	71999.38	6334.00
3	BATS	BR.Amer.Tob.	20.24	3.89	1.27	2.46	24.19	2933.00	57868.58	2329.00
4	DGE	Diageo	18.61	2.85	1.89	11.30	14.35	1416.00	35457.03	1584.00
5	ULVR	Unilever	16.27	3.40	1.81	3.12	8.87	2050.00	26858.21	1986.79
6	BARC	Barclays	7.15	2.53	5.53	-4.08	-27.26	217.35	26494.56	793411.00
7	TSCO	Tesco	8.75	4.48	2.29	-18.18	-19.49	322.10	25887.18	1670.00
8	RB.	Reckitt Ben. Gp	15.54	3.42	1.88	-4.27	-2.77	3358.00	24518.12	588.00
9	IMT	Imp.Tobacco Grp	12.78	4.20	1.86	8.00	23.80	2258.00	22696.55	1171.00
10	NG.	National Grid	9.69	5.88	1.76	1.98	12.96	618.00	22069.75	3791.00
11	PRU	Prudential	12.43	3.39	2.38	3.30	4.06	762.50	17950.94	6888.00
12	IPR	Intl Power	34.18	3.36	0.87	6.18	-23.96	325.18	16540.47	1260.00
13	BT.A	BT Group	10.69	3.57	2.62	6.36	16.65	207.20	16128.08	361.00
14	CNA	Centrica	7.67	4.96	2.63	-11.26	-11.53	288.79	14924.81	467.00
15	RR.	Rolls-Royce Hlg	25.31	.	2.25	14.75	15.47	739.00	13840.29	2859.00
16	TLW	Tullow Oil	227.54	0.43	1.02	8.61	3.74	1387.00	12560.22	338.38
17	BSY	Bskyb	14.46	3.46	2.00	-7.37	-10.93	671.00	11709.07	921.00
18	SSE	SSE	7.55	6.13	2.16	-8.72	2.43	1222.00	11485.63	476.90
19	CPG	Compass Group	15.56	3.22	1.99	3.28	7.06	597.50	11383.88	1110.00
20	AV.	Aviva	7.03	7.20	1.98	-12.56	-19.03	354.10	10297.88	25455.00
21	BA.	Bae Sys.	10.31	5.56	1.74	4.69	-11.16	314.50	10182.87	2813.00
22	PSON	Pearson	7.29	3.28	4.19	2.43	12.17	1177.00	9624.39	1736.00
23	WPP	WPP	15.77	2.38	2.67	4.03	-3.97	747.00	9438.27	1965.20
24	ABF	A.B.Food	16.89	2.13	2.78	5.26	6.81	1158.00	9183.42	341.00
25	ARM	Arm Hldgs.	271.59	0.49	0.76	1.10	14.90	597.50	8074.11	29.38
26	MRW	Morrison (WM)	12.36	3.25	2.49	0.82	11.29	296.00	7495.80	228.00
27	LGEN	Legal&Gen.	8.33	4.05	2.96	2.72	7.82	117.20	6882.18	13036.00
28	REL	Reed Elsevier	19.63	3.81	1.34	-4.88	-5.96	535.00	6521.37	876.00
29	WOS	Wolseley	22.78	2.06	2.13	16.41	-0.82	2184.00	6227.30	403.00
30	KGF	Kingfisher	12.30	2.74	2.97	-0.39	-1.97	257.90	6120.00	731.00

There is one for US and Canadian shares too. If you know what kind of company you are looking for, FilterX can drag those shares out of the pack in a matter of minutes rather than through hours of manual paperwork work.

It a real boon.

The internet is the best thing to happen for the private investor, period, and the funny thing is, most share traders couldn't care less about the facts and figures on the shares they follow, they want tips. They want to get rich quick.

Sadly instead they get poor fast.

On the other hand, professional investors use tools like FilterX, so the select group of conscientious private investors are in a small segment of the overall market when they use their own research to select stocks, and this puts them at an advantage over speculators who chase tomorrow's big riser or people that follow the research or tips of others.

Another key advantage to value investing is that many companies you will find that meet the right criteria are too small for institutional investors to chase, so you and a few other investors may be the only ones following these stocks. By finding such a stock you are getting in at the ground floor of an upwards move, an advantage that adds to your upside.

Of course, to select a stock you have to have some criteria. Beginners don't have any and in fact might not understand what all the mumbo-jumbo in a company's financial information means.

Don't worry, you would be truly horrified if you knew how few have any clue what many of a company's business metrics actually mean. This is hard to believe, but pretty soon you will note that when you read articles about shares, little is mentioned about the financial figures of the business and when they are, little detail is considered.

This is because it is boring. Boring doesn't sell newspapers or for that matter shares. What sells is hope. Words sell, not numbers. As they say in the US, don't sell the steak, sell the sizzle.

As someone interested in quality steak you can buy it cheap when it's raw.

Few people care about the financial facts, even if that is exactly what they should be watching. This is a part of human nature that gives smart diligent investors an edge.

As a proper value investor you will have your criteria which you will tune over time. You will come up with a few extra rules as you go along and hopefully that will improve your profits further.

It is your criteria and the tools you use that will determine your stock picking; tips will have nothing to say in the matter.

A value investor has a plan and sticks to it.

That plan should be that a share meets a set of criteria and that the criteria must be drawn from the basis of an investment idea. A value investor doesn't have to buy every value investment company that comes along, they should collect the strongest. They should buy the best of the best, a share that stands out.

When deciding to take the plunge to buy a share, remember the gold miners' saying, "If you think it's gold it isn't. If you know it's gold it is."

It also must be remembered that when you start on this journey you may end up with a large group of companies to pick through. Don't worry, there is no rush to buy, tomorrow is as good a day to buy as today or next week.

The stock market will always be full of prospects. What is more, as months pass you will learn about different companies and you will start to know which are good choices and which are risky or hopeless. Over time your skill and knowledge will build, so it is OK to start slow and build slow. Investing is a means to an end not an end in itself. Take your time.