DOW THEORY FORECASTS®
Stock Market Trends & Securities Reports Since 1946

You, too, can be an individual investor

Because institutional investors spend millions on well-credentialed research teams and sophisticated software, many compare do-it-yourself investors to amateurs at a table of professional poker players. Unlike poker, however, investing in the stock market is not a zero-sum game; the positive returns realized by winners do not equal the losses of the losers.

In fact, it is Wall Street's insistence on viewing the stock market as a short-term performance derby — with losing strategies and managers discarded after brief bouts of underperformance — that represents your key advantage as an individual investor.

You don't need to report results to clients every three months; you don't need to convince anybody your strategy is sound; and you don't need to worry about getting fired because of a bad year. As a result, you can focus on what's really important over the long haul: following a consistent strategy.

History suggests there is no shortage of winning strategies; what's in short supply is stick-to-itiveness. As James O'Shaughnessy wrote in *What Works on Wall Street*, "If you use even a mediocre strategy consistently, you'll beat almost all investors who jump in and out of the market, change tactics in midstream, and forever second-guess their decisions . . . Successful investing isn't alchemy; it's a simple matter of consistently using time-tested strategies and letting compounding work its magic."

Our strategy — using the Quadrix® rating system to screen relentlessly for attractively valued growers with superior fundamentals, then doing individual company analysis to determine if Quadrix is telling the full story — is working nicely. We'd like you to mimic our Focus List, Buy List, or Long-Term Buy List exactly, but most important is that you use our advice as part of a consistent approach.

As you plot your strategy, be wary of what passes for conventional wisdom on Wall Street. Particularly dangerous to your cause are the fallacies highlighted below:

You don't suffer a loss until you sell.

Because selling a loser requires admitting a mistake, you may be tempted to hang on to losers and hope for a rebound. Yet holding a stock because it trades below your purchase price makes no sense; the only reason to own a stock is because you like its prospects going forward.

Except for taxes, whether you are up or down on a stock should have no bearing on your decision to hold or sell. In general, tax considerations favor selling losers.

Remember, nobody is keeping track of the winning percentage of your stock picks. The only percentage that matters is the return of your total portfolio, and the best way to maximize that number is to limit your portfolio to your best ideas.

Buying stocks at their highs is foolhardy, as smart investors buy low.

Academic research suggests stocks trading near 52-week highs provide above-average returns. Our own work and that of other researchers have shown that stocks with good six- and 12-month trailing returns tend to deliver superior year-ahead gains. Yet among the most frequent complaints we hear is that we recommend too many stocks at their highs.

On Wall Street as elsewhere, you'll tend to make more money if you're willing to do something others are not. For a variety of reasons, including a fear of feeling foolish, many investors don't like to buy stocks near 52-week highs. Perhaps as a result, buying stocks with strong share-price momentum has been a winning strategy, especially when used in tandem with value-oriented metrics.

Expecting a stock to rally 25% or 30% in a month or two is not realistic, so locking up some profits after such rallies is prudent.

The U.S. stock market's historical annual return since 1926 is about 10%, and you should be dubious of strategies that promise huge returns in short periods. But just as it is dangerous to walk across a river with an average depth of five feet, it is silly to conclude a stock has exhausted its potential because it is up from your purchase price.

The market's long-term average return reflects a huge range of individual stock returns. You may want to sell a big gainer if it no longer represents a good value, but don't sell simply because you don't want to be greedy.

Also, don't sell because a stock has reached your initial price target. Considering a stock's upside potential before you buy is common sense, but don't fool yourself into thinking you know the precise fair value of a stock. If a stock you own rallies (or even if it does not), review it with an open mind and determine if it represents one of your top picks going forward. If it doesn't, sell.

We don't know which of our Buys or Long-Term Buys will go up the most over the next year. We do know we are likely to earn attractive returns — with a few losers and a few big winners — if we stick to our Quadrix-driven, growth-at-a-good-price methodology. Portfolio returns are often driven by big winners and big losers, and selling stocks simply because they are up 25% or 30% is a good way to cap your returns.

Owning the entire market is the only way to eliminate the risk of underperforming.

Many academics define the "market" as the sum value of the shares issued by companies of a country or region, and on this basis a fund based on a capitalization-weighted index like the S&P 500 or Wilshire 5000 does a great job of eliminating the risk of underperformance.

But, when you really think about it, does your portfolio's return relative to the S&P 500 have any impact on the money you'll have available for retirement? No. If you earn 13% per year, whether the S&P 500 earns 11% or 15% is irrelevant.

Because you don't need to worry about getting fired for lagging the "market," you can design your portfolio to maximize returns at an appropriate risk level. You don't need to worry about whether your exposure to energy stocks is high or low relative to the S&P 500. All you need to worry about is whether any energy stocks rank among the most promising stocks available — and how much your energy exposure adds to the risk of a portfolio decline.