Progress Data Services

10 STEPS TO SUCCESSFUL SHARE MARKET INVESTING

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Introduction

Congratulations on deciding to become a professional investor! By using these steps, we hope that you are brought closer to your objective of reaching financial independence.

Some of these steps may seem mundane and simple, but it is often the most simple and apparently obvious ideas that determine the difference between success and failure. The key is to develop a receptive attitude that has you asking questions at every turn. It is suggested that you return to these steps and re-read them again and again. As your experience in the market expands, you will find yourself more appreciative of their significance and you will accelerate your progress towards an in-depth understanding of the problem and its solutions.

Successful investors are those that are the most humble in the market, always willing and ready to learn, and always prepared to abandon pre-conceptions and to think laterally.

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Step 1: Setting of Goals

As a beginner in the share market, you need to ask yourself questions – Where would I like to be in 10 years financially? At what point do I want the income from my investments to be equal to or greater than my monthly salary? It is important in share market investment to set goals. These are the objects of your ambition, the objective that you would like to achieve as a result of your efforts. In order to obtain this desired state, it is imperative that you define these goals. Goals which are not written and specific are just dreams – and dreams usually do not come true. Your goals should be measurable, specific, timeous and realistic. As an investor you want to reach these goals as cost effectively as possible, so that the end result of your initiatives is as profitable as possible.

Most people get up every weekday morning and go to work from nine until five. They get an hour lunch break and between 15 and 20 days leave per year, excluding public holidays. They do this for the best years of their life, usually for as long as 45 years or more. They devote an enormous slice of their life to working for money. And yet they spend little or no time planning their finances and setting financial goals. If asked, such people will say that they do this to “earn a living” – in other words, to make enough money to buy food, clothes, pay for their kid’s education and other necessities of life. But in reality they also harbour a dream of reaching some measure of financial independence. Sadly, very few people have any clear idea of how they will go about it, or how long it will take, or even exactly what they mean by financial independence. And very few achieve it.

Every month pay-day comes, and as soon as that money arrives in your bank account it is gone. Rent, bills, credit card payments, amongst other things, make it impossible to get out of the vicious cycle of earning and spending and earning and spending. Round and around you go in this cycle, never actually making any financial progress – just earning and spending, earning and spending. If you are serious about investing in the share market, you need to get out of this vicious cycle. You need to decide where it is you are going, and then set out specific goals that will help you get there. Because the simple truth is that there are only

two ways to make money in this life – you can work for it, or you can make it work for you. And nobody has ever become rich by working for a salary.

Your ultimate and long-term goal should be to reach financial independence. Your “sub-goals” should be more specific and short term, aiming to get you to this point. But what is financial independence? It is important to quantify the idea of financial independence clearly so that it becomes a concrete and achievable plan within a defined time period. We say that financial independence is that point where you have no financial worries. More specifically, it refers to independence from the need to work. This is achieved when the income from your investments is equal to or greater than your monthly salary. In other words, at the point of financial independence, you will have enough income from your investments to live off of without having to work. To achieve this, there are two things that you need to do:

1. **Save**
   In order for you to build a capital base, you will need to save a portion of your monthly salary. Without this, you have no hope of achieving financial independence, unless you inherit a large sum of money or win the lottery. For most of us, the simple truth is that to acquire a capital base, we need to save for it. Of course, paying off debt is a form of savings, as this reduces the amount of interest you need to pay per month. Avoiding paying interest is the same as earning interest.

2. **Make your savings work for you**
   If your capital base (your savings) is not getting a return of at least the inflation rate, it is in fact shrinking. Therefore the first prerequisite for making your money work for you is to beat inflation. Because of this, it is very important that your capital is invested rather than being swallowed up by commissions and bank charges.

Only by taking full responsibility for your money will you be able to achieve financial independence. You have to choose to be rich. No one is going to take you by the hand and walk you there. This is your decision, and becoming rich is a conscious and deliberate choice.

In order to get your money working for you, you need to:

- Get out of debt
- Begin saving towards a capital base that you can invest and earn an investment income.

So let us put this idea of financial independence into practice:

Let's say that your monthly salary is R30 000, and you are able to save 10% of this towards your capital base per month. You currently have no debt and R50 000 saved, you are expecting to make a 30% per annum return on your money in the stock market, and inflation is 6%.

How many years will it take for you to reach financial independence?

We have entered these figures into our PDSnet Financial Freedom Calculator and come up with the following spreadsheet:

AFTER YEAR 1			
Year	Return	Saved	Total
1	22630	36000	108630
AFTER YEAR 2			
Year	Return	Saved	Total
2	43175	38160	189965
AFTER YEAR 3			
Year	Return	Saved	Total
3	71568	40452	301985
AFTER YEAR 4			
Year	Return	Saved	Total
4	110568	42876	455429
AFTER YEAR 5			
Year	Return	Saved	Total
5	163874	45444	664747
AFTER YEAR 6			
Year	Return	Saved	Total
6	236474	48180	949401
AFTER YEAR 7			
Year	Return	Saved	Total
7	335080	51072	1335553
AFTER YEAR 8			
Year	Return	Saved	Total
8	468717	54132	1858402

So according to this spreadsheet, after only one year of saving 10% of your salary and investing your capital in the share market at 30% per annum (which is very realistic), you will have earned a total return of R22 630, and your portfolio will amount to R108 630. After five years, your portfolio will be worth R664 747. And after only 8 years, the income from your investments will be more than your salary, and you will have reached the first level of financial independence.

Obviously, the more capital you have to start out with, the shorter the amount of time it will take you to reach financial independence. Please visit our website and enter your own personal details into our PDSnet Financial Freedom Calculator (www.pdsnet.co.za) to see at what point the income from your investments will be more than your salary.

Models like this are of course theoretical, however they are very useful when defining and setting goals.

Step 2: Eliminate the Middleman

Once you have managed to save some capital, the next question to answer is "What should you do with it?" There are several large industries waiting hungrily to relieve you of this problem. They make their money out of people's ignorance and fear of investment.

Almost all South Africans invest in shares on the JSE. They just do it through a "middleman" institution such as an insurance company or unit trust. If you find yourself in this position, then you should do some hard thinking about the value that these organisations offer in return for their fees. The companies listed on the JSE are primarily the wealth-generating engines of the economy. If you place a middleman between you and this engine, you will have to pay regular fees. You should at least, therefore, know if the middleman is worth paying.

Endowment Policies

Endowment Policies are policies which have investment as their primary objective rather than life cover. These days most endowments are coupled with life cover to "sweeten" the package (and to obscure the effective return). But you will usually find that you can obtain the life cover on its own for far less. If the company or broker that you deal with cannot offer this, then find someone who can.

Life cover is "term" insurance and contains no savings or investment element. It simply covers you against a risk which you cannot afford such as your death or major disability. This is the true and original function of insurance and it is well worth while. Almost all forms of term insurance are well worth having, especially group life policies.

This opinion is based on common sense. In simplified terms, insurance companies take small amounts of money from thousands or even millions of individuals on a regular monthly basis. They then invest this capital on the JSE in huge lump sums. In a good year they can double their money, and on average over the years they always perform well above inflation. When you reach the maturity date of your policy, they pay you back your investment plus about 15 – 18% compounded – and with the difference they pay their administration costs, the salesman's

commissions and their shareholders' dividends. You can almost always do better by buying blue chip shares directly and holding them.

The only benefit that endowments can purport to offer is security. Your investment is protected against stock market bear trends such as the 2008 bear trend etc. But do endowments really offer a security benefit? Especially when compared to a long-term portfolio of blue chip shares? Definitely not. They can only offer a security in the short-term against a "crash" such as October 1987, but as we have seen, the market generally goes up and recovers from crashes over the medium- to long-term, even in inflation-adjusted terms. In fact, an investment in blue chip shares on 1 January 1987 would, by 31 December 1998, have beaten the performance of any endowment policy, despite the crash.

Some facts to clarify this point:

1. In the history of Liberty Life, never has it been better to buy one of their pure endowment policies than to buy their shares in the open market. At no point in the last twenty years would you have done better with a Liberty endowment policy than with the equivalent value invested in Liberty shares. This applies to all insurance companies.
2. A study by the Sunday Business Times showed that ten-year endowment policies from Liberty Life Commercial Union and Protea Insurance returned 12.13%, 12.26% and 12.96% respectively. The same money used to buy the listed shares of the companies gave returns of 25.26%, 30.83% and 21.42%.
3. R1000 worth of Liberty Shares when they first listed on the stock exchange would today be worth over R10 million – excluding dividends.
4. Endowments also completely lack liquidity. You can be on the phone and sell your Liberty Life shares in two minutes and the money is in your bank within a week. Getting out of an endowment policy is both difficult and very expensive.
5. It was always better to be Donny Gordon's (Chairman of Liberty Life until the 90's) partner than his client.

If an organisation has to send a commissioned salesperson to you to sell you an investment, it is almost certainly a bad investment. No one sent

a salesperson to sell Afribrand shares when they first listed. They were 75 times over-subscribed before they even reached the JSE. If endowment insurance was such a great investment, smart investors would snap it up with no need for salesmen. Here is a great truth:

Excellent investments are always bought, never sold.

Unit Trusts

These days many private investors buy unit trusts. Unit trusts generally offer a better return than endowment policies and do not have the same liquidity problems – for these reasons they are a far better investment. But they still require you to pay considerably higher costs than you would if you had bought the shares directly from a stockbroker. And what do you get for these extra costs? Why are you paying the unit trust company to manage your money? There are several answers to this question:

1. **Management** – most people believe that managers of unit trusts will manage their money more effectively and more profitably than they themselves could. If you are completely ignorant of the share market this is the easy conclusion to draw. And the unit trusts advertise that they have a team of experts who manage the funds with the best information available. But do they really offer a superior return? The only way to judge this is on results – against some kind of benchmark. A person who was completely ignorant of the share market would be forced to choose his or her shares at random. So let us suppose for a moment that you limited your share purchases to the shares which make up the JSE overall index, and that you chose your shares completely at random. You would then expect to perform roughly in line with the overall index over time. This must be true, because the overall index is an average of the shares from which you would be selecting. Now, you would certainly expect a team of professional managers to out-perform such a purely random selection. The JSE overall index therefore makes a good benchmark against which to measure the performance of general equity unit trusts. There would be no point in paying a percentage of your hard earned, after-tax savings to an organisation which could not at least keep

pace with the overall index. It is therefore important that about 80% of unit trusts, here and throughout the world underperform the indexes of the sector in which they compete. And there is no guarantee that the few unit trusts which did beat the index this year will beat it next year. The high probability is that they won't. So you have the same problem in choosing a unit trust that you have in choosing shares on the share market. Only unit trusts are harder to assess because they are comprised of many shares and they keep changing their holdings.

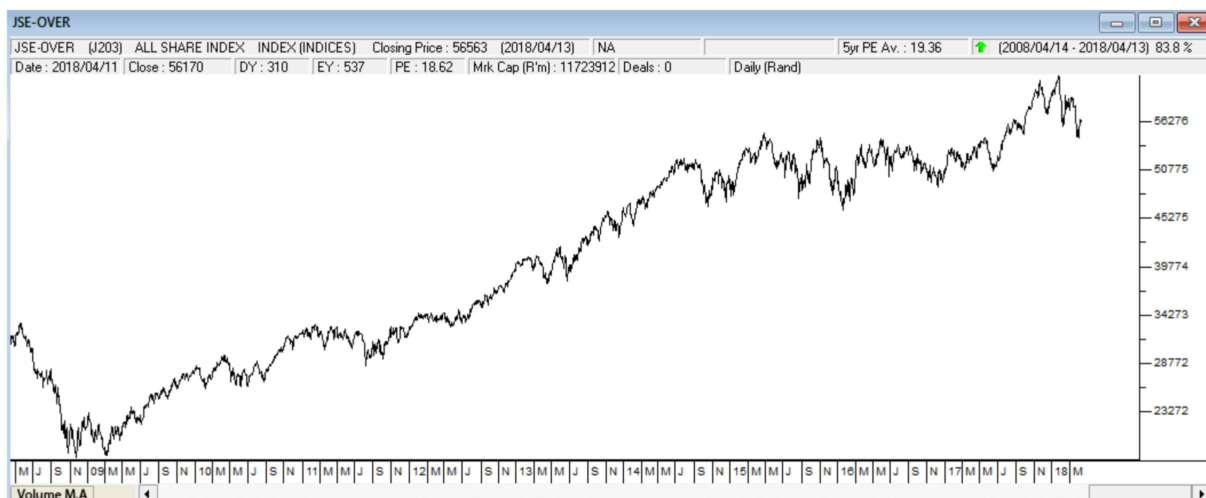
Dow Jones S&P Indices produces the Spiva Scorecard which measures the performance of actively-managed investment funds against their benchmark indexes over one, three and five years. In their most recent report on South Africa (mid-year 2016) the Spiva Scorecard shows that over one year 76% of actively-managed investment funds in South Africa underperformed their benchmark index, over three years 85% underperformed and over five years 86,3% underperformed. Spiva produces these statistics for the US, Canada, Europe, Japan, India, Australia, Latin America and South Africa (https://www.spindices.com/documents/spiva/spiva-south-africa-scorecard-mid-year-2016.pdf). What is interesting about this scorecard is that it clearly demonstrates that you are far better off managing your own money over any time period than handing it to a fund manager in a unit trust, insurance policy or pension fund. After all, why should you pay someone to have an 86% probability of under-performing an average (the benchmark index) over 5 years?

2. **Security** – The second most common reason for buying unit trusts is that they are perceived to somehow offer more security than buying directly into the JSE. After all, they are managed by large financial institutions with well-known names like Old Mutual, Standard Bank and others – surely one's investments are safe with such organisations. The unit trusts have subtly nurtured this idea so that today most people believe that an investment in unit trusts must be more secure than a direct investment in blue chip shares (such as Bidvest, Imperial, Old Mutual or Standard Bank, which is

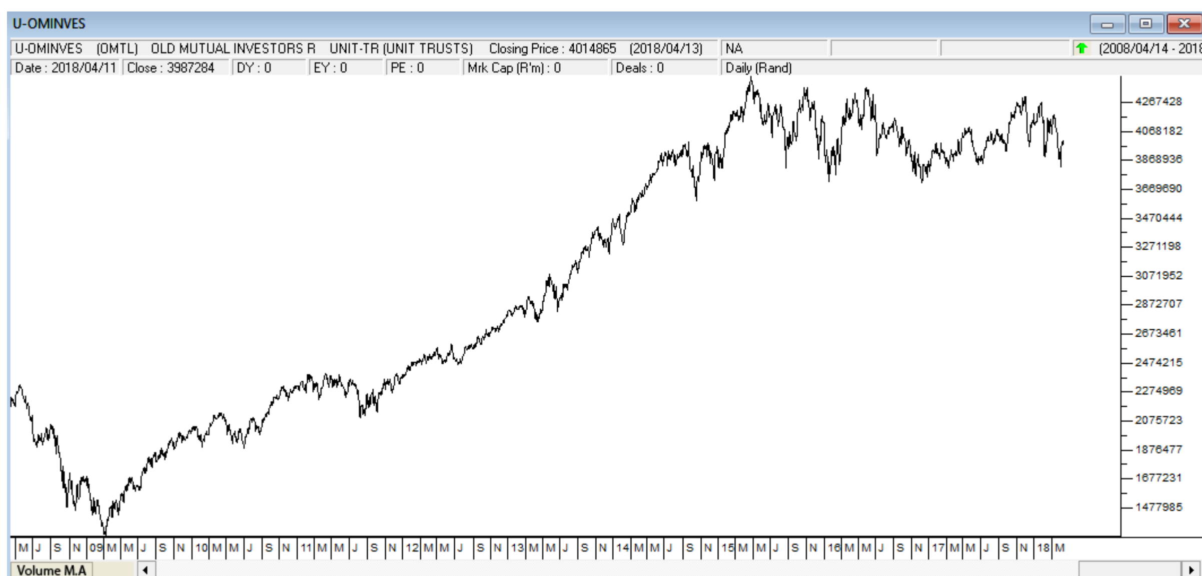
as diversified as any unit trust). There is absolutely no basis for this assumption. A comparison of the chart of any unit trust and the JSE index for the sector in which it is active shows clearly that unit trusts are just as risky as the JSE itself. Old Mutual is considered by many to be one of the best unit trusts, so let us compare the performance of OMI with the JSE overall index over the period from January 2008 until January 2018.

From the two graphs on the next page, you can see that there is very little difference between the price movement of this leading unit trust and the JSE Overall Index. Certainly the unit trust did not protect investors against the 2008 sub-prime crisis or any other dip in the market. The truth is that it would be impossible for them to do so. If, for example, Old Mutual had known of the 2008 bear trend 3 months before it began, it is unlikely that they could have sold more than a very small percentage of their portfolio. The reason? They were holding such a large portfolio of shares at the time (worth trillions of rands) that if they had tried to liquidate they would simply have precipitated the downtrend earlier.
The point is that by buying a unit trust you are in effect buying the index. Your investment will crash when the index crashes and boom when the index booms (although, as we have seen, they usually under-perform the index).

Unit trusts are no more secure than a portfolio of blue chip shares bought directly on the JSE.



JSE Overall Index – January 2008 to January 2018



OMI Unit Trust – January 2008 to January 2018

3. **Diversification** – Protagonists of unit trusts will say that by buying unit trusts you, as the small investor, will be able to diversify and invest in more expensive, better quality shares than he could if he went directly to the market. This is no longer true since with dematerialisation of shares on the JSE there are no penalties for buying small, odd-lot quantities of shares as there used to be. So you can buy 5 shares in Naspers without paying additional dealing costs. Anyway, there is not much benefit to the small investor. If

you only have R5000 to invest, then you also have very little risk (when compared, say, to your annual income) and so your need to diversify to avoid risk is also limited. Your risk increases as the size of your portfolio increases. And as your portfolio increases you can diversify it more and more and purchase better quality shares. Therefore this argument has very little merit.

4. **No-Brainer** – Perhaps the real reason why people find unit trusts so attractive is because they require no thought. Once your stop order is in place you can more or less forget about the whole problem. This philosophy of a "no-brainer" is similar to that suggested by the enforced saving of endowment policies – you are in effect, paying someone else to think for you. But we say that you can only make money from things that you understand well and where you are actively involved. For example, your profession – you make money there because you really understand the work that you do and you are actively involved in it every day. You will make money from the share market when you understand it and when you become involved. You cannot expect to make money from something when you are both passive and ignorant of it. And, remember, nobody cares about your money except you!

Step 3: Understand Your Mental Posture

Your mental posture, when investing in shares, can be your greatest asset. By mental posture we are referring to your emotional and subjective feelings towards the stock market and your investments in particular. It is important when investing in shares to make rational, logical and objective decisions. When you have a weak mental posture, decisions of what to buy and sell and when to do so are governed by your emotions and frame of mind.

But perhaps you don't think that you have an emotional response to your shares?

Let's use an example to illustrate what we mean by mental posture:

Suppose you buy a share for R12 and it falls to R9 within the week. What are you feeling about this? You are feeling worried and a certain amount of cognitive dissonance towards your purchase. You are trying to convince yourself that you still made the right decision, even though the share price has fallen by 25%. You are saying to yourself "I cannot sell the share because then I will lose money", and "I have not lost the money until I sell the share". But of course this is not true. You have lost the money. You just do not want to admit it. By feeling this way, you have made the price that you paid for the share the only important issue about the transaction, when in fact what you paid for the share does not matter anymore. The only thing that matters at this point is whether the share will go up or down.

To demonstrate this concept further, let us suppose that you bought the share for R8 and not R12. You would be feeling completely different if the share price was now R9. The point is that you have become emotional about your share, and instead of admitting that you made a mistake, you are trying to convince yourself with every emotional and subjective argument that you are still going to make money from that share, and that you haven't lost until you sell. The problem is that your mistake could become a very expensive mistake if you do not accept that it was a mistake.

A share is only ever worth what you can sell it for *today* in the market.

Let us use another example, this time referring to the exact opposite situation:

Suppose you are a beginner in the share market. You have come across a share which you want to buy, and you believe you have done all the necessary preparations in deciding it is the right share to buy and that this is the right time – you've read the financial statements and done the little technical analysis which you are familiar with. So you decide to take a chance and invest in this share by taking a small amount out of your savings. And to your delight, the share begins to rise – you are up 25% in just two weeks. So you decide that you have made a big enough profit and sell the share so as not to take any further chances that it might fall in price. Then, to your absolute horror, the share continues to go up in price. First it doubles, and then it triples, and finally it quadruples the profit you made. Every day that it continues to rise you kick yourself for selling out too soon. Finally, you can't take it anymore, and you decide to buy back into the share. Only this time, you aren't going to be so nervous – you are going to use all your savings, and take out a second mortgage on your house. Now you are about to buy a massive amount of a share after it has risen substantially with far more money than you can afford. This is all because you are emotionally involved with the share.

In your newspaper, you will find a list of the top performing shares on the stock exchange. These shares have done amazingly well over the last few weeks and months. And yet, although you are anguished by the share that you sold that is rising, you do not care about these shares. The professional investor does not get emotionally involved with his or her shares. They understand that there are many investment opportunities that are missed in the market.

A professional sells too soon!

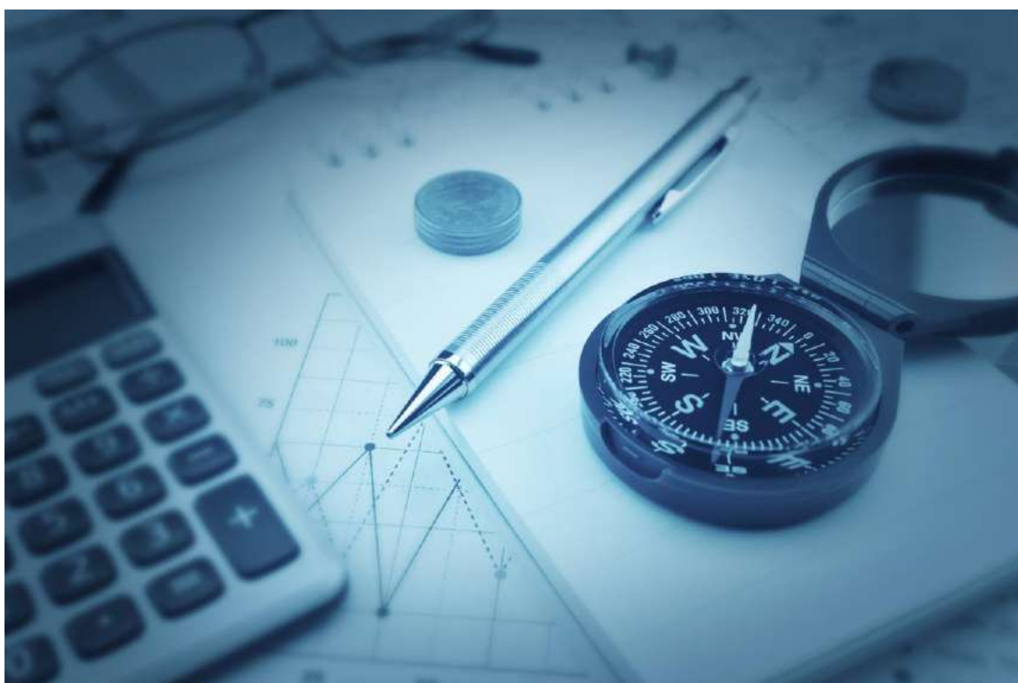
Good mental posture means that you are able to maintain your objectivity in the buying and selling of your shares. It also means that you can admit when you have made a mistake and bought the right share but at the wrong time.

The biggest contributor to bad mental posture is over-investing. This is done in two ways:

1. You invest more than you can cope with emotionally – this comes from investing with borrowed money or while you are still in debt. You need to eliminate all forms of debt, except for your property mortgage, before you invest in the stock market. Once you have paid off all debt, you need to save into a stockbroking account the surplus money you have after paying your monthly bond repayments. In other words – this is money that you can afford to lose. Because it is surplus money, your mental posture will be stronger as your loses will be less (you will not have to sell your house to survive, should you make the wrong investment decision).

2. You put too much of your available funds into a single trading idea – generally, we say that you shouldn't put more than 20% into any singe trading idea. This is to avoid putting all your eggs in one basket should that share fall. Diversification improves your mental posture as you are assured of your position even if one portion of your portfolio does not do so well.

One of the best ways to deal with your mental posture is to establish and maintain a stop loss strategy – dealt with later in this eBook.



Step 4 – Learn the Art of Share Selection

There are around 400 listed companies on the JSE at any time – we call this the universe of shares. The amount of listed companies varies, depending on the market. In a listings boom, you will find that a lot of new companies list – almost one a day. In a bear market, the weaker companies on the JSE might delist to save costs, or because they are bought out by other larger companies. You, as a private investor, need to assess these listed companies and make up a watchlist.

A watchlist is a list of companies that you deem to be the best opportunities on the JSE, and which you need to watch intensely. The shares in your watchlist could potentially become a part of your portfolio. The number of shares in your portfolio is important and is a trade-off between keeping your risk level in check, and managing your time effectively. Having one share would be too risky, as all your savings would be in one basket. Having 50 shares in your portfolio would result in an enormous amount of work for you, taking up too much of your valuable time. You would not have enough time to properly monitor so many shares. We recommend that you do not have more than 8 shares in your portfolio, so that your attention is not too widely spread and your risk level is not too great. So, because there are about 400 listed companies on the JSE, and your portfolio shouldn't have more than 8 shares in it, the shares you choose must be what you think are the top 2% of opportunities listed. If you don't think that a share is part of this percentage, then it should not be in your portfolio.

Your watchlist should be anywhere between 20 and 50 shares, depending on how much time you have available for studying the market. From this watchlist, you will choose the shares that you will actually buy.

To sum up the above, your portfolio is the 6 to 8 shares which you have chosen from your watchlist and which you deem to be the top 2% of opportunties on the JSE. Your watchlist is a list of between 20 and 50 shares that you have selected from the universe of shares, and includes shares which you are interested in and which you intend on studying and

becoming familiar with. The universe of shares includes all the listed companies on the JSE.

So how do you go about including companies in your watchlist?

There are two important aspects here – fundamental analysis, which helps you to find those shares in the market which could be great buying opportunities; and technical analysis, which involves using your charting software to identify the right time to buy. Ultimately, you want to buy the right share at the right time.

The most difficult part about investing on the share market is finding shares amongst all the listed shares on the JSE that will perform well in the future and which are worth investing in, and then choosing the right time to buy in.

In order to identify those shares which you believe are interesting and which you believe could be part of the top 2% in terms of future performance, it is important to observe and acquire as much knowledge as you can about what is happening in the current market place.

Fundamental Analysis

This involves using financial reports and statements that have been released to the public to find good shares. For example, you could look to see if a company's headline earnings per share has risen at a rate of 15% or more over the last 3 or 4 years. On top of this you can look at the dividend yield of a company to see whether it is fully priced or not. These are just some of the ratios that you can look at when trying to find buying opportunities. Fundamental analysis will help you to find undervalued shares.

Technical Analysis

Technical Analysis refers to share market analysis that is done by computer. More specifically, technical analysis involves the monitoring of patterns of share prices and volumes traded in the share market. These patterns can be used to assess whether you as the investor are making the right share picking choice and at the right time. There are various technical analysis indicators that you will find on the ShareFriend Pro and Metastock software packages. These indicators are there to help you make profitable decisions in the share market. For example, by using the overbought/oversold indicator, you are able to see if a share is oversold, which would signify a good buying opportunity. Technical analysis should be performed in conjunction with fundamental analysis to get the best analysis.

Monitoring of the News

The financial media is probably the best way for you to stay informed on what is going on in the markets. By reading a business newspaper, listening to financial radio shows, reading financial websites and keeping up to date of current news, you are most likely to spot potentially profitable investment opportunities. These forms of media should be monitored every day in order for your knowledge to stay up-to-date and current.

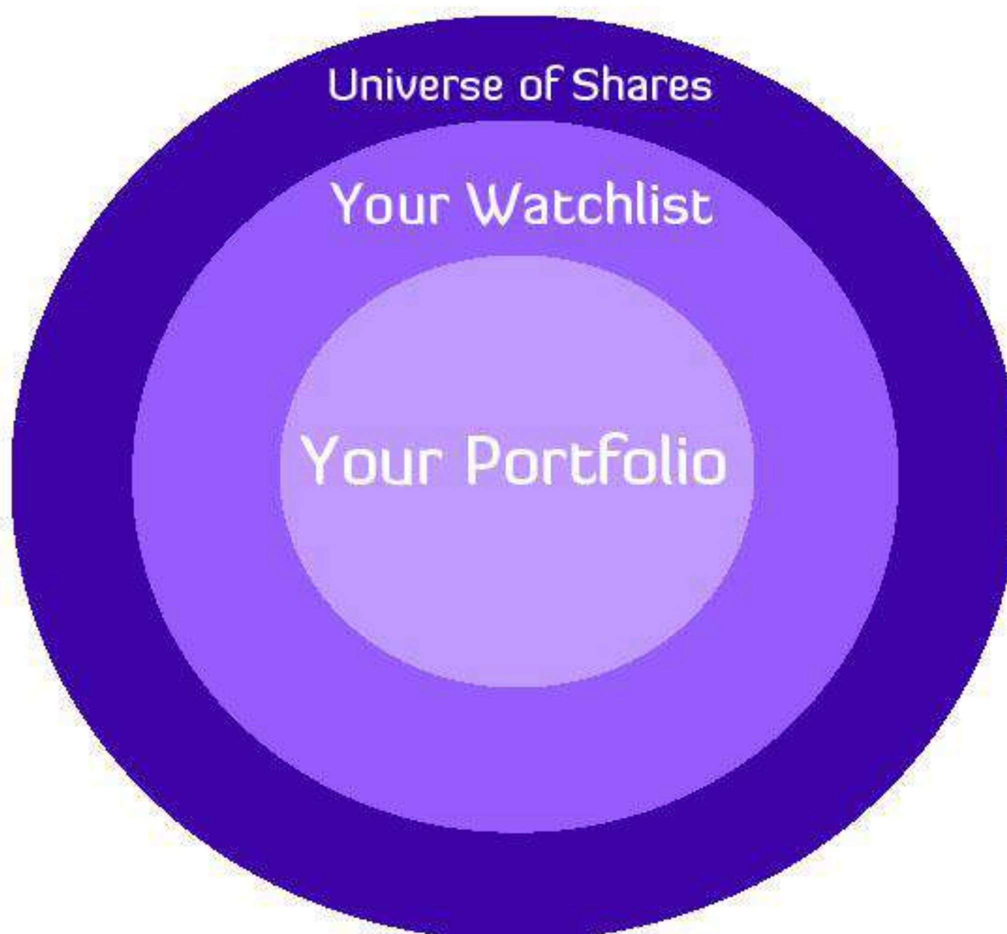
Another great source of media is the Johannesburg Stock Exchange Hand book, which comes out every 4 months. This has the latest fundamentals and other information of all the listed companies on the share market. Company websites are also a good place to look to get

product information and company history, giving you a solid background when identifying companies that interest you.

Gain a worldly view

Having a good knowledge of what is happening in the rest of the world can determine your ability to understand the general trend in the market. Gaining a worldly view entails looking at the global economy, currency fluctuations, the rising and falling of growth in individual economies like America and China, and getting an understanding of different industries.

Using these four techniques, you'll be able to find information to recognise the companies that you are interested in, and sufficiently add them to your watchlist. Once your watchlist is of a decent size, you should concentrate of fine-tuning your analysis to those shares which you believe represent a good buying opportunity.



Step 5 – Develop a Stop Loss Strategy

There is risk when investing in the share market. This is due to changes in the economy and changes in investor's perceptions, among other things. The risk associated with the stock market keeps most people away, and this is just how the big institutions like it. But this perception of risk is what is keeping these people away from the best investments in the economy.

"The ultimate risk is not taking a risk"

(Sir James Goldsmith)

As an investor there are techniques that you can use to protect yourself against the risks of the share market. One of these techniques is called a stop-loss strategy.

When you climb into a motor car, you put on a seat-belt. You do this not because you are expecting to have an accident that day, but because you wish to protect yourself against the unexpected (i.e. if someone jumps a traffic light etc.). A stop-loss strategy is the private investor's seat-belt in the share market.

A stop-loss strategy consists of a set of rules for selling out of a share after it has fallen by a pre-determined amount or to a pre-determined position. There are many different methods for establishing and adjusting "stops", but we will just deal here with the simplest method – a percentage stop-loss.

It is difficult for the big institutions to implement a stop-loss strategy, because they usually have large amounts of funds invested in one particular share, that if they were to sell out, it would affect the market, probably moving against them.

Using a stop-loss strategy is simple:

Suppose you have done your homework on a particular share which you believe is going to do well and you are ready to buy. You should set a

stop-loss level at, say, 10% below the purchase price. So, if you are buying the share for R10 (1000c) then you should establish your stop at R9. If the share falls instead of going up, then, when it reaches R9, you sell out – because your original decision to buy was clearly wrong, at least in its timing if not in both timing and selection. This action limits your potential loss to 10% (plus your dealing costs). If you follow this approach you will never end up in the position where you have lost 50% or 75% of the value of your investment – an experience all too common with novices in the share market.

Suppose, on the other hand, that your share goes up, say to R15. Then you should maintain your stop-loss level 10% below the current market price, moving it up as the price goes up. So when the share has reached R15, your stop-loss will be R1.50 lower at R13.50. Now if the share starts to fall, when it reaches R13.50, you sell out, thereby locking in most of your profit.

So this stop-loss strategy works like a ratchet – it can only go up, and cannot come down. In fact the cardinal rule with stop-loss levels is they cannot be moved down.

Your choice of a stop-loss percentage is based on how much you are prepared to risk losing. If you say that you are not prepared to risk losing any money at all, then you should rather invest in the Post Office (which is the safest place to lose money – it's absolutely guaranteed!).

In this world, to beat inflation you have to take some risk.

The point is that you must control and limit those risks to a pre-determined amount or percentage. Obviously, nobody is willing to lose 50% of their investment (although it is surprising how many do). If you lose 50% then you would have to make 100% just to get back to where you started from without taking into account inflation. Even 25% is a considerable amount and should only be accepted for your very long-term and highest-quality investments (like Liberty Life, perhaps). In general, a maximum of around 15%, including your dealing costs, is a sufficient potential loss to accept in return for the very substantial potential gains to be made from shares.

The choice is yours. Martin Zweig, one of the leading investment analysts in America says, “To control risk, I use a system of stops (sell orders at pre-determined levels). To my mind, the only consistent way to beat the market in the long run is to cut losses, allow profits to run…”.

The Implications of a Stop-Loss Strategy

On the face of it, a stop-loss strategy is very simple and straight forward – cut your losses while letting your profits run. In reality, however, very few people are able to maintain a strict stop-loss strategy because their emotions get in the way; they have an inappropriate mental posture.

Good mental posture is strongly influenced by the way in which you value your shares.

Most people value their shares at “market”. In other words, if they own 1000 shares which are trading in the market for R10 each then they say to themselves that they have an asset which is worth R10 000. The problem with this is that if the shares go up to, say, R15 and then decline to R13, they will fixate the highest market value at which they have seen the shares (i.e. R15). They say to themselves, “Why sell at R13 when it is clear that the share has the potential to reach R15? Rather wait until it returns to R15.” The problem with this logic is that it places no downside limit on how much they could lose.

On the other side of the coin, conservative people like accountants like to value their shares at cost. So if a share is bought at R8, then that is what it is worth. If it then falls to R6, they are extremely unwilling to sell. Logically, nobody sells something for R6 which they think is worth R8. And again by valuing the shares in this way, they place no downside limit on how much they could lose.

The correct way to value your shares is at their stop-loss price – because this is the price at which you have made a strategic decision to sell; that is the price which you can sleep with at night. In other words, if you have 1000 shares trading at R10 in the market and your stop-loss level is R9, then you should value your shares at R9000. The reason for this is that if the shares should fall to your stop-loss level, then you will feel no pain at selling them – because that’s what they were worth to you

anyway. This ensures that you have the correct mental posture to sell when you have to.

Of course, valuing your share at stop-loss has certain implications. It means that the very act of buying a share is the act of taking an immediate 10% (or whatever your percentage stop-loss is) loss. One benefit of this is that it will make you very careful about what you choose to buy. But it also makes sense from another perspective. You are moving from cash to shares. Cash is (in the short-term at least) a totally risk-free asset, while shares are a risk asset.

Beating the Index

If you were to choose your shares completely at random, and you selected only from the shares which make up the index, then, theoretically at least, half of your selections would be above the index and half would be below. This must be true because the index is an average of the shares from which you are selecting.

If on the half which are above, you can make 50%, 100% or even 150% depending on how far the shares run, but on those which are below the index, you cut your losses at your stop-loss level, losing only 15%, then you can see that, even if you choose your shares completely at random, so long as you have a strict stop-loss strategy, you will out-perform the index. Isn't that an amazing thought!

Imagine if you could play the roulette-wheel and apply a stop-loss.

The fact of the matter is that even with the best information available on the share market you will still probably make about 3 or 4 bad selections out of 10. Professional investors know before they start that there is probably a 4 out of 10 chance that the share they choose will not go as they wish. So they have a stop-loss strategy to cope with that eventuality.

So, it becomes like playing a roulette wheel where the odds are stacked 60% or 70% in your favour – so long as you do not put all your money on one number and so long as you keep playing, there is no way that you can lose. But as we said earlier, you will not choose your shares at random. You will use your analysis, your knowledge and experience to bend the odds in your favour.

You see, investment is about probability. It is not about security or certainty. The JSE overall index has risen substantially since 1910. Your probability of choosing a winner is already greater than your probability of choosing a loser. And you can apply a stop-loss strategy – further bending the odds in your favour!

By investing directly in the share market, actively monitoring and adjusting your portfolio, maintaining an objective mental posture and managing your risk through a stop-loss strategy, you can achieve financial independence. It is therefore very worthwhile to educate yourself thoroughly in the art of share selection and transaction timing.

Remember, nobody cares about your money but you. You should invest first in your education, then in the market.

Please read the following article related to the stop loss strategy on our website:

http://www.pdsnet.co.za/index.php/making-the-most-of-the-stop-loss/

Step 6 – Always Watch the Ball

Nothing worthwhile in your life has ever been achieved by being ignorant or passive. Consider your profession – you make money at it because you are knowledgeable and actively involved. The stock market is no different. To be successful you need to acquire the necessary knowledge and then you need to watch what is going on in the markets of the world, and particularly the JSE, every trading day. Without this close monitoring, you will miss important opportunities and remain ignorant of key threats.

So what can you do to "watch the ball"? Many things – but here are a few good ideas…

1. **Regular Time**

   To be successful in the share market you need to spend around 45 minutes to an hour working on your goal of achieving financial independence every day. During this time you will read widely about the markets, check on the progress of whatever shares you have in your portfolio and on your watchlist, check on various markets like the S&P500 from Wall Street, the rand/US dollar exchange rate, the gold price, the oil price and other macro-economic indicators.

   We suggest that you do this in the early morning before you go to work. It might seem like a huge effort to get up an hour earlier, but in time, if you stick to it, this will become the most profitable hour of your day – you will ultimately make more money in this hour than you do in the rest of your day put together – pretty much no matter what work you do.

2. **Follow the Financial Media**

   Every day thousands of pages are written about the economies of the world, their stock markets and the JSE. You need to get into the habit of reading as much of this material as possible – especially those articles which deal with the individual shares

traded on the JSE. There are about 400 shares listed there and you need to develop your knowledge and understanding of as many as possible – especially the larger more established blue chip companies.

Obviously, the internet offers the best source of media articles and analysis. The Business Day newspaper is available online and there are many other websites that offer good analysis of both the South African and Overseas markets. For example, go to:

http://www.google.com/finance?client=ob&q=INDEXSP:INX

This shows a chart of the S&P500 index – it usually begins trading at around 4.30pm (our time) in the summer and 3.30pm in the winter (because of their daylight saving).

Over time you should aim to collect together a range of websites that you visit almost every day to keep yourself informed of local and international investment news.

3. Maintain your own Stop-Loss Levels

It is possible these days to put stop levels onto most stockbrokers' trading platforms. However, we advise you not to use these facilities, but to rather develop a spreadsheet with your own stop level calculations. The simple 10% stop-loss can be modified in a number of very interesting ways to make it a better device for preserving your capital.

For example, you could modify it to take into account the fact that shares typically fall by the amount of their dividend on the ex-div date. This would prevent you from getting stops on shares when they go ex-div. You could also include a formula to adjust your stop levels to reflect the percentage of your total portfolio which is exposed to that share – thus shares where you have a heavier exposure should have tighter stops and so on.

Another idea is to widen your stops once you are in-the-money. For example, if you have made a 200% gain on a blue chip share, then you could consider making your stop-loss level 25% below the highest price reached. This would allow for more volatility in the share and still afford you significant profits.

4. Visit the Company

Most investors are content to stay at home and do their research on the internet – and indeed, this is an excellent way to begin. But if you really want to get a good feel for a company, you need to visit it and talk to the CEO or one of the directors. In practice, you will find that especially smaller companies' directors are more than willing to talk to you and show you over their operation.

You just need to phone them up and explain that you are interested in investing in their shares and that you would like to talk to the CEO – or, if he is unavailable, one of the directors. Make sure that before you go you have read everything that is in the public domain about the company – and particularly make sure that you are very familiar with their latest financial statements. That way you will be able to ask pertinent questions and pick up on information which has not been published. Be sure to explain that you are just an investor – and not a financial journalist (because that would put them on their guard).

To be truly successful in investment, you need to buy shares in a company which has passion, excitement, dynamism and energy. Those things cannot be read off a balance sheet or on a chart. To see those things you need meet the CEO of the company and listen to him talk about his business. You need to look into his eyes.

5. Download the Company's latest Financials

These days almost every listed company has a company website on which they give a huge amount of information to investors. Most

importantly, they usually provide a PDF file of their financial statements which you can download onto your computer and read at your leisure. It is very important that you take the time to download the financial statements of the companies that interest you and then carefully read them through – making notes of any interesting points.

Warren Buffett is arguably the most successful investor who has ever lived. He began with $100 that he made doing a newspaper run when he was ten years old and today he is worth over $60 billion. He studies 2000 sets of financial statements each year. That is his secret. He is constantly sifting through the reports of companies on the stock market, looking for anomalies that might offer a good return.

There are approximately 400 listed companies on the JSE – which means that, with interim and final accounts, there are about 800 sets of financial statements produced by JSE-listed companies each year. The more of these you read the better informed you will become about exactly what is going on in our economy and where the good opportunities lie.

So keeping your eye on the ball in the share market is essential. Imagine trying to play a game of tennis wearing a blindfold. It would be impossible, even if you had the best tennis player in the world telling you which way to run and how to place your racquet. The simple truth of tennis and of the share market is that if you want hit the ball, you must be watching it all the time!

Step 7 – Learn to Time your Transaction

The risks involved in buying shares are either that you buy shares in a bad company that has no prospects, or that you buy shares in a good company, but at the wrong time.

These risks are real, whether you are a speculator, in and out of the market every few weeks, or an investor. Either way there is always the chance that you may buy into the wrong company, or buy at a bad time - or both.

Timing your transaction is perhaps the most important ability that you can learn. If you have found a company which you believe to be a great investment opportunity, buying their shares at the wrong time could result in you losing money, despite the future profitability of the company.

We suggest that you spend as much time as you can learning how to manipulate your charting software to reveal those trends that signify buying opportunities. There are various features on your software that allow for this. We will go through a few of the basics:

The Moving Average

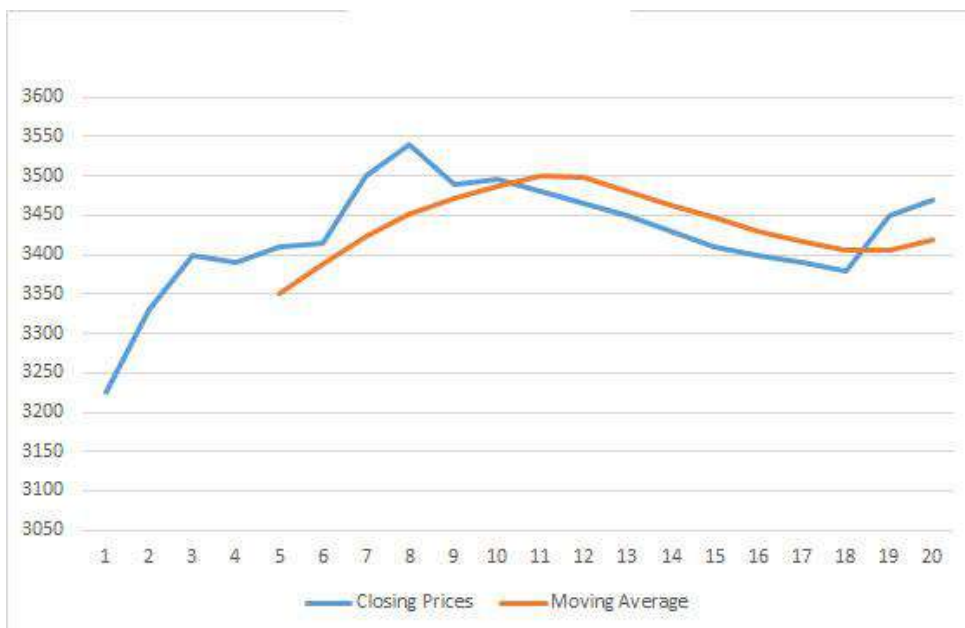
The moving average is a very simple charting indicator that allows you to identify when in a trend is the best time to buy and the best time to sell. Of course, these are the most important questions when investing on the stock market. The moving average forms the basis of most technical analysis, and so it is recommended that you become familiar with it in your quest to reach financial independence.

You may have come across this technique in your schooling career. Using daily and weekly closing prices, this indicator is able to distinctly give you those signals which you are looking for.

Let us illustrate this by using an example of a five day moving average:

Day	Closing Prices	Moving Average
1	3225	
2	3330	
3	3400	
4	3390	
5	3410	3351
6	3415	3389
7	3500	3423
8	3540	3451
9	3490	3471
10	3495	3488
11	3480	3500
12	3465	3498
13	3450	3480
14	3430	3464
15	3410	3447
16	3400	3431
17	3390	3416
18	3380	3406
19	3450	3406
20	3470	3418

So in the example, we have taken the closing prices of a share over the past 20 trading days. We then added the first five share prices together and divided by five. This will give you the average price of the past five days. We did this for all the days, adding the previous five day's share prices and divided by 5. The chart of the results looks like this:



The two lines on the graph follow each other closely, with the moving average just behind the share price. This continues until there is a change in the trend and then the two lines cross each other. This cross-over gives a clear buy or sell signal. So, in the example above, as you can see on day 10 the trend has changed, and as the moving average crosses over the line for the share price you would be advised to sell. The exact opposite occurs on day 18 when the trend changes again, this time moving upwards. The moving average crosses the share price and you are given a buy signal.

You can use any length of moving average. The shorter the moving average, the closer it will follow the share price and therefore the more buy and sell signals it will give. The signals from a longer moving average are usually more reliable. The disadvantage, however, is that they come later and are not as frequent.

You want to use the moving average to smooth out the daily fluctuation of a chart to give you an overall trend.

To use a real life example, have a look at the chart below:

S&P500 Index – July 1988 to April 2018

This is a chart of the S&P500 over the last 30 years. The S&P500 is an index of the US's top 500 listed companies weighted according to market capitalisation. The significance of using this index is that it is a very good indicator of world markets, as it shows the performance of the

world's biggest companies. And this makes it very useful for identifying whether we are in a bull or bear market.

We have placed a 300 day moving average on this chart, and as a result you can see how the trend of the index is closely followed by its moving average. At the beginning of the chart, you can see that as the trend rises the moving average follows mostly below the index. The trend peaks around the year 2000 and begins to fall. The moving average crosses the trend shortly after it begins to fall – this would be an indicator for you to sell out of the market. For the remainder of this bear trend, the index follows below the moving average. Then in March 2003 the trend of the index begins to turn, and you can see that the moving average crosses the index shortly after it begins to rise. Then the bull market turns in 2008, and once again the moving average crosses the index shortly after it begins to fall. Finally, in July 2009, the index breaks up through the moving average and signals a new bull trend which lasted until at least April 2018.

What is important to observe is that it is only after the moving average changes its direction that the trend of the market actually changes.

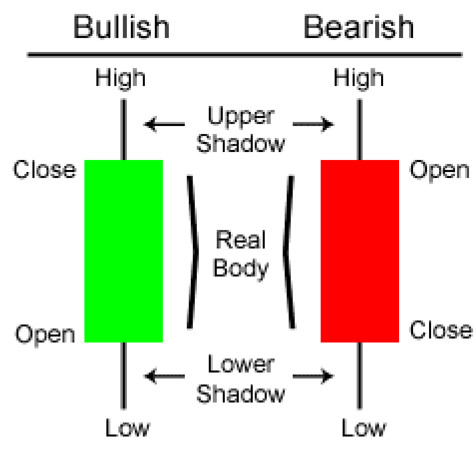
The moving average tells you what trend we are in. And since the JSE closely follows Wall Street, using the S&P500 as an indicator of whether our market is in a bull or bear trend is highly recommended.

Candlesticks

The use of candlesticks in charting is also very useful for determining buy and sell signals. Developed by the Japanese, candlesticks have been around since the 1700s. The significance of using candlesticks is that they give the investor a clear perspective of investor perception and emotion in the market. There are many different candlestick signals. In this eBook, we will just cover the basics:

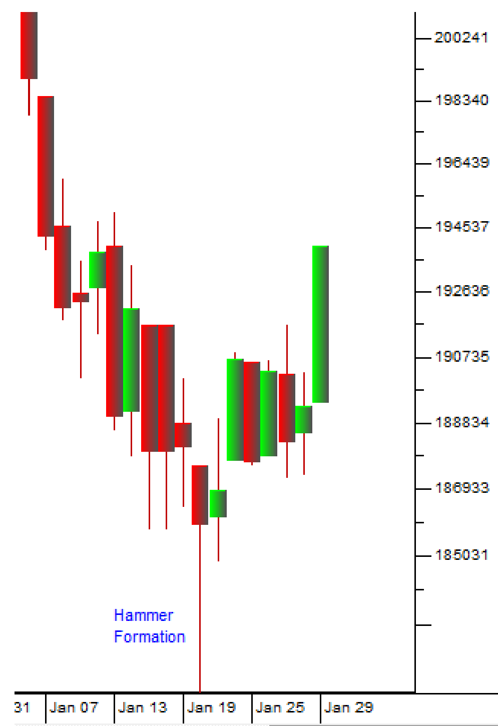
Each day's trade is represented by its own candle. The body of this candle represents the range between the opening and closing prices for the day. When the closing price is lower than the opening price, the candlestick is red. When the closing price is higher than the opening price, the candlestick is green. The lines above and below the candle are called shadows and reflect how high and how low the price went during the day. The longer these shadows are, the more uncertainty

there is in the market.



Obviously, red candles are negative and represent a bear trend in the market, and green candles are seen as positive and represent a bull trend in the market.

There are many different forms of candles and many different formations or patterns, which can tell the investor at what point a trend might turn. In this eBook, we only want you to grasp the importance of these candlesticks and understand how they can help you to time your transactions. We will use an example to illustrate:



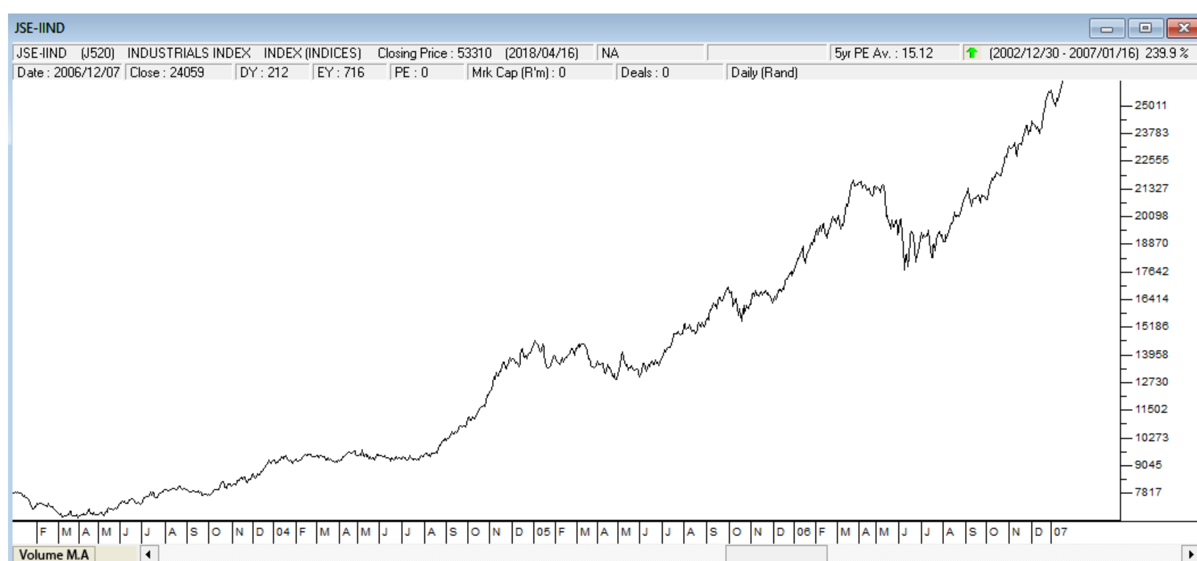
Hammer Candlestick Formation

In the example above, you can see an example of a “hammer” formation occurring between 7th January 2016 and 29th January 2016. This formation signals that the trend is likely to change and become bullish. The significance of this candlestick is the length of its shadow, which should be double the length of the body of the candle. As well as this, there should be no shadow at the top of the candle, which means that buying pressure is strong.

So, as you can see from the above explanations of moving averages and candlesticks, there are simple yet effective means of performing technical analysis which will allow you to time your transaction in the stock market.

Step 8 – Beware of the Guru

Whenever the market has been in a strong bull trend for some time, it is common for stock market gurus to appear. In reality, there are always people who publicise stock market predictions. But very few people pay more than passing attention to them because they are right as often as they are wrong. After an extended bull run, however, some of them will, partly by luck and partly because the whole market is rising, have an astounding track record. This qualifies them for "guru status" in the eyes of the investing public and they attract growing numbers of "believers" who will immediately and unquestioningly implement all their buy recommendations.



JSE Industrials Index (J520) 2003 to 2007

The above chart shows our industrial index from 2003 until 2007. It had been performing really well and was rising steadily for years, with the exception of a few minor corrections. Given this type of growth, it is almost impossible to choose shares which will fall. Provided you make sure that the company is of reasonable quality, you can be almost certain that it will go up in the near future. It is a guru's heaven.

After a while, the guru becomes the "super-guru". This means his predictions have such a wide following that he begins to move the market – his prophecies become to an extent self-fulfilling. Stockbrokers and institutional analysts find it necessary to subscribe to his material

simply to be aware of its impact on specific shares. But what really makes a super-guru is ego – he begins to believe he is infallible.

It is at this point that the market generally turns down (as it did in 2008) and just when everyone thinks he will be right – he is wrong. His mistakes are hugely compounded by the number and willingness of his followers. They have reached the point of over-trading on his predictions. In other words, they are committing far more than they can afford to each share that he tips. Overnight his following deserts him and as suddenly as he arrived he is gone – another relic to gather dust in the annals of the JSE.

Experienced investors will tell you that the emergence of gurus is a classic sign of the top of the market. They are never around when the market is low or falling and they take some time to build their following as the market rises. We suggest that you retain your independence. Do not abandon responsibility for your own financial affairs in favour of a guru. Always do your own homework and make your own decisions. When faced with "hot tips" ask yourself this question:

"Would I have bought this share even if I had not received the tip?"

And if the answer is no, proceed with extreme caution.

Step 9 – Understand General Economics

When investing, it is very important to have some basic economic knowledge so that you can understand what is going on in the economy and therefore the market in general. This will help you to anticipate market trends, and to know how certain economic happenings might link and therefore affect your investments.

The importance of the study of economics in relation to the stock market and investment is that the two subjects are interrelated: what happens in the economy affects share prices. The markets will move in anticipation of the economy.

There are two broad types of economics. Macroeconomics deals with the economy at large, and includes such things as inflation, economic growth and interest rates. Microeconomics is concerned with the smaller more individual parts of the economy, including such things as the consumer, the labour market, and fluctuations in demand and supply. As well as this, it is important to realise that the economy is made up of limited resources with an ever increasing and infinite supply of needs and wants. These wants and needs, and the ability of the consumer to pay for those things that satisfy them, are what drives the

economy. There are various things that might stifle demand, including a hike in interest rates, which occurred on the 28th of January 2016, in an attempt to control inflation. This in turn affects the strength of the rand which drove share prices up. This is just one recent example of how what is happening in the economy can affect your investments.

Understanding how economic variables interlink is a fundamental necessity when investing on the stock market. We recommend that you keep up-to-date on all the recent happenings in the economy by reading a good business newspaper and listening or watching good economic broadcasts.

Important Components of the Economy worth Understanding

There are certain components of economics that are well worth understanding when you endeavour to become a successful investor. These components are things that could impact on your investment decisions. Without some basic knowledge of economics, you will not be able to predict market changes or understand the significance of the fluctuations in your investments.

These components include:

1. **Inflation**

Very simply, inflation refers to the rise in prices and the drop in the purchasing power of the rand. This can happen for many reasons. Increased demand within the economy is one reason, and this occurs when disposable income is high and economic growth is steady. A second reason is increased costs including wages, raw materials, import prices, lower productivity or increased taxation. One other reason for increased inflation is the printing of money, which causes there to be more money chasing the same amount of goods in the economy.

So how does inflation affect you as an investor? Generally inflation will not be good for your investments for the following reasons:

- Inflationary growth tends to lead to recession.
- Inflation discourages investment.
- Inflation discourages growth.
- Inflation devalues our currency.

As an investor, inflation can hamper the growth of your investments, and knowing the intricacies of these effects could greatly improve your ability to be profitable in the market.

2. **Economic Growth**

This refers to the increase in the number of goods and services per person in the economy over a certain period of time. Generally, economic growth is accompanied by a bull trend in the market, where most share prices will rise in value. They say that economic growth is the indicator of the health of an economy. Substantial economic growth will benefit the economy at large and for a prolonged period of time. Such Benefits include an increase in disposable income, an increase in the general standard of living, a reduction in poverty, improved developments in technology and infrastructure, as well as an improvement in the health sector.

Taking these benefits into account, you will be able to understand how economic growth could impact you and your portfolio. A boom period, signified by a bull trend on the stock market, will only lead to increased profits for you. The question is, when will the market turn? And when, in fact, does the economy enter this period of economic growth that sets a bull trend in motion? You need to be able to read market indicators and understand economic figures in order to make these predictions so that your transaction timing is such that it correlates with the movement in the economy.

3. **Exchange Rates**

An exchange rate refers to the value of one currency for the purpose of converting another currency, and is another indicator of economic health. Countries buy goods and services from each other and therefore it is important to know the value of our currency and how that affects the economy. Exchange rates will also impact on the real value of an investor’s portfolio.

Like any other market, the foreign exchange market is determined by supply and demand. An increase in supply in relation to demand will bring the price down, and an increase in demand in relation to supply will bring the price up. A country’s exports are more expensive and its

imports are cheaper with a higher exchange rate. On the other hand, a lower exchange rate results in cheaper exports, but more expensive imports, which can damage a country that relies heavily of other countries for certain resources.

The determinants of exchange rate fluctuations are many, all of which involve trade relationships because an exchange rate is based on the comparison of the currency of two countries. Some of these causes:

- Inflation
- Political instability
- Economic performance
- Current account deficits
- Interest rate
- Public debt
- Terms of trade

As an investor you need to know that a declining exchange rate means a decline in the purchasing power of your money and capital gains. It also affects other incomes such as interest incomes. Ultimately, you need to know that the return on your investments will be less the less the currency is worth.

4. Other Economies

South Africa has relationships with other countries through imports and exports, as well as investment. What happens in the rest of the world therefore affects us and our economy. The share market is in turn affected as most listed companies have a vested interest in some other part of the world. Major economic events that happen in other countries can greatly affect South Africa, and it is important for you as an investor to understand and have up-to-date international knowledge.

5. Government

The government directly affects the economy through such things as taxation and legislation. The decisions made by government can also affect the share market. For example, new legislation or an amendment to the Company's Act could have both negative and positive effects. Keep up-to-date will all economic decisions the government makes,

especially regarding monetary and fiscal policy, in order to gage how the economy will be affected, and in turn your investments.

Generally, the stock market anticipates changes in the economy by about 9 months – sometimes longer. So, for example, the current bull trend at the time of writing began in about March 2009 – in anticipation of a boom which would follow the extremely loose monetary policy adopted by the US Fed and other major countries world-wide. As an investor, we encourage you to become knowledgeable about what happens in our economy as well as those economies which our country is tied to. This will ensure the your portfolio is better managed.

Step 10: Make your money work for you

The final step in this eBook is for you to make your money work for you. This involves taking all the previously discussed steps and building a system which will ultimately allow your portfolio to grow.

You cannot expect to make money from your investments unless and until you are prepared to take responsibility for your own financial affairs. This implies that you need to educate yourself in the art of investment and obtain access to the information necessary to follow what is happening on a day-to-day basis in the market.

Finding great opportunities in the market is as simple as having the right tools to help you in your stock picking choices. Once you have devised a winning system, you'll soon be on your way to wealth creation.

Here are two examples of two shares on the JSE which have performed amazingly well in the last two years:

Comair (COM) April 2016 to April 2018

As you can see from the chart of Comair above, this was an amazing buying opportunity at the beginning of 2016. The share price moved from 330c in April 2016 to 600c in April 2018. This is a gain of 90.5% in just two years. The company has been in business for 71 years and has

always made a profit every year. When you consider that it has done this in one of the toughest industries and against the unfair competition of SAA, Mango and SA Airlink – all of which have been government subsidised. The secret of its success according to its CEO, Erik Venter, is the constant renewal of its fleet of aircraft. This has the benefit of reducing fuel costs and increasing the number of passengers per flight. New aircraft also have the advantage of less maintenance and so spend more time in the air. Its latest acquisition of 8 Boeing 737-8 Max aircraft means it will use 14% less fuel while carrying more passengers.

The second example is of Clicks:

Clicks (CLS) April 2016 to April 2018

The share price of Click rose from 10690c in April 2016 to 18914c in April 2018, which is also a 80.1% increase over the last two years.

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