SILVER LAKE PUBLISHING

EARLY TO RI$E

A Young Adult's Guide to Saving, Investing And Financial Decisions That Can Shape Your Life

"...a valuable tool for young people."
–The Kansas City Star

Second Edition

MICHAEL Z. STAHL

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Michael Stahl
Minneapolis, MN
May 2005

Early to Rise

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Introduction: Why Now?

As a young adult in America, you may have already realized that, while money doesn't buy happiness, it can sure help. I believe that over the long term investing is the most effective way to fundamentally improve your future. Investing is the most important avenue for you to increase your personal net worth through the proper allocation of whatever money you have—or will have in the future. As a young adult, you are entering a time when you will spend and save more money than you would believe possible.

Think big!

Why Should You Invest and Why Now?

By investing early and wisely you may achieve lofty goals-the sports car, the yacht, the French chatêau. You may want a few thousand dollars (or many thousand) to help finance your college education. You may want to spend the day sitting in a café in Paris or take an African safari before you turn 30. You may want to retire in a big mansion on the Florida intracoastal with large Roman pillars in the entry way and a retractable roof over your bed so you can see the stars at night. Wait a minute—that's my dream and I have first dibs on it. So stick to the Paris café.

The point is: You will be living on your own and paying the bills soon. And, it would be nice to have a large amount of savings to help you through the first years of the real world—of rent, insurance, utilities, cable TV, etc. Maybe you are still a few years away from *those* expenses, but the earlier you begin investing (and saving) the easier it will be to finance your future.

Investing in stocks or stock funds is the best way to increase your financial resources. Costs for teenage necessities these days are rising rapidly. A new (to you, possibly used to the world) car will run you more than $10,000; four years at college can cost you $35,000 for public, or more than $100,000 for private; a laptop computer has a price tag in excess of $1,000. And the list goes on and on.

Parents may not have the extra cash to buy their wonderful, caring teenagers everything that they need or want. Investing can be a way to solve this dilemma.

Many of us probably don't remember the first time we were aware of money and its purpose. Or the fact that you can use money to invest and make more money. I first learned about markets (the money—not food—kind) as an elementary school kid when my grandpa faithfully placed me on his lap and watched the Financial News Network, the predecessor to CNBC.

Perched on his knee, I intently watched the stock ticker flash by in blips of meaningless letters and numbers. Stock charts and company profiles were always left around the house, and if anybody taught me how to put my weekly $1.05 allowance to good use, it was my grandpa. Even today, he is still my greatest influence in the investing world. The lessons I have learned from him have brought me to appreciate all that investing has to offer—when done with diligence and shrewdness.

Investing not only has its financial rewards, but it is enjoyable at the same time. It is fascinating to conduct research on the billions of dollars a company has, or to look at your collection of stocks, commonly referred to as a portfolio, and think, "I own a piece of these great companies!"

I invested in my first mutual fund when I was learning how to write a research paper—in the fifth grade. One of the companies in my mutual fund's portfolio was PepsiCo. So, during this period, I urged my mother to purchase Diet Pepsi instead of Diet Coke. Why wouldn't I indirectly contribute to my investment? It's exciting—gets me feeling like I own a little piece of the world.

Which brings me to another interesting point about investing: Through stock ownership you are a part of something larger. As a part owner of the company, you can help guide the company's operations through voting on shareholder proposals and electing the board of directors.

> **You can also attend the company's annual meeting which gives you the opportunity to step up to one of the many microphones placed around the room and ask the big boys—the CEOs, the money men—a tough question and watch them attempt to please you. How many times will a person, whose net worth dances somewhere in the nine or 10 figures, be eating out of the palm of your hand?**

Investing Is Fun

There's some fun involved too. My investment club experienced this for many years when we attended an AMC Theatres annual meeting each December while in high school. We watched a free yet-to-be-released movie at the company's premier movie complex. We enjoyed a free lunch and enough popcorn and Reese's peanut butter cups to tide us over until the summer.

These are some of the perks of working a capitalist economy to your advantage.

Besides, what can be better than doing a little research and watching your money grow and work for you? It's great to come home, flip on the computer, check the stocks and realize that while you were taking that math test today, you made $500. Days like this keep me going. Days like this inspire me to invest more and stick with it.

After all, investing is something that can be done in your free time, is not labor-intensive, can shore up your future and reap countless rewards (not all of which are money related).

When thinking of investing, remember that there is no license required. Investing is not just a game for professionals or adults, either. When I started investing, I had never taken a class on the subject and I began the fourth grade.

No person has an inherent advantage over another. Every teenager has the ability to invest and invest well. And don't let anyone tell you otherwise. With the possible exception of Alan Greenspan (Chairman of the Federal Reserve), no one can predict how the market will act or how to guarantee a winning combination of investments.

I urge you to join the club.

Throughout this book, I'll write about the importance of thinking like an investor. This is a critical point for young people. Too many people in high school or college think of themselves as children, financially. They only think of spending—not making—money. That's too bad...and a waste of time and ideas.

This book aims to get rid of that waste.

CHAPTER

1 Develop an Investor's Mentality

Before you begin to invest you must ask yourself the following three questions:

1) Do I have the money?
2) How long can I keep the money invested?
3) Can I afford to lose money in the short run to make money in the long run?

Your answers to these questions are essential to the making of an investor. You should take note of your responses before deciding on whether to become one.

In order to do well as an investor, you need to have an **investor's mentality**. For a teenager or young adult, this means thinking like someone who makes money—not someone who borrows it. And, for a young person, **avoiding the borrower's mentality** can be a major challenge. But you can do it.

In this chapter, I'll give you some guidelines for thinking about money like an investor.

Do You Have the Dough?

In the world of investments, *you need money to make money*. If you don't know how much money you have, you will first need to assess your financial situation accurately.

You can't start investing your money for tomorrow unless you know where you stand today.

In order to know where you stand financially, you will first want to discover where all your money comes from—and where it goes. In other words, identify your sources of income, as well as the drains on your cash. Don't be surprised if the answers don't fall into your lap. You may have to do a little digging.

To find out where all your money comes from, you will want to total your **monthly income**. Add up all the money that is paid to you each month (for example, allowance, paychecks, birthday money, etc.) and what you expect to spend each month (on dates, books, movie tickets, clothing, etc.).

You can use the charts on the following pages to organize and calculate an estimate of your monthly income and expenses. If you have an income or expense that is not listed in the chart, add a new category. This should provide you with a template; by no means is it an absolute way to measure everything in your financial life.

An important note: If you have a girlfriend (or boyfriend) and it's starting to get serious, factor in double the amount you currently spend on dates. With commitment comes anniversaries and presents and, of course, this means more money going out than usual. In addition, if you do not currently have a girlfriend (or boyfriend) but there are some possibilities, you might want to go ahead and factor in the added expenses-just in case.

Be sure to record any bank savings you have access to and can use (though you do not have to clean out these accounts—and probably *shouldn't*), plus any money you can squeeze out of your parents for investing.

Sources of Money

Estimate of Disposable Income for One Month

Earned Income	
Paycheck	$ ______________
Paycheck	______________
Paycheck	______________
Bank Accounts	
Savings	______________
Checking	______________
Other	______________
Other	______________
Additional Income	
Allowance	______________
Birthday Money	______________
Other	______________
	______________
	______________
	______________
	______________
	______________
	______________
	______________
Total Income	$ ______________

Where the Money Goes

Estimate of Expenses for One Month

Taxes		
Federal	$	______________
State		______________
F.I.C.A.		______________
Payroll Deductions		
401(k) Plan Contribution		______________
IRA		______________
Social Security		______________
Other Payroll Deductions		______________
Phone		______________
School Tuition		______________
Transportation		
Car Payment		______________
Gas		______________
Maintenance and Repairs		______________
Other		______________
Clothing		______________
Misc. or Personal Expenses		
Snacks/Food		______________
Gifts		______________
Entertainment		______________
Other		______________
Total Expenses	$	______________

Reviewing Your Expenses

Once you have completed the charts, come up with a grand total of your total monthly income and your total monthly expenses. Fill in the chart below to arrive at your profit or loss for each month.

Gross Monthly Income	**$** ____________	
Less Total Expenses	**-** ____________	=
Potential Savings or Shortfall	**$** ____________	

If, after totaling your monthly income and expenses, you believe that your **income and savings are substantially more** than you are spending, then you have passed the first test and you are on your way to investing. Congratulations. You're among the very few.

If, on the other hand, you find that the amount you earn each month and the amount you spend each month are too close...welcome to the majority. You need to begin to **increase your earnings** or **decrease your spending**. This prepares you for producing the initial capital you'll need to get started as an investor.

> **When I was younger, I had a great deal worked out with my parents where they have agreed to match each dollar I invest with fifty cents. An instant 50 percent gain! After a while, my parents became large depositors in the Bank of Mike Stahl. And there is no better place to invest.**

Need More Money? Get a Job

If you need to increase your earnings and you don't already have a job, you might want to get one. A job can substantially increase your earnings and help to prepare you for the professional world. A job will also help you stand out among college applicants, and perhaps give you tools that will help you succeed in college.

There's some debate on whether young people should have jobs. Some families believe that having a job too early makes a teen materialistic and shortsighted about college and other long-term life choices. Others feel that work interferes with school or sports of other activities. Also, some teens feel they shouldn't have to work as long as they can get money and things from their parents.

I tend to look at the issue another way: Anyone—including a teenager or young adult, even from a family with money—should work to cover at least some of his or her personal expenses. This helps you keep savings as savings; and it can help you keep your expenses in line with financial reality.

You may not find your dream job on your first attempt. But at the same time, don't go out and sign up for the first job behind the McDonald's fryer because it seems to be the only one available. When looking for a job, other factors besides money come into play. The perfect job would be one that pays well, has hours that do not interfere with your social life or school work and is enjoyable.

If you don't want to work in fast food, get creative. Sorry, someone named Michael Vick has already taken the quarterback job for the Atlanta Falcons. But there are plenty of other jobs out there for teens that don't involve asking "Fries with that?"

In high school, I worked for a demonstration agency. I would hand out food samples at supermarkets on the weekend. Sometime they made me wear this dorky cheap tux but otherwise I truly loved this job. I was paid between $6.50 and $8 an hour, I could choose when and where I wanted to work, the job was fairly simple (not laboring) and I could eat all the snacks I wanted.

If you are having trouble finding a job that fits your schedule, maybe you should consider a job such as baby-sitting or mowing lawns. These jobs are relatively easy to accomplish and you can usually choose when you want to work and how much you want to charge.

However, these jobs tend to have one disadvantage: They are not stable; one week the phone will be ringing off the hook, the next week you may be forgotten.

Working in a family business or for a family member can be a good deal. Just try to make sure the job involves legitimate work for appropriate pay.

Other job ideas for teens include working at the local pool or becoming a camp counselor. Advantages to these jobs are they will not interfere with your school work and they are steady, but the disadvantage is you cannot set your own hours.

> **The specifics of the job are less important than the idea of doing something that helps you earn enough to keep your savings and things like birthday gift money in the bank. Finding the right job is an important step as you prepare to think like an investor...not a borrower.**

Cutting Back

If working is not enough, or the right job hasn't come along, then you will have to decrease the amount you are spending each month. In order to decrease the amount you spend, you need to become more frugal-but not cheap. Unless you have an extremely comfortable relationship with your girlfriend (or boyfriend), you might not want to ask her to go dutch on dating expenses; you could offend her.

> **You don't need to cut out all of your spending, you just need to cut back. We, as young adults, need to enjoy our money, but we also need to look at what we buy and why we're buying it.**

Make a list of what you spend every month. (You can use the chart from the previous pages.) At the end of the month take a look at the list. Was there any excess spending on your list? Were there any items you bought that you could have found at a lower price if you had done a little shopping around before you made the purchase? Did you purchase things with a credit card? Did you buy something just to buy something? Did you purchase teal green tube socks? I sure hope not.

After answering these questions, you should have a good idea where your sore spots are and where you can cut back. Look for ways to trim your unneeded spending.

A problem I have with spending is that sometimes I buy things that I didn't intend to purchase in the first place. My solution? Normally I keep approximately $20 in my wallet. Only when I go out with the intent of spending do I put more money in my wallet. You can't spend what you don't have on you. That is, unless you're using a credit card to make your purchases.

Buying with Plastic—The Downside

Although credit, debit and ATM cards may seem like a dream come true, **buying on credit is probably one of the worst habits** you can have. Credit cards are not essential to the teenage lifestyle and are the worst form of debt. It may seem important to establish good credit, it is not necessary at our age—and a credit card gives the illusion of having more money than you really do and it can actually become quite burdensome to your financial health.

Let's take a look at each type of card and distinguish them from one another.

Credit Cards

The most popular forms of credit cards, Visa and MasterCard, are really what are called **bank credit cards**. Accepted by certain merchants instead of cash or check, credit cards are issued by banks that are members of the card company's network. To receive a card, you must submit a credit application proving your ability to pay off your credit card bills. If approved, you will then receive your card via postal mail.

> **A growing number of teenagers and young adults (people under 25) are carrying credit cards. If you're under 18, you usually need your parents' approval to get a card. Some parents agree to these arrangements because they believe the cards will make their kids responsible about money. Maybe this happens in some cases; but, in my opinion, the opposite is more likely.**

When you begin using your credit card, a statement will arrive consistently in the mail each month, listing all of your purchases. You then have two choices, each with very different outcomes: either pay the full balance of your purchases or pay a lesser amount, at or above the minimum amount stated on your bill. The statement also provides you with a due date for your payment and a maximum limit to your purchases.

If you pay the full amount every month, you are not charged any interest. But if you fail to do so, interest as high as 20 percent or more will accrue.

> **Credit cards are clearly the most expensive type of loan available and those interest payments can kill you. To put that interest rate in perspective, if you did not pay off your credit card, you would have to earn an investment return in the stock market at *double* the average rate of return, just to stay even with your credit card debt.**

Interest on debt is a revolving crisis. It just keeps piling and piling on top of itself, making it more and more difficult to pay off.

Plus, if you end up with a bad credit rating, it can ruin your chances later in life to receive loans for more important items such as cars, student loans and home loans.

I do not advocate credit cards for teenagers. Look, there's not that much we should be spending before adulthood anyway and credit cards just make it too easy to spend money we would be better off investing.

Debit Cards

The bank where you keep an account may issue a debit card—sometimes called a check card. This card usually functions as both an automated teller machine (ATM) card and like a credit card; it will carry the markings of ether a Visa or MasterCard. But it's not a credit card.

> **Every time you use the card to purchase something, the purchase amount is automatically deducted from your account, much like an instant check. You do not wait a month and you do not have to pay any bills later. The bank merely takes the money from your account right then and there—and shows the purchase as a deduction on your monthly statement.**

Basically, a debit card is a checkbook in plastic except there is no accompanying ledger to keep track of your debits. This, of course, can present a big problem. I know because I have one.

Unless you carefully deduct your debiting, you don't necessarily know how much damage you have done until your bank statement arrives. And, you cannot track whether the bank has made an error on your account.

Additionally, much like a credit card, a debit card gives you the false sense of money and encourages you to spend more than you should.

I advise you to stay away from debit cards as well; they will only entice you to spend too much.

One other point: credit and debit cards are one of the main ways that identity thieves commit their crimes. ID thieves work out elaborate ways of stealing cards or copying card information from legitimate transactions. And ID thieves love getting young people's credit information, because it tends to be cleaner than older people's.

Of course, many people feel that it's just too hard to function in our plastic-driven society without having some form of credit or debit card in their wallet or purse. If you are one of these people, try to avoid using the card as much as possible. Don't use it for impulse purchases. Try to remember all of the useless purchases you've made in your life before pulling out the plastic. Ask yourself, "Is this video game really worth the money?"

Overdrawn—What May Loom Ahead

Because it is difficult to keep track of what you draw from your back account, debit and ATM cards can drain your savings very quickly. I have a friend who constantly draws cash with his ATM card. He always seems to withdraw $80 for dinner, movies or whatever.

Well, to make a long story short, he ended up sucking the life out of his bank account. And get this: the account got so low that he wrote a check to his dad for gas that would have bounced had he not torn it up before his dad cashed it. The bank tank was empty within a year of his receipt of an ATM card. Not to mention the fact that he almost bounced a check to his own father! This is definitely not the type of financial control you want to exercise.

Although credit and debit cards provide a wealth of services, they are not essential to the teenage lifestyle and as I will explain in more detail later, they can do more harm than good.

If you want to have more money, get a job. A job can substantially increase your earnings and, of course, your spending capability, without charging you a 20 percent fee every month.

Establishing Credit—One Reason to Use Plastic

Okay, so now that I've questioned the very notion of credit cards, let me make one minor point. While buying on credit is probably one of the worst habits you can have, it can be advantageous for building a good credit rating—if managed properly.

For example, a charge card-often used synonymously with a credit card, but they are not the same thing-is designed for very different purposes. Since charge cards, such as American Express, only provide you with short-term credit that must be paid off at the end of each month, it is more difficult to get into debt troubles.

A good idea is to get a charge card and commit to using it for only one monthly expense—such as gas, if you have a car. Gas is a consistent, monthly expense that you should know that you will be able to pay off.

This will give you a start with a solid credit rating without the possible debt storm.

Consumer Debt—Avoid It at All Costs

Consumer debt plagues many Americans, hence the millions of dollars earned by authors of how-to books about getting out of debt, and money-managing gurus that fill Saturday morning infomercials. Your best plan is not to have any consumer debt-and avoid the step into its vicious cycle, which for most, usually occurs early in life. If you're already racking up interest charges on credit cards (again, things I don't think you should even have right now), then you need to be aware of consumer debt and how to alter your spending habits for the future. Believe me, the last thing you want as you begin to accept more responsibility and become independent is debt. And massive debt will only hurt you to the very end.

Thanks to the human competitive instinct and billions of dollars spent every year by advertising geniuses, we have been brainwashed into judging ourselves by whether we have the same material goods as our friends. When that new cell phone comes out, we want to go get it. When the latest fall fashion hits department stores, we want to spend a Saturday at the mall. This is the familiar rat race of consumption. We need more money to support a fancier lifestyle, which then requires even more money.

And the word *lifestyle* doesn't only mean buying BMWs and entertainment centers. It can apply to just about anything-the amount of time we spend on the Internet, the number of times we see our favorite band in concert, the food we eat or the clothes we wear. It's amazing how this impulse remains consistent across generational and ethnic lines-from our parents to us.

Some people get into money problems that are like an eating disorder—a life-consuming cycle that's very hard to break. The best strategy for avoiding this problem is to avoid the first cycle of spending. And that means establishing good spending and saving patterns now—sometimes at the expense of status and style.

> **Status is the reason that Ralph Lauren can sell a $10 polo shirt for $85. Like buying on credit, though, searching for status in disposable goods is a bad idea.**

It makes sense to pay for quality in things that you expect to have for a long time, but don't be fooled by fancy labels. Labels can mask questionable value, and the more expensive the purchase, the more relevant this rule is.

Forming Good Habits

If you're going to adopt an investor's mentality, you have to discard the dependent, childlike set of beliefs that you've internalized about money. Why? The earlier you begin to educate yourself concerning your own financial matters, the better prepared you will be to make wise, profitable investments and handle any curve balls life may throw you down the road. Besides, it feels good to be in charge-even if you're still learning.

All of the things you choose to do with your money are interrelated: If you save a dollar, you don't get to spend that dollar; if you spend your dollar on food you can't use it for clothes, etc. The key is to make conscious decisions to allocate your money to the places that will make you the most happy now and later.

I won't instruct you on when you should save your money, and when you should spend it on something you need or even something that you want. Only you can know what's best for you. The specific things that make you want to spend money aren't as important as the patterns that emerge over time. What you need to ask yourself is: "How do I spend my money? And is there anything I can change that will help get more for my dollar?"

Ditch the spendthrift within you. Spenders spend. Moreover, they often spend money that they don't have (frequently using credit cards to do it) and with no thought as to how to repay the debt. You'll know if you're a spender. If you felt empowered when you purchased *Tony Hawk's Pro Skater* game for your PlayStation, or the latest Abercrombie & Fitch fashion trend, you're a spender.

If spending perks up your self-image fills a void or alleviates depression, you're a spender. And, you're definitely a spender if you buy things you don't need.

Consider how the expenses you normally incur impact other things you could do with your money, such as investing. Also consider whether any of the expenses you listed require credit card financing or other costly terms-the expenses could be hitting you on multiple levels.

Prioritize your spending habits. Pay bills that need to be paid-credit cards, car payments, school loans, etc.-before you make any other purchases. Remember, technically, you made a commitment to purchase these things first. And, you'll be better off putting your money toward the purchases with the highest interest first, anyway.

Spending can be both dangerous and addictive. It can lead to excessive debt-and in the worst cases, even bankruptcy. So, try to avoid adopting bad habits early on in life. If you have to, cut up credit cards, stay out of stores-use cash and get support.

Control Your Spending Impulses

Having an investor's mentality means realizing whether you're a spender or a saver and—if you're a spender—figuring how you can control those impulses. Don't give up, if you're a spender. Sometimes, being a spender means you have a good sense of retail and fashion trends. And this can be very useful to an investor.

My advice: make specific savings goals for yourself. Many Internet stock brokerages have minimum initial investments of $1,000 to $3,000. So, it is important that you check what the minimum is and ensure that you can meet the initial requirement. All this must be done before you begin to invest. If you don't have it right away, set a schedule for saving money in a regular bank account until you have enough.

Learn to save money. It's always good to keep some money—if only a little—tucked away for emergencies. And the best thing you can do for your financial future is get into habit of moving money on a regular basis into investment accounts.

By *regular basis*, I mean put money into your investmets once a month or once a quarter.

You don't have to go overboard. Get yourself a treat—or, more importantly, take a reasonable risk—every once in awhile. These steps don't have to be dramatic; but they should be big enough to shift your perspective to include planning for the future and enjoying the present.

Another good idea is to make a schedule for what you want in the future. Do you want money for car when you turn 16? Do you want money for a private college? Do you want to skip college and start a business? Do you want to buy a house before you're 30? Do you want to retire when you're 50?

Use **investment deadlines** to help focus your goals.

What you do with your money is your own business. Just make sure you understand the short-term and long-term impact of the spending decisions you make.

Remember: Making good decisions about the money you have now, and the money you'll make later, will give you a framework for accumulating wealth throughout your life.

CHAPTER

2 Basic Money Management

Before we get into the details of analyzing stocks, mutual funds and other investments, I think it's important to take a quick look at some of the basic **money management skills** that anyone needs in order to function like an adult in the financial world.

> **To say it simply: You need to be able to use checking or savings accounts well. And this is an important first step, before you move on to the other services and accounts that banks, brokerages and other financial institutions offer.**

For some readers, the information and tips that I provide in this chapter may seem a little *too* basic. But I suggest that everyone read this section; it doesn't hurt to review things you know—especially when it comes to the simple disciplines of **keeping your bank accounts in good order**.

Like so many things we discuss in this book, the importance of this chapter is establishing good money habits that will last you through your whole life.

Bank Accounts

Later on, I'll talk about using an investment club as the best way to get started analyzing and buying stocks. But, before you start a club, you'll need to know where and how to keep its money. So, you'll need to know about setting up a **bank account** from the start.

There are three things to keep in mind when setting up a bank account. First, a checking account is a must for any investor. Checking accounts are a good place to keep some of your own money to pay your investment club own membership dues, etc.

> **A check is a form of an IOU that your bank pays out of an account that you have set up with them. Most checking accounts pay little or no interest, so you won't want to keep more than the maximum amount you need for two months of expenses.**

Besides, you'll probably want to put most of your money in a savings account so that you can earn better interest and prevent frivolous shopping sprees.

Even if someone else handles the investment club's accounts, you're going to have to keep track of the money in your own checking account, so it's imperative that you know how to **balance your checkbook** and do it diligently.

Why is this so important? If you write a check for more than the amount of your balance, called an overdraft, the bank may refuse to pay your check. If this is the case, you have bounced a check. Bouncing a check is both embarrassing and expensive; banks can charge as much as $35 for each bounced check, which can eat into your investments.

> **Avoid bouncing a check. Technically, it is a form of fraud—and could land you in either civil or common court if it gets to be a problem. This may sound overly harsh, but—in my experience—many young people tend to take an overly lazy approach toward managing their checking accounts.**

In some cases, if you bounce a check, you can be forced to take a money management course to learn how to balance your checkbook, face probation, fines and even jail time.

Some banks reduce or waive fees for overdrafts if you keep a minimum balance in another account. And, in some cases, banks will even pay on a check as a courtesy—even if you don't have the funds in your account. Of course, the bank will still charge you all kinds of fees; so be careful about using these services.

I suggest that you shop around. Overdraft protection may sound appealing, but you might save more if you invest your money elsewhere.

> **The chart on the next page can help you choose a checking account that best suits your needs and—when the time comes—the needs of your whole investment club.**

How Checking Accounts Work

The checking system is organized nationally, with the **Federal Reserve System** as the backbone. If a check from your account is deposited into your sister's account at the same bank, the money is drawn out of your account immediately.

However, if you live in New York, and your check is deposited into another New York bank, the check is sent to the New York Federal Reserve Bank, which routes the check to your bank. If there is money in your account, your bank wires the money electronically to the New York Fed, who passes it on electronically to the other bank. This usually takes at least one day.

If you send a check to someone in Chicago, and they deposit it in a bank in Chicago, it has to go to the Chicago Fed, and then to the

Types of Checking Accounts

Regular Checking	You can write unlimited checks, but you don't earn interest on your money. Usually comes with an ATM card.	Monthly fees of about $10, but fees can be waived if you keep minimum balances in checking and/ or other accounts.
NOW Accounts	You can write unlimited checks and earn interest on your money.	Usually have fees and require a higher min- imum balance in checking and/or other accounts.
Money Market Accounts	You earn higher interest, sometimes even tax free. May have limits to the number of checks you can write. Also may not be federally insured.	Usually have fees $5 to $10, but can be waived if you keep minimum balances in checking and/ or other accounts.
Asset Management Accounts	These are through a brokerage firm, and usually have unlimit- ed checking and superior inter- est. Opened in tandem with a portfolio of stocks, bonds or other investments.	You will need a higher min. balance, and pay monthly fees and fees for other investments.

New York Fed, and then to your bank. If your bank account has money, it is then transferred to the New York Fed, the Chicago Fed and then to the bank account in Chicago.

Type of Check	When the $$$ Is Available
Check from your bank	1 business day
Check from local bank	2 business days
Check from out of town bank	5 business days
Federal, State or Local Government check, U.S. Postal Money Order, U.S. Treasury checks, cashier's or certified checks	1 business day

So what does all this mean? It means that if you deposit a check in your account, the **money may not be there right away**. However, federal laws require that your money be made available after a maximum amount of time for a variety of checks.

Balancing Your Checkbook

Once you understand how the checking system works and how to make the most of it, you are ready to learn how to balance your checkbook.

"Balancing" a checkbook means comparing your account records to the bank's to make sure that you both agree on the amount of money in your account.

The very thought of balancing a checkbook makes most people wince, but the few minutes it takes every month will save the hours of headaches—and arguments—that can come with overdraws from your own account or the group's.

Balancing your checkbook is also a good way to find out if you or the bank made any math errors. And, believe me, mistakes do occur.

There are a number of computer programs out there which can be a big help in keeping your records straight, but if you are going to try it on your own, you might want to use the following as a guide.

Every month, the bank sends you a statement for your checking account, reflecting the most recent information the bank has recorded on your account.

The first step in balancing your checkbook is to take the balance shown on your bank statement, and update it by adding all of the checks you have written and withdrawals and deposits you have made that aren't yet reflected in your statement. (When it comes to an investment club's account, you will want to go over any monthly contributions, membership fees, resignation payouts or purchase and sell orders made with the club's brokerage.)

I suggest keeping a special file for all this information. Then, compare this balance to the balance you're showing in your checkbook.

This entire process can also be accomplished over the phone via the bank's automated service or online. Of course, some banks charge fees if you go over the maximum number of times you are allowed to access the automated system. If you don't know the services offered with your account, then ask your bank before you start racking up a load of access fees.

Are the numbers the same? If they're not, you will have to look for the mistake in your accounting or the bank's. This could take a little time, but there's a method to it.

1) Make sure your checkbook **register is up to date**. In other words, make sure that you have correctly recorded and deducted all checks and added in all deposits. Be sure to make note of any interest you have earned or fees that you have been charged (this is usually indicated by an asterisk on your bank statement).

> **Forgetting to record interest and fees in your checkbook is the most common reason for discrepancies in your accounting.**

2) Take checks out of the envelope from the bank and put them **in numeric order** by check number. In your check register, check off all the checks you received with your bank statement: These are the checks that have been paid. (Most checkbooks have a spot for the check marks. Try using different color pens each month. This helps you to separate what happened in each month.)
3) If you have any **ATM or point-of-sale (POS) transactions** in your checkbook, make a check mark next to each transaction that is reflected in your bank statement.

> **A POS transaction is when supermarkets, gas stations, fast food restaurants, etc. allow you to use your ATM card to deduct a purchase directly from your account. This feature can also complicate the checkbook balancing efforts.**

4) Be **as detailed as possible** on your check register. Distinguish between teller machines from different banks and

POS transactions from specific merchants, e.g., Tower Records. The bank statement will provide this information, and any notes you have in your checkbook will help you to match transactions.

> **Do not be surprised if the ATM or POS transaction dates shown on your bank statement are a day or two later than those on your receipts. It takes a few days for the bank to record these charges.**

5) Make a check mark next to **each deposit** reflected in your bank statement, including any transfers into your checking account from other accounts, e.g., a savings, and any uses of overdraft protection (if you have it). In most cases, the deposits are much less troublesome because there are relatively few.
6) Check off any **fees or interest** entries in your checkbook that are reflected in your statement.

After you have finished the above, you are ready to do the math. Follow the steps below and use the chart on the previous page to record your figures.

- Step 1. Enter the **new or ending balance** shown on the bank statement.
- Step 2. Add any **deposits or transfers** into the account that have not been checked off because they were not processed by the bank before the closing date of the statement. Total these.
- Step 3. Calculate the subtotal by adding the **balance and the new deposits**.
- Step 4. Subtract **outstanding checks and ATM/POS withdrawals** that have not been checked off on the regis-

ter (use the chart on the following page to help you arrive at this number).

- Step 5. The ending balance should match the **current or latest balance** on your register.

If you find that your numbers don't match, keep your eyes peeled for some of the following:

- A **mathematical error** on your register. Double-check your math. Look back several pages in your register; you may find an old check that still hasn't been cashed.
- A dollar amount that is off between your register and the statement your bank sent you is a round number, e.g., 40, 80, 100. This is almost always a math error. Check all math in your register to make sure you haven't made an error.
- You think you have a few dollars (less than $25) more than your bank statement indicates. Make sure you have entered **bank fees and charges** in your register.

Some people balance their accounts more than once a month. Instead of waiting for their statements to come in the mail, these people will call automated information lines at their banks...or print so-called **mini-statements** from their ATM machines. However the information is collected, the process of balancing the account is the same.

If money is tight or you're new to managing your own finances, it might make sense to **balance your account frequently**—say, on a weekly basis.

And, you may want to try one of several brands of banking software that will allow you to computerize your check register. The most popular personal banking software is *Quicken*, which is available in Windows and MAC formats. *Kiplinger's Simple Money* (Windows), Microsoft *Money* (Windows) and *Managing Your Money* (Windows and MAC) are other variations.

Using Bank Technology

Most banking software lets you categorize your expenses and provides you with a summary of your spending habits. Although the programs require some set up time, once you have the information loaded onto your computer, balancing your checkbook will be a breeze.

Also, most of these programs allow you to pay your bills online, using any of several independent electronic funds transfer services (these outfits operate like credit card processing companies...and will usually charge a fee).

If you bank at a larger bank—such as Chase Manhattan, Wells Fargo, Bank of America, etc.—you can also use the newest versions of Quicken or Microsoft Money to pay bills online directly from the bank, invest in CDs, transfer funds between accounts and get balance and account statements online. Some of these banks will even provide the software for free.

CHAPTER

3 Evolution of the Teen Investor

Five years ago I opened this chapter as follows:

In most ways, I'm an average 17-year-old. I listen to MA$E, Will Smith and Usher. I read Sports Illustrated and watch MTV every day. I wear my Tommy Hilfiger jeans low. I run cross-country. I play intramural basketball. I hate waking up early in the morning to go to high school.

Today, life is a little different. I'm 23 years old, Usher still fills the radio airwaves—along with OutKast and others. My jeans are less low and now from Express for Men (I don't like that new name, go back to Structure!). And, I still hate waking up in the morning; now it's for my first job out of college.

The main difference between me and most teenagers is that **I invest as much of my money as I can**—and I use it to generate more money. This difference is important because it's not hard to do what I do. And it makes me a lot more self-reliant. It feels much better to buy a CD with money you've earned than with money your family has given you.

I began investing when I was 10 years old. As a fourth grade student, I heard endless rumors about a new video game system that quickly became the talk of the class. The Atari Lynx was the first color, hand-held game system and I thought it would kill Nintendo's black and white Game Boy at the stores. Because I was a minor, my mom helped me set up a custodial account with the family broker and I bought 100 shares of Atari's stock at nearly a dollar a share. I recall the memory of my mother telling the broker exactly what I wanted to do as I stood in the corner—too shy to make the request myself.

Atari's Lynx system did have some success when it came out. But a few months after I bought the stock, **I sold it at $5 a share and made 400 percent** on my investment in the fourth grade! Shortly after Atari's Lynx sensation, Sega produced a new and improved color system and Atari's stock plummeted (good thing I knew to sell when it was on top).

How did I know when to sell? When thinking about selling, I asked myself a question that today seems profound: Would I buy Atari at this $5 price? The answer was *no*.

> **If I was not willing to buy it at this price, I thought others must feel the same way and the stock price was likely to decline. So I sold the stock for this reason and, sure enough, the stock price fell to just below $2 within a week after my sale.**

Do You Have the Personal Qualities to Invest?

When you've been able to train yourself to get rid of the borrower's mentality and begin to have an **investor's mentality**, there is one important question that remains for you to ask yourself: "Do I have the personal qualities to invest?"

By *personal qualities*, I mean temperament and focus to recognize reality when it's happening in front of you.

These qualities do not refer to the manners, social skills or fine morals that most people think of when they hear such terms. They're a different type of thing. In this chapter, I'll explain how **any young person can evolve** into them.

To be an investor, you must be mentally tough. An investor must be patient, flexible, willing to admit mistakes, do his own research and, most of all, have common sense. If you don't have common sense, all else *will* fail. An investor without common sense is not an investor. She is a gambler.

Investing is not a game—at least it shouldn't be. As an active investor, you should be making rational, thoughtful decisions about your money and future. This isn't Las Vegas. Be prudent, sensible and at the same time, willing to take small risks over a long haul.

Good investors are not swayed by public opinion. They do not buy a stock just because someone on TV or in the newspaper says it is a quality buy or a sure thing. There are an overabundance of cheerleaders out there disguised as analysts and business journalists.

Never buy a stock without first assessing the skills of the players on the field. Many skillful investors trash everything they hear or read, so it's important to do a little research of your own.

Don't ever go on the word of someone else. Read up when you hear something. Conduct your own research on the topic. Then formulate your own opinion.

Doing the Digging

Good investors do their own research. By conducting your own research, you become an independent investor, which allows you to work for yourself and invent your own qualifications for the companies that you decide to invest in. No one cares more about your money than you do, so why would you hire someone else to make all the decisions about your money? Being an independent investor also saves you cash. There is no need for you to pay a big-shot broker an extensive commission if you can do the work yourself. This rule especially applies to teenagers. If, as a teen, you learn to be an

independent investor, it will be easier to make your money work for you as an adult.

(For more on conducting your own research, refer to Appendixes B and C.)

Watching the Market

Many times when you first begin to invest, you feel the urge to watch the market and specifically your stocks almost every day. It is good to be excited about investing but try to tone it down a bit and resist this urge. As important as it is to scrutinize your investments, constant obsessing will make you go nuts.

> **Remember: You are in this for the long haul. Day-to-day fluctuations should not be important to you. What matters is month-to-month and year-to-year changes.**

On a day-to-day basis, the market takes enormous swings, but those variations **smooth out over time** into a more reasonable curve.

For example, by noon on April 4, 2000, the Dow had plunged more than 700 points below its high for the day—a record fall. Many CEOs saw billions of dollars in wealth slip away (at least on paper) and many investors panicked, thinking this was the second coming of Black Monday. But in the afternoon, the Dow surged and ended the day with a minute loss of only 50 points.

If you had been home that day (were you skipping school on a Tuesday?), watching a financial program or browsing various Web sites, you may have been one to panic, surf to your Internet broker and sell stock.

Watching the market too often can lure you to buy or sell stock simply **based on emotion**. This is not a sound investment strategy. Avoid quick and irrational maneuvers and when in doubt, reacquaint yourself with your notebook. In fact, each month you should review your original reasons for buying what's in your portfolio. Based on your outlook for the future-and not necessarily a single day's performance-make an informed decision.

Newsletters

Are you going to listen to someone else tell you how to invest? I have received solicitation after solicitation for subscriptions to investment newsletters—yet I resist. These solicitations say everything under the sun. Many boast returns of 40, 60 or even 80 percent annually if you follow the advice that appears in the newsletters.

That is just not feasible over a long period of time.

During one five-year period, my stock portfolio returned nearly 500 percent, but I am not about to tell you that it will continue to have that return. In fact, I will be the first to indicate that such a return is an anomaly. Do not listen to claims of huge returns because they probably are not entirely truthful. If you read the fine print, somewhere it will say: Results shown are not typical.

> **Only the lazy investor uses newsletters because they do not want to devote the time to research themselves. If you won't devote a little time to your own money, what are you devoting your time to?**

Newsletters cost money, too, and they are never cheap. Some can cost as much as $250 per year. (In comparison, you can subscribe for a year's worth of Money Magazine, which is actually respectable and my favorite financial publication, for only $20.

I do not completely trust newsletters and, even if I did, I believe that they are just too costly. Two hundred and fifty dollars a year is way too much money to just give away for a product that is unregulated with no one to verify the promoter's claims.

Patience Is Essential

Are you patient enough to be a calm investor? An investor should have the patience to weather any storms the market brews. The market fluctuates, but unlike the law of gravity, what goes up doesn't always come down. By the same token, at times stocks will plummet; however, if the company still appears reliable, patience will undoubtedly prevail, turning a loser into a winner.

Sometimes stocks will go down when current financial information about the company is released. If the company has changed (in your mind) from an exceptional company to an inferior one, you should be willing to admit the mistake and take a loss.

Only sell the stock if the company's prospects look bad. Never sell when a stock price appears mediocre.

Why? If the stock falls but the company still looks solid, it may be a time to add to your position. For example, when I bought Qualcomm at a pre-split (2-for-1 and 4-for-1) price of $66 back in late 1997, my investment club—Falcon Investment Enterprises (FIE)—also bought Qualcomm at the same time. Well, the stock soon dipped to around $55 and I did some additional research. Everything looked fine with the company so I bought more. My investment club, on the other hand, looked solely on the stock price and when it moved up a little, they voted to sell, feeling lucky to come out with only a little loss.

Two years later, I still was holding on to the stock, which climbed to a split-adjusted price of $1,600 at the end of 1999 (I got out then). Buying more at the lower price helped me out a lot (and made me a good amount of money).

Don't make a decision based only on the share price. Do some additional research first and then make a decision to sell or not.

Flexibility is also an important key to investing. Teenagers may run into dilemmas when buying stock in a company. Sometimes, we find a remarkable company in which to invest but our money is held up elsewhere. Be flexible. Look for additional sources of money. Sell stock in a company that isn't doing well. If all else fails and you can't come up with the cash, be patient and keep an eye on the company for a purchase later on down the road.

> **Don't be afraid to make mistakes. And don't let your emotions ride with the vagaries of the stock market.**

It's human nature to botch things up every once in a while. Most people (not just teenagers) feel the need to go with their gut feelings. However, a conscientious investor blocks out his inner feelings and **focuses primarily on the facts**.

This brings me to reiterate my other point to keep imbedded somewhere in your investing mind: It's the market's nature to move up and down, sometimes violently or not at all. And sometimes not to your liking. Use common sense and separate your feelings from the facts. Emotions oftentimes will only get in the way of sound investing; when the signals tell you to make a move—sell or buy—do it.

How Long Should You Keep Your Money In?

By answering this question you will position your investments so they can begin to work well for you. The closer you get to your **investment deadline**, when you plan to use the money currently invested-the more you should reduce the risk tied to your investments. If you have an extensive amount of time before your deadline, look for high-return investments, which tend to carry an intense risk load.

An example: In 1993, Danny was 13 years old when he received $6,000 in gifts for his Bar Mitzvah. Danny knew that he wanted to buy a car by his senior year in high school—four to five years away. Danny figured that he would spend around $12,000 on a new car. In order to come up with this amount, Danny needed to double his money over a period of four years. I know it sounds like an insurmountable return, but it was possible.

Since Danny was already 13—somewhat near his deadline—he did not want to fully invest in stocks, thus reducing his risk of losing money. If, however, he was already preparing for retirement, then he could invest all of his money in stocks because he has an decades before he needs the cash.

With the help of his father, Danny allocated 80 percent of his money—or $4,800—in relatively safe investments that have reliable returns: blue chips and utilities. Then, with the remaining 20 percent-or $1,200—he opted to invest in Microsoft stock. He figured, "If I lose that portion in the market, then I may have to pick a cheaper car." However, on the flip side Danny thought, "If I hit it big with some successful growth stocks, then perhaps I can exceed my goal and have more money with which to invest for later."

> **Danny could think this way because his young age gives him the opportunity to take on a greater level of risk. He has plenty of time to make up for a potential loss. The worst that could happen is he has to pick a cheaper car. This compromise between time, risk and return is one that investors face every day.**

In the end, Danny invested well and during a time when the market experienced greater-than-average annual returns. In fact, Danny's initial $1,200 invested in Microsoft translated to roughly $18,680 four years later.

Initially, $1,200 had bought him 160 shares of Microsoft (MSFT) at $7.523 per share. Four years later, the company's stock was valued at $116.75 per share. Selling at this price gave Danny a gain of over $17,000 (total return minus initial input). Danny's safer investments also happened to perform well and win him a sizable return.

Ninety-three shares of Coca-Cola (purchased at $25.875 and sold at $58.25 four years later) and 93 shares of Consolidated Edison (purchased at $25.75 and sold at $34.50) added almost $4,000 to his portfolio.

In the end, Danny's portfolio was worth well over $27,000, which, when compared to his starting $6,000, means he made over $21,000 from investing. That's a 450 percent return!

So, Danny not only made his mark, but with the excess dollars, he contributed to a Roth IRA account and reinvested in the stock market.

If you are investing for the purpose of buying a car within the next few years, you may not want to fully invest in the stock market—thus lowering your risk of losing money. In contrast, if you are 16 and investing to retire at 60 then by all means invest it all. In stock!

Short Run vs. Long Run

Can you afford to **lose money in the short run** to make money in the long run? If you are like me and want to invest for the long term, then you should be able to afford to lose money in the short run.

I am investing for my after-college years because I don't want to put all my eggs in one basket with only a diploma over my head for shelter. And, I still have some time before I begin to take money out of my investments; therefore, I still have some leeway with the stocks I pick. This allows me to consider a few riskier stock investments and balance it off with a medium-risk mutual fund (an entity that pools your money with other investors and invests it for you).

While you may choose to allocate your money differently, I have regularly kept at least 50 percent in mutual funds. Depending on the status of the market, I have had as little as 13 percent in individual stocks, and as much as 50 percent. When the market is steadily growing, more individual stocks will win you more than funds. However, investing and self-managing stocks requires a higher level of risk tolerance, which I'll discuss in detail a little later. I also participate in an investment club that is well diversified. For more on mutual funds and investment clubs, turn to Chapter 6 and Chapter 8, respectively.

> **If you can afford to lose money in the short run to make money in the long run, then you should consider investing in more uncertain securities that may substantially increase your return. (Securities are anything used for investment purposes from stocks to bonds to Treasury bills.)**

Risky investments will not always be risky and stable investments will not always be stable. This sounds confusing, but stocks and even entire industries can change from high to low risk at any time. Think of the tobacco industry.

In the 1950s, cigarettes were thought to be harmless; in the 1960s the first cancer data came out, and now, cigarette companies, which are being fiercely attacked by state and federal governments, are a high-risk investment. Enhanced risk does not always mean an investment will lose money, but it is more likely to fluctuate up and down.

If you don't have the guts or cannot afford to lose money in the short run, then investing in stocks and the stock market may be the wrong thing for you. If this is the case, look into bonds (interest-bearing securities issued by the government or businesses) or a bank savings account as investments.

Stock investing is not like handing in your pair and drawing in hopes of a flush, but it may be just as nerve-racking. In stock investing, you have to know when to raise the stakes and when to fold. The best poker players do not always get the best cards, but they know how to make the most out of what they are dealt.

Do you have the nerve and the will to be dealt into the largest game in the world? If you do, shuffle the cards and ante up!

CHAPTER

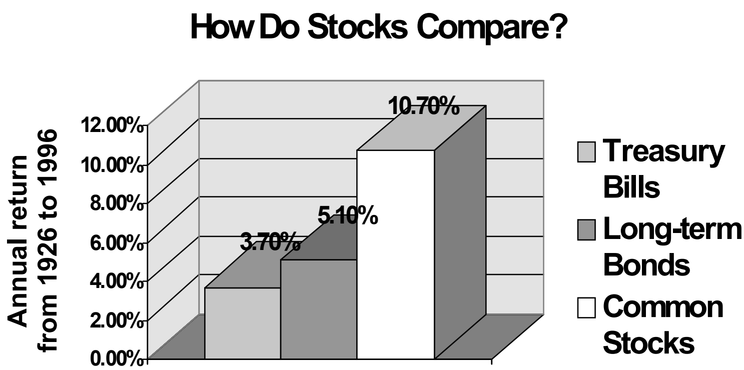
4 Stocks... What *Are* They?

Common stock represents ownership in a public business. By obtaining stock, you can be a part owner of Coca-Cola, Tommy Hilfiger, General Motors, The Gap, Microsoft, Sony and thousands of other businesses that are traded among the general investing public.

> **I think that stocks are the best place for a young person to invest. There are many technical reasons...but there is one broader reason. By investing in stocks, you learn all of the details of financial reporting, money management and analysis that you can use with other types of investment at other times in your life.**

With stock ownership you can own your favorite companies without the hassle of running the day-to-day operations. When you become a part owner, you reap the benefits of improved profits and suffer the losses as well. This occurs through a company's distribution of its profits—also known as **dividends**—and fluctuations in the price of the company's **shares in the stock market**.

Stocks have historically shown to be the best investments for your money, balancing risk with reward. On average, large U.S. stocks have returned almost 11 percent per year since 1926, as shown in the graph that's on the following page. Small U.S. stocks have done even better. That kind of growth far outweighs the 5 percent return of bonds and the 4 percent return for Treasury bills. Stocks are clearly the best investment, period.



U.S. stocks have consistently returned almost 11 percent annually since 1926, clearly outperforming the lower risk T-bills and long-term bonds. (Data taken from *Stocks, Bonds, Bills and Inflation 1997 Yearbook*; Ibbotson Associates, Chicago.)

I know a lot about music, sports, fashion, cars, entertainment, computers and food. I use this knowledge to help me make my money grow. Most likely, you, too, are a reputable authority on these aspects of teenage life. And, you, too, can use it to your advantage.

If a teenager in 1995 (when I was a 13-year-old) invested $100 in each of the well-known companies listed in the chart on the opposite page, the gains would have been phenomenal.

A $1,000 investment in the companies listed on the opposite page would have generated a four-year return of 304 percent—or 76 percent annually. That $1,000 would have earned $4,037.82, bringing the investor an astounding return on your money. Doesn't that make you want to read on?

Of course, not every investment makes this much money. The years between 1995 and 1999 were the end of a record-long eco-

Company	Product(s) Known to Teenagers	Price at Beginning of 1995*	Price at End of 1998*	Value of Stock in 1998	Percentage Gain
The Gap	Clothes	6.7	56	$835.82	736%
Intel	Pentium	15.9	119.56	$751.95	652%
Microsoft	Windows	15.16	138.69	$914.84	815%
Sony	Stereos	57.88	72	$124.40	24%
Tommy Hilfiger	Clothes	22.06	60	$217.99	172%
PepsiCo	Drinks	17.75	40.88	$230.31	130%
Coca-Cola	Drinks	25.31	67	$264.72	165%
McDonald's	Fast-food	29	76.81	$264.86	165%
Nike "B"	*Shoes*	*17.97*	*40.96*	*$227.94*	*128%*
Ford	Mustang	28.63	58.69	$204.99	105%
			Totals:	**$4037.82**	**304%**

*These prices are adjusted for splits.

nomic expansion and booming stock market. Then came the so-called "dot.com bust" of the early 2000s when the stocks of technology companies took a big dive. Most stock averages have had mixed or even negative results in the years between 1999 and when I'm working on this updated edition in 2005. (Although the high-tech sector has started to recover from the dot.com bust recently.)

Despite the ups and downs of the market in any particular short-term period, stock markets generally expand over mid- and long-term periods. And these longer terms are what you can take advantage of as a young investor.

The Mechanics of Following Stocks

The prices of most stocks go up or down every day. And most papers and financial sites on the Internet track the changes daily, if not in real time. When you check the stock tables in the newspaper or on-line, you'll see that stocks are listed by **abbreviations** and **stock prices** are listed in dollars and cents.

The abbreviations can be either one- to four-letter **symbols** (these are the popular "ticker" symbols that appear on the real-time reports that scroll along the bottom of cable news channels) or longer abbreviations that try to include more of the company's name.

Before 2000, **stock prices** were traditionally reported in dollars and fractions (½, ¾, etc.) of a dollar. That practice traced back to the old days, when trading was done by hand and among people standing on the floors of the various stock exchanges. On-line trading has changed that—but you may still occasionally see a company's stock listed somewhere as selling at 10¾. This just means $10.75 per share.

A company does not control shares that are sold to the public on a stock exchange. Rather, each share is controlled by the individual owner. Nonetheless, there are things a company can do to influence how its stock is being traded at a given time.

The simplest of these moves is that the company can buy its own stock, just like any other investor. This is called a **share buyback plan** and is usually done to remove shares from the open market, or shares outstanding. It's generally a good thing that supports or increases the price of the stock.

A company can also order a **split of its stock**. In this process, the company swaps every issued share of its stock for two (or more) shares of the same stock, priced accordingly. This is usually done when the stock's price has risen high enough that it's intimidating to small investors—$100 per share is a favorite level when companies consider a split. This is also usually seen as a good thing.

In early 2005, Apple Computer was doing well on the success of its iPod music player. The company's shares had climbed to an all-time high near $80 each. So, Apple ordered a 2-for-1 split; everyone who had an $80 share the day before the split ended up with two $40 shares the day after.

On the other hand, a company can also order a reverse-split. In this case several shares of a stock trading very cheaply are combined into one share with a higher price. But this move is rare—and often related to a buy-out, merger or other transaction.

An important point: The price of a stock doesn't allow apples-to-apples comparisons *between* companies. Just because one company's stock is $50 and another's is $10 doesn't mean the one is five times as big or successful as the other.

There are many reasons that stock prices vary from company to company; and many reasons that companies choose to manage the number of shares they have outstanding through buyback plans or splits. I'll discuss some of these financial management strategies in more detail in Chapter 11.

Types of Stocks

Stocks can be extremely complex. To help simplify the analysis of stocks, start by placing them into one of the following categories:

- growth stocks;
- value stocks;
- cyclical stocks; and
- income stocks.

All of these stocks are stocks in companies. The type of company or the nature of that company's industry determines its category.

Growth Stocks

Growth stocks are generally in companies that promise **strong earnings growth** in the future, translating into a higher share price today. Although growth stocks tend to rise in price more often than other stocks, they also are at more of a risk for big declines, too. These stocks are extremely volatile and their outlook tends to change frequently. Investing in growth stocks requires solid research, but these stocks are exciting and can be more rewarding in the long-term.

> **An example of a growth stock would be a booming fashion-based company such as Mossimo or a small, fast-paced company like DoubleClick.**

Large, proven growth stocks can also be referred to as blue chip stocks. Science companies like Amgen or Genentech, as well as the wild and crazy Internet stocks like Amazon.com and Yahoo! Inc., are considered growth stocks and act more like roller coasters. These companies may find it difficult to stay in front when more and more firms chase them through the changing face of technology. If you do get on board, be ready for a wild and exciting ride. In 1998, both Amazon.com and Yahoo! Inc. were up more than 350 percent; a year later, they were down more than half of that. Hold on tight.

The tide can sway just as easily in the other direction, clearly exemplified by eToys. The stock plummeted from $76 a share in May of 1999 to $9 a share at the end of March 2000. It would not have been a very kind investment for you. But this also illustrates the beauty of simple stock investing. Whereas you can make 10, 20, 50, 100 and even 350 percent on your original investment, you cannot lose more than 100 percent (of the amount of your original input).

Value Stocks

Value stocks are stocks in which the company is **worth more than the stock price** actually reveals. A value stock has a higher or equal book value per share than the stock's price.

The book value is the value of everything the company owns plus cash.

Essentially, if the company was sold off for parts it would be worth more than the stock price indicates. With this in mind, you would think that eventually the stock price will rise and equal the book value.

> **How could the total share value be less than the sum of the company's parts? Stock prices are profit-driven; some companies are just not making any money. The company may own land, factories and equipment that, if sold, would be worth more than the value of the company's stock; however, if the company is losing money, the stock price may be low.**

Eventually, the share value must at least equal the company's assets. The important word here is *eventually*. This is why value stocks tend to be slower movers, but they are less prone to volatility and declines. Examples of value stock tend to be companies with large amounts of cash and/or land.

Value stocks are not specific to a certain industry; they come in all shapes and sizes. The only thing binding them under one roof is that they appear to be more valuable than they cost. One current example is R. J. Reynolds Tobacco Holdings, makers of Camel cigarettes among others. Although I would not buy its stock because of its tobacco operations, the company follows the traditional value stock indicators such as a low price-to-book ratio.

Cyclical Stocks

Cyclical stocks are in companies whose earnings have a tendency to **mirror the cycles of the economy**. When the economy is stable and people are making more money, these stocks rise in price.

> **The opposite is also true. When the economy is down, cyclical stocks take a big hit. Examples of cyclical industries include real estate, automobile manufacturers, paper and steel.**

In general, when people are not making as much money they will not buy a new car or a new house; they will probably wait until the economy gets back on its feet. Stock in companies involved in new or cutting-edge industries can also be considered cyclical.

The old stalwarts of Delta Airlines and General Motors are perfect examples of cyclical companies because their profits rise and fall with the economy as people have more or less money to spend on vacations or new cars.

Income Stocks

Income stocks are in companies that pay an above-average dividend, also considered income. Income stocks are some of the most stable stocks. Their stability enables them to provide a continuous flow of income every year.

> **Examples of income stock industries are utilities—such as Consolidated Edison (ConEd), New York State Electric and Gas Company (NYSEG) and most telephone companies in the U.S.**

The stocks in these industries are less exciting and generally do not move much, but every year you will get an above-average check. You can reinvest the dividend, thereby adding some growth prospect to the steady performance. The stock price can also go up, providing additional return and growth.

Don't be confused; some stocks can be both growth and income.

"Blue Chips"

Blue chip stocks, named after the most valuable chips in a casino or poker game, are high-quality companies that have a stronghold on their industry. Blue chips are typically larger, solid-performing companies like General Electric, Coca-Cola and IBM.

These companies have a long history of consistent growth and are often stable, well-known companies. They may not be as flashy as a Ferrari, but they are as dependable as a Chevy truck.

"Penny Stocks"

Penny stocks can usually be found trading under a dollar per share. They are highly speculative, risky and dangerous. The companies are small, new and sometimes quite unknown.

These stocks often trade on smaller, regional exchanges that don't have as much self-regulation as the New York Stock Exchange or the NASDAQ system.

Penny stocks also exhibit huge price fluctuations on a daily basis. It may not look like much when a stock moves down 0.25 from 0.50—but if you had owned the stock at 0.50, you lost nearly 50 percent of your value! **My advice is to stay away from penny stocks.**

Initial Public Offerings

Initial Public Offerings (IPOs) are new issues of a company's stock. Typically, the company was previously held privately by one owner or a group of owners. Now the owners wish to sell stakes in the company to the general public in the form of stock.

Be careful; these new stocks can be very enticing, but they are often **over-hyped by the brokerages and banks** in an attempt to sell their huge inventory of shares.

I suggest doing a lot of research if you want to invest in an IPO. And it may be hard to do research on an IPO. Since the companies have traditionally been privately-held before the IPO, they haven't had to make public reports of their performance or financial status. Often the information that's available has been released by people with some kind of vested interest.

> **The simple truth is that IPOs are often hyped by the investment banks and brokerage houses that are offering them. That's why many IPOs jump in price initially and then settle down rather quickly.**

If you can, keep an eye out for any deals going on **behind the scenes**—such as new product launches timed to the IPO or changes in executive management immediately beforehand. Officially, a company about to make an IPO is supposed to honor a "quiet period" when it doesn't make any big announcements. But there are usually rumors and informal news flashes in places like **on-line chatrooms** and **industry publications**.

You don't want to be taken for a sucker. You may think you are going to make a quick killing, but wind up finding yourself squashed beneath the power of billion-dollar brokers and venture capitalists.

One example of how you can get caught up in the IPO frenzy was the high-flying Internet company theglobe.com. Theglobe.com, based in New York City, was originally offered at $9 a share; within five minutes of its IPO, it had climbed to $97 per share.

Individual investors couldn't buy fast enough—and most of them were stuck paying a horrible price for this unknown company.

Although the stock closed 600 percent higher, at $63, than the offering price, many **individual investors bought near the top** and suffered a one-day loss of $30 or $35 per share.

Within a few months, theglobe.com was trading around $3 per share. Within a few years, it had folded.

> **Remember: The playing field in this game is not always level. Especially with new stocks, the investment banks and brokerages selling the stock always know more about what's really going on than the people buying the stock do.**

I'll touch upon this topic again a little later. But for now, just keep in mind that jumping into an IPO at the start-without waiting for the stock to settle with time-can quickly corner you without a defensive weapon in hand. Be cautious.

Foreign Stocks

As the economy moves globally, foreign stocks may provide a superior advantage. Buying on foreign markets can be a bit of a challenge considering you not only have to deal with the fluctuations of the stock's price but the fluctuations of the foreign currency.

If the stock's price goes up 25 percent you may think that you'll come out ahead; however, the value of the currency can actually go down 30 percent in comparison to the almighty dollar and you could wind up losing 5 percent.

> **Additionally, it's difficult to research foreign companies because many countries do not require them to divulge as much information as the U.S. government does.**

As an experienced young investor, **I would advise you to stay away** from foreign markets. Remember, you are only a revolution or military incident away from losing all your money. Unstable economies and suspect policies can also cost you big bucks.

Also some Canadian exchanges (particularly the Vancouver Stock Exchange) are known for listing volatile penny stocks that trade up and down dramatically for a while...and then declare bankruptcy.

If you would like to diversify across the oceans, you can do so without ever leaving American soil if you go the ADR route. ADRs or **American Depository Receipts** are a way for foreign companies to trade on an American stock exchange like the NASDAQ system or the New York Stock Exchange.

ADRs work in the same fashion as regular stocks from domestic companies—only the ADR signals that the company is operated overseas. ADRs are normally issued by large, foreign corporations such as Sony, Honda and British Airways on the trustworthy NYSE.

Since they are listed on an American exchange, companies that offer ADRs are required to provide the same information and follow the same financial laws as any American company.

Primary Stock Exchanges

The United States' first and most prestigious stock exchange—the **New York Stock Exchange** (NYSE)—was founded in 1792. Presently, the exchange is located on the corner of Wall and Broad Streets in downtown Manhattan, New York, where trading takes place on a centralized floor.

This is where auctions occur from 9:30 a.m. to 4 p.m. Eastern Standard Time. Exchange members, acting on behalf of investors, shout buy and sell orders until an agreed upon price is reached. Prices are determined by simple supply and demand. The NYSE ensures that no investor—no matter how big or small—is at a disadvantage.

And if you ever have the chance to see the floor in action, I suggest paying a visit to the *Big Board*, as the NYSE is often called.

A brief lesson on the concept of supply and demand is useful here, since the relation between the two provide the foundation for a capitalist economy.

Basically, when public demand for a product, service or commodity increases, so will the price of that which is demanded. As demand for the item increases, people will be willing to pay more for it. The exact opposite is also true: When demand for something decreases, the price will also fall. For supply, when the supply of a product, service or commodity increases, the price decreases. The item is so readily available that people are not willing to pay more for it.

The opposite is true for supply: less supply means higher price.

Supply and demand not only come into play when analyzing a company's product and its potential for profit, but supply and demand affects stocks themselves. Stocks are bought and sold just like any other item. Furthermore, if millions of people flood the market wanting to sell, say Coca-Cola, then the stock price for Coke will fall. Conversely, if everyone wants to buy Coke shares, then the stock price will rise in conjunction with demand. So when you're watching the floor of the New York Stock Exchange, you're essentially watching the concept of supply and demand in live action.

The NYSE is home to 1,700 of the largest and most well-established companies in the United States.

Additionally, foreign corporations offer their shares to be traded on the NYSE in the form of American Depositary Receipts (ADRs), which are essentially the same as U.S. shares. The NYSE is largely considered to be the place to find solid, blue chip investments.

The **American Stock Exchange** (AMEX) came to be known as the Curb Exchange until 1921—because it originally organized much of its trading on the street curb. The AMEX is now home to 800 medium- and small-growth companies and, like the NYSE, the AMEX hosts many foreign corporations.

The **National Association of Securities Dealers Automated Quotation** system, commonly referred to as the NASDAQ, does *not* conduct trading on a centralized floor but through a network of broker-dealers connected to an intricate **telephone and computer network system**.

> **Many people consider the NASDAQ's on-line system to be the future of stock trading. In fact, in the early 2000s, the NYSE added some on-line trading to its system. But, generally, the NASDAQ remains more technologically-advanced and the NYSE remains more prestigious.**

In 1999, the NASDAQ and American Stock Exchange merged, to create the NASDAQ-AMEX Group. The merger brings together the AMEX's auction-based system, similar to the NYSE's system, and the NASDAQ's computer network system. Although both will still function separately, they have become a formidable competitor to the NYSE. In fact, the technology-laden NASDAQ in recent years has passed the NYSE in daily volume of shares traded.

The Basics

These are the basics of what stocks are and how they work. In the next chapter, I'll take a look at how you—as a young investor—can use stocks to learn about Corporate America…and make money in the meantime.

CHAPTER

5 How to Use Stocks

In this chapter, I will apply some of the mechanics of how stocks work from the last chapter to a discussion of how a young investor can use stocks to his or her advantage and profit.

In short, we'll take a look at stocks, indexes, risk and the fun you can have with all of these.

Stock Indexes

Researching stock indexes is a great way to get an overall feel for how the market is doing. But what is an index?

A **stock index** is a group of stocks placed together for the purpose of analyzing the market—or a specific industry group—as a whole. Commonly known indexes are the **Standard & Poor's 500** (S&P 500) and the **Dow Jones Industrial Average** (DJIA).

The S&P 500 consists of 500 of the largest, most profitable American companies. These companies range from the well-known corporations like Hilton Hotels, Campbell Soup and Bank of America, to the relatively unknown ones like Mallinckrodt, which produces medical products, and Knight-Ridder, which publishes newspapers.

This index is such a key indicator of the market's performance, that financial centers (Web sites, networks and numerous publications) always include the current status of the index. This is often juxtaposed with the Dow Jones Industrial Average.

The Dow, as it is frequently called, is a listing of 30 industrial companies that range from General Electric to General Motors. It is the nation's most widely quoted market measure. Among the numbers you see on the front page of your newspaper (often accompanied by arrows either pointing up or down to indicate a gain or loss), is the Dow's closing value from the previous day's trading. The S&P 500, **NASDAQ Composite** and other important indicators (such as gold and the bonds yield) are usually included as well.

> **If you were to turn on a financial TV channel during the day, the Dow would be the center of attention and would be in constant movement-fluctuating with the changing stock values of the member companies.**

The component stocks of the Dow Jones Industrial Average are selected by the editors of *The Wall Street Journal*, which is published by Dow Jones & Co. Changes have occurred throughout the Dow's 100-plus-year history as to the companies that comprise the indicator. And, most recently, new-economy stocks—Microsoft Corp., Intel Corp., Home Depot, Inc. and SBC Communications, Inc.—have replaced the old-economy strongholds of Chevron Corp., Goodyear Tire & Rubber Co., Sears, Roebuck & Co. and Union Carbide Corp.

This change reflects the first time two stocks from the NASDAQ Stock Market (Microsoft and Intel) have joined the blue chip market meter. The switch also reiterates the growing importance of technology to the U.S. economy. Other companies represented in the Dow include AT&T, Coca-Cola, Walt Disney and McDonald's.

Dow Jones also produces other indexes such as the **Dow Jones Transports**, which, obviously, lists companies in the transportation industries-airplanes, trains, etc., such as Union Pacific, Federal Express and Delta. Dow also produces the Utility Index, which includes electricity and related companies such as ConEd and Unicom.

As I've mentioned before, I think that stocks are the best place for a young person to invest. By investing in stocks, you learn all of the details of financial reporting, money management and analysis—things you can use with other types of investment at other times in your life.

> **As I've mentioned before, stocks have historically shown to be the best investments, balancing risk with reward. On average, large U.S. stocks have returned almost 11 percent per year since 1926 (and that counts the Great Depression). That growth outweighs the average 5 percent return of bonds and the 4 percent return for Treasury bills.**

But there are various ways to invest in common stocks. You can buy them directly or you can buy them through mutual funds, index funds and other less direct methods.

What Are Index Funds?

Index funds are mutual funds that buy shares in the companies that make up the indexes. Index funds cause some debate among professional investors and money managers. Are they worth including in an investment portfolio? Basically, the funds don't require any analysis to run—so there's no reason to pay a professional money manager some big fee to buy the same mix of stocks that business newspapers print every day. And, in fact, these funds usually do have lower fees than other kinds of mutual funds.

> **Also, since they reflect general economic trends rather than the performance of any single company or money manager, index funds are considered a hedge against individual investment risks. Many smart investors prefer to use index funds as the safe portion of their retirement or investment portfolios.**

I recommend allocating a portion of your portfolio to at least one index fund for the following reasons. Broad-based funds such as those that track the S&P 500 or Wilshire 5000 indexes provide instant diversification—thereby reducing your portfolio's risk. Moreover, after fees and taxes are considered (we have to pay 'em so why ignore 'em?), index funds outperform approximately three-fourths of professional managed funds each year.

> **This is mostly due to drastically lower fees and low tax allocations, since index funds do not move in and out of stocks (which causes taxable events) as much as professional managers do. Lastly, owning an index fund helps keep you in tune with the gyrations of the general market, providing a good perspective as you research other investments.**

In all, index funds provide a great foundation to any investor's portfolio. Good performance, low expenses, broad diversification. There's not much more you could want.

A Key Goal: Develop Your Own Skills

As I've said before, the main reason to start investing early on is to develop **research and analytic skills**.

Index funds—and mutual funds, in general—make sense for a new investor. They are low-risk and simple. But, in other ways, they work against the purpose of using investments as a real-world lesson in how to understand companies and pick stocks.

My conclusion: Understand how index funds work—you do already, now—and keep your eye on them as a kind of **baseline**. A good investor should be able to pick stocks that perform better than the index funds.

If you're having a hard time keeping ahead of them, you need to review and reconsider the investment decisions you're making. You need to change something. Are you picking stocks that are too risky? Are you playing it too safe? Are you focusing on the wrong industry or geographic region? Are you getting too much advice from the same sources?

And index funds are always useful tools. At some point in the future—when you are old enough and rich enough to need some hedging against inflation, investment risks or other economic factors—you can put some of your money in index funds.

What Is Investment Risk?

Investment risk is typically defined as short-term volatility. Stocks can be considered risky because of their large fluctuations in price. Erratic movements in stock price can occur far too often and the unpredictability of a stock's movement can be intensely frustrating.

The **long-term definition** of risk is drastically different from the short-term. Over the long haul, risk is defined as the probability that your investment value will not be sufficient to meet your monetary goals. Although stocks have the highest risk in terms of short-term variability, they have historically proven to be the best protection against the erosion of inflation.

For the short-term, bonds and Treasury bills appear extremely low-risk because their prices rarely change, but over time, these investments will gradually eat your money. If you had invested in bonds and T-bills for many years and had achieved an average return on each investment (see the chart on page 38 again), it is entirely possible that inflation was at or above your 3 to 5 percent return. In this case, you would have lost money. It is more than likely that inflation will consistently stay below 11 percent—an average stock return. One lesson: Stick with stocks!

If there is one thing I want to reiterate in this book, it's the power of youth. Even though you may not be able to stay out past midnight, vote or take a drink (yet), you can safeguard your financial future and prepare to be wealthy by initiating a sound investing practice now. Believe it or not, time and youth combined are the most powerful tools in your hands. Use them—before your youth slips away.

> **In Chapter 6, I'll discuss this power of youth and the ways in which you can tap into what you already know for making the best, most informative decisions in the stock market.**

What Inflation Means to a Stock Investment

Inflation is the rate at which general prices for goods and services increase. Inflation is determined by what is called the **Consumer Price Index** (CPI). The CPI is a basket of goods that is representative of what the typical American purchases.

The average rate of increase in the prices of the items in the market basket are determined to represent the overall increase in prices for goods across the entire United States.

Every so often, the items in the basket are updated by the agency that maintains the CPI—the Bureau of Labor Statistics. This occurs because what the average American buys changes over time. For example, such things as record players and typewriters were common purchases in the 1970s. However, they would not accurately represent what people buy today.

Recently, personal computers and the cost of Internet service have been added to the market basket as more people move into the Information Age. Constant updating of the market basket is essential to accurately determine inflation.

But what's so bad about inflation?

Inflation makes your money worth less every year. And, as an investor, what you have is money—not commodities, assets or other things.

For example, if you bought a nice stereo for $500 last year, at an inflation rate of 5 percent, that same stereo would now cost you $525 and next year, $551. Because of inflation, in reality, the dollar you have now will not buy a dollar's worth of goods next year.

Why is this important? If your money is continuously becoming less valuable, then you must find a way to beat inflation. If inflation is 5 percent a year and you earn 6 percent a year on investments, then your money has really earned only 1 percent in real terms. If you are only earning 3 percent then you are actually losing money to inflation.

> **Inflation should always be taken into account when assessing the performance of your investments. Inflation, more than anything else, affects the true value of your stocks and is the reason why keeping your money under the mattress is not a good idea for your future or your back.**

The Privileges You Receive As a Stockholder

Okay, I've spent the first part of this chapter discussing indexes and risks. Now, I'm going to turn to **the fun part** of how you can use stock investments. And you can have fun doing this.

There are many privileges you receive as a stockholder. Aside from the profits gained through ownership in a company, many companies provide additional perks for their shareholders.

> **One of the privileges that a stockholder has is the opportunity to attend the company's annual meeting, as I've already stated. Annual meetings usually begin around lunchtime and you may receive a free catered lunch alongside many other freebies.**

My investment club had a small holding in AMC Theaters, based in Kansas City, MO, and at one annual meeting we all received **unlimited concessions, a free lunch, a free movie, free movie posters** and a Flubber Beanie Baby. Here are some other freebies and promotional items that companies offer investors.

Investor Freebies[1]

- **Anheuser-Busch**. Save 15 percent on tickets to Anheuser-Busch theme parks, such as Busch Gardens and Sea World, plus 25 percent to 50 percent off merchandise from the company's catalogues.
- **Carnival Corp.** Receive $250 off a cruise of 14 days or more; $100 off a seven to 13-day cruise, $50 off a less-than-seven-day cruise.
- **Goodyear Tire**. Receive 10 percent off a set of four tires for your car.
- **McDonald's**. This year's annual report included a coupon for a free large order of fries.
- **Starbucks**. Starbucks's annual report includes a coupon for a free eight-ounce coffee.
- **Bristol-Myers Squibb**. The company sends all new shareholders a welcome packet of its consumer products, including, for example, small bottles of Excedrin, Bufferin, Nuprin, Clairol hair care products and Ban deodorant.
- **General Mills, Inc.** General Mills occasionally sends out coupons for some of its products along with its quarterly reports. It also offers holiday gift boxes in December at very attractive prices.

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[1] Source of data: *Everyone's Money Book* by Joran Goodman and Sonny Bloch; Dearborn Financial Publishing, 1994.

- **Kellogg Company.** All new shareholders of record receive a welcome kit with brochures and reports on the company along with a pair of coupons for free grocery products. At the annual meeting in Battle Creek, MI, shareholders also receive product samples and discount coupons. The company sometimes hands out special gifts such as decorative Kellogg's plates.
- **The Limited, Inc.** The company sent out a coupon with its most recent annual report for 15 percent off merchandise at any of its stores (Structure, The Limited, Express, Gaylan's, etc.).
- **Sara Lee Corp.** Each year at the annual meeting, shareholders usually receive a gift box of Sara Lee products, including such items as coupons, bath soaps and other company products.

These freebies and giveaways are fun to get...and to compare. But **you shouldn't think of them as an end in themselves**. If you make an investment decision based on a free order of french fries or free movie tickets, you're not keeping your eye on the ball.

If you buy $100 worth of McDonald's stock because you get a large order fries and the stock drops 10 percent after the company announces it's had a bad financial quarter, you spent $10 for those fries. Not exactly an extra value deal.

Freebies are worth something of greater value to a smart investor, though. They do tell you important things about the kinds of business that different companies are in.

Compare the free order of fries that McDonald's offers shareholders to the $250 discount certificate that Carnival Cruises offers.

McDonald's is a bigger company, so why does it offer a stingier freebie to shareholders?

There are several reasons; and they tell you a lot about the two companies.

What Freebies Mean

First, and most obvious, McDonald's sells products that cost less—an average of about $2 each—than Carnival's cruises, which cost several thousand dollars each.

So, why doesn't McDonald's give its shareholders a gift certificate worth $250 of free food to match the Carnival freebie?

Now, we get to a more important distinction between the two companies. McDonald's doesn't just charge less for each item it sells. It also makes **less profit on each dollar** of sales it generates. This is what financial analysts call the profit margin of the business.

> **So, McDonald's has a smaller profit margin than Carnival Cruises. Of course, it still makes a profit; thus, if it sells a lot more burgers and fries than Carnival sells cruise packages, it may end up making more money at the end of the year.**

Also, Carnival—like many companies in high-margin businesses—may use its fatter margin to borrow money to buy new cruise ships or lots of ads telling people to go on a cruise. Relative to their total sales, **Carnival may have more debt** that has to be repaid than McDonald's...and, therefore, have less money at the end of the year.

Still, because of the higher item price and fatter margin, it will be easier for Carnival to offer a bigger discount.

Another relevant analysis can be made with reference to these freebies—beyond the obvious remark about profit margins and how much a given company can afford to provide to its shareholders. All things being equal, McDonald's free large order of fries and Carnival's generous discounts on cruises to stockholders says something about how the different companies choose to entice and retain their stockholders.

> **When Carnival offers discounted cruises, it is banking on the likelihood that you will travel with others, thus making more money for Carnival. Most do not travel alone, so by offering such a discount to you, Carnival is, in essence, advertising through you. Their discount is merely a promotional vehicle.**

McDonald's, on the other hand, will not profit considerably by you bringing a few friends along to dinner at a restaurant. The difference in the nature of the companies' profitability here is great. Carnival stands to gain a lot more via discounted cruises to stockholders; McDonald's does not stand to gain a lot via a free order of fries.

To put it another way, while Carnival chooses to "invest" in its stockholders because the company will make more money for Carnival, McDonald's invests elsewhere (e.g. restaurant cleanliness or meat quality) in order to ultimately profit.

> **In fact, McDonald's mission statement states this very idea: To offer...food prepared in the same high-quality manner worldwide...in a consistent low-key décor and friendly atmosphere. Clearly, McDonald's knows where to spend its money in order to maximize profit.**

As the stockholder, you must decide how valuable a given company's freebies are to you. If, for example, you would use Carnival's discount and take a cruise, you are creating a win-win situation for yourself by investing in Carnival. This does not mean that the utility of a freebie should determine whether or not you buy a given stock, but you should be aware of a freebie's worth to you-especially when picking between two companies with comparable financial profiles.

New companies may offer good stuff in order to initially entice stockholders; old companies may revamp their freebies if bad press or precarious reputations have hindered their performance. You must take these things into consideration when deciding upon a stock. And never, under any circumstances, value any company based solely on its freebie. If anything, freebies are merely tools for companies to advertise, promote and keep investors happy.

Freebies should never be a reason to buy, sell or hold any stock. Think of them as promotional bonuses.

Your Responsibilities As a Stockholder

Your primary responsibility as a shareholder is to watch over the well-being of the company. Each year, stockholders elect a group of people to oversee the day-to-day operations of the company. It is through this group, often referred to as the board of directors, that shareholders have the potential to influence how their company operates.

Every year, you will be sent a ballot to vote for the company's board of directors. Along with the ballot, often called a **proxy**, you will receive a packet discussing the various candidates.

Be sure to read through the packet to give yourself a better understanding of the qualifications for each candidate. It also gives you a better idea of the issues a company is facing. In most cases, a proxy will only allow you to vote for either all of the candidates or none, so make your decision carefully.

In theory, through the board of directors, shareholders have the power to direct the company. This is a very important responsibility and should be looked upon in that fashion.

Additionally, you can go to the annual meeting and bring up questions or issues. The company executives have to respond in public and, sometimes, you can really make a difference.

> **I have met important people at these meetings (Warren Buffet among them) and learned a great deal about what executives closest to the company feel about the future—where the company is headed and why.**

I can't stress enough the importance of performing your duties as a shareholder. You have real money on the line and the work you do to understand and protect that investment is crucial. In a time when corporate scandals are becoming all too commonplace, these issues become all the more significant.

Government officials cannot turn over every rock to find the bad seeds—and you can't ensure completely that nothing improper will happen at a company whose shares you own. But, you *can* ensure that independent and (more importantly) independent-minded directors are elected to the board that will keep the shareholders' best interest at heart. It's your money. Protect it.

CHAPTER

6 Using Youth to Your Advantage

As a young investor, you have several advantages in stock picking. Youth is a major plus—because **time is a major plus**—when it comes to making money from investments.

> **From my experience, to become successful at investing, all you really need is a little common knowledge (the kind of knowledge people under 25 draw on every day) and time. Every day a teenager comes across dozens of prosperous companies in such industries as retail and technology, just by living the life of a teenager. In fact, consumer products companies actively design these things for the teenage market.**

The shoes you wear, the hot gadget you stand in line to buy at your local electronics store and the quick-selling CD you beg to have for your birthday are all making someone very rich. The companies that produce these popular items are the ones to invest in. You not only understand and relate to their popularity, but you can transform that trend into your own financial success.

The real young adult advantage comes from finding gems in certain industries tailored toward you. Most teenagers are experts in music, sports, fashion, cars, entertainment, computers and food. Surprisingly, **this seemingly ordinary information can earn you money**! Maybe you will realize this season that everyone at school is wearing

Tommy Hilfiger. With a little common sense, you should recognize that if other teenagers across America are similar to the people at your school, then they will probably be buying Tommy. And Tommy is making some serious cash. Maybe you notice that most of the blockbuster movies this year have been made by a division of Sony or you notice that everyone at school seems to carry a cell phone from Nokia.

Brands like Hilfiger, Nokia and Sony have become household names because people like us buy and use their products (and in doing so, we promote more of their products). But how many of you have actually taken that popularity into your own hands? **Into your own bank account?** Don't think that you cannot cash in on someone else's invention or trend-setting product. It doesn't take much mental power to come up with a Top 10 list of popular items in today's market. More than likely, many of these will have been produced by publicly traded companies.

> **Popular items—the things you wear, watch, play with and listen to—generate lots of money. Investing in the companies that produce such things can make you generate cash, too.**

Use Consumer Knowledge to Your Advantage

As a teen consumer, you have the greatest advantage. You notice when certain stores seem to go in and out of style. You notice when a new store is an instant hit. You notice when a restaurant suddenly falls out of popularity. You, as the consumer, notice all of these things, and you talk about them daily. "Hey, did you see Martini's Restaurant went out of business?" "Have you been to the new AMC Theater with the stadium seating? It's great!" "Every time I go into The Limited, it's packed!"

Companies pay big marketing money to track down these opinions. Your job, as a young investor, is to **use this knowledge** to the best of your ability. Maybe more people will go to an AMC theater because of its new seating. When it looks like The Limited is making a killing this fashion season, it probably is. Chances are, consumers in New York, Wisconsin, Oregon or any other state are just like you and your friends.

In general, what people buy in your city is going to be mirrored across the nation. Consumer knowledge can also help you find companies to conduct further research on. If the company is not doing well in the consumer's mind, then it is probably not worth your while to dig any further.

Stick with common sense and you'll be fine.

Parents—Can They Help?

Sure. The second-largest advantage teenagers have is their parents. No, no I'm not kidding. Your parents have an inside edge to certain industries as well. If your mother is a pharmacist she can point you toward the revolutionary new Pfizer drug just approved by the Food and Drug Administration. If your father owns a gas station; he will know how oil prices might affect oil suppliers such as ExxonMobile.

Here is an example. Recently, I was doing some research on medical stocks before a meeting for one of my investment clubs (Falcon Investment Enterprises). While conducting my research, I came across a company called Medtronic. And, since my father is a cardiologist, I asked him what he knew about the company. He told me that Medtronic, a company that manufacturers heart pacers, is renowned for its products. In fact, he told me that he only uses Medtronic's heart pacers for his patients and that other doctors commonly use the pacers as well.

I presented my research at the meeting, and although it was not chosen as a stock the group wanted to invest in, Medtronic soon rose from \$40 to \$70 in one year.

Your parents can also be used to obtain free, expert advice. If your parents have a broker, as most adults do, ask your parents to obtain the information you need for any company you wish to research. This way, you can get the information without having to personally set up an account or pay a fee to the broker.

> **Use what you know and what your parents know to place yourself a step ahead of everyone else.**

Risk Tolerance—Time Is on Your Side

There's an old saying that you hear around horse racing tracks and casinos: **Don't bet more than you can afford to lose**. The same goes for investing: Don't take on a level of risk that can potentially lose you more than you can afford—or want to afford.

Risk and reward are interdependent. The more risk you take in a given investment, the more money you stand to make. Conversely, the less risk you take, the less money you are likely to make. You must not only evaluate your investment goals—when you plan to cash out and with how much—but you must decide upon your tolerance for risk, reward and possible failure. Measuring and weighing these factors is a personal choice, and one that makes investing all the more fun. No one can tell you what to do with your money and future.

> **At the same time, however, there is an advantage to being a teenager: We have a lot of time to play the market, make mistakes and live to correct them.**

Although I like to advocate relatively conservative investments, you must also realize that you have a lot of time on your hands that allows you to **take on more risk** than the average, middle-aged adult. Think of it this way: If you lose everything before you turn 20 (an extreme scenario, to say the least), you will most likely be able to alter your investing practices and get everything back again and then some before you're 30. However, you may also hit it big with a few lucky investments (or maybe just one) like Cisco Systems or eBay, and acquire a fat net worth before you've reached the drinking age. Then, you'll be miles ahead of the rest.

Of course, you can't count on luck. You still need to have sound research, well thought out stock picking and prudent portfolio planning. There's always a bit of luck involved—but minimizing the luck needed to win big and honing your investing skills are the greatest keys to success.

Don't overestimate your tolerance for risk. Don't plan on being lucky. Losing money hurts, no matter how old you are.

To show you what a little fortune now can return to you later, assume you've amassed $10,000 by your 13th birthday. Compounded annually at 15 percent, this will earn you nearly **half a million dollars** by the time you reach the age of 40. If you watch $50,000 grow at the same annual rate of 15 percent, you'll see a million dollars in 20 short years.

To understand this amazing growth, you need to know about **the power of compound interest**.

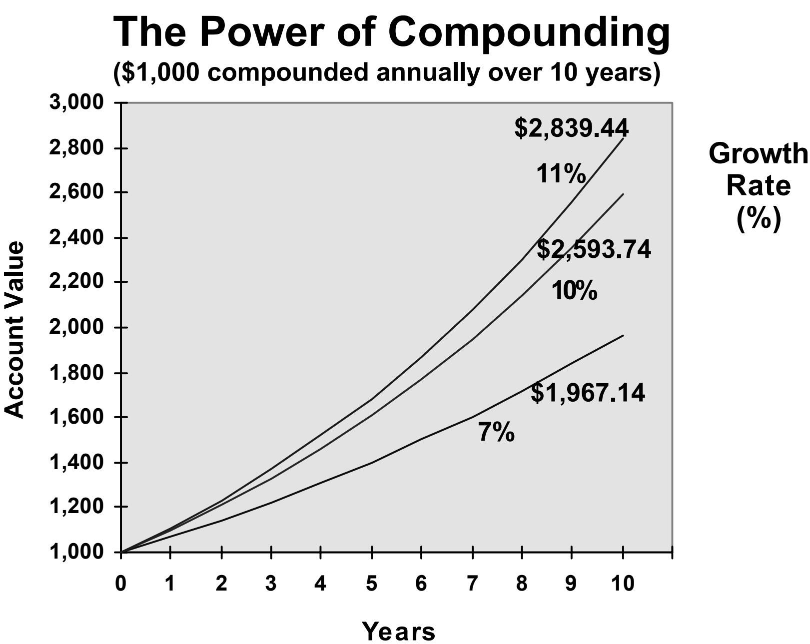
Compounding Growth

Compound growth is the process of earning interest (or dividends) on your interest. For example, if you invest $1,000 and it earns 10 percent each year, after the first year your investment will be worth $1,100. In year two, you now earn 10 percent on that $100 as well as the original $1,000, which brings your total to $1,210—and so on and so on. If you leave your investment to compound, in 50 years that

$1,000 will be worth $117,391. That is a lot of money. And it all came about because of **time and patience**.

> **Get-rich-quick schemes just do not work for the average person because they ignore the importance of time and patience. Compounding is so magical that simple low returns can double your money many times over, with the benefit of time. And that's exactly what you have: time.**

They may not be as exciting as blackjack in Vegas or Powerball, but the returns of 8, 9 or 10 percent will make dreams come true. There is no uncertainty; it will happen. Hey, I'd choose predictability over excitement any day. As an investor, you need to think like this, too. **Watch a ballgame for excitement.** Speculating with money is not exciting, it's agitating.



The magic of compounding relies on the fact that money not only earns interest, but *interest* earns interest. (Example shown taken from *Investor's Guide to Low-Cost Mutual Funds*; Mutual Fund Education Alliance, Second Ed.; 1996.)

Here's another example to show you the power of time and compounding: Let's compare **a hypothetical investment for you and your parents** both earning 10 percent per year. If you invest $200 a month from the time you are 15 until you are 35 when you stop putting money into the nest egg but continue to let it compound until you retire at age 65. Your parents, on the other hand, invest $5,000 a month when they are 35 and do so until they retire 30 years later.

Who do you think will have the most money when they retire—you or your parents?

The answer is *you*. When you retire, you have invested a total of $48,000 and your portfolio is now worth a cool $2,650,000. Your parents started late but they pumped much more money into their investment, totaling $360,000, which at retirement is worth $2,260,000. Both of you retire with almost the same amount of money; but you only invested two-fifteenths the amount that your parents did.

> **It's nice to share your gratitude with the ultimate investment tool: time. Need I say it again?**

Dollar-Cost Averaging

Another phenomenon in the world of investing (besides compound growth) is the miracle of **dollar-cost averaging**. Dollar-cost averaging is one of the easiest, most efficient ways to invest. I recommend this technique as the best way to nurture your investment portfolio over a long period of time.

The essence of dollar-cost averaging is to **place a fixed dollar amount in your portfolio** on a regular basis. Monthly or bimonthly investments are the most common with contributions ranging from $50 to $200 for each period. If you buy a fixed dollar amount consistently, when the price is low, you will purchase more shares and inversely, when the price is high, you will buy fewer shares. This helps to keep your average purchase price low, since the majority of your shares will be bought at lower prices.

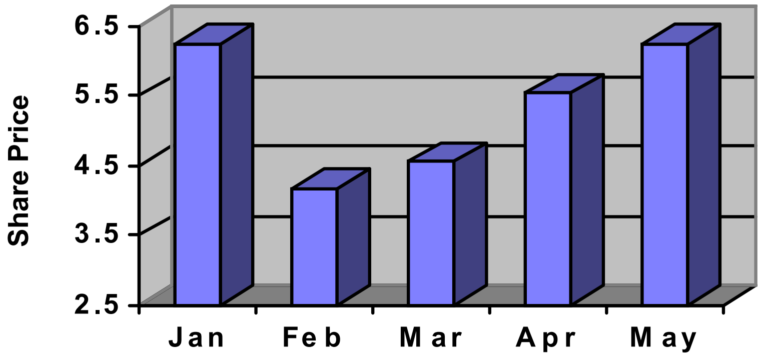
Additionally, dollar-cost averaging helps to train you to invest regularly.

How Dollar-Cost Averaging Works
(Monthly investments of $100)

Month	Price	Shares
January	$6.25	16
February	$4.17	24
March	$4.55	22
April	$5.55	18
May	$6.25	16
Total	$5.21	96

Source of data: *Investor's Guide to Low-Cost Mutual Funds*; Mutual Fund Education Alliance, Second Ed.; 1996.

With dollar-cost averaging, you are investing for the long haul. By committing yourself to invest regularly, you are forming a much-needed investment foundation to your portfolio. There is no elaborate analysis; you simply invest on a periodic basis no matter what the share price is. Now let's graph these numbers and see how periodic investing averages your investment price. These are the results:



Periodic investing with a consistent dollar amount will average your investment price, thus eliminating the hazards of a stock's frequent fluctuations.

Here's another way to look at it: According to the graph on the previous page, although your initial (January) and closing (May) investments were unchanged, you lowered your average investment price to $5.21 and, thus, **created a 20 percent gain**.

Mutual Fund Dividends & Reinvesting

You can practice dollar cost averaging with mutual funds too. By reinvesting your dividends, they roll over into additional fund shares. Rolling over your dividends into new shares allows you to experience the power of compounding.

Furthermore, when you reinvest your dividends, you are **never charged a sales fee**, so your investments will be cheaper. Compound growth will, more than anything else, make a substantial contribution toward your long-term investment performance.

It All Comes Down to Research, Baby!

Why should I research my stocks if it takes so much time? If you're even bothering to ask this question, you might not be cut out to be an investor. Good research can vastly improve your stock picking and ultimately increase your stocks' performance and your earnings. A professional football team would not invest in a quarterback if they had not watched his past performance in college, so why should you buy a stock without researching the company's past performance?

> **Never invest your hard-earned money into a company you do not fully understand.**

Look at it this way: If researching stocks was so easy, then we would all be millionaires with nothing to worry about except when to buy that new Porsche.

Using Time

Speaking of millions, I recently received a pamphlet in the mail explaining how to make **$1 million in the stock market with an investment of only $600**. This scam artist was selling a how-to program illustrating how simply glancing at a few stock charts turned a few hundred dollars into millions. In reality, this crook probably made his million by selling this program for $100 to any sucker who came along—rather than generating it from $600.

It makes me wonder, if he could so easily change $600 into $1 million, why does he need to sell this program? **He should be rich enough to donate his knowledge to the public.** The truth is, he has no idea what he's talking about. And, you need to watch out for this type of would be investment advisor.

> **Be careful. Once you start investing, people get your name from mailing lists and they will send you junk constantly. There is almost no way to make $1 million with $600 and especially by merely looking at a stock chart—no, wait, scratch that. There is *absolutely* no way to make $1 million with $600 without doing a lot of hard work.**

Money doesn't come easy. Only a few have an abundance of it, because only a few are willing to work for it.

Thus, we come to the *how* part. How do you go about acquainting yourself with the market? You must work at understanding and knowing the market, which is what I will help you tackle in this next chapter so you can start investing today.

CHAPTER

7 Getting Comfortable with the Market

Now, you understand the basics of how the stock market works. But how do you get *comfortable* with the market? Where do you find your information? There are millions of answers to these questions, but there is one step you can take to ensure that you stumble upon a gem of a company: **Read the business section of your local newspaper or favorite Web site every day.**

Reading the news is step one. By doing this, you should trip over interesting company news about once every two weeks. For example, an automotive company releases a cool new car, a major computer company introduces a new and improved computer screen or an entertainment company releases a bunch of blockbuster movies.

> **An article is never a reason to buy stock in a company. At the most, it should only convince you to conduct more research on the company.**

Now for step two. Researching a company means **digging for details**. But where do you find details? There are two great spots to start your search. The first is your local library. Libraries have many reliable resources.

Ask your librarian to direct you toward the section that houses investment resources. You may even find a librarian who is knowledgeable enough to show you the **various information resources**, and how to use each one. Otherwise, you will have to spend time acquainting yourself with the resources, compare and find one that is easy to use.

> **I prefer Value Line Investment Survey (a large binder filled with analyses of about 1,700 companies), but you can do your own research and may want to combine various resources' analyses to obtain a wider breadth of information.**

Another great place to find research is at the convenience of your fingertips. If you own a computer with Internet access, you have immediate access to **millions of Web sites** offering up the information you need to better investigate your potential investments.

Research on the Internet is much like the research found in the paper format at the library. The primary difference between the Internet and what's at the library is that Web sites tend to have their figures updated regularly with more recent information. Hard copies on paper are dated upon their printing.

> **One drawback of the Internet, however, is that its enormity makes it difficult to find what you need. Searching the Internet is like walking through the world's largest library with no card catalogue. Sure, there are search engines that can make the walk less lonely—but a growing portion of search engine results are paid advertising. And this is especially true for investment information.**

This leads to another potential problem with the Internet: the sources of investment information are sometimes shady. Make sure that you know where the information you are basing your decision on is coming from. There are lots of charlatans out there—especially on the Internet—trying to sell people on worthless investments.

Because so much of the Internet is shady, I suggest that any young investor starts learning about the stock market with paper resources at the library. Then, when you begin to feel that the shelves at the library don't give you as much up-to-date information as you need, you might want to visit a few of the following sites.

Good Internet Sites

A good starting point for your investment research is one of the major financial portals. I happen to like MSN MoneyCentral (**www.investor.msn.com**). The MoneyCentral site will provide you with all the information you will need in addition to furnishing you with an investment finder. With this gizmo, you plug in all the criteria for a stock such as its P/E or book value, and the computer spits out the finest companies that meet your standards.

Other such sites for this type of work include Yahoo Finance (**finance.yahoo.com**) and Big Charts (**www.bigcharts.com**). For even more examples, refer to Appendix B at the end of this book.

> **Technical analysis (sometimes called "quantitative analysis")—the study of a stock's price movement without regard to its underlying business—is quite complicated. And I, personally, don't go for it. But, as you become a more advanced investor, it can't hurt to broaden your investment knowledge.**

The best Web site for the research into the historical price movement that technical analysts call "charting" is MarketWatch (**www.marketwatch.com**). This site—part of the Dow Jones media family—allows you to customize stock charting with by criteria.

As your research becomes more advanced, you may want technical analysis or Securities and Exchange Commission (**www.sec.gov**) data. The SEC site includes the **annual and quarterly reports** for most publicly-traded companies.

> **SEC filings also provide you with the most detailed information available. Companies are required to divulge everything to the SEC, right down to the hair color of their CEO. Obviously the last part isn't true but they do list management's compensation, which is fun or sometimes outraging to look at.**

See Appendix H at the end of this book for a list of government and other useful sites that may help you find what you need.

You can also try to contact a company directly and ask them to send you its filings. In fact, if you get enough companies to send you filings, you can create your own SEC database.

Reading a Published Stock Listing

Most daily newspapers carry a listing of each stock on the NYSE, NASDAQ and AMEX. Generally, listings appear as follows:

52-Week										
High	**Low**	**Stock**	**Div**	**Yld**	**PE**	**Vol**	**High**	**Low**	**Close**	**Chg**
110	82.25	Merck	1.00	1.7	27	3000	102	100.75	101	+0.5

52-Week High & Low. The highest and lowest price at which the stock has traded during the past year. Merck has traded at a high of $110 and a low of $82.25. Use this data to determine how the stock has fluctuated in the previous 52 weeks and where it is now compared to its yearlong variation. If a stock is near its low, yet its future seems bright, non-specific issues such as economic concerns may have precipitated this decline. This may be a better time to buy than when it is at its yearlong peak.

Div. The annual dividend per share owned. Merck currently pays a dividend of $1 per share. If you owned 100 shares of Merck, the dividend you would receive would total $100 per year, or $25 every quarter. Dividends are usually paid to shareholders quarterly.

Yld. Calculation of the dividend yield is done by dividing the annual dividend by the most recent closing price. Thus, a $1 dividend divided by a $100 stock price results in a 1 percent yield. Therefore, if the stock doesn't move, you will still see a 1% return in the form of dividend checks.

PE. The Price-to-Earnings ratio is calculated by dividing the closing stock price by the company's earnings per share for the previous year. This ratio helps to determine how the stock's current price is valued against its earnings. I know this sounds confusing, but this measure can be used to compare companies in the same industry. Basically the P/E ratio tells you how much you will pay for each dollar the company earns. Generally, it makes sense to look for earnings that are at a discount. High P/E ratios indicate that the stock price is high, while low P/E ratios usually mean the opposite.

> **Remember: You must compare apples to apples. Similar industries tend to have companies with similar P/E ratios. Compare car companies with other car companies. Do not compare the P/E ratios of a car company with the P/E ratios of an Internet provider.**

Vol. The previous day's volume is listed in the thousands of shares traded. Usually if there is a sharp increase in the volume of a company, then something extremely important is happening to make so many people want to buy and sell their shares. If this happens, watch your stock more closely and try to find out the scoop.

High & Low. The highest and lowest price at which the stock traded during the previous day.

Close. Sometimes listed as Last, the close is the last price the stock traded at during the preceding day.

Chg. The change or net change is the difference in the closing price listed and the closing price of the day before. Merck's closing price was $101, 50 cents higher than the day before. Thus, the closing price of the day before was $100.50.

Dividend and Earnings Report Tables

Dividend report tables tell you whether a company's board of directors has offered a higher, lower or comparable dividend as the previous quarter or, in some rare cases, omitted the dividend altogether.

Stock	Period	Amount	Stock of Record	Date Payable
Stahl	Q	25	3-15	4-1

Stock. The first column lists the name of the stock or the corporation offering the dividend.

Period. The period refers to the time when the dividend will be paid. (Q refers to quarterly. A refers to annually. M refers to monthly. S refers to semiannually.)

Amount. The amount refers to the amount of dollars distributed per share.

Stock of Record. The fourth column, the stock of record, denotes that the dividend will be paid to shareholders of record on the date recorded. In the above example, the dividend will be paid to shareholders of record on March 15. In other words, if you were to buy the stock on March 16, you would not receive the dividend.

Date Payable. The date payable cites the date when the dividend is actually paid.

In an earnings report table, companies record their earnings on a quarterly basis. The tables are used to compare the firm's current earnings to the profits of the same quarter in the previous year.

Earnings Report Table

1. **Stahl (N)**

	This Year	Last Year
2. **Quar Mar. 30:**	This Year	Last Year
3. **Revenues**	$100,000,000	$80,000,000
4. **Net Income**	$10,000,000	$7,000,000
5. **Share Earns**	.9	.5
6. **Avg. Shares Outstanding**	10,000,000	11,000,000

1. The first row in an earnings report table notes the **corporation** reporting its earnings. The letter in parentheses denotes where the stock is traded. The following is a list of the various exchanges:

STOCK EXCHANGES
A-American Stock Exchange
B-Boston Stock Exchange
F-Foreign Stock Exchange
M-Midwest Stock Exchange
Mo-Montreal Stock Exchange
N-New York Stock Exchange
O-Over-the-Counter Market
P-Philadelphia Stock Exchange
Pa-Pacific Stock Exchange
T-Toronto Stock Exchange

2. The second row refers to the date when **the quarter being reported ends**. In the above example, the quarter ends March 30.

3. **Revenues**, often referred to as sales, are the amount of money taken in by a company without subtracting its costs. In the above example, sales rose from $80 million in the same quarter from the previous year to $100 million for the current year.

4. **Net income** is the amount of profit earned during the quarter. Net income is calculated by taking the total revenues minus the total costs. Thus, if revenues total $100 million and expenses total $25 million, then Net income is $75 million. Similar to revenues, this is also compared to the same quarter a year ago.

5. **Share earns** indicate the amount of net income that is earned per share outstanding. This number is important when analyzing the amount of profit each share is worth.

6. The common **shares outstanding** is reported as an average for the quarter. The total number of common shares outstanding is the number of slices of the ownership pie if you will. A decrease in the number of shares with the same earnings would create a favorable increase in earnings per share. The inverse is also true.

For more information on stock, earnings and dividend tables, consult Jordan Elliot Goodman's *Everyone's Money Book*, published by Dearborn Financial, 1998.

What's Next?

At first glance, company profiles appear smothered with thousands of insignificant figures. The challenge is to decipher the jargon into useful information. Let's cover some of the important terms you'll encounter so that you can make sense and use out of the data that will ultimately affect your investing.

Among the resources available to you-such as Value Line- look for some of the following data. This kind of basic information is extremely useful in your study of a particular company. Note that each numbered item below may not necessarily be published in every resource. Thus, you may have to combine various references to complete your research.

1. **Company name**, the **stock exchange** the stock is traded on and the **ticker symbol**. A ticker symbol is an abbreviation used to trade a specific stock. For example, Intel's symbol is INTC. You will have to enter the ticker symbol to buy, sell and receive quotes via the Web. Knowing where the stock is traded—on what exchange—will help you find quotes in the newspaper and on the television.

2. **Timeliness** and **safety** rankings. For example, Value Line uses a 1-to-5 ranking system, whereby timeliness is ranked according to whether Value Line believes it's the right time to buy into the company. Likewise, safety is ranked according to whether Value Line believes a company is a safe investment. Value Line is a good source for this information, since most resources don't contain this data.

3. A **future projection** of the high and the low price for the stock in the years ahead. There is no guarantee with this prediction, but the estimates are made by analysts who follow a given company on a daily basis. While you shouldn't base your entire decision on what the analysts predict, the projections provide you with a perspective from a very knowledgeable person.

4. A list of **insider decisions** from executives and directors within the company. These are the people who work with the company every day and know its operation better than anyone. If insiders have made recent stock acquisitions, then they typically believe the company's prospects will improve. In most cases, employees have more insight into the prospects of a company than an analyst. Check if they are buying the stock—a measure of their confidence. Are employees' interests aligned with those of the stockholders? Yes and no. Don't concern yourself with the occa-

sional sell among executives; some may have to sell in order to pay for a house or a child's college tuition. Most profiles will detail insider decisions for the past 12 months (a much more helpful indication of employee confidence).

5. A list of **institutional decisions** (purchases and sales), which are usually listed in thousands of shares for the last year. Institutions, such as pension plans, mutual funds, universities and insurance companies, control millions upon millions of dollars and when they are interested in a company, they can flood massive amounts of cash into a stock. When money rushes into a stock, its price usually rises. The inverse is also true; when money floods out of a stock, its price will usually fall.

6. A graph representing the fluctuating **stock price** of the company over the last several years. Also in graph form you'll want to find the stock's high and low prices for recent years, as well as the stock volume (percent of the total shares that changed hands). The highs and lows can give you an idea of how the stock fluctuates. Sometimes knowing where it has been allows you to better project the future. When the volume increases sharply, it indicates that something important (either positive or negative) is happening to the company.

7. Detailed financial information dating far back into the company's history. Such important figures include **earnings per share**, **dividends per share**, **book value per share** and **average annual P/E ratio**. An historical perspective may accompany each of these numbers.

8. Data on the company's **debt**, long term and short term, as well as its cash positions. Large amounts of debt can hinder a company unless it is used wisely for expansion or other

measures. But, a large debt load can be negated if the company has a large cash holding and it can easily pay the banks off.

9. A brief description of the company and an accompanying editorial written by an analyst. Usually, a measure of the company's financial strength will be included.

Publicly-Owned Shares vs. Stock Price

Shares are the units of ownership in a publicly-owned business. The greater the number of total shares available, the less each share is worth. Because of a difference in the shares outstanding, companies with the same total value (also referred to as market capitalization) can have different share values.

For example, suppose the Stahl Corporation is currently valued at $1 billion and has 100 million shares outstanding. The value of each share would be $10.

$$\frac{\$1{,}000{,}000{,}000}{100{,}000{,}000 \text{ shares}} = \$10 \text{ per share}$$

Michael Industries also is valued at $1 billion but it has only 10 million shares outstanding. The value of a share in Michael Industries would be valued at $100.

$$\frac{\$1{,}000{,}000{,}000}{10{,}000{,}000 \text{ shares}} = \$100 \text{ per share}$$

So, even though each company had the same value, a share of Michael Industries is 10 times as much money.

Why is this important? Often, strong corporations will reduce the number of shares outstanding over time. This is a good sign. Through

share buyback plans (where a company purchases its own stock with the intent of taking those shares out of circulation), a stable company will decrease the number of total shares outstanding, thus increasing the potential value of those shares and thus your shares.

Let's say Michael Industries has just announced its plan to reduce its shares by one million to a total of nine million shares outstanding. With a current value of $1 billion, each share should be worth $111 and change.

$$\frac{\$1{,}000{,}000{,}000}{9{,}000{,}000 \text{ shares}} = \sim \$111 \text{ per share}$$

So, if you had bought Michael Industries at its previous value of $100 per share, you could earn roughly $11 per share.

Share buyback plans also hint to a company's financial stability. Only a strong corporation would spend its extra cash on a buyback plan. In most cases, this company would have little debt and little chance of going bankrupt (it happens even to the best of them. Even Chrysler, who merged with Daimler Benz to form Daimler Chrysler A. G., filed for bankruptcy in the 1980s).

> **Share buyback plans benefit everyone—especially the shareholder—so seek out companies that do them. And be grateful any time a company whose stock you own decides to buy back its own shares.**

Buying, Owning and Selling

What is a broker and what can he do for you?

A **broker** is a person or an Internet site that facilitates your trades for you. A broker arranges the buying and selling of securities at a stock exchange for you.

Additionally, brokers offer various services—investment advice, research, knowledge as to the different types of trades and types of securities offered—to help improve your investing experience.

Choosing a Broker

As someone who has used many brokers to facilitate trades, I believe that an Internet brokerage best fits a teenager's needs. However, for purposes of this book, let's run through the pros and cons of the three types of brokers: full-service, discount and Internet. A more complete list of brokerages can be found in Appendix F.

A **large-firm** or **full-service broker** offers the most perks of any broker (that's why they are so expensive). Large-firm brokers, like Morgan Stanley, provide an excellent sense of security because of their well-known name. But that sense of security also costs a pretty penny.

> **A large-firm broker only provides a sense of security, making you feel like your money is in safe hands. But, who knows what he'll do with your money. With a large-firm broker, you have little hands-on control of your money. The broker does all the research and selects the stocks to pitch to you.**

In most cases, you'd be better off doing the research yourself. More than likely, a large-firm broker's commissions will be out of your league. Leave the full-service brokers to the people who have full-time jobs and families to support.

The same thing can be said for the **discount broker**, like Charles Schwab & Co. Discount brokers are slightly cheaper and offer much of the same perks for clients that a large-firm broker offers. If you think you would feel more comfortable working with an actual person, you'll probably want to sign up with a discount broker, but it will still cost you.

Internet brokerages are a perfect fit for the teen life-style. Most of us love to surf the net anyway and Internet brokers usually offer the best deals. In fact, some Internet brokers only charge $8 to $10 for a trade. This is considerably cheaper than the 1 percent to 2 percent charged at a large firm or the $30 to $50 it would cost for a discount broker.

Some of the more well-known Internet brokers are E*Trade (www.etrade.com), Ameritrade (www.ameritrade.com) and Scottrade (www.scottrade.com). Again, Appendix F can provide you with some more firms.

> **Your broker will provide you with all of your research needs such as charts, company profiles and recent news that may not have been reported in your local newspaper. You can also find an abundance of information on Web sites such as Yahoo! (www.yahoo.com) or AOL (www.aol.com).**

You can do your research and place your buy or sell order all in the convenience of your own home. Furthermore, you have full and total control of your money.

What's Wrong with Internet Brokerages?

Though Internet brokers offer many advantages, there are some disadvantages. First, you don't get the chance to speak with a human (however, some Internet brokers offer a number so you can call in your buy and sell orders-usually not a toll-free number). Second, some sites have been known to crash and remain down for hours though the frequency of these occurrences has lessened considerably in recent years.

Although neither of my two Internet brokers has ever crashed while I was using them, I've read articles where people have complained about the service of their Internet broker. Despite this, I still recommend an Internet broker for a teenager. They are cheap (the less money you give to someone else, the more money you have to invest) and they still offer tremendous opportunities.

> **To prevent a possible shut-out in the event you cannot log on to your broker's site, I recommend setting up an extra account with another Internet broker. That way, with two separate accounts you can be sure you can place an order when you need to.**

Diversification and Investing

Traditionally, the technique for reducing the risk of investing in stocks is to obtain many stocks that have diversity in investment attributes. If you've ever heard the expression "Don't put all your eggs in one basket," be aware, it is never more applicable than in investing. If you place all your eggs (i.e., investments) in one basket (i.e., industry), over the long haul you will not come out on top.

In fact, you will be beholden to the sharp ups and downs in only one industry. On the other hand, if you place only one or two eggs in many different baskets, then only a few would crack if one basket gets damaged.

Suppose your portfolio, or collection of stocks, consists only of oil producers. When the price of oil drops below normal levels, the companies you own will experience a decrease in earnings. Every barrel of oil produced will sell for much less than expected and the stock price will surely mimic the decreasing profits. However, if you invest in airline stocks and oil producers, and the price of oil drops, airlines will experience a decrease in a significant cost—jet fuel. This would increase airlines' earnings (sales dollars minus costs) and, in turn, their stock price.

The inverse is also true; when oil prices hit new highs, the oil producers prosper while the airlines falter. In both situations, the two inversely related industries counter balance each other and overall reduce the risk of your portfolio. Spread your investments out into many varying industries to make your portfolio more efficient, profitable and less risky.

Dividends—How Do They Affect You?

As a shareholder, you are entitled to a part of the profits from the company in which you own shares. Dividends are a way to distribute a certain amount of the profits to the shareholders (not all profits should be distributed; some must be funneled back into the business for expansion and growth).

Ordinarily, the board of directors of a company will meet each quarter to set the quarterly dividend per share. Depending on current and future predicted earnings, the money required to pay interest on the firm's debt, the amount of money needed for expansion and many other factors, the board of directors votes to determine the dividend paid for each share of stock owned.

A company's directors are not required to grant a dividend to the company's shareholders and some firms have never given a dividend.

During the same meeting, the directors will also establish the date when the dividend is paid and the date when a person must become a stockholder to be entitled to the dividend. You will not have a claim to the dividend if you buy stock in a company after the ownership date is set by the board of directors.

A shareholder can receive a check for his dividend or reinvest the dividend in more stock in the company. This is accomplished through **dividend reinvestment plans**, commonly referred to as DRIPs. If you want a list of companies that offer DRIPs, your best bet is the

Internet. Various financial Web sites (some of which are in Appendixes B and D) can also provide you with this information.

By utilizing a DRIP, you put the magic of compounding to work for you. The shares that you buy with reinvested dividends churn out more dividends, which buy more stock, and so on. Another added advantage to DRIPs is that most of them will purchase the stock free of commissions and other charges.

To encourage shareholder participation in DRIPs about 100 companies offer the **sweetened DRIP**. The sweetened DRIP gives up to an additional 5 percent discount on reinvested dividends. For every $100 you reinvest, you receive $5 extra purchasing power.

> **I encourage the use of DRIPs as a way to vastly increase your investing discipline and your returns.**

What Is a Dividend Yield?

A **dividend yield** is the company's dividend divided by its current share price. A company's yield will change day to day as the stock price changes. For example, if Stahl Electric has an annual dividend of 70 cents per share and is currently trading at $20, its dividend yield is 3.5 percent.

$$\frac{\$0.70 \text{ (annual dividend)}}{\$20 \text{ (current traded price)}} = 3.5 \text{ percent (div yield)}$$

If the stock price dips to $17, the dividend yield rises to 4.1 percent.

$$\frac{\$0.70 \text{ (annual dividend)}}{\$17 \text{ (current traded price)}} = 4.1 \text{ percent (div yield)}$$

What does the yield mean? Well, if you bought 100 shares of Stahl Electric at $20 a share for a total cost of $2,000, your yield would be 3.5 percent. Now, at the end of the year, Stahl Electric pays you a dividend of 70 cents a share, totaling $70. If the stock price is still at $20 at the time of the dividend payment, your stock's value plus dividend income is worth $2,070, which is an automatic gain of 3.5 percent.

Put simply, the dividend yield is an automatic gain. So, with a yield of 5 percent, you will automatically gain 5 percent. But, remember, this can be offset by a loss in share price.

Stock Splits

A **stock split** is when there is an increase in a company's outstanding shares of stock without a corresponding increase in the firm's total value. A stock split can be a great benefit for you as a stockholder. A high share price may scare off many individual investors. At a lower price, more individuals can acquire the stock, thus, boosting the stock's price.

The other big advantage is that you automatically double the number of shares you own in the company. Suppose you bought 50 shares of Stahl Corporation at $150, costing you $7,500. After you have owned the stock for a year, a 2 for 1 stock split is announced. For every one share of stock you previously owned, you now own two shares. After the upcoming split you will own 100 shares of Stahl at $75 apiece with the same total value of $7,500, instead of originally owning 50 shares at $150. The advantage? Now when the stock price rises $1 you earn $100 ($1 x 100 shares) instead of the previous $50 ($1 x 50 shares).

Stock splits are a great advantage to the stockholder, because they increase the number of shares you own, thus, increasing your earnings with future stock price gains.

CHAPTER

8 Mutual Funds 101

If the process of selecting individual stocks seems overwhelming, one alternative is to pick a **mutual fund**. Although mutual funds have been around since the 1920s, in recent years they have blossomed into the most commonly utilized vehicle for investments.

Put simply, when an investor sends his money to a mutual fund, it is pooled with that of thousands of other investors. That pool is then managed and taken care of by a fund manager. The fund manager's job is to increase the value of the investor's holdings with a minimal amount of risk.

> **A mutual fund firm—such as Fidelity, Vanguard or Merrill Lynch—usually sponsors each fund. You can think of a fund family as the company that owns and runs each fund, appointing the fund managers and overseeing their performance.**

A mutual fund works much like stock. In exchange for your money, you are given shares in the fund. A share's price fluctuates with and mimics the value of the fund. The share price is reported as the **net asset value** (NAV) and is determined at the end of each day by dividing the value of the fund's investments by the number of shares. For example, if the Michael Stahl Fund owns $1 billion worth of stocks, bonds and/or cash and investors hold 50 million shares of the fund, then the fund's NAV is $20.

$$\frac{\$1{,}000{,}000{,}000 \text{ worth of securities}}{50{,}000{,}000 \text{ shares of the fund}} = \$20 \text{ net asset value}$$

A mutual fund is a great building block as you start an investment portfolio, even if you choose to pick individual stocks. A fund or tow can give you a great foundation from which to build.

Mutual funds offer certain key advantages over common stocks:

- Mutual funds offer **instant diversification**. On your own you do not have enough money to diversify as much or as efficiently as a fund. When you have money in a mutual fund, you own pieces in dozens or even hundreds of different companies. If one company performs poorly, hopefully the others will-most of the time-balance them out.

- A professional manager chooses the stocks for you. It is the manager's job to spend all day looking over stock reports and analyses to determine the perfect stocks for the fund's portfolio. Though the portfolio managers are professionals, don't give them more credit than they deserve. They are **not certified by any government institution**.

> **Many people don't like this. They say there is something wrong with this world if my barber is certified by the Kansas Board of Cosmetology and a manager handling millions upon millions of dollars is not certified.**

  One *good* thing about a professional is that his butt is on the line. If his fund does not perform well, someone more qualified will take over the reins.

- **There is a fund for every financial goal and risk tolerance level.** Like stocks, in the financial press, each fund is listed on a scale for every type of risk. The way a fund's risk is calculated is complicated and somewhat mystifying.

It is very important to understand that risk and return are not perfectly related, since risk is somewhat determined by your individual personality.

> **While analyzing the same fund, one person may feel that the fund's investments are over the edge while another person sees the investments in a totally different light. Everything has risk; some things just carry more risk than others.**

If you have an interest in anything, whether it pertains directly to investing or not, there is a fund for you. If you are interested in drug companies, there are funds that concentrate on those stocks. If you like sports, there are funds that invest in stocks such as the Boston Celtics, Topps, the Cleveland Indians and other companies related to the sports world.

A Good Place to Start

A mutual fund (or several) is a wonderful beginning to a portfolio. I recommend owning at least one. Each fund family defines its funds by the investment goal, the types of securities in which it invests as well as the risk level.

Personally, my favorite fund is the Vanguard Index 500, which I talk about later in this chapter. I think every teenager should look closely at owning an index fund, and I'll explain why a bit later.

Another good point about mutual funds: They're easy to buy, mechanically. If your parents don't have a broker or access to financial services, you can buy a mutual fund easily yourself through any of the various brokers or directly through the fund family itself.

Load vs. No-Load

There are two classifications of mutual funds that differ in the way they are sold.

When a broker, salesperson or financial planner charges a commission, that fee is referred to as a **load**. Therefore, a fund in which you have to pay a fee is called a load mutual fund.

Of the thousands of load mutual funds, the commissions vary but can be as high as 8.5 percent, which is fairly expensive. For instance, if you send $500 to a load fund that charges 8.5 percent, the broker or the fund immediately takes $42.50 (8.5 percent) for themselves and only invests $457.50 for you. You immediately begin investing at a disadvantage.

The other kind of fund, called a **no-load** mutual fund, is sold directly from the mutual fund without any broker involved.

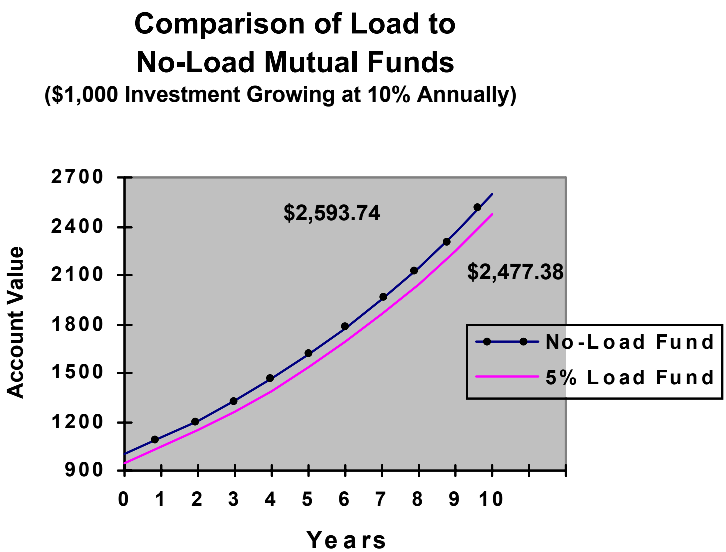
> **To purchase a no-load fund you usually call the fund family directly through a toll-free number or use the firm's Web site.**

No-load funds do not charge a commission for purchasing shares in its fund. However, they are still managed by professionals. The term no-load is murky because some no-load funds do charge fees that are not sales commissions. You never get something for nothing. Fortunately, the additional fees are easily identifiable and avoidable.

Most people believe that load funds are better managed because they charge a fee. This has not been proven to be the case. No-load funds have done equally as well—or better—than load funds.

> **If you invest an original $500 in a no-load fund and earn 10 percent the first year, your value will be $550. For a fund that charges 8.5 percent, you will need to gain 20 percent to reach the same concluding value.**

Why did the load fund have to earn double the amount of the no-load instead of just 8.5 percent more? The load is taken off of the original payment ($500) and the gain needed is taken from the amount actually invested ($457.50). Therefore, you would need to make $92.50 to reach $550, or exactly 20.2 percent. Not easy.



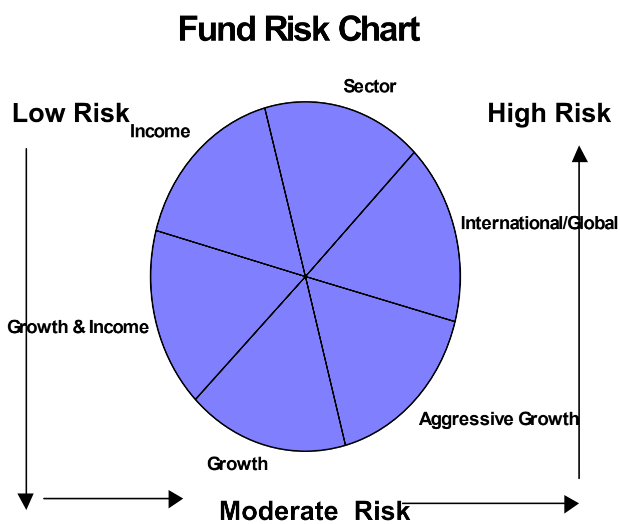
Load funds, while they may allow you to invest in very profitable, well-performing funds, may end up costing you more—even in the long term.

How Are Funds Categorized?

Since mutual funds gather thousands of people with the same investment goals and objectives, you might have guessed that there are several different types of funds. The variety of funds reflects the diversity in investment goals.

Seven types of funds will be covered in this section, including: Growth, Aggressive Growth, Sector, Income, Growth and Income, International and Global and Index. The following is a table of the most popular types of funds followed by a brief synopsis of each fund:

FUND CATEGORY	GENERALLY HOLDS
Growth	Large Company Stocks
Aggressive Growth	Small Company Stocks
Sector	Stocks in a Certain Industry
Income	Bonds and High-Dividend Stocks
Growth and Income	Stocks and Bonds
International and Global	International and U.S. Securities
Index	Stocks or Bonds from an Index



Growth Fund

A **growth fund**'s objective is to increase the value of its portfolio by purchasing stocks whose prices will rise in the future. With this goal in mind, growth funds focus on purchasing large and well-established stocks.

Growth funds are not usually looking for stocks that declare dividends because a dividend is considered income and growth funds generally do not concern themselves with income. Instead, they are seeking out companies that are performing well in their industries and will probably grow and expand-raising the price of their stocks and creating value that way.

Aggressive Growth Fund

An **aggressive growth fund** aims to grow at an accelerated pace. They invest in small, risky companies with the belief that the companies will rapidly expand, thus reaping the rewards for the fund investors. It can be viewed as a supercharged version of the traditional growth fund.

Aggressive funds are extremely volatile and, therefore, usually carry more elevated risk. Some years, the small companies will fly high and produce enormous gains but other years some of the stocks will just fall off the map. When choosing an aggressive fund, research the fund thoroughly.

Sector Fund

Sector funds concentrate all of their energy and money in one particular industry. Sector funds are some of the most aggressive mutual funds available due mainly to the lack of diversification they exhibit.

A technology sector fund might invest in Microsoft or Intel. A health care sector fund might invest in Merck or Pfizer.

To invest in a sector fund you must feel strongly about that industry and its importance to the economy. Sector funds are best for investors with experience who can afford to lose money if they misjudge a specific industry.

Income Fund

Income funds provide an investor with current income rather than growth. If you send an income fund $1,000, it would most likely earn you a steady stream of income instead of turning your $1,000 into $3,000.

Income funds purchase bonds from the government or corporations since bonds provide an income through interest payments. Some funds also purchase certain stocks with large dividend payments for income.

I do not recommend an income fund for a teenager; they are just too boring. If you look in the newspaper, the daily change in your fund's price will be minuscule—if anything. This leads to an unexciting investment and you will surely lose enthusiasm. Plus, with our investment time horizon we have the ability to take on a little more risk in the hopes of a better return.

Growth and Income Fund

A **growth and income fund** attempts to give the investor the best of both worlds. Managers of growth and income funds look for investments that provide long-term growth as well as current income. Most funds would like a steady diet of both growth stocks and bonds to provide balance and stability.

Growth and income funds are exceptional because they really do not restrict the professional manager. A fund manager may know that hardship is coming upon the health care industry but his sector fund must always be invested in that industry. A growth fund manager may see a recession for stocks before it occurs but he cannot switch over to bonds for safety. Growth and income managers can move the money anywhere they feel is the best place for it.

International and Global Fund

Foreign investing can be rewarding, but it is also complicated. Investing overseas offers a way to diversify your portfolio not only across industries but also across countries. If you restrict yourself to only domestic corporations, then you'll be missing out on some of the best companies in the world. Put simply, global funds enjoy the freedom to invest in the most profitable securities wherever they exist.

While the reasons to consider investing throughout the world are impressive, you should be mindful of two important risks: **political instability** and **currency fluctuations**.

> **In a country where our biggest political problem is the President's dismal vocabulary, we may not be aware of how political troubles can affect the economy of an entire nation.**

Sudden political problems can crush everything in the country, including all of the promising stocks. Additionally, currency fluctuations can ruin even a profitable investment. For example, suppose your Asian fund bought Japanese stock that is priced in yen, not U.S. dollars. If the stocks that fund owns rise 25 percent, but the exchange rate for the yen to the dollar falls 30 percent, then you would have an overall loss (in terms of dollars) of 5 percent. It can work both ways; a loss in many stocks can be offset by a rise in the exchange rate.

Remember: International investing is not for the faint of heart. Exchange rates can run amok and erase any trace of your sound investment. If you decide to take the risk, don't forget to keep your eye on the going rates.

Index Fund

An **index fund** reflects a popular market index, such as the S&P 500, the Russell 2000 or the Dow Jones Industrials. An index fund purchases all of the same companies that are listed on the index.

The advantage to owning an index fund is that your return will mirror the index average, minus the fund expenses. The drawback: You will never beat the index average; conversely, you will never lose to the average. But, as you will notice, most stock mutual funds do not out-gain the average anyway, and their expenses far exceed that of the index fund. For example, the Vanguard Index 500's fees are a mere 0.28 percent—the cheapest in the industry—while producing a return that three-quarters of funds cannot beat.

Index funds are easy, inexpensive and produce relatively reliable returns. Four out of five doctors prescribe index funds to their patients. See Chapter 5 for more information on index funds.

Past Performance Is Not Indicative...

Where do you find research on funds? Research on mutual funds can be found everywhere. Most financial magazines provide sections on featured funds in every issue. Some of the better publications include *SmartMoney* or *Money* magazine. *Money* has a listing of its favorite 100 mutual funds and updates information on the funds monthly. *SmartMoney* has a monthly fund watch that profiles different funds. *Bloomberg Personal Finance* provides insightful information and is extremely well written. Each of these publications is very useful to the fund investor and will provide information on everything from stocks to the superior used-car buys.

The library is the place to be. The public library provides you with free access to information from two of the most recognized fund experts: *Morningstar Mutual Funds* and *The Value Line Mutual Fund Survey*.

Morningstar's approach to fund research is to provide you with every possible thing you could ever want on a single page. In a separate volume, *Morningstar* provides a manual explaining the arrangement of its fund pages and what the information means. *Morningstar* is best known for its rating system. It assigns each fund a star rating between one and five based on its past balance of risk and reward (five being the highest). The rating is nice but they are only an after-the-fact look at how a fund performed.

Value Line's setup is strikingly similar to that of *Morningstar*'s. A separate manual is also included to explain how to use *Value Line*'s information. Rather than a star rating system, *Value Line* uses a number ranking of one through five based on past performance and risk. A rank of one indicates the least risk coupled with the most return, and a rank of five indicates the least return with the most amount of risk. A *Value Line* fund page will present you with all of the information needed, such as past returns, expenses and a description of the fund's management style. Always go to the library first for research; it has the greatest advantage...it's free.

In fact, a great book to obtain more information on mutual funds is *The Neatest Little Guide to Low-Cost Mutual Fund Investing* by Jason Kelly (published by Plume).

Mutual Fund Performance

A report of your mutual fund's performance is provided to help you evaluate your investment in the fund or to help you decide whether to purchase shares in the fund. A mutual fund's performance should not be the only factor you use to select your investments.

> **Remember: A fund's past performance is not indicative of future results. Unlike a bank account or a savings bond, a fund does not offer a guaranteed, fixed rate of return.**

Mutual fund prices frequently fluctuate with the value of the securities in which the fund invests. It is always important to keep in mind that performance is based on historical data and is not intended to project future results.

What Is a Mutual Fund's Prospectus?

A mutual fund's **prospectus** is designed to give current and possible shareholders a complete disclosure of the fund's investment objectives and goals. The prospectus outlines the types of securities (stocks, bonds, etc.) the fund owns, the names and background of key players on the portfolio management team, the level of risk the fund seeks and condensed financial statements for previous years.

The prospectus can be boring and puzzling, but what can you expect when most are written by a bunch of lawyers? Reading the prospectus before you decide to invest can save you a lot of headaches and lost money in future years.

The first thing to look for in the prospectus is the **minimum investment**; some can be in excess of $3,000 or as little as $500. Three thousand dollars may be hard to come by, so look for a lower minimum investment that fits your cash flow. Most funds have lower minimum investments for **custodial accounts**, so—if you are under 18—you may not be able to vote, but you can get into a fund for less money.

Then, take a look at the fund's **investment objectives**. If they invest in mostly low-risk, slow-growth companies and you are a high-flying, high-risk person, then this fund is not for you. If you match a fund's objectives with your personality, you and your fund will have a joyous marriage. If not, you may be stuck with something that doesn't fit your personality.

An important thing to check out is the fund's discussion of fees and expenses. Don't forget that no-load funds do have some expenses—so watch out for the loopholes.

Toward the back of the prospectus you will find the fund's historical information including financial highlights that reveal the fund's past performance. It must be said again: Past performance is not indicative of future results. Most funds will report their performance over one year, three years, five years and the past 10 years. It is better to concentrate on long-term performance because anyone can get lucky when the economy is doing well in a given year.

If you need additional information or have any questions about investing in a certain fund, I recommend that you call the fund and talk to a representative. See page 109 for more on researching funds.

A Keeper

My favorite fund is the **Vanguard Index 500**. This index fund tracks the Standard and Poor's 500 and vastly outperforms its competitors. Every year and over the long term, the index beats over three-quarters of all other mutual funds.

Interestingly, index funds were believed to underperform in bad markets. Contrary to this belief, this fund is near the top in Bull (rising) and Bear (falling) markets. An example: During one of several recent market corrections from July 17, 1998 to October 14, 1998, the Index 500 lost a measly 9.1 percent while the average diversified stock fund lost 11.2 percent.

Not only does the Index 500 perform well, it also has other advantages. First, the index is a no-load mutual fund, so it doesn't charge commission fees. And, since it is an index fund, it has a low turnover (The amount of times it moves in and out of stocks). In other words, the Vanguard Index 500 has to own every company listed on the S&P 500. Unlike most mutual funds that trade frequently, the only time this fund trades is to balance the portfolio so money is equally distributed. Moreover, decreased activity means lower costs for you. Why? Because it costs less in trading fees, which means an increase in the fund's return.

The Index 500 fund also saves on taxes. When a mutual fund trades frequently it passes the **capital gains**—the increased value of an investment—on to you and you have to pay the hefty taxes on the gains each year. When you own an index fund, your taxes are far less than the average mutual fund because the fund does not often sell stocks in its portfolio (they have to keep the same 500) for capital gains. Not only does the Vanguard Index 500 have superior performance when compared to most mutual funds, it cuts the costs for the investor as well.

A Good Place to Start

As I've explained, mutual funds are a good place to start in the investing world. They are relatively safe, easy to invest in and allow a young person to test his or her investing theories without having to deal with a lot of paperwork and hassle.

However, in some ways, investing in a mutual fund defeats one of the important reasons to start investing young—to learn how to do you own research and gain confidence in you own conclusions. Ultimately, I prefer to do my own research and invest directly in companies that I think will succeed.

The use that makes the most sense for mutual funds is retirement planning. In many companies, your investments in 401(k)s and other tax-advantaged retirement plans will be limited to a menu of mutual funds and other similar investments. They are fine for that purpose—especially if the employer matches your contributions to the plan.

Even if you start out buying some mutual funds, I suggest that you move on to investing in specific companies as soon as you can.

CHAPTER

9 Investment Clubs

Investment clubs are a great learning tool for young people interested in investing and financial matters.

I have been a member of a club since the summer following my eighth grade year and have loved every minute of it. Currently, I am a member of two clubs. These clubs have taught me invaluable lessons about the stock market and, more importantly, about the challenges and rewards of working with others.

An investment club is somewhat **similar to a mutual fund**. You pool your money each month with a group of people, but instead of a fund manager picking which stocks to own, your group votes on what to buy and sell.

Why Start an Investment Club?

Becoming a member of an investment club is one of the finest things you can do to better your financial future while vastly **improving your knowledge of investing and finance**. The monetary gains can be numerous and the educational prospects are incredible. An investment club not only offers an exciting way to educate yourself in the investing world, but a club is socially enjoyable, too.

Additionally, investing in a club reduces the risks related to one person solely investing in stocks. Historically, investment clubs have produced some of the finest returns. This is probably because clubs diversify not only investments but also individual impulses and perspectives.

> **Education should be your first priority as a teenager. If you can practice and learn how to invest now, you will be better positioned to handle your cash when you have a bigger income and other larger assets. An investment club can provide you with the tools to manage your future earnings.**

With several members, **everyone learns from each other**. The little knowledge each person possesses compounds to create greater knowledge for the group. Since I first began investing with a club, my knowledge about investing has grown enormously.

Diversifying your stocks is an essential practice if you are to become a successful investor. A baseball team would not invest all of its money on a centerfielder; the team also needs pitchers, infielders and other outfielders.

Investing in a club can help to diversify your team of stocks. By doing this, an investment club is less risky than the investments of an individual and better situated to perform. Additionally, by owning more stocks, your investment club can go to more annual meetings and listen to more millionaire CEOs explain what they do.

If you invest with friends, you work as a team. Each of the investment clubs I belong to is very close. On half-days at school, we visit a company whose stock we own. Some days we eat lunch at McDonald's or Applebee's Bar and Grill, or we see a movie at an AMC theater. Investment clubs provide an opportunity to hang out with friends and manage your future.

Your future can be vastly improved by your membership in an investment club—and in more ways than one. While the monetary gain is beneficial, the club assists in other ways, too. Listing "member of an investment club" on your college application—or résumé—may catch the eye of the admissions departments of the colleges you are applying to or the eye of prospective employers. It can set you apart from other applicants, especially if you are applying to a competitive college or applying for the one job everyone in town is after. In fact, it could be enough to jump you ahead of other applicants.

> **Another benefit: financial control. Your monthly investment in a club allows you to save—and compound—money that you would have spent (or squandered) otherwise. At least I know *I* would have burned through the money had I not had a worthy place to put it.**

Even without considering the investment return, monthly contributions add up, and your savings alone provides a wonderful perk that is well worth the effort.

The question now is, how do you start?

Starting an Investment Club

Starting an investment club can be a long and difficult process, but a process that is well worth the struggle. The first step is to **find members** for the club. When looking for members, seek people you trust and respect. It's a lot like working with classmates on projects in school. If you had a group project to do at school, you'd want to work with someone who would be fun and who could also maximize your grade.

Additionally, members who have a general understanding and knowledge of investing are a plus.

> **The most important aspect to look for in a club member is compatibility (do you get along with them?). If all of the members are friends, then meetings will run more smoothly and efficiently.**

If members are fighting a lot—or unable to talk freely with each other—many issues can get ugly. So, if you are going to start a club, I suggest starting it with friends. This is a question I think applies to personal life issues as well as business life ones.

Where Do You Start?

The first thing to do once you've chosen members is call a meeting to discuss the four elements essential to setting up an investment club:

1) **commitment to the club**;

2) **the investment philosophy**;

3) **the mission statement**; and

4) **a creative name**.

The **commitment by the members** to the club will ensure its success. Members must realize that commitment to an investment club includes both monetary commitment and, most importantly, time. In my experience, meetings typically take an hour and a half. Members should also spend at least two to four hours monthly researching investment materials.

A club's **investment philosophy** is a fundamental aspect that contributes to its success. An investment philosophy typically answers the following questions:

- What types of stock should the group purchase?
- How often should the group purchase stocks?
- What should the group do with its earnings?

Answers to these questions should be decided as a group according to how the members would like the club to operate.

A **mission statement** outlines the goals. What do the members seek to gain by being a member of this investment club? Two primary goals usually include educating members as to how the stock market works and how to invest in it—which will, of course, ring in the dough.

> **One point to remember: Not every investment works out—even in the best of times. So, no matter how friendly you are with other members, make sure the paperwork and background work is done carefully from the start. When hard decisions have to be made and people are feeling tense or nervous, a thing like a clear mission statement can help keep priorities clear.**

Choosing a name for your club can be exciting. The possibilities are endless. After you have decided on a creative name, you may want to call your County Clerk's Office to be sure that the name has not been used by another investment club. Because a club is a legal entity like a partnership, you must ensure that no other business or investment club has obtained the same name. You can find the County Clerk's phone number for your area in the government section of the white pages.

Legal Requirements for Investment Clubs

Dealing with the legal requirements is probably the most grueling thing you will encounter while setting up an investment club. But once it's over, it's over. Like any other business, investment clubs must register as a legal entity for the Internal Revenue Service (IRS). Generally, **most investment clubs register as partnerships**; thus, the club is not taxed but its profits and losses are passed on to the members and they must report them on their individual tax returns.

It is helpful to have an accountant among your friends or family. Because you're just starting out, this person may be willing to give you free advice. If you don't have an accountant in the family, contact the state or county Association of Certified Public Accountants. These groups will often be willing to offer free—or very inexpensive—services to teen investors.

> **Have the accountant review the tax implications of the club and ask if she would be willing to help you figure out your future tax returns. Befriending an accountant will ensure you that your club is meeting all of the requirements—including paperwork—required by the IRS.**

The next thing your club needs is a set of rules and regulations for its operations. These rules are set up as a partnership agreement, often referred to as the club's bylaws. A good set of bylaws outlines the rules on monthly contributions, officers, meetings, voting and various other issues catered to meet the specific needs of an investment club.

The bylaws are the foundation of an investment club and must be written accordingly.

Setting Up a Partnership Agreement

A partnership agreement is vital to the stability of your investment club. The agreement will provide a basis for how the operations of your club should proceed. Although you may be starting a club with friends and you may trust them, you must always draw up a binding agreement to protect against and resolve any controversies that may arise.

As I've said before, these rules are most important when something goes wrong. Without a set of bylaws, members may not submit dues on time; members may feel they can buy and sell stock without the consent from the group; and members may disagree over payout when a person chooses to withdraw from the club.

> **Starting a club without a set of bylaws is like starting a country without a constitution. The bylaws exist to protect you, your friends—and your investment.**

Read the bylaws and its clarifications carefully. They are extremely important in the start-up process. Use the sample Megabucks Investments partnership agreement here to guide you through the process.

MEGABUCKS INVESTMENTS
PARTNERSHIP AGREEMENT

I. **Formation of Partnership**: The undersigned hereby form(s) a General Partnership in, and in accordance with, the Laws of the State of and the United States of America.

II. **Name of Partnership**: Megabucks Investments

III. **Term**: The partnership shall begin on (mo/day/year).

IV. **Purpose**: The purpose of the partnership shall be to invest in: stocks, bonds, securities, land/real estate and any other money-making ventures voted and agreed upon by the board unanimously for the benefit and education of the partners.

V. **Meetings**: Periodic meetings shall be held when decided upon by majority of the investment club.

VI. **Contributions**: After an initial lump sum of $100.00 is contributed to the partnership, equal contributions once a month of $25.00, or an agreed upon amount set by the partners by an unanimous vote, shall be contributed to the partnership. During the summer months of June, July and August, the monthly contribution shall be $30.00. Contributions shall be made payable to the club's treasurer by cash or check.

VII. **Valuation**: The current value of the assets and property of the partnership, minus the current value of the debts and liabilities of the partnership (hereinafter referred to as "value of the partnership") shall be determined as of the statement date of the treasurer's monthly statement. The above mentioned date shall be hereinafter referred to as the "valuation date."

VIII. **Capital Accounts**: There shall be maintained in the name of each partner a capital account. Any increase or decrease in the value of the partnership on any valuation date shall be credited or debited, respectively, to each partner's capital account, in proportion to the value of each partner's capital account, on the said date. Each person's contributions to the partnership shall be credited to said partner's capital account.

IX. **Management**: Each partner shall participate in the management and conduct of the affairs of the partnership on an equal basis. Decisions shall be made by a majority vote of the members of the partnership. A written and signed proxy, when assigned to a partner in attendance at a meeting, shall be considered the vote cast by the absent partner. However, no more than one proxy may be accepted or voted by one partner per issue being voted upon.

X. **Sharing of Profits and Losses**: Net profits and losses of the partnership shall inure to, and be borne by, the partners, in proportion to the credit balances in their capital account.

XI. **Books of Account**: Books of account of the transactions of the partnership shall be kept available and open to inspection and examination by any partner on a meeting day.

XII. **Annual Accounting**: At the first business meeting of each calendar year, a full and complete account of the condition of the partnership shall be made to the partners.

XIII. **Bank Account**: The partnership shall select a money market for the purpose of opening a money market account. Funds deposited in said account shall be withdrawn by checks signed by the treasurer or the chairman.

XIV. **No Compensation**: No person shall be compensated for services rendered to the partnership, except for reimbursement for authorized expenses.

XV. **Withdrawal**: Any partner withdrawing from the partnership shall receive one of the following treatments, within thirty (30) days of withdrawal, based on the club's valuation as of the date the withdrawal is submitted to the chairman.

A. By Death or Incapacity: In the event of death, or physical/mental incapacity, or if a partner is unable to participate actively in the partnership for reasons approved by a two-thirds (excluding the said partner) majority vote of partners, 100 percent of the said partner's capital account, as described in sections VII and VIII above, less expenses incurred to liquidate assets to satisfy said amount, shall be made available for payment to the partner's estate.

1. Partnership may purchase capital account or sell to any person acceptable to a unanimous vote of the remaining partners.

2. Partnership may liquidate assets to satisfy said amount.

B. By Voluntary Withdrawal: A partner may withdraw from the partnership by submitting a withdrawal request to the Chairman. The partner may:

1. Sell his capital account (as described in Section VII and VIII).

2. Liquidate his account incurring a 15 percent fine of all assets in the capital account for the first twelve (12) months. After the first twelve (12) months, upon a capitol account valued at less than $1,000.00, all trading fees of no more than 10 percent of said account value will be charged. If the capital account is valued at $1,000.00 or more, trading fees of no more than 5 percent can be incurred.

C. Automatic Withdrawal: Should a partner be delinquent in his monthly contributions for a period of sixty (60) days, he will automatically be terminated as a partner and will receive an amount equal to 85 percent of his capital account as described in sections VII and VIII, less the amount of any delinquent contribution and fines as described in section XVI of this agreement.

1. Partnership may purchase capital account or sell to any person unanimously accepted by the partnership.

2. Partnership may liquidate assets to satisfy said amount and deduct the expenses from proceeds to the delinquent partner.

XVI. **Delinquent Contributions**: Monthly contributions to the partnership are due to the treasurer the first to the third of each month. Should a partner be delinquent in his monthly contribution, a $1.00 fine will be imposed for each week that he is late. Should the delinquency exceed 91 days, the said partner's membership will be terminated as outlined in section XV, paragraph C of this agreement. Fines shall be deposited in the club's money market account.

XVII. **New Members:** New members may be unanimously elected into the partnership by the board. The new member must pay the $100.00 initial payment, as well as an amount equal to all of the monthly contributions since the formation of the partnership. They also must pay any profits and interest made by the investments.

XVIII. **New Member Fee**: There is a $10.00 paperwork fee charged to new members joining the club.

XIX. **New Member Time Limit**: If a new member has been elected into the club as stated in section XVII, he will have one week (seven days), after being notified of the decision, to pay the amount owed to the treasurer as stated in section XVII and XVIII above. If the new member does not pay his amount by that time, he will not be accepted into the partnership unless another vote is taken.

XX. **Officers**: Chairman and Treasurer will be elected annually at the end of each fiscal year. The newly elected officers shall assume the duties of their respective offices at the first February meeting. Officers may succeed themselves in the same office if elected by majority vote of the partnership.

A. It shall be the duty of the Chairman to preside at meetings, appoint industry executives upon recommendation by the board, appoint committees, oversee club activities and record minutes during meetings.

B. The Treasurer shall place, buy and sell orders on instruction from the board; collect and disburse funds; maintain a set of books covering the club's financial operations, assets, valuations, member's capital accounts; and issue receipts to partners for their deposits and withdrawals. He shall prepare an annual statement of liquidating value and prepare-with help from other partners-proper tax forms.

XXI. **Amendments**: The partnership may, at any time, amend this partnership agreement by a unanimous vote of the board, with the exception of this section (section XXI).

XXII. **Forbidden Acts**: No partner shall:

A. Have the right or authority to bind or obligate the partnership to any extent whatsoever with regard to any matter outside the scope of the partnership business.

B. Assign, transfer, pledge, mortgage or sell all or part of his interests in the partnership to any other partner or non-partner, except as stated in section XV, B, paragraph 2.

C. Use the partnership name, credit or property for other than partnership purposes except when deemed okay by the board.

D. Do any act detrimental to the best interests of the partnership or which would make it impossible to carry on the business or affairs of the partnership.

XXIII. **Forbidden Acts II**: Any partner who violates a forbidden act as stated in section XXII (22) will receive a hearing. During this hearing both sides of the accusation will be heard. The accused and the accuser will be excluded from the vote pertaining to the said matter. The voting partners must then find—by a unanimous vote—that a violation occurred. The voting partners will then decide by majority vote the penalty of the violating partner.

This agreement of partnership is hereby declared and shall be binding upon the respective heirs, executors, administrators and personal representatives of their parties.

IN WITNESS WHEREOF, the parties have set their hands and seal the year and the day first above written (mo/day/year). The undersigned hereby agree to this proclamation and future amendment of Megabucks Investments.

Name: ______________ Date: ___________________

Name: ______________ Date: ___________________

Now let's take a closer look at the agreement. I'll break the agreement up by paragraph and offer some thoughts and experiences I've had in the course of starting and helping run two investment clubs. This should give you a better understanding of what each section of the agreement means...and why it's in there.

I. **Formation of Partnership**: The undersigned hereby form a General Partnership in, and in accordance with, the laws of the State of and the United States of America.

II. **Name of Partnership**: Megabucks Investments

III. **Term**: The partnership shall begin on (mo/day/year).

Paragraphs 1, 2 and 3 are pretty self-explanatory. But there is one point here worth mentioning: Technically, the club is a partnership and the people involved are partners. The agreement uses these terms. However, the people involved usually prefer to use the terms club and members. These terms are less formal...and they emphasize the team spirit that should be a part of the club.

IV. **Purpose**: The purpose of the partnership shall be to invest in: stocks, bonds, securities, land/real estate and any other money-making ventures voted and agreed upon by the board unanimously for the benefit and education of the partners.

Paragraph 4. The purpose of the club should be strictly limited. Why? Because if not, the club could end up debating non-investment activities that would distract from the purpose of the club.

V. **Meetings**: Periodic meetings shall be held when decided upon by majority of the investment club.

Paragraph 5. Establishing meeting dates allows members to plan their schedules accordingly. This becomes important when you start getting into detailed research.

VI. **Contributions**: After an initial lump sum of $100.00 is contributed to the partnership, equal contributions once a month of $25.00, or an agreed upon amount set by the partners by an unanimous vote, shall be contributed to the partnership. During the summer months of June, July and August, the monthly contribution shall be $30.00. Contributions shall be made payable to the club's treasurer by cash or check.

Paragraph 6. An important principal of an investment club is to contribute regularly. Sometimes, monthly investments are increased during the summer months to reflect the usual increase in the members' incomes during summer vacation.

Of course, the amounts I've included here are just suggestions. You and your fellow members can decide any amounts you think will work. But try to keep the contributions large enough to mean a serious commitment from members.

VII. **Valuation**: The current value of the assets and property of the partnership, minus the current value of the debts and liabilities of the partnership (hereinafter referred to as "value of the partnership") shall be determined as of the statement date of the treasurer's monthly statement. The above mentioned date shall be hereinafter referred to as the "valuation date."

Paragraph 7. The assets of a club (and, therefore, its overall value) consist of investments that fluctuate in value on a daily basis. So, this is something that needs to be tracked carefully. It becomes important when you consider letting new members in or buying current members out; in either case, you'll need to know what to charge...or pay.

The value of the club should be calculated by the treasurer and presented to members at each meeting. This is probably the treasurer's most important ongoing duty to the club. And it needs to be the kind of thing that your treasurer likes doing, because he or she will be doing it a lot.

VIII. **Capital Accounts**: There shall be maintained in the name of each partner a capital account. Any increase or decrease in the value of the partnership on any valuation date shall be credited or debited, respectively, to each partner's capital account, in proportion to the value of each partner's capital account, on the said date. Each person's contributions to the partnership shall be credited to said partner's capital account.

Paragraph 8. A capital account is the value of each member's investment (calculated by dividing the total value of the club's investments by the number of members). This is an important number to track because it's the main tax mechanism for members. Increases in the capital account are usually taxable; decreases are usually usable as a tax credit.

Tax issues can get very complicated (some members may have trusts or family situations that require professional management). The club really isn't responsible for advising individual members about their tax situations; the best thing it can do is keep the capital account reporting timely, simple and accurate.

IX. **Management**: Each partner shall participate in the management and conduct of the affairs of the partnership on an equal basis. Decisions shall be made by a majority vote of the members of the partnership. A written and signed proxy, when assigned to a partner in attendance at a meeting, shall be considered the vote cast by the absent partner. However, no more than one proxy may be accepted or voted by one partner per issue being voted upon.

Paragraph 9. This is kind of obvious...but it may become an issue among members. Each member is expected to participate in the club's operations, including votes on investment decisions and even absentee votes when someone can't make a meeting. Sometimes this basic expectation becomes an issue for members who lose interest in investing or don't like the amount of research, reporting and other work expected of them.

If your group ends up with a member or two who are doing a lot less work than everyone else, you can bring up this paragraph to remind them that membership means more than just having a capital account.

X. **Sharing of Profits and Losses**: Net profits and losses of the partnership shall inure to, and be borne by, the partners, in proportion to the credit balances in their capital account.

Paragraph 10. The profits and losses of the partnership should be distributed equitably among the members of the club. This gets to an interesting point: equitably doesn't always mean equally. Some clubs are designed to assure every member of an equal stake. And an equal voice in all decisions. Others allow members to buy more shares (either from other members who leave or from larger initial investments). The second version is more like a publicly traded company or a true business partnership...but the first (the equal-vote structure) is better for assuring a good learning experience.

Try to avoid a situation in which one member can say to another something like, "I have more money at stake here than you do...."

XI. **Books of Account**: Books of account of the transactions of the partnership shall be kept available and open to inspection and examination by any partner on a meeting day.

Paragraph 11. The books of account will be prepared by the treasurer and should detail all transactions made by the partnership.

All members should be able to recheck the accuracy of the books of account. Even if they don't do this, they will usually feel better knowing that they can.

XII. **Annual Accounting**: At the first business meeting of each calendar year, a full and complete account of the condition of the partnership shall be made to the partners.

Paragraph 12. Each year, the partners assess the condition of the club with a review of the club's accounting books. Aside from being a necessary financial discipline, this also forces the group to review its decisions at least once a year.

XIII. **Bank Account**: The partnership shall select a money market for the purpose of opening a money market account. Funds deposited in said account shall be withdrawn by checks signed by the treasurer or the chairman.

Paragraph 13. The need for a bank account is pretty self-explanatory. The main issue that comes up here: Who should sign checks for the club? Some clubs say everyone should be able to...but that gets a little complicated. Some say just the treasurer. Others say two members need to sign each check (to avoid any solo decisions or abuse).

I've found it best to say that either of the two key officers can sign checks. But it remains the treasurer's job to manage the account.

XIV. **No Compensation**: No person shall be compensated for services rendered to the partnership, except for reimbursement for authorized expenses.

Paragraph 14. No partner should be paid for work that he has done for the club unless an expense is authorized for reimbursement. This should be clear from the beginning because some members usually end up doing most of the research for the group. Sometimes people feel frustration or resentment about how much work they're doing. And, once in a while, they'll argue that they should be getting paid for their work. Make it clear from the beginning that no one's in the club to get paid.

XV. **Withdrawal**: Any partner withdrawing from the partnership shall receive one of the following treatments, within thirty (30) days of withdrawal, based on the club's valuation as of the date the withdrawal is submitted to the chairman. (etc.)

Paragraph 15. Withdrawal is outlined for most expected circumstances. (In fact, I've abridged the text repeated here—for the complete text, refer back to the sample agreement.) This is one of the longest and most detailed parts of the agreement because you don't want any confusion about how a member can get his or her money out. Nothing is more likely to cause problems than a misunderstanding about how money can be withdrawn.

A point to consider here: The "expenses" described in this section should be limited to specific bank or brokerage fees related to freeing up enough cash to let the member make the withdrawal. Don't deduct anything that you can't link directly to a bank or brokerage...and don't over estimate these expenses to reflect the time or effort it takes to get this thing done.

XVI. **Delinquent Contributions**: Monthly contributions to the partnership are due to the treasurer the first to the third of each month. Should a partner be delinquent in his monthly contribution, a $1.00 fine will be imposed for each week that he is late. Should the delinquency exceed 91 days, the said partner's membership shall be terminated, as outlined in section XV, paragraph C of this agreement. Fines will be deposited in the club's money market account.

Paragraph 16. The due date of the monthly contribution is set and the penalty for delinquency is set; timely contributions are necessary when purchasing stock for an investment club.

XVII. **New Members**: New members may be unanimously elected into the partnership by the board. The new member must pay the $100.00 initial payment, as well as an amount equal to all of the monthly contributions since the formation of the partnership. They also must pay any profits and interest made by the investments.

XVIII. **New Member Fee**: There is a $10.00 paperwork fee charged to new members joining the club.

XIX. **New Member Time Limit**: If a new member has been elected into the club, as stated in section XVII then he will have one week (seven days), after being notified of the decision, to pay the amount owed to the treasurer, as stated in section XVII and XVIII. If the new member does not pay his amount by that time, he will then not be accepted into the partnership unless another vote is taken.

Paragraphs 17, 18 and 19. These paragraphs explain how new members can join the club, including any fees to be paid and any time limits. The purpose of these rules is to ensure that new members enter on an equal financial footing with the already existing members.

In short: The more successful your club becomes, the more expensive it will be to join.

XX. **Officers**: Chairman and Treasurer will be elected annually at the end of each fiscal year. The newly elected officers shall assume the duties of their respective offices at the first February meeting. Officers may succeed themselves in the same office if elected by majority vote of the partnership.

A. It shall be the duty of the Chairman to preside at meetings, appoint industry executives upon recommendation by the board, appoint committees, oversee club activities, and record minutes during meetings.

B. The Treasurer shall place, buy and sell orders on instruction from the board; collect and disburse funds; maintain a set of books covering the club's financial operations, assets, valuation, members capital accounts; and issue receipts to partners for their deposits and withdrawals. He shall prepare an annual statement of liquidating value and prepare with help from other partners' proper tax forms.

Paragraph 20. Your investment club may want to add the positions of secretary and vice-chairman. But, as we've seen before and will see again, the most important positions are chairman and treasurer.

XXI. **Amendments**: The partnership may, at any time, amend this partnership agreement by an unanimous vote of the board, with the exception of this section (section XXI).

Paragraph 21. This is pretty self-explanatory. The main point worth noting that it will require a unanimous vote of members to change the agreement. Some clubs choose to make this a simple majority or a two-thirds majority. My feeling is that you don't want to make changes unless you really have to (this is an exercise in investing, not parliamentary debate). The best way to make sure you don't spend too much time rewriting the agreement is to make changes something about which everyone has to agree.

XXII. **Forbidden Acts**: No partner shall...

A. Have the right or authority to bind or obligate the partnership any extent whatsoever with regard to any matter outside the scope of the partnership business.

B. Assign, transfer, pledge, mortgage or sell all or part of his interests in the partnership to any other partner or non-partner, except as stated in section XV, B, paragraph 2.

C. Use the partnership name, credit or property for other than partnership purposes except when deemed okay by the board.

D. Do any act detrimental to the best interests of the partnership or which would make it impossible to carry on the business or affairs of the partnership.

XXIII. **Forbidden Acts II**: Any partner who violates a forbidden act, as stated in section XXII, will receive a hearing. During this hearing both sides of the accusation will be heard. The accused and the accuser will be excluded from the vote pertaining to the said matter. The voting partners must then find-by a unanimous vote-that a violation occurred. The voting partners will then decide by majority vote the penalty of the violating partner.

Paragraphs 22 and 23. The purpose of these paragraphs is to keep any member from doing anything that will harm everyone else's investment. And, if one member thinks another is doing something harmful, these paragraphs make it clear how the club will handle the situation.

In most cases, you won't need to call on this part of the agreement. But, if things ever do get difficult among members, you want to be able to resolve them quickly and effectively. That will give everyone the best chance to calm down and not do anything to prevent the club from keeping its focus on investing.

Making Your Own Agreement

It is important to note that these bylaws are what my clubs and I have used and they have worked well for us. However, your club may need to modify this example to fit the needs of your members.

After the first year, you will usually find what works and what doesn't work for your club. At the first annual meeting, be sure to review the bylaws and make any necessary changes.

Officers

Strong officers can maintain an investment club and lead it on the right track. There are four main officers needed for a successful club:

- chairman;
- vice-chairman;
- treasurer; and
- secretary.

Each position is important. I recommend rotating officers every two or three years. However, a rotation should not be required and there should be no term limits.

If the club is doing really well, you probably won't want to change anything. Nonetheless, a general rotation will provide that everyone is both equally involved and committed to the club.

A **chairman** is needed to organize and oversee all of the club's activities such as meetings, social activities and educational events. A good chairman will also help arrange and guide club meetings.

Additionally, it is the chairman's task to ensure that each member is involved and having a good time. This is important if you want the investment club to work-and the most crucial job of the chairman.

A **vice-chairman** will take over for the chairman in his absence but, more importantly, he should organize an educational subject—such as defining new financial terms or learning about different investment philosophies—for every meeting. The vice-chairman's job is one of the most important. If his subjects and presentations are knowledgeable and interesting, members will remain committed, and a more educated club will increase its investment return.

A **treasurer** handles all monetary operations including monthly contributions, brokerage and bank accounts and taxes. The treasurer should also provide a monthly financial statement and place buy and sell orders with the club's brokerage. He should also get to know the club's accountant and work with her on yearly tax statements.

A **secretary** will record minutes at each club function. The minutes are a journal recording of every important happening during a club function.

> **During a meeting, records will include voting tallies, pros and cons for each stock presented, the members attending and any other necessary information. The minutes should be available for review at any time.**

A secretary can also run a club newsletter and arrange for educational articles to be written for the newsletter. An investment club newsletter can be very useful. It can help to keep members informed of the club's operations, including the price of recently purchased or sold stock, the full financial statement submitted by the treasurer and research articles written by various members on industries or stocks in the group's portfolio. A newsletter can also include information about the club's last golf tournament or football game, as well as any upcoming birthday announcements.

> **Choose your officers wisely; they are crucial to the club. A strong core of officers, like a strong coaching staff in sports, is needed to hold the investment club together.**

Setting Up the Club's Bank Accounts

One of the first things that the officers will need to do is **set up a checking account** (and, maybe, an attached savings account) where the club will keep whatever money isn't invested in stocks.

The account will also be the place that the club **gathers new resources**—from members' monthly dues or new members joining the group—and **distributes monies paid out** as dividends or to people leaving the group, etc.

After the group decides on a bank account, it will need to decide who will have the authority to sign checks. Obviously, your treasurer should sign the checks, but I advise requiring **two signatures** on all the checks written from the club's account. The second signing member can either be the chairman or the vice-chairman.

> **Something the club's treasurer should consider: The club needs an account with no minimum balance. This is significant because there are times when the club will have as little as a few dollars in the account since most of it will be invested.**

Something else the club's treasurer should consider: A bank account with **no extra fees for a low balance**. Some banks charge you if the balance on your bank account goes below a certain value; this is not the account you want for your investment club. Look for a no-fee account to save your club extra cash.

Do You Need a Broker?

An investment club should set up a brokerage account. You may want to look into a special account for investment clubs. I highly recommend an Internet broker. Brokerage sites offer a plethora of **research** for your stocks, as well as **other helpful tools**.

In addition, there is no need to pay a regular broker for his advice when members are going to do all of the research and make the recommendations themselves. Using an Internet broker accelerates the learning process since all of the major decisions are being made by the group. Why would you be in an investment group if you were just going to pay someone else to do the work?

> **If you use an Internet broker, give the user name and password to every member; this will ensure that everyone has access to the information.**

Thinking of Everything

Did you forget anything?

No, you did not. Your club should be in perfect shape to succeed; now it's up to you and the rest of the members. If you have any questions or need help setting up your club, contact the National Association of Investment Clubs (NAIC), an organization that is committed to nurturing and educating investment clubs.

Your club may even want to join the NAIC. It has numerous benefits for a fee (always a fee!). However, it is not necessary (our club is doing fine on its own).

You can also look into the NAIC's book, *Investor's Manual: The Handbook for Learn-by-Doing*. For more about this organization—as well as **other useful books**—refer to Appendix I. Good luck!

CHAPTER

10 Operating an Investment Club

Your club has gotten off to a fast start. All you have to do now is hold your own down the home stretch. The **operations of an investment club** are quite simple, a few meetings here, a few decisions there and the club will run smoothly. You are now ready to get started.

How Do You Structure the Meetings?

Structure and organization are vital to conducting all of your club's meetings. To ensure that your time is well spent, you must first construct a detailed **agenda**, outlining the operations of the meeting. An agenda is a list of items the club needs to address at the present meeting.

Furthermore, an agenda helps to keep the meeting flowing from one topic to another and also helps to quicken the process. (See the sample agenda below.)

Megabucks Investments
6/8/05
12:00 P.M.
Kyle's House

AGENDA

I. Call Meeting to Order (Chairman)

II. Reading of Last Meeting's Minutes (Secretary)

III. Financial Report (Treasurer)

IV. Presentation on Current Holdings

A. ABC Company (Justin)

B. KRB Corporation (Kyle)

V. Presentation on Drug Industry

VI. Educational Presentation: How Do You Use Our On-line Broker's Research Tools? (Matt and Scott)

VII. Presentations on Possible Purchases

VIII. Adjournment

Items I and II of the above agenda are self-explanatory.

Item III describes the point in the meeting when the treasurer presents the club's financial report with the club's investment performance and each member's value.

Item IV is the point in the meeting when members update the club on stocks the club currently owns. This includes: current news on a company, new financial information and anything else the club needs to know about its holdings.

Item V is the point at which you discuss how a particular industry works and how to choose companies within this industry to buy stock in the future. Each meeting should focus on a different industry such as health care or e-commerce. This will gradually expand the knowledge of the club as you become acclimated to each industry.

Item VI is the point during the meeting for educating members on everything from using research tools to explaining inflation.

Lastly, **item VII** is the point during the meeting when each member presents the stock that he feels the club should purchase. After each presentation, a vote is taken, a decision is made and the meeting is adjourned.

As your club grows, you will probably want to add more items to the investment club's agenda. In the early stages of the club, however, it is best to keep the meetings short and simple. Later, you may want to add guest speakers or discussions on holding a basketball or golf tournament.

How Should the Club Elect Officers?

Your club should hold an **annual meeting** every year. This meeting should be an important affair where most of the major decisions about the club are made. The election of officers should also be conducted at this meeting.

Each member running for office should give a short speech about his strengths and a simple majority should elect the new officer.

Structuring the Annual Meeting

The **annual meeting** is extremely important to an investment club's growth and prosperity. At the annual meeting, members should take time to entertain suggestions on how they think the club can improve.

Look over last year's **financial statement**. How did you do? How did the club do? Can the club stand to improve or are the members happy with the way things are?

Review the stocks in the portfolio and the reasons you purchased each of them. Review the goals your club set at last year's meeting. Did the club meet all of its goals? If not, how can it attain these goals in the future?

If the club didn't reach its goals, make changes. Amend the by-laws to better fit the group's personality. Discuss adding new members. Do anything needed to improve the club. Furthermore, write out a list of goals for the coming year and the possible ways to attain these goals. Lastly, make it enjoyable. Annual meetings can last in excess of four hours. In my club, everyone brings food, and we spend much of the day together eating, discussing and taking breaks to play basketball. Investing is fun; keep it that way.

Picking Stocks

When it comes time to pick stocks for the group, every member of the investment club should have access to a **stock worksheet** (there's an example on the next page and **blank version** at Appendix A at the end of the book). This worksheet includes everything needed to present a new stock at a meeting. During the meeting, every member will discuss the company and information on his worksheet.

The secretary should bring **three folders** to every meeting: one for companies not chosen, one for companies to consider and one for stocks that the group already has or is planning to purchase.

> **After the presentations, the stock worksheets will go into one of the folders, this way the club can accumulate its own library of research. The stock worksheets should provide the adequate amount of information needed to make a decision as to which stock to purchase.**

Stock worksheets should be brought to every meeting. When you are reviewing stocks that the club owns, pull out the original

Stock Worksheet Date: ________

Stock Name: McDonald's

Business Description: Fast-food restaurant, specializing in hamburgers and greasy fries.

Current Price: $72.25 **52-Week High:** $81.50

Low: $58.13

Stock Exchange: NYSE **Current P/E:** 20.4

Timeliness: 2 **Safety:** 1

Company's Financial Strength: *Value Line*: A+

Long Term Debt: 15% **Beta:** 1.12

Industry Outlook: Growth looks strong in international markets.

Future Projections: **High:** $105 **Low:** $89

Are sales and earnings projected to increase in the future? If so, by how much? Sales: 14% Earnings: 17%

Comments:

Expansion in India and China, the two biggest markets in the world. If people don't eat beef in India, what are McDonald's plans for the Big Mac?

Reasons to Buy the Stock:

1) Asian expansion
2) Stock's safety
3) Great past performance and earnings on the rise

Action Taken:

X Buy___ Hold for future consideration ___ Do not purchase

Member Following Stock: Matt

worksheet and read the group's initial reasons for purchasing the stock. If the company fails to continue to meet the original qualifications, it may be time to sell the stock. If it continues to look good, hold on to it or purchase more, but don't be upset if your stock is not chosen.

Fighting for your favorite stock is one of the greatest educational experiences. You have to express your position knowledgeably and concisely. Wow your members with facts—not fluff.

> **You're dealing with real money. Keep track of all of your previous picks. If you can show the group that you have made solid choices in the past, they may be more likely to go with your picks. Also, trust your friends.**

The stock name, business description, current price and the stock exchange are all basic facts about the company that the club will need to know in the event of a purchase.

Using the Stock Worksheet

The **52-week High and Low** can be compared to the current price to understand the stock's position within its normal range. Is it higher than normal or lower than normal? That's a question that the 52-week prices can answer. Once the group has answered that question, another more important question needs to be answered: Why is it near its high or why is it near its low, or why is it sitting smack dab in the middle? The lower part of the worksheet will attempt to answer this question.

The **current P/E ratio**, or stock price divided by annual earnings, will give the group an understanding of how expensive or cheap the stock may be in comparison to the company's earnings. The average P/E for a stock is 18, but it varies depending on what industry the company is in. Consult Value Line or a comparable source for analyses to find an industry's average P/E ratios.

Timeliness and safety are figures that only Value Line produces. Timeliness ranges from 1 to 5 (with 1 being the best) and measures a company's outlook. The safety, along with the company's financial strength, allows you to assess the risk of an investment. Safety is on the same scale as timeliness, the lower the better. Obviously the stronger the company's financial strength and the lower the debt, the less it is likely to do something dreadful like go bankrupt.

> **A Beta Factor is a figure used to estimate the volatility of the stock. A beta of 1 is the average for the stock market, thus the stock would fluctuate at an average rate. A beta of 2 would be twice as volatile as the average and conversely a beta of .5 would be half as volatile. The club will need to create its own parameters for the amount of volatility it can handle. Some stocks fluctuate so much, they will make you go crazy.**

The **industry outlook** is a nice piece of information for the group to have. You clearly want to invest in the best company within a growing industry, so this description is very important.

The **future projections** in stock price and for sales and earnings can be found at a library or anywhere on the Internet. But remember, these are only projections for where the stock's price will head—made by professionals—they are not set in stone.

> **The comments section and the reasons to buy section are for the presenting member to give his opinion of the stock and present any other information that may be a deciding factor for the group.**

Lastly, the action taken section is simply for recording purposes. The group will want to keep track of what happens to a stock well into the future and also, if a buy is made, to assign a member to follow the stock's every move and report back to the club on a regular basis.

How Do Members Get Involved?

One great way to get every member involved in the investment club's research is to **assign each person an industry** to follow. Each member will then sign up to give a presentation once or twice each year on his assigned industry.

Make a sign-up list of industries with examples of companies in the industry for the members to fill out (see below for a sample list). Refer to each member as the vice-president of such-in-such industry. This builds morale and allows you to list vice-president of a teen investment club on a college application or resume.

<u>Vice-Presidential Industries</u>

Aerospace/Transportation Vice President______________

Lockheed Martin, Goodyear, Chrysler, Ford, US Air, Federal Express, etc.

Financial Vice President______________

Citigroup, JP Morgan Chase, Merrill Lynch, Allstate, Morgan Stanley, etc.

Consumer Products Vice President______________

Nike, Gillette, Procter & Gamble, Liz Claiborne, John Deere, etc.

Retail Vice President______________

The Gap, Home Depot, Wal-Mart, Toys 'R' Us, Dillards, Pep Boys, Nordstrom, etc.

Health Care Vice President______________

Merck, Pfizer, Johnson & Johnson, Eli Lilly, Medtronic, Abbot Labs, etc.

Technology Vice President______________

Intel, Texas Instruments, Microsoft, Dell, Xerox, Novell, etc.

Telecommunications Vice President_______________

Motorola, SBC, BellSouth, Verizon, Sprint, Nokia, AT&T, etc.

Utilities/Fuel Vice President_______________

Edison International, CINergy, Pacificorp, Amoco, ExxonMobil, etc.

The Club's Stock Selection Process

Over the course of four years, my club has arranged stock presentations in two ways. At one time, we had an industry designated for each month's meeting and everyone was required to present a stock from that industry.

> **For instance, at the March meeting we would assign everyone the task of presenting a company in the financial industry for the April meeting. And, in April, each member gave his own presentation on banking stocks, brokerage companies and insurance companies as well.**

The benefits of this system are that it requires everyone to study the same industry at the same time. Thus, by the meeting date, each member has already sifted through numerous stocks, becoming more informed on the industry and many of the companies that will be presented. The disadvantages: Although it assures that each member brings his favorite stock in the industry, it does not allow members to pick their overall favorite, which may cause the group to miss out on some great opportunities.

The other option—an open forum where anyone can present anything—provides for less informed decisions, in my experience. However, there is a way to overcome this dilemma: a club newsletter.

With today's technological advances, publishing a newsletter is easy to do via e-mail. You can have the chairman appoint an editor and the process should be quite simple.

One week before the meeting, everyone should e-mail the editor the stock they wish to present, its ticker symbol and either a few links to articles or research on the company. The editor organizes the information and e-mails it to everyone in the group. This way, every member attending the meeting will have some background knowledge about each stock that will be presented at the meeting. It also allows members to have in-depth discussions about each company instead of covering only simplistic financial numbers and news.

Okay, now you are at the meeting, you have done your research and stocks are currently being presented. Since a dozen companies may be presented over the course of an hour, you may forget key points about some of the first stocks.

To solve this dilemma, my investment club **lists the pros and cons** of each company after its presentation (this is where something like a chalkboard or dry-erase board comes in handy). This gives members a brief synopsis of each company and a cheat sheet to study before the vote. The secretary will also record this information in his journal.

We then go over the notes on each stock right before we take a vote. When everyone's mind is refreshed, it is time to take a vote.

Always allow for the option of purchasing no stock at all and holding the money until the next meeting.

Members often feel that none of the stocks presented are worth investing in. You should not feel pressured to buy something if you don't feel it's a good investment. **The group does not have to buy something at every meeting.** Sometimes, but not always, a good investment is no investment. Make sure you leave that option open.

How Does the Club Add Members?

As the investment club begins to grow, the group may want to consider adding members, thus enhancing the club in certain ways. A new member can bring new life and outside experience to an old club. Although finding prospective members is not difficult, adding members can be very complicated, particularly financially.

It may be important to the group that every member has equal ownership of the club and equal value. This is key if you want to prevent any arguments over power and control.

There are two ways to add a new member but still keep the continuity within your club. The first method is easy for the club but may be burdensome on the new member. This system provides that everyone is equal all of the time, including the new member. Say, after two years, each person in the club has contributed $700 and each member's value is $850. Under this equality system, a new member wanting to join after two years will have to produce $850 on the spot. This makes the calculations easy and, because everyone is equal, the group will not have to worry about someone gaining too much power. The disadvantage of this method is that as each member's value continues to grow, it becomes increasingly difficult for new members to join.

The second method of admitting a new member may make it easier to solicit new members, but the calculations and the work are more bothersome. With this method, the new member contributes a little extra initially and each month until his value is equivalent to every other member. For example, if John wants to join the club after two years and each member's current value is $850 and the estimate for each member's value by year end is $1,150, it could be difficult for John to come up with the initial $850.

It might be easier for him to work his way up to $1,150 before the end of the year. So, John works out a payment plan with the club, which requires him to pay an initial $250 and then $75 each month for a year (founding members started with $100 and $25, respectively).

A payment plan will be much easier for both John and the club. And the same can be done for each new member.

You may need to change the length of time or the contributions according to each new member. **Be flexible.**

Membership Resignations

Inevitably, **members will resign**—no matter how enthusiastic or fun your club may be. If this is the case, a resigning member must present the club with a written resignation. When the resigning partner submits his resignation, his current value is locked in place. His value on the official day of his resignation is the value he should receive minus any fees incurred.

Based on how your club outlined withdrawals in its bylaws, the resigning partner should follow those rules accordingly.

Using the bylaws presented in the previous chapter (see section XV, B), I'll use Scott as an example. Let's say Scott handed in his resignation January 2, 2000. On January 2, 2000, Scott's current value was $750. He had been with the group for more than one year so he is not penalized the 15 percent fine described in section XV, B, paragraph 2.

However, he does have a value less than $1,000 therefore he cannot be charged more than 10 percent for commission fees. The club had to sell two stocks to produce the money for John's value, so it was charged $40. This fee is passed on to John ($40 is less than 10 percent of $750) and he receives $710.

Make sure the resigning member receives his money within a reasonable amount of time. Our club's bylaws state that the resigning member must be paid **within 30 days** of his resignation. If the group follows these rules, it leads to a peaceful divorce with no hard feelings.

Disagreements Within the Club

Throughout the life of your club, members may get into **verbal arguments** and heated disagreements. This is common and may even be somewhat healthy for your club—that is, if it doesn't get out of hand. Disagreements require you to be immensely knowledgeable about your side of the argument, forcing you to do more research and come better-prepared.

Early on in Falcon Investment Enterprise's history, we argued religiously at every meeting. It may have been because we were immature or because we were extremely confident in our investment skills, but, either way, I'm glad we grew out of it. **We've learned to be better listeners**, although we still give each other jabs now and then.

Try to withhold from tying a person to his stock picks. Everyone has bad picks from time to time. As long as the member adequately researches his picks, try not to give him too hard of a time.

> **The entire group made the decision to purchase each stock, so you're all to blame. Refrain from arguing as much as possible, but allow for structured debates on certain subjects. An investment club can be like a marriage—no one gets his way all the time. You have to compromise in order to make it work.**

Transition from High School to College

I would hope that you plan on maintaining your club for the long term. Most clubs begin with that vision in mind; but a high school investment club often encounters a roadblock when it comes time to pack up for college.

You can always choose to dissolve the club, but why would you want to throw away a chance at making money?

> **FIE went through this transition and we took the necessary steps to construct what we call our "college plan." I feel, as do other members of FIE, that it is important—at the very least—to attempt to continue through college. Regardless of the financial benefits, the club provides a connection between you and your high school friends, furnishing you with strong and healthy friendships.**

There are several ways to construct an investment club's college plan and you may want to mix and match the pieces to fit your club's preferences. First, you should always try to **meet as much as possible**, just as the group did before college. Even if this means you can meet only over the summer, spring and winter breaks.

Meetings are an efficient and effective way to maintain an investment club's well-being. During those periods when class is in session, technology can bridge the gap between you and the other members.

> **FIE has decided to use chatrooms and our club's Web site to stay in contact, pass along research, suggest stock ideas, watch current holdings and tally votes in an election. Meetings scheduled during breaks and conversing during off-times via e-mail or telephone will be more than enough to sustain the club. The only difficulty left to overcome is how to pay dues each month.**

Currently, each month our members hand the treasurer a check for $25 and he brings it to the bank at his convenience. But once I got to college, I was living in Philadelphia; our treasurer in Boston, the chairman in California and the rest of the club sprinkled everywhere in between which will made it difficult to collect checks each month. There are three possible solutions to this scenario.

If you have a bank account with a national chain, members may be able to make deposits into the account each month from their respective locations. However, this is only possible with a large bank, such as Bank of America or Citibank.

A local bank cannot provide this service. Your club may want to switch banks for this reason, or if you are loyal customer and want to stay with your current bank, there are two other options.

Although it is less convenient, you can require everyone to pay dues in advance, say six or 12 months ahead of time. This may be difficult for some members, but it will guarantee that the money is in the bank when you need it. The last option is to mail the dues each month.

> **This method requires too much memory for me. Having to find envelopes and stamps and remembering to drop it in the mail every month is a lot of work. I prefer to switch banks—preferably to a national chain—and be done with it.**

Whatever method you decide to use, make sure it's easy and convenient. There will be more for you to worry about in college than how to get your check in on time.

Follow the Rules

The important thing to keep in mind when you're dealing with the day-to-day matters of operating your investment club is that you need to follow the **guidelines and rules** you set in your agreement.

You need to follow the rules because you're dealing with members' money—and people can be emotional about money. So, the faithful and consistent use of the language in the agreement makes for the most objective results.

Most of the time, disagreements occur when someone is joining or leaving the club. So, be especially careful when you handle these transactions.

For more information on operating investment clubs, I recommend *The Investor's Manual* by Helen McLane, published by the National Association of Investment Clubs, and *Investment Clubs: A Team Approach to the Stock Market* by Kathryn Shaw (see Appendix I).

CHAPTER

11 Stalking Winners

To discover those top stocks, you are going to have to do a little investigating. Or more than a little. Flip on the computer, log onto the Internet and listen to the buzzing from the modem as you prepare to dive into the expansive sea of stocks. The availability of investment information on the Web, at little to no cost, is what financially-driven teenagers have been waiting for.

The Internet has everything; the only challenge is to find it and to know how to use it effectively to your advantage.

> **If you've been investing at all, maybe you're familiar with Maria Bartiromo's face on CNBC (you know, that channel with the blue and white strips running across the bottom of the screen). Or perhaps Lou Dobbs on CNN is your source for financial news.**

I have to mention that CNBC happens to be one of my favorite television channels (short for Cable National Broadcasting Corporation). When I want financial news and to broaden my investment knowledge, I tune in to CNBC. Nevertheless, there are several other programs available to most people—especially with cable. CNBC, CNN and the Fox News Network are just a few.

All of these programs share an enormous amount of data and articulate things slowly so you can accumulate the knowledge you need to become a skilled investor. Pretty soon, you'll find yourself accustomed to one particular show and its anchors.

Throughout the day, these programs schedule important guests like chief executive officers, chief financial officers, mutual fund managers and market analysts. Informative interviews mixed in with real-time reporting make for very instructive programming. An added bonus is the attitude of the anchors, who always seem to be having a good time, laughing and joking amid stiff financial topics. You'll find plenty of information available to you through these networks.

Some, like CNBC, will organize the screen to provide a real-time ticker on the bottom, which shows both the trades of the NYSE stocks and those on the NASDAQ and AMEX. Typically, this will be shown in two moving bands. And some tickers are color-coded, so when you see your stock's ticker symbol—say KO, Coca-Cola—if it's red, then the stock is down. If the symbol is green, then your stock price is up when compared to the previous day's closing price.

The movement of the major indexes—the Dow Jones Industrial Average, the NASDAQ Composite and the S&P 500—will also be included somewhere on the screen. During the trading day, the values change continuously to give the viewer instant updates on the indexes' fluctuations.

These shows will help you research and, more significantly, hone your knowledge of the financial markets.

Targeting a Stock

If you're into some of the lingo, then you've probably heard people talk of price-to-earnings ratios (P/E) or earnings growth (for a detailed discussion on these, go back to page 89). These are just two of the tools professionals and amateurs alike use to become potent stock connoisseurs. You need to become familiar with these on your quest for the perfect stock (not all of us have found it yet. Hey, nobody's ever perfect).

To begin, try to narrow your stock choices to large, well-known companies. In most cases, Internet sites don't carry information on small companies. This can be frustrating and, at times, hamper your research capabilities. Stick with the big ones until you become accustomed to what you're dealing with.

> **In my research I tend to favor companies with revenue (money received by a company before subtracting costs)—sometimes also referred to as *sales*—of more than $4 billion, thus eliminating most of those puny companies.**

To use your information efficiently, you must devise a way to comb through the thousands of stocks available to you. The first yardsticks from which to narrow your field, are stocks with the best equilibrium between earnings growth and financial stability, all at a superior value.

Set up a stock screening system. While you can sift through companies by hand, a computer, especially a computer with Web access, can vastly improve and quicken the process. Allowing you to enter certain criteria (P/E, earnings growth, etc.), any investment finder located on the Web will spit out the stocks that best fit those requirements. Use an investment finder as your fishing net. Hang it off the side of the boat and you will scoop up the best fish in the sea. Then, you can look at each individual fish to find the right one for dinner.

My suggestion is that you surf on over to MSN Money Central (www.moneycentral.com) and use its investment finder. Money Central has the most detailed criteria for stocks, thus immensely improving your screening system. Additionally, MarketPlayer (www.marketplayer. com) has a finder, as does Stock Search (quicken.com). The chart on the next page offers some pros and cons for some stock finders.

Stock Finder Pros & Cons		
Finder	**Pros**	**Cons**
MSN Money Central (A-)	-Free -Pre-defined searches allow for quick searches -Easy setup -Tons of criteria -Explanation of criteria terms -Quality research following stock search	-Takes some time to input information
Market Player (C)	-Free -Easy setup -Ability to save searches	-Design is arcane -Fewer criteria -You have to go to other sites for detailed research
Stock Search (A)	-Free -Pre-defined searches allow quick searches -Easy setup -Tons of criteria -Quality research follow-ing stock search -Ability to compare stocks easily with charts	-Hard to find (It took me 10 minutes just to find the site) -Cannot save your searches

These sites have **pre-defined screens** for you, such as "large-cap stocks with high momentum" or "highest yielding stocks on the S&P 500." The predefined screens have bundled several criterion together to produce the top stocks that qualify for each screen. Screens are helpful as you begin to invest, before you develop your own preferences for screening stocks.

Once you have developed a taste for the type of stocks you want, you can move on to a **custom screen**. Custom screens are fairly easy to set up. Simply enter in the type of data you want to filter for, such as forward P/E or current dividend yield, and then input the restriction on the data, such as less than 20 or greater than two. That's it. Each row should read: Forward P/E less than 20 or Price-to-Book Value under 1.5 or whatever you prefer.

> **Move down a row and enter in criteria after criteria to narrow your screen until you are ready to go. When you click the "Run Search" button, you'll see a list of the top stocks based on your criterion—from best fit to least fit. Once you comb through the possibilities, you can continue with in-depth research to arrive at a more manageable list of a dozen or so stocks.**

These Web-based tools come in handy, but the final decision is up to you. These systems only provide you with a combed list from which to make your final decision. The investment finder won't pick a winning stock for you; you have to do the picking yourself.

As you set out in search of an investment that best suits you, there are three things you must look for that are needed for the foundation of your stock selection. First, **evaluate the investment's risk** and compare it to your own risk tolerance.

Usually risk is mathematically evaluated through a company's beta, the figure used to measure a stock's volatility. Again, a beta of 1 is the norm and a beta of 2 is twice as volatile as normal stocks and conversely, a beta of 0.5 is half as volatile.

Beta is a commonly used figure supplied in Value Line or on the web. Additionally, debt-to-equity ratios assess a company's risk through its financial condition.

Second, it is essential to **assess the potential growth** of the investment. A stock's profits will directly coincide with a company's profits, so you want to be confident that a company will have the capability of sustaining—and improving—its earnings growth rate.

Lastly, estimate whether a company's **value is worth its stock price**. You may want the biggest fish in the sea, but if it costs you a ton of money for the bait and hook, is it really worth it?

In the following sections, I will go through a step-by-step process of how to choose a growth stock, a value stock and an income stock. Each example is just that—an example. The financial information used in the examples are out of date. They are utilized to help describe the process for you to use as a blueprint.

Not to copy word for word.

How Do You Pick a Growth Stock?

Growth stocks depend on price appreciation to provide the majority, if not all, of their return. This appreciation is undoubtedly driven by earnings growth (profit or money made on sales after costs are subtracted).

To beat the market's 11 percent average return, screen for companies with earnings growth above 12 percent in the last year and annually over the previous five years. Next, screen for projected earnings growth of 12 percent to 25 percent for this year and the succeeding one. Companies with strong, yet modest, earnings growth have historically proven to be better investments than the high-flyers, which are more accustomed to come crashing back to earth. If that sounds confusing, then think about companies with growth rates between 12 and 25 percent.

You must remember that these figures are estimated by analysts, investment researchers that work for an investment firm, who follow the company extremely closely. The figures are only an estimate, by no means are these figures guarantees.

Third, you also need to be confident in the company's financial strength. I suggest adding another ingredient to the mix: a debt-to-equity ratio of less than 35 percent. This ratio compares the company's debt to its overall net worth, or equity. With a low ratio, you can be assured that if the banks come calling for their loan payments, the company will have the money to pay them off. If they don't and the company goes bankrupt, your investment could be in some serious trouble.

In addition, I suggest eliminating any stocks with P/E ratios above 35. Although the P/E ratio listed in the newspaper will work, it is not the ratio of choice in today's market. Newspapers base their ratios on the most recent earnings report, but most stocks actually trade on future projections of earnings. This means you should utilize a future P/E ratio, which takes into account future profits. Many Web sites will supply you with future P/E ratios (also known as a forward P/E), but if they do not, simply take the current share price and divide it by the estimated 12-month earnings for this year.

For example, Stahl Technology's stock price is $60 with an estimated 12-month earnings per share of $1.50.

$$\frac{\$60.00}{\$1.50} = \text{a future P/E ratio of } 40$$

Let me reiterate that this is only an example. After you have skimmed for the best fish, remember to buy what you know and stay out of industries that are volatile and confusing. This will save you both time and money in the long-run.

So, let's say you've trimmed down the pickings to three companies: Apple Computer, Merck and Office Depot. (The fish that didn't make the cut are now back to sea.) Now what?

After you have made your selection, consult a company profile and research any recent news on each company (this is usually provided on the Internet but you should also consult Value Line or another comparable source for analyses). After doing a little research, you find that there is a lot of uncertainty about the future of Merck, a pharmaceutical corporation. In the near future, many of Merck's drugs are coming off patent and there is a fear that the loss of those drugs could greatly diminish their prospects. Merck has been nixed.

Now that you are down to two companies, it basically comes down to preference. Is the P/E ratio the most important aspect of your investment? Is good financial news or a revolutionary new product more important? What about the companies' debt? Which has the least amount of debt? If the P/E ratio is the most important, you might lean toward Office Depot, which has a forward P/E of 23 compared to the 25 P/E ratio for Apple (though the difference is almost negligible).

If good news were most important, you should lean toward Office Depot whose ratings were recently raised by Standard & Poor's. If the fish with the least debt is more appealing, I would go with Apple, which has zero debt load.

Again, when it comes down to choosing between two capable companies, choose what you know. For myself, I would have chosen Apple because our family purchases many of its products, is happy with the results and the company appears to have strengths in many areas.

How Do You Pick an Income Stock?

If you are in search of income stocks, your job is as easy as can be. All you are looking for is a solid company with a generous dividend. Since dividends rule in the income stock world, you can accept growth at a much slower rate than both growth and value stocks.

Income stocks do not depend as much on earnings growth like growth and value stocks do; thus, begin your screening process by ensuring that the companies have had positive earnings growth in the past five years and growth above 3 percent in the past year. Lastly, screen for companies with a dividend yield (the dividend per share divided by the stock price) above 4 percent, thus guaranteeing a quality income from your stock investment.

An example: Stahl Utility's stock price is $20 with a dividend of $2 per share.

$$\frac{\$2.00}{\$20.00} \quad = \quad \text{a 10 percent yield}$$

Seven stocks passed my initial test. To chisel down to the perfect income stock, look down the line for stocks with the highest yield. Secondly, you may want to favor utility companies (you know Water Works and the Gas Company from Monopoly) since they have historically been the classic income companies.

A perfect example of such a company is Consolidated Edison, which boasts a 4.6 percent dividend yield and has its hold on the utilities industry for New York City. As an added bonus, the company plans for expansion into New Jersey and Pennsylvania, making ConEd an attractive home for your money.

How Do You Pick a Value Stock?

For value stocks, again, let's go to the computer and set up your stock screen. Let's say you are looking for a stock that may be temporarily out of favor and undervalued. When people realize the stock's true worth, the stock price will rise to the occasion, thus creating a nice gain in market value.

The most important thing to identify when looking for a value stock, is that it is inexpensive, according to the various value statistics. Two such ratios are the P/E and the price-to-book value (the company's assets minus its debt and liabilities).

Let's move on to the stock screening. Similar to growth stocks, you should immediately eliminate companies with revenue below $4 billion. The next requirement: earnings. You want to look for a company with earnings growth exceeding 4 percent annually over the past five years, and a projected growth greater than 6 percent for the next year.

> **Remember: Modest earnings are needed to sustain growth in the company's financial picture; ensuring financial growth with earnings is the best way to ensure a good investment.**

Next, we move on to the P/E ratios. The price-to-earnings (P/E) ratio is the foundation of all stock research. If you ever talk to someone about a stock, the first thing they will ask you is "what's the P/E?" or "how big is the multiple?" The P/E is simply a way to compare the stock's price to the company's earnings for the past 12 months. Say the P/E of The Gap is 20. So, if you bought the stock, you would be paying $20 for every $1 in earnings the company generates.

Obviously, you want to buy stock at lower multiples but it is all relative. How do you know when a P/E is high and when a P/E is low? Well, you can compare a stock's P/E to a number of things. The average P/E for the S&P 500 is in the high teens, so you might want stocks with a P/E at or below 20.

> **Another option is to compare a stock's P/E to the average P/E for its industry. You can find an industry's average P/E ratio in Value Line and on various Web sites. Certain industries are valued higher than others are; this is reflected in the multiple.**

Industries that have faster growth, such as telecommunications, will generally possess greater multiples than slower-growth industries because investors are willing to pay more for accelerated growth. It may be unfair to compare Qualcomm's P/E to the S&P, which also carries slow-moving industries such as utilities.

This is where the industry average P/E comes in handy to compare ratios with their peers. The last option is to compare the stock's current P/E to its average over the past five years. You can also find this statistic on the Web.

A new way to explore the P/E ratio has come into vogue recently, the forward P/E. Instead of using the past 12 months' earnings to calculate the P/E, as with the traditional multiple, the forward P/E uses the estimate for the next 12 months earnings.

The theory is that a stock's price already has its future projections priced into it so it is more accurate to use its future projected earnings for its multiple and analysis.

How you analyze the P/E ratio and what ratio you use is a personal preference, but that statistic is fundamental in examining whether a stock is expensive or relatively cheap.

Lastly, and most importantly in your search for a value stock, screen for price-to-book value ratios of less than three-halves.

What exactly does this mean? Well, the optimum price-to-book value is actually below 1:1 (although you may not find many companies with this gem of a statistic), which would tell you that the company's accounting value-in machinery, property, inventory, cash, etc.-is worth more than you would pay in stock price.

This is beautiful. If this fictional company were sold off for its parts, a stockholder would receive more money than he paid for the stock. Once people realize this, they will want to get on the bandwagon as well, leaving room for only a jump in stock price.

The Last Mile

After using these five requirements to screen stocks, you are left with two companies that meet your standards: Ashland, Inc. and Loews Corporation. If past and future earnings growth rates are more important to you, you will want to go with Ashland Inc., maker of Valvoline motor oil, as the company of your choice. Ashland's astounding past and future earnings growth rates, 20.5 percent and 26.5 percent respectively, and its forward P/E ratio of less than 12 percent should be quite enough to entice you. These figures appear to outweigh their price-to-book of 1.42, which could have been a little lower.

However, if you determine that price-to-book is more important to your decision, then with a ratio of 0.82, Loews Corporation, which produces tobacco, watches and oil (interesting combination), would be the best choice. Despite the spectacular price-to-book value, I would not have gone with Loews because of the cigarette aspect (the company manufactures brands Kent, Newport and True). As a shareholder, I would have to hope for increased earnings, which would mean more cigarette sales-something I'm against. Furthermore, tobacco companies recently have been hit hard with enormous fines in the billion-dollar range, which will clearly hamper the company.

Remember: Value stocks may take years to appreciate to their true value. Hang in there and your patience will pay off. Time is always on your side. Take advantage of it!

Tips for When to Buy a Stock

Here are some common, quick formulas to follow when you're considering buying a stock in each of several categories.

Growth

- Earnings growth > 12 percent over last five years

- Projected earnings growth = 12 to 25 percent for this year and last
- Debt-to-equity ratio < 35 percent
- P/E ratio < 35 percent

Income

- Dividend is generous (earnings growth is positive over past five years and growth > 3 percent in past year)
- Dividend yield > 4 percent
- Look for classic income histories (e.g. utilities)

Value

- Revenues > $4 billion
- Earnings growth > 4 percent annually over the past five years
- Projected growth > 6 percent for the next year
- Forward P/E ratio < 18 percent
- Price-to-book value ratio < 3/2
- Positive general outlook

Cyclical

- When the economic cycle for the industry sector of a particular stock is beginning
- Be aware that things like the larger economy and societal trends can have an effect on a given cyclical stock

Other important questions to ask yourself:

- Do I know and have confidence in this company?

- Is the general buzz around the company good?
- Are there any legal issues or potentially hazardous situations that will negatively affect the company?
- Does it have, or will it have, a revolutionary new product?
- What are its debt ratings by Standard and Poor's?
- What is its debt load?

Keep a Notebook

Dedicate a notebook specifically for your investments. Much like the stock worksheet for investment clubs, record all of your reasons for purchasing a stock. You can then refer to this periodically, and it will help you decide whether to sell, buy more or just hold on to your position. If the stock fails to meet your past requirements, it may be time to sell. Let's say you bought a restaurant stock because its new menu promised to be a blockbuster.

If the restaurant turns out to be serving junk on a stick, get rid of it. In contrast, if the company is exceeding your expectations, you may want to buy more. But, you won't remember what your original criteria for the company was if you don't write it down. Always remember to write it down.

Additionally, you can record stocks that you're interested in but are a little pricey for your budget. When the stock goes down to your optimum price, you'll have all the information in front of you to make a sound purchase.

CHAPTER

12 Dumping Losers

What fundamental thinking is behind **selling a stock**?

> **Knowing when to sell a stock is just as important, if not more important, as knowing what and when to buy. Many substantial gains have been diminished or even wiped out by untimely selling. You must devise a selling technique and you must stick to it through thick and thin.**

The first thing to always keep in mind as you buy and sell stocks: Don't get greedy! Greed can blur both common sense and rationality. Contrary to Gordon Gekko's (character played by Michael Douglas in the movie *Wall Street*) belief that "Greed is good," greed can cause you to make rash decisions without thinking things through, without looking at all the facts and, in many cases, cause you to put off selling when you should have.

I've heard many investors wonder why their stock, which has gone up in the past, won't go higher? This is the **greedy approach to selling decisions**—not the logical approach. This person did not look through the company's financial statements and recent company news to make the decision that the stock's price will climb higher.

For example, financial experts have been predicting the crash of Internet stocks because they know that the tremendous gains are not based on sound financial assessments but on a follow-the-leader frenzy that will end when the first big stockholder turns around and sells. There will then be a rush to get off a sinking Titanic (can't you hear Celine Dion in the background?).

Many Internet investors base their decisions purely on speculation, which, in time, causes the demise of their portfolios.

> **Of course, the opposite situation can also be deadly. Selling a stock merely because its price has fallen is a surefire way to lose a quality company and future gains. In some cases, a stock's price falls for no apparent reason. The company may look stronger than ever.**

Some overlook the company's strengths and **concentrate on its fallen stock price**. These people will sell, while others light up with joy and buy additional shares in the company. In the crash of October 1987, you would have been better off if you had bought equities (another term for stock) than if you had sold them because the market quickly recovered.

What Do You Do in the Event of a Crash?

Stock markets run on a combination of logic and emotion. Sometimes, the emotion takes over and the markets shoot up…or crash down.

In the event of a crash, stick with the stocks. Stay in the market, do not get out. Hey, as a young adult, you have decades of investing ahead of you and you are bound to run into a few crashes along the way. As I have said many times, the stock market dips and crashes from time to time, but over the long haul, you will earn more money in stock investments than in any other investment.

In fact, a market crash or correction can be a perfect buying opportunity, giving you an opportunity to invest in stocks that were once overvalued. Since the last market crash of October 1987, otherwise referred to as *Black Monday*, when the Dow Jones Industrial Average fell 22.9 percent, the Dow has risen more than 500 percent. This is why it's important to **stay in** the market, **add more** to your stock portfolio and **hold on**. You are young and the years wipe away many of the hardships.

Plus, buying at the bottom can make you a rich, rich man or woman.

Keep a Clear Eye

Every time you check up on your stocks—be it daily, weekly or monthly—**wipe the slate clean** and reassess all of your holdings as if their **previous gains and losses** were unknown to you.

> **Let's look at an example. If Danny bought Stahl Textiles and in three months the stock shot up 100 percent to $30 a share, he'd think, "this is great." And it is. But during his next monthly checkup, he bypasses Stahl, thinking, "it has already doubled, why wouldn't it go up more?"**

This is a perfect example of greed. Danny got greedy. He failed to look at the company closely and he's going to pay for it. Why?

For the past two weeks Stahl Textiles has been receiving bad press because of its sweatshop operations in Southeast Asia and some human rights activists are planning a protest of the company and its products. A number of analysts believe that the widespread boycott of Stahl's clothing will cut into sales and earnings.

Danny should not have overlooked this vital information because Stahl's earnings were nicked by the boycott and its stock plateaued for two years, never breaking $31 per share. Looking back on Danny's circumstances, if he had recognized Stahl's failures, he may have sold after the stock's big jump.

Although Danny doubled his money in just over two years, he lost a major battle. His first three-month competition was nicely fought but he would have been better putting his money in the bank after those three months because Stahl Textiles went nowhere.

> **Some people assume that stocks are their friends. But you can't stick with a stock through thick and thin like you can with a friend. Investing is business and stocks are not your friends; if they're not good to you, kick 'em to the curb.**

If you find that your loser stocks are sucking the life out of you (and your portfolio), you may need to consult your inner psychologist and find the guts to ditch those leeches. Otherwise, you may never get to buy that Armani suit later in life.

Watch yourself. Even professionals in this business are ruined when they mistakenly lead with their heart instead of their head. Always keep your investing practices in check; don't be swayed—seduced or lured—to follow a heartfelt impulse.

Remember: Your heart may deceive you. **Keep emotions out** and sense and sensibility in.

Dot.Com Stocks and IPOs

In the past few years, dot.com stocks—companies that do most of their business through the Internet—and especially IPOs for dot.com stocks have grasped America's attention for their enormous gains, their unheralded volatility and their uncanny vision on how to lose as much money as possible in the shortest amount of time.

These high-flying companies dominated the financial news during the late 1990s. Then, they suffered a spectacular crash in the early 2000s. Now, most recently, they have started to come back into the news with new financial gains.

Initial public offerings or IPOs have always been the rage for young dot.com and e-commerce companies. Most dot.coms have very little history, have young, inexperienced management, have yet to turn a profit and have no plans to do so in the near future. Yet, they continue to grace the pages of *Money* magazine and *The Wall Street Journal* as the next Microsoft. But, IPOs are overhyped. They just do not make for smart decisions. Information on IPOs is very limited and even professional analysts and investors get burned when diving into IPOs from time to time.

> **I stay away from the dot.com stocks and the IPOs for the most part. Except for a brief ownership stint with America Online in Burro Investments (one of the investment clubs I belong to), I have not touched this industry and plan on keeping it that way. At least until Darwin does his thing and only the premier companies are still alive.**

The dot.com sector is much like the automobile industry was 100 years ago. At the time, everyone and his mother were building cars in their barn or garage, similar to today's dorm room dot.com startups. But over time, hundreds of small manufacturers died off, leaving the Big Three—General Motors, Ford and Daimler Chrysler A. G.—in control of their marketplace. I see the same fate for 95 percent of the dot.com companies.

So, why don't I choose one or two of the most promising dot.coms and invest in them? Because it's nearly impossible to pick the GM, Ford or Chrysler out of the enormous pile of companies.

> **To put it simply, I do not like an industry where a noname.com can report a 12-month loss of $100 million, and then gain 20 points in the market because an announcement remarked: Hey, at least it didn't lose $200 million.**

This kind of **whiplash cause and effect** just does not make sense to me. I see the Internet as a way to make business and customer service more inexpensive, but these companies merely find ways to spend more money—ways I did not even know existed.

Their volatile stock performance leads to a kind of gambler's mentality about running their businesses.

During their first boomtime in the 1990s, executives from several Silicon Valley dot.coms put $2.5 million on the roulette table of advertising and lost. Literally, they spent $2.5 million per Super Bowl advertisement—ads that everyone including me has forgotten.

In this case, **roulette and Super Bowl ads are the same thing**. In fact, many people detested all of the dot.com ads, primarily because they were annoying and they could rarely tell what the company did.

We may have entered a New Economy, deemed as such for the astronomical rise in Internet startups and the accompanying surge of high-tech companies on the playing field, but economics still exist.

> **In the end, a company—start-up, high-tech or no-tech—must still earn money at some point if it is going to stay alive and healthy. Until a stable blood pressure is established with these volatile companies, I recommend investing in the more predictable ones.**

For me, dot.coms do not afford me a risk tolerance I can accept. They may be exciting, but I have a blood pressure to maintain, too.

Despite the news of dot.com IPOs soaring hundreds of percentage points in the first day of trading, **very few individual investors** get in on the act and the ones that do, lose by buying at the peak before the stock inevitability pulls back. I do not recommend getting in on a stock in its first day of trading. If you must invest in these young companies, wait a few months for analysts to gather substantial information on the company. There is not enough data at the beginning to make a wise investment. Hold off for a bit and go back to look them over later. You will not miss much and you will be better off if it all comes crashing down.

> **You do not have to get in one the first day of trading for the next Microsoft-like IPO to get rich in the stock market. You can wait, enter the game when you're ready, and still make money.**

In fact, let's take Microsoft as an example to reiterate this point. If you had invested $100 in Microsoft (at the IPO price) when the company went public in 1986, and if you had sold it at the end of 1999, you would have amassed $60,180. However, if you had waited six months after the IPO to invest, you would have experienced the same return. It does not hurt to wait a little time to ensure that your investment is a sound investment; for every successful Microsoft-like stock, there are at least 100 others that tank.

For example, 1800Flowers.com was offered at $21 per share in August of 1999, traded almost immediately down to $5 per share and has basically has stayed in a $7 to $9 range for the past few years.

It's okay to allocate a portion of your portfolio to dot.com stocks, if you can afford to lose it, but don't bet the whole farm. You can also post a significant return without them. I prefer the telecommunications industry over IPOs. During the Internet boom, my portfolio of stocks at my web broker, Ameritrade.com, returned well over 1,000 percent in two years (certainly *not* typical).

Thanks, for the most part, to Qualcomm (which I have held since I set up the account), I have produced a huge return without dot.com stocks.

Even though I have succeeded without them, I do see the power of the Internet and I feel that in the long-term, dot.com companies will come around. The trouble still is finding the small group that will stay alive to lead the industry.

Another No-No: Day Trading

Recently, the phenomenon of **day trading** has captivated America. Stories of the common man spending his day trading stocks and turning himself into a millionaire has swept across newspapers and television. Despite the glamour portrayed on TV, for every millionaire trader there are thousands who lose their life savings.

Day trading is simply not a viable system for investing. In fact, it's not investing at all, it's gambling and I highly recommend staying away from it. With day trading, a day trader buys and sells stocks many times within hours or minutes, hoping to make a quick profit before getting out. Day traders trade on information found in stock chat rooms and rumors found on TV and the Internet, both extremely suspect sources for information. Minute-by-minute fluctuations in a stock's price have no historical backing, thus making day trading extremely risky, holding the potential for enormous losses.

Another disadvantage to day trading is the actual **trading fees** themselves. Even though Internet trades are as low as $8 to $10, if you have a small portfolio, those fees add up. Say your portfolio is worth $1,000. If you trade 10 or 20 times, your fees can cut into the value of your assets by as much as 10 to 20 percent. Additionally, it has been shown that a person who trades less per year actually produces higher returns than his heavier trading compatriots do.

Understand that, when you day trade, you are betting on minute-by-minute information—not long-term historical data. The problem with short-term data is that it is **less reliable**. In day trading, it is also essential that you find data first and act on it early. This is impossible as an individual. No matter what you find, there is always someone out there who knows before you.

For this reason alone, I say **stay away** from day trading.

Stock Market Games: Should You Play?

At many research and brokerage sites, you can find various **investment/stock market games**. In these games, you are given a fictional sum of money, say $100,000, to invest. At the end of a specified amount of time, the game ends and the value of your portfolio is calculated. Many times, these games give away prizes and money for the winner with the largest portfolio value.

Freshman year in college, a few friends and I set out to build a better stock market simulation. Most stock market games only look at a 10-week time frame. We did not believe this accurately illustrated the virtues of long-term investing. Therefore, we built StreetSage, the first stock market game to simulate 25 years of stock market history. We also aimed to make the program more fun though a video game like online environment.

Since then, StreetSage (a concatenation of "Street" referring to Wall Street and "Sage" meaning wise) has experienced great success. The game has been featured on CNN and schools and students from across the country have used StreetSage in classrooms and at home to better understand how investing can fundamentally improve your future.

> **If you want to learn more, feel free to drop by our online storefront at www.StreetSage.com.**

As a practice tool, I see the importance of games such as StreetSage. Before you throw your own money in the ring, you can refine your skills in research and stock picking with an online investment game. The games will allow you to acquaint yourself with various **research tools** and the process of buying and selling before you jump on in. That is, if you have the time and take it seriously.

After-Hours Trading

Long used by institutions, after-hours trading occurs after the normal close of a U.S. stock exchange. This sort of trading occurs over a digital network that matches buyers with sellers of a particular stock. The oldest known ECN, or **electronic trading network**, is Instinet. ECNs allow trading to take place at any hour of any day from any location.

Recently, investors have been clamoring to have equal access to after-hours trading. They cried foul play because institutions were the only ones allowed to use the systems. Many companies report their earnings after the close of the trading day. (The purpose of this is to allow investors the time to sleep on the news before they make irrational trades.)

> **Individuals wanting to conduct after-hour trades felt that institutions had an unfair advantage; while institutions were allowed to trade based on real-time news, individuals had to wait until the next morning. Hearing this cry, some Web brokers, such as E*Trade and Ameritrade, have started offering after-hours trading to their customers.**

Despite the demand, **I don't see the appeal of after-hours trading**. The concept brings a whole new set of problems to investors, particularly the lack of liquidity. Whereas the NYSE and the NASDAQ provide mechanisms to support smooth trading, where a buyer is always matched with a seller, after-hours markets cannot offer this service. For example, as a seller you may never find a perfect match for you in the after-hours market, which requires a buyer to want the exact amount of shares at the exact price you have offered. If the match is not made, the trade is not executed and you are left with a stock that you don't want.

Additionally, ECNs don't have a standard for reporting stock prices and volumes; thus, those numbers can and do vary greatly from

ECN to ECN. A share of Qualcomm, for example, may be priced at $150 on Instinet and $152 on Island, two ECNs. This is the essence of why an individual investor would be better off if he did not participate in after-hours trading.

Professionals on the other hand, who keep track of the differences among ECNs, can manipulate the spread. You may be looking to purchase 100 shares of Qualcomm and get duped by someone with immense knowledge of the reporting systems. So instead of buying 100 shares on Instinet for $15,000, you end up purchasing the 100 shares from the duper on Island for $15,200. And, you probably wouldn't even know.

You probably didn't know that the true going rate for Qualcomm was $150—not $152—and overpaid by $200 because of the lack of knowledge.

Put simply, after-hours trading is too sophisticated for individual investors. You're better off waiting until the morning.

How Do You Know When to Sell?

I've mentioned some dubious investment tools in this chapter—but the real focus here is on when to sell a stock, regardless of how or when you came into it.

When it comes to investments, knowing when to sell is every bit as important as knowing what to buy.

The signals to sell a stock differ for each type of company. Growth stocks should not be sold for the same reasons value companies should and cyclical stocks should not be sold when an income stock should.

Determining when to sell growth stocks depends almost entirely on earnings and revenues. When these begin to deteriorate, all signs point to selling the stock. If the P/E ratio begins to outpace the growth rate, **things may be slowing down** for the company. Whether the earnings are too low or the P/E is too inflated, these are troubling signs.

Furthermore, when the company **saturates its market**, it will have trouble expanding in the future. If Wal-Mart expands into every community known to Man—all the way to small, African villages, for example—then its future potential for growth is really limited.

For a **cyclical stock**, the best time to sell is obviously at the end of its cycle. The problem is determining when the cycle ends. Otherwise, when something starts to go wrong, this is the best time to sell a cyclical stock.

> **Review why you bought the cyclical stock in the first place. If it was because the economy turned prosperous and people were going on more vacations and buying more cars, then when the economy takes a turn for the worse, you may want to get rid of that auto or airline stock.**

If you bought an oil stock and the price of oil begins to drop, clearly, the company will earn less by selling oil at a depreciated price. This means it's time to sell.

If you bought ABC Tech because the inventories were low, when they start to pile up again, it may be time to sell. High inventories mean lower prices and lower profits in the future. If the executives have to work in the hallways because their office space is being used for inventory storage, ABC Tech has problems.

Knowing when it's time to sell an **income stock** is simple. When the company's actions seem to threaten your dividend, sell and move on.

Additionally, you might want to sell when a company has recently acquired other corporations and thus depleted its cash reserves. Why? This means your dividend will not rise any time soon. If the company has burst into large debt problems, it will not raise the dividend and may even lower it. Sell, sell, sell!

> **Watch the company's cash funds. If it is drastically being depleted, your dividend is in danger. Move on.**

Determining when to sell **value stocks** is almost as easy as income stocks. When a value company's stock price rises enough to the point where investors have realized its true value, you should sell.

> **The basic question to ask yourself when dealing with value stocks is, "Would I purchase the stock at this price?" If your answer is no, chances are many other investors feel the same way and thus, less people will be driving the stock price up with purchases.**

For example, if you purchased XYZ Industries at $10 because its book value was $20 per share, but the stock price rises to $25, $30 or $40 a share, the company ceases to have more value than the stock. Thus, the stock is now fully valued.

Tips for When to Sell

Here are some common, quick formulas to follow when you're considering selling a stock in each of several categories.

Growth

- P/E ratio outpaces growth rate
- Either earnings or revenue decrease

Income

- The dividend is decreased or is eliminated
- The company has any problems servicing its debt

- The company reduces or eliminates its cash reserve (this happens a lot during or after an acquisition)

Value

- Value stock price = true stock price
- Ask yourself: "Would I buy at this price?" If not, sell

Cyclical

- The end of an industry cycle

Other important factors to consider when deciding to sell:

—Changes in company financials

—Changes in management

—Changes in company reputation (sudden improvements can be a unsettling as sudden decreases)

—Trends/styles/poorly made products

—News/buzz around the company

> **Remember: Don't get greedy. Accept fluctuations in the market; they're natural. And stick with stocks for the long term—even in the event of a market crash or "correction."**

Pay attention to your stocks and always recheck your reasons for purchasing each one. Slap those together with some common sense, a slice of turkey and a little mayonnaise and you'll have yourself a nice-looking investment sandwich.

Conclusion: Start Early, Be Happy

When you think of the foremost attributes that determine success in investing, does a graduate degree in business come to mind? Holding a coveted title at a top firm? Being a successful entrepreneur? I hope not. If you thought yes to any of these things, then you were 100 percent wrong!

> **The primary attribute that guarantees successful investing is time. Period. End of story. I urge you to embrace your youth and this opportunity to get into the game and start acquiring wealth.**

All of us have the potential to be wealthy; we just need to know how to go about gathering our resources and rethinking our dollars and cents. I hope I've provided a starting ground for you to begin the journey.

Youth allows you to take greater advantage of the power of compound interest.

A 50-year-old bigwig on Wall Street cannot experience this tremendous power because what you have—and what the bigwig doesn't have and cannot buy—is time. As you've probably already heard, time is money. The more you let time go by without setting aside money to invest—the longer you wait to invest—the more money you are losing day after day in opportunity costs.

Here is a final example. Let's say at 16 years of age you start investing $2,000 every year into a simple Individual Retirement Account (IRA), a tax-free savings system set up by the government. Your investment grows 10 percent each year, roughly the average for stocks (as I mentioned at the start of this book).

When you retire at 65 you will have accumulated...you may want to sit down for this ...$2,327,816 and six Lincoln pennies. Over 49 years your $98,000 investment increased more than 23-fold.

In contrast, a person who begins his IRA contribution at age 30 and experiences the same 10 percent yearly growth will accumulate less than $600,000. This pales in comparison to the sum of over two and a quarter million.

There's an even more dramatic example of the power of compounding. If you start at 16 and contribute exactly like I described above but you stop adding $2,000 each year when you turn 30, and stay fully invested until your retirement at 65, your input of $28,000 over 14 years would grow to become a whopping $1,785,768.32! That still vastly outweighs the person who started at 30 and finished with only $600,000.

Over the long haul, a meager annual return of 10 percent can make you rich. And, if you become a smart investor, you should be able to get an annual return of more than 10 percent.

Bottom line: Start early, be happy.

And, in the process:

- Don't be afraid to make mistakes. You have time and youth to your advantage;
- Think long-term-you're not in this game to make a million in just one day;

- Use what you already know, but conduct research and be willing to learn as you go; and
- Diversify your portfolio as you see fit between low- and high-risk investing, but think carefully about your tolerance for risk.

The ball is in your court. All you have to do is pick it up and run with it. I wish you luck and wealth!

Appendix A: Simple Stock Worksheet

Date: ________

Stock Name: ____

Business Description: ________________________________

Current Price: ________ 52-Week High: ________

Current P/E: ________ Low: ________

Stock Exchange: _______

Timeliness: ________________ Safety: __________________

Company's Financial Strength: _________________________

Long-Term Debt: _________ Beta: ___________________

Industry Outlook: ______________________________________

____

____

Projected Stock Price? High: ______ Low: ______

Are sales and earnings projected to increase in the future?
If so, by how much?
Sales: ____________ Earnings: _____________

Other Comments:

____

____

____

Reasons to Buy the Stock:

1) ______________________________

2) ______________________________

3) ______________________________

Action Taken:

Buy

Hold for future purchase

Do not purchase

Club Member Following Stock: ______________________

Appendix B: Internet Resources

Before you invest, you will want to conduct a little research. The following list of financial Web sites and some of their features will help you get started.

www.cbs.marketwatch.com

- Hot Stock Tracker
- Interactive Charting
- Industry Analysis
- Earnings Headlines

www.smartmoney.com

- Free Annual Reports
- Free Fund Prospectus
- Breaking Market News Browser
- Map of the Market

http://finance.yahoo.com

- Track Your Favorite Stocks
- Take an Investment Challenge
- Real-Time Quotes, Stock Alerts and News Ticker

www.fool.com

- Discussion Boards
- Motley Fool Research
- Dividend Discount Model

www.bigcharts.com

- Historical Quotes
- Major Market Indexes
- Interactive Charting

http://investor.cnet.com

- Broker Reports
- All Tech Headlines
- Stock Splits

www.stockinfo.standardpoor.com

- S&P Personal Wealth
- Sector Scorecard (Index Services)
- Mutual Fund Reports & Industry Surveys

www.moneycentral.msn.com

- Family & College Link
- Highlights from Financial Providers
- Saving & Spending Link

www.cnnfn.com

- Life Expectancy Calculator
- Stock Tips & Talk
- Small & World Business News

www.quicken.com

- Book of the Week
- Personalized News

Appendix C: Web Sites For Young Investors

You may also want to check out a few of the following Web sites that are geared toward younger investors.

www.anincomeofherown.com

- Teen Business Pages
- Business Plan Competition
- Just Ask an Entrepreneur

www.fleetkids.com (very young investors)

- Buy Lo/Sell Hi Stock Game
- Frontyard Fortunes
- The Windfall

www.youngbiz.com

- Stock Pick of the Week
- Rising Star Internships
- YoungBiz.com Portfolios
- Link for Applying for Financial Aid Online

www.youngmoney.com

- Online Loan Calculator
- Stocks that Rock
- *Young Money* Magazine

www.younginvestor.com

- Company Profiles
- Stein Roe Young Investor Fund
- Guide to Annual Reports

Appendix D:
Media Databases

The following is a list of online news databases to help you with your financial and investment research.

American City Business Journals
www.bizjournals.com

Barron's
www.barrons.com

Bloomberg Personal
www.bloomberg.com

Business Wire
www.businesswire.com

CNN Financial
www.cnnfn.com

Dow Jones News Service
www.dowjones.com

Forbes
www.forbes.com

Fox News
www.foxnews.com

MSNBC
www.msnbc.com

The *New York Times*
www.nytimes.com

Newspage
www.newspage.com

PR Newswire
www.prnewswire.com

Quote.com
www.quote.com

Reuters
www.reuters.com

Business Week
www.businessweek.com

The Wall Street Journal Interactive
www.wsj.com

Stock Research Group
www.stockgroup.com

Appendix E: Financial Magazines & Journals

The following is a list of online magazines to help you with your research.

Traders World
www.tradersworld.com

Forbes
www.forbes.com

The Economist
www.economist.com

Kiplinger newsletters
www.kiplinger.com

Worth
www.worth.com

BusinessWeek
www.businessweek.com

Internet World
www.internetworld.com

Investor Guide Weekly
www.investorguide.com/weekly

Money Magazine
www.money.com

Standard and Poor's
www.stockinfo.standardpoor.com

Bloomberg Personal Finance
www.bloomberg.com

STOCKZ
www.stockz.com

Stocks & Commodities Magazine
www.traders.com

Fortune
www.fortune.com

Appendix F: Stock Brokers, etc.

The following is a list of full-service, discount, online brokers and mutual funds where you can trade stocks and make other investments.

Merrill Lynch
www.ml.com

A.G. Edwards & Sons
www.agedwards.com

Fidelity Investments
www.fidelity.com

Edward Jones
www.edwardjones.com

Charles Schwab & Co.
www.schwab.com

UBS Paine Webber
www.ubspainewebber.com

Prudential Securities
www.prudendial.com

Oppenheimer & Co.
www.oppenheimerfunds.com

J. P. Morgan
www.jpmorgan.com

Salomon Smith Barney
www.smithbarney.com

Piper Jaffray & Co.
www.piperjaffray.com

E*Trade
www.etrade.com

ScotTrade
www.scottrade.com

Ameritrade
www.ameritrade.com

TD Waterhouse
www.tdwaterhouse.com

Vanguard
www.vanguard.com

American Century
www.americancentury.com

Franklin Templeton
www.franklintempleton.com

Appendix G: Discussion Groups & Chatrooms

The following is a list of Internet-based and on-line discussion groups and/or chat rooms you may want to check out.

Avid Traders Chat
www.avidtrader.com

INVESTools
www.investools.com

Mutual Fund Interactive
www.fundsinteractive.com

Stock Chat Rooms
www.daytraders.com

The *New York Times*
www.nytimes.com

Wall Street City
www.wallstreetcity.com

The Wall Street Journal Interactive
www.wsj.com

Zachs Investment Research
www.zacks.com

StockCharts.com
www.stockcharts.com

The TradersGroup
www.tradersgroup.freeservers.com

Active Traders Network
www.activetraders.net

Appendix H: Government Agencies & Regulators

The following is a list of government and/or other useful sites you may want to check out.

Securities and Exchange Commission
www.sec.gov

National Association of Securities Dealers
www.nasd.com

Federal Trade Commission
www.ftc.gov

International Trade Commission
www.usitc.gov

Federal Reserve Board
www.federalreserve.gov

FedWorld
www.fedworld.gov

Department of Treasury
www.ustreas.gov

Department of Commerce
www.doc.gov

National Association of Investors Corporation
www.better-investing.org

Internal Revenue Service
www.irs.gov

Commodity Futures Trading Commission
www.cftc.gov

Appendix I: Useful Books

The following is a list of books you may find useful for expanding your investment knowledge.

Investor's Manual: The Handbook for Learn-by-Doing
by Helen McLane; The National Association of Investors Corporation, 1994. (See the NAIC's Web site at www.better-investing.org or write: P.O. Box 220; Royal Oak, MI 48068.)

Getting Started in Stocks
by Alvin D. Hall; John Wiley & Sons, 1994.

Investor's Web Guide
by Douglas Gerlach; Lycos Press/Macmillan, 1997.

Buying Stocks without a Broker
by Charles B. Carlson; McGraw Hill, 1996

NAIC's Official Guide: Starting and Running a Profitable Investment Club
by Thomas E. O'Hara, Kenneth S. Janke, Sr.; Times Books, 1998.

Bogle on Mutual Funds: New Perspectives for the Intelligent Investor
by John C. Bogle; Irwin Professional Publications, 1998.

Directory of Companies Offering Dividend Reinvestment Plans
edited by Sumie Kinoshita; Evergreen Enterprises, 1995.

NAIC Investment Club Accounting Manual
by The National Association of Investors Corporation, 1995.

Growing Money: A Complete Investment Guide for Kids
by Gail Karlitz, Debbie Honig, Stephen Lewis; Price Stern Sloan, 1999.

Online Investing: How to Find the Right Stocks at the Right Time
by Jon D. Markman; Microsoft Press, 1999.

Investing for Dummies
by Eric Tyson; International Data Group Company, 1999.

24 Essential Lessons for Investment Success: Learn the Most Important Investment Techniques from the Founder of Investor's Business Daily
by William J. O'Neil; McGraw-Hill Companies, 2000.

The Wall Street Journal *Guide to Understanding Money & Investing*
by Kenneth M. Morris, Virginia B. Morris, Alan M. Siegal; Simon & Schuster, 1999.

Investing Online for Dummies
by Kathleen Sindell; International Data Group, 1999.

Learn to Earn: A Beginner's Guide to the Basics of Investing and Business
by John Rothchild; Simon & Schuster, 1995

The Motley Fool's Investing without a Silver Spoon: How Anyone Can Build Wealth through Direct Investing
by Jeff Fischer, David Gardner; Motley Fool, 1999.

The Neatest Little Guide to Stock Market Investing
by Jason Kelly; Penguin USA, 1997.

The Everything Investing Book: How to Pick, Buy and Sell Stocks, Bonds and Mutual Funds
by Richard Mintzer, Annette Racond; Adams Media Corporation, 1999.

One Up on Wall Street: How to Use What You Already Know to Make Money in the Market
by Peter Lynch, John Rothchild; Simon & Schuster, 2000.

Beating the Street
by Peter Lynch, John Rothchild; Fireside, 1994.

Stocks for the Long Run: The Definitive Guide to Financial Market Returns & Long-Term Investment Strategies
by Jeremy J. Siegel, Peter L. Bernstein; McGraw Hill, 1998.

Rich Dad, Poor Dad
by Robert T. Kiyosaki; TechPress, Inc., 2000.

Appendix J: When to Buy

Here are some common, quick formulas to follow when you're considering buying a stock in each of several categories.

Growth

- Earnings growth > 12 percent over last five years
- Projected earnings growth = 12 to 25 percent for this year and last
- Debt-to-equity ratio < 35 percent
- P/E ratio < 35 percent

Income

- Dividend is generous (earnings growth is positive over past five years and growth > 3 percent in past year)
- Dividend yield > 4 percent
- Look for classic income histories (e.g. utilities)

Value

- Revenues > $4 billion
- Earnings growth > 4 percent annually over the past five years
- Projected growth > 6 percent for the next year
- Forward P/E ratio < 18 percent
- Price-to-book value ratio < 3/2
- Positive general outlook

Cyclical

- When the econocmic cycle for the industry sector of a particular stock is beginning
- Be aware that things like the larger economy and societal trends can have an effect on a given cyclical stock

Other important questions to ask yourself:

—Do I know and have confidence in this company?

—Is the general buzz around the company good?

—Are there any legal issues or potentially hazardous situations that will negatively affect the company?

—Does it have, or will it have, a revolutionary new product?

—What are the ratings by Standard and Poors?

—What is its debt load?

Appendix K: When to Sell

Here are some common, quick formulas to follow when you're considering selling a stock in each of several categories.

Growth

- P/E ratio outpcaes growth rate
- Either earnings or revenue decrease

Income

- The dividend is decreased or is eliminated
- The company has any problems servicing its debt
- The company reduces or eliminates its cash reserve (this happens a lot during or after an acquisition)

Value

- Value stock price = true stock price
- Ask yourself: "Would I buy at this price?" If not, sell

Cyclical

- The end of an industry cycle

Other important factors to consider when deciding to sell:

—Changes in company financials

—Changes in management

—Changes in company reputation (sudden improvements can be a unsettling as sudden decreases)

—Trends/styles/poorly made products

—News/buzz around the company

Remember:

Don't get greedy.

Accept fluctuations in the market; they're natural.

Stick with stocks for the long term—even in the event of a market crash or "correction."

Glossary

American Stock Exchange. A small stock listing for United States companies.

Annual Report. Yearly summary sent by a mutual fund or company to its shareholders showing its financial details.

Bear Market. An extended period of overall declining stock prices.

Beta-Coefficient. Measure of a stock or mutual fund's relative volatility in relation to the S & P 500, which has a beta of one.

Blue Chip. An high quality investment usually known to be very safe.

Book Value. What a company would be worth if all assets were sold (minus all debts and liabilities).

Broker. Person who buys and sells stock for an individual or group.

Bull Market. An extended period of overall rising stock prices.

Commission. The fee charged by a broker to buy or sell an investment.

Director. A member of a company's governing board (Board of Directors).

Diversification. Spreading risk by putting assets into several different investment categories.

Dividend. A portion of a company's earnings that is paid to its shareholders.

Dividend Reinvestment Plan. A plan that allows shareholders to have their dividends automatically reinvested in additional shares of the company's stock.

Dow Jones Industrial Average. An average stock price that is calculated daily by using the stock prices of 30 large industrial corporations on the New York Stock Exchange.

Earnings per Share. Net income of a firm divided by the number of outstanding shares of common stock.

Exchange. An organization in which securities are traded.

Fund Family. Group of mutual funds managed and distributed by the same company.

Going Public. Selling publicly all or part of a private company's ownership.

Growth Stock. A common stock whose company is expected to have above average earnings growth.

Income Stock. A common stock that pays a relatively high annual dividend in comparison to the stock price.

Index Fund. Mutual fund that seeks to match the returns of a particular market index, such as the S & P 500.

Inflation. A persistent upward movement in the general price level of goods and services that reduces the purchasing power of money.

Initial Public Offering (IPO). The first public sale of a company's common stock.

Institutional Investor. Organization that trades a large volume of securities (i.e., a mutual fund, bank or insurance company).

Investment Club. A group of people who agree to pool their money and invest it together equally.

Issue-1. To sell securities in the primary market. 2. A particular group of securities

Limit Order. An order to buy or sell a security at a specified minimum price.

Liquidity. The ability to redeem all or part of your investment (shares of stock, mutual funds, bonds, etc.) any business day into real cash.

Load. The sales fee charged by a mutual fund to compensate the person who sells them (usually a broker or financial planner).

Market Capitalization. Calculated by multiplying the number of shares outstanding by the per share price of a stock.

Market Order. An order to buy or sell a stock at the best price available at the time.

Most-active Stocks. Stocks with very high trading volume.

Mutual Fund. An investment company that raises money from shareholders and puts it to work in stocks, bonds and other securities. Mutual funds pool investors' funds into an actively managed portfolio of securities.

NASDAQ Composite. An index representing domestic companies that are sold on the NASDAQ Exchange.

NASDAQ Stock Exchange. A stock listing that is largely based with United States technology companies.

Net Asset Value (NAV). Market worth of one share of a mutual fund.

Net Change. The amount of change in a security's price since its closing price the previous trading session.

New York Stock Exchange. The largest and oldest organized securities exchange in the United States.

No-load Mutual Fund. A mutual fund whose shares are bought and sold without any sales charges or commissions.

Portfolio. Collection of investment securities owned by an individual, group or institution that might include stocks, bonds and other securities.

Price-Earnings Ratio (P/E). Price of a stock divided by its earnings per share.

Prospectus. Official document describing a mutual fund's investment goals, policies, services, fees and past performance history.

Proxy. Ballot sent to shareholders to be used to vote for directors of the company.

Securities and Exchange Commission (SEC). Federal agency that regulates everything in the financial community including mutual funds and companies with common stock.

Share. One piece of the ownership in a company.

Shareholder. Investor who owns shares in a mutual fund or company.

Standard & Poor's 500 (S&P 500). A group of 500 widely held stocks put together to represent the movements of the United States' stock markets.

Stock. Represents ownership in a company listed in terms of shares.

Stock Broker. A person who acts as an agent in buying and selling stocks and bonds.

Stock Brokerage. A company with a group of stock brokers working together.

Stock Split. An increase in a company's outstanding shares of stock without a corresponding increase in the firm's assets.

Trading. The buying and selling of securities.

Volume. The number of shares changing hands during a certain time period, usually a day.

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