



KALABASH FINANCIAL

LOCATED AT THE ALOHA PACIFIC FEDERAL CREDIT UNION,
2ND FLOOR

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FUNDAMENTALS OF INDIVIDUAL STOCK INVESTING

I typically recommend the average investor stick with mutual funds and electronic traded index funds (ETF) when investing in stocks. They offer daily professional management and risk diversification.

However, picking stocks can be educational and rewarding for those who do their homework. If you invest in stocks, I suggest focusing on the fundamentals. This is a disciplined and logical method for picking stocks.

No method is perfect and this article is for discussion purposes only, not individual advice. Your circumstances may be different. Mutual fund and ETF performance incurs risk of loss and you cannot directly invest in any index.

FUNDAMENTAL VS. TECHNICAL ANALYSIS

There are two basic schools of thought for investing. Technical investing uses future stock prices using historical price movements and transaction volumes as an indicator of future performance.

Fundamental analysis looks at the financial prospects of a company to determine its' future value—(1) review financial information, (2) look for economic or social trends, (3) make price projections and (4) review assumptions regularly.

Although, I prefer fundamental over technical analysis, neither offers any guarantee. Emotions, events, regulations and technology make things unpredictable.

FINANCIAL INFORMATION

A company's annual report and regulatory filings contain valuable information. You may want to focus on significant

variations and the footnotes. Compare key financial ratios (percentages) and compare it with other companies in the same industry. Never invest in companies without audited financials.

The Income Statement shows revenue and cost trends. Rising revenues (sales) are great, but if the expenses are rising faster than revenues or margins are below the industry average, it may be a clue that future prospects are not very favorable.

The Balance Sheet lists the assets, liabilities (debt) and equity of the company. Avoid business with too much debt or have significant changes in equities. Also, look for rapidly growing account receivables. These are warning signals of potential problems.

The Cash Flow Statement measures the amount of actual money the company takes-in and where it's going. Look for large differences between operating cash flow and net income. If there is a wide negative divergence between the two, something significant is happening and you should investigate.

ECONOMIC TRENDS

The future of a business depends on what is happening in the real world. You need to take the information from other sources to identify trends that will affect your individual stocks. You're common sense and judgment is important.

It is not good enough to identify a trend. You must identify the stocks that will benefit from this change. Examples: Xerox developed the mouse and windows, but Microsoft was the beneficiary. CompuServe created the consumer e-mail system, but AOL came out on top. Woolworth's created the discount store, but Wal-Mart now dominates. Nothing about the future is certain, except change.

FORECASTING PRICES

One method of setting a price target is to use the projected future EPS (net income divided by number of shares outstanding) and multiplying it by the historical average PE ratio (share price divided by earnings per share).

The downside risk can also be estimated by taking the low expected EPS and low historical PE ratio. Remember, individual stock prices can go to zero.

REVIEW YOUR PORTFOLIO

Always review your individual stock holdings regularly. This takes time. If you cannot devote time, don't invest in stocks because a company's fortune can change rapidly. Large stocks can easily lose 10% in a single day. Smaller ones can be even more volatile.

Because of the power of diversification, you need to own enough stocks to maintain a balance across different industries. As you add new stocks to your portfolio, research time will increase. Avoid holding more stocks than you can effectively monitor and track.

To simplify things, you may want to start investing in the things you know. Also, leverage your career knowledge for an added edge.

There are many good books and resources for investing in individual stocks. However, many investors, including professionals, fail to outperform the market averages over time. It is just hard to predict the future.

If you would like a FREE portfolio review, please give me a call (539-0133).

Source: Fidelity Investments, National Association of Investors Association