

YOUR MONEY

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Lessons learned from top investment gurus

You don't need to look much farther than the likes of Benjamin Graham, Warren Buffett, and Peter Lynch to learn about value investing. Legends in their own right, they wrote the code for successful portfolio management and, although each established a unique style, their core philosophies are consistent.

The first common thread: do your homework. Learn as much as possible about the company whose shares you are considering. Study its business model, learn about its industry, examine its competitors, and determine its prospects for growth. As Lynch said, "The person who turns over the most rocks wins the game".

If you still don't understand the company's fundamentals, don't buy its stock. "Staying within your circle of competence" is a virtue that Buffett has upheld. He famously avoided technology stocks during the high-tech boom while peers criticized him but, when the bubble burst, he emerged a winner.

Don't be afraid to go against the grain, to be a contrarian. Lynch commonly used institutional ownership as a gauge. The higher the institutional ownership the less likely he was to purchase a stock because interest typically peaks when most of the gains have already occurred. If you buy when the Joneses do, you're not likely to see much upside.

Those that pick the under-favored yet high quality stocks, tend to reap benefits. Look at our financial sector, which was the dog of 2008. The S&P/TSX financials sector is now up 24% year-to-date and the contrarians who bought Royal Bank near its lows are currently up over 85%.

Another common element between all three investment gurus is the focus on quality. Look for businesses that

are consistently profitable, with good prospects for continued growth. You should also take into consideration a company's debt levels. Lynch looked for companies with 25% debt to 75% equity ratio or lower.

Examine the company's competitive advantage. What are the barriers to entry? Are there patents to block competition or sufficient brand power to sustain long-term growth? Coca-Cola is a good example. It has immense brand power with very few direct competitors. As Buffett put it, "I try to buy stock in businesses that are so wonderful that an idiot can run them because, sooner or later, one will".

When assessing quality, Lynch would often examine a company's inventories. If inventories have built up, it usually points to underlying issues. Red flags should also arise if there is excessive corporate waste, such as unwarranted executive perks.

Always look for a good deal. As Buffett says, "Whether we're talking about socks or stocks, I like buying quality merchandise when it is marked down". Using the Graham approach, you should look for good quality stocks that meet fundamental criteria and are trading below their intrinsic value; creating a "margin of safety".

Once invested, control your emotions. Benjamin Graham said, "Individuals who cannot master their emotions are ill-suited to profit from the investment process". Consider those who sold out their portfolios at the beginning of March and missed a chance to participate in a rally that saw the S&P/TSX gain almost 38%. "The key to making money in stocks is not to get scared out of them", says Lynch.

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All three investment experts would agree that their approach does not mean buy-and-forget. Investors must monitor their investments and know when to exit positions. If a company is fully valued, or if the business takes a turn for the worse, it's probably time to pull the trigger.

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