## 20RIJIES

## for Your Investment

 Success

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Investor's Business Daily's industry-leading stock market research dates back to 1880 and focuses on the best performing stocks each year and the characteristics they displayed before their big price gains. We analyzed 100+ fundamental and technical items, and identified the key traits shared by all of these winners.

Based on this study, we created 20 Rules to help the individual investor make money in the market. Learn these proven rules and watch your investing results dramatically improve!

## 20 Rules for Your Investment Success

1. Consider buying stocks with each of the last three years' earnings up $25 \%+$, return on equity of $17 \%$ or more and recent earnings and sales accelerating in their \% rate of increase.
2. Recent quarterly earnings and sales should be up $25 \%$ or preferably much more.
3. Avoid cheap stocks. Buy higher-quality stocks selling $\$ 15$ a share up to $\$ 100$ and higher.
4. Learn how to read and correctly analyze charts to see sound bases and exact buy points.
5. Cut every loss when it's $8 \%$ below your cost. Make no exceptions so you can always avoid huge, damaging losses. Never average down in price.
6. Follow selling rules on when to sell and take your profits on the way up.
7. Buy when market indexes are in an uptrend. Reduce investments and raise cash when general market indexes show five or more days of volume distribution in the last 4 or 5 weeks.
8. Read IBD's Investor's Corner and The Big Picture columns to learn how to recognize important tops and bottoms in a major market index.
9. Buy stocks with a Composite Rating of 90 or more and a Relative Price Strength Rating of 85 or higher (in the IBD SmartSelect ${ }^{\circledR}$ Corporate Ratings.)
10. Pick companies with management ownership of stock.
11. Buy mostly in the top six broad industry sectors in IBD's New High List or top 20 industry sub-groups.
12. Select stocks with increasing institutional sponsorship in recent quarters.
13. Current quarterly after-tax profit margins should be improving, near their peak and among the best in the stock's industry.
14. Don't buy just because of dividends or P/E ratios.
15. Pick companies with a superior new product or service.
16. Invest mainly in entrepreneurial New America companies. Pay close attention to those with big earnings increases and an IPO in the past eight years.
17. Check into companies buying back $5 \%$ to $10 \%$ of their stock and those with new management.
18. Don't try to bottom-guess or buy on the way down. Never argue with the market. Forget your pride and ego.
19. Find out if the market currently favors big-cap or small-cap stocks.
20. Do a post-analysis of all your buys and sells. Post on charts where you bought and sold each stock. Evaluate and develop rules to correct every one of your major past mistakes.

## 1 Consider buying stocks with each of the last three years' earnings up $25 \%$ or more, return on equity of $17 \%$ or more and recent earnings and sales accelerating.

With such a vast universe of stocks to choose from, where do you start screening for potential winners? Look for firms with growing profit and return on equity. Time after time, those are traits shared by the most winning stocks. Wall Street tends to reward growth.

So try to stick with companies that have averaged at least $25 \%$ profit growth in the past three years.

Go to Investors.com's IBD Stock Checkup ${ }^{\circledR}$ feature and scroll down to the Vital Statistics section to quickly look up a stock's three-year Earnings Per Share Growth Rate.

Also, make sure the company is using shareholders' money as efficiently as possible. Check out its return on equity. The best stocks usually carry an ROE of $17 \%$ or higher.

You can find ROE in the daily charts on the Stocks In The News pages, as well as those on the weekly Big Cap 20, Your Weekly Review and IBD ${ }^{\circledR} 50$ pages.

Another common trait of leading stocks: accelerating profit and sales growth. Let's say in the most recent quarter a company grew earnings $50 \%$. In the prior quarter, its profit rose $35 \%$. Such growth is a positive sign. Similar trends in sales also can be a constructive signal.

Earnings growth from the two most recent quarters is also included in the charts on the Stocks In The News, Big Cap 20, Your Weekly Review and IBD 50 pages. Just as important before buying any stock: Be sure it's breaking out of a sound chart base in a market uptrend.

## 2 Recent quarterly earnings and sales should be up $25 \%$ or more

Once you've selected stocks with good chart bases that show strong annual earnings growth and a high return on equity, examine earnings and sales in the most recent quarter.

Are they up $25 \%$ or more? Is the rate of growth accelerating?
Remember to always compare the most recent quarter's earnings per share with the
same quarter a year earlier, not the previous quarter. This way, you'll eliminate any seasonality factors and properly assess the firm's growth.

During bull markets, it is reasonable to expect growth stocks' earnings per share to rise more than $25 \%$. Stocks with EPS rising $100 \%, 200 \%$ or more stand the biggest chances of rallying.

Sales growth should also be $25 \%$ or more, and preferably accelerating.

Look at how a firm's sales growth compares with its earnings growth. If sales are somewhat weak or ticking up slowly while earnings are skyrocketing, this may be a red flag.

Is the company artificially inflating earnings by cutting costs to please its demanding shareholders?

## 3 Avoid cheap stocks. Buy higher-quality stocks selling for \$15 to \$100 or more

It helps to have allies. In stock market investing, institutional investors can be your friends. Managers of mutual and pension funds have billions of dollars at their disposal. They sink that cash into stocks they deem worthy. Buddy up with them by investing in the same kinds of stocks they do.

You won't find many managers in cheap stocks. Why? They know that you get what you pay for. A \$2 stock trades at that level for a reason. Usually earnings and sales are lackluster.

About 3,000 stocks trade below \$15. Their average Earnings Per Share Rating is a lowly 14. That's way below the IBD 80 EPS rank you want for stocks you buy.

You might hear a lot of hype about some low-priced stocks. Their business is going to be great for this or that reason, you're told. Too often these stocks ride more on promise than performance. When the sizzle fizzles, they don't have much of a foundation and fall fast.

Most big winners start their runs trading between $\$ 25$ and $\$ 50$. More of them have solid earnings and sales records - proof that they can deliver the goods. They also have a more promising future.

You might think it's easier for a stock to go from $\$ 2$ to $\$ 4$ a share than $\$ 30$ to $\$ 60$. But they're both doubles, and the gain is more likely to stick with a stock of substance. Plus, don't be fooled into thinking that cheap stocks can't or don't fall as much as high-priced stocks. In reality, the distance between \$2 and \$1 is the same as \$50 and \$25.

And don't be lured by the false benefit of more shares. Sure, $\$ 10,000$ will buy 5,000 shares of a $\$ 2$ stock. But that number of shares isn't worth any more than owning 200 shares of a $\$ 50$ stock.

Because of higher quality, you have a better chance of cashing in with a higherpriced stock.

## 4 Learn how to use charts to see sound bases and exact buy points.

Want to buy the stocks that have the best chance of being big winners?
A study of the best stocks of the past 125 years shows that they always launch out of sound chart basing patterns on big volume.

You might think that you can get such stocks at bargain prices. Yet IBD research shows that winning stocks start their big run-ups at or near their 52 -week price highs.

Learning to spot these bullish chart base patterns is the key to buying stocks at the right point. Visit Investors.com's Learning Center.

Under "Lesson on Buying," take a look at Reading Charts I and II. What's so special about these formations? Stocks that break out from them tend to escape the kind of pullbacks that trigger sell rules. Learning to read charts will put you far ahead of other investors.

Less knowledgeable investors sometimes dismiss the movement of a stock's price as random, and chart reading as akin to astrology.

But they're wrong. Charts tell the investor how a stock's supply compares with its demand. They trace the emotions of fear and greed that govern the market.

Because emotions never change, price and volume patterns remain the same, year after year and cycle after cycle.

Imagine a stock that hits a new high, generating lots of volume. Then the stock drops $25 \%$ over several weeks and begins to move sideways. Those buyers who bought at the top are unhappy. They bought at the wrong time and failed to cut their losses. They refuse to take a loss, so they're trapped in the stock.

But wait. As the stock moves sideways, there are signs of buying by big investors. A skilled chart reader spots occasions when the stock drops to a new low, only to end near its high for the day on good volume.

The stock moves for days or weeks in a tight range. The big investors know that the
stock's drop is a chance for them to build a position in an outstanding company.

Some investors don't understand this. As the price rises on the right side of the base, they see a chance to get out at close to their buy price so they begin to sell. But the stock's rise is so strong, it can fight through this resistance. Finally, the stock explodes to a new high on big volume when most investors are afraid to buy.

What was once resistance now becomes support. That is the safest place to buy.

But remember, you won't always be right. When a stock falls 7\% to 8\% below your purchase price, sell immediately. That way you'll have your capital intact the next time a top-rated stock sets up in a base. And never chase stocks over 10\% from a base sound.

5 Cut every loss when it's 8\% below your cost. Make no exceptions so you'll avoid any possible huge, damaging losses. Never average down in price.

Keeping losses small is an absolute must in investing.

In his 1935 book, The Battle for Investment Survival, legendary stock investor Gerald Loeb called curtailing losses "the most important single investment device."

Loeb added that "it is also the action that most people know the least about and that they are least liable to execute."

It's hard, after you've identified what you're convinced will be a winner, to admit that you chose a dud.

While a stubborn refusal to accept defeat can be a virtue in many of life's pursuits, it's just a recipe for bigger losses in the stock market. Even worse than letting your losses run past $7 \%$ to $8 \%$ is piling more money into a losing stock. By hoping and averaging down, you're creating a potentially bigger loss. To illustrate how tough it is for a plunging stock to turn around, just imagine trying to catch a falling knife.

As the accompanying chart shows, an $8 \%$ loss requires only an $8.7 \%$ gain on the next trade to get back to even. But let that loss run to $15 \%, 25 \%, 50 \%$ or more, and it gets tougher to dig out of the hole.

At that point, your emotions can take over. You try to make up for the loss with a long-odds investment that can lead to even more losses. But the investor who has the humility to recognize a mistake and cut losses quickly preserves capital and emotional balance.

After that 8\% loss, it's important to "go to the videotape." You don't want to move on to your next trade until you find out what went wrong.

Did you ignore certain flaws in the fundamentals or chart? Was the overall market sending cautionary signals that you shrugged off? Was the stock in a strong industry group within a strong sector, or did you buy a weak laggard sympathy stock instead?

IBD database studies show that most leading stocks breaking out of sound bases do not fall $8 \%$ from the buy point. That's another reason to get out while the loss is still small.

## Steepening Climb

When your losses are allowed to deepen, you will find it more difficult to get back to the break-even point

| Loss | Gain needed <br> to break even |
| :---: | :---: |
| $8 \%$ | $8.7 \%$ |
| $15 \%$ | $17.7 \%$ |
| $25 \%$ | $33.3 \%$ |
| $40 \%$ | $66.7 \%$ |
| $50 \%$ | $100.0 \%$ |
| $70 \%$ | $233.3 \%$ |

Remember this mantra for selling: "Bulls make money and bears make money, but pigs get slaughtered." Sell early to lock in gains. It's better to leave money on the table than to get out late.

When a stock goes up $20 \%$ or more in the first three weeks after a breakout, you should hold it for at least eight weeks. Such stocks usually go on to become the market's biggest winners. Many stocks aren't quite so powerful. They may climb $20 \%$ to $25 \%$ in the span of weeks or months, then stall. They may also form a base, dipping into a fresh correction. Be ready to take profits when such stocks flash sell signals. Not every stock needs to be a home run. Bagging your fair share of singles and doubles by selling for decent profits will pay off in the long run.

## Here are some other key sell rules:

- Be wary of big price declines in heavy trade. That's a sign that big-money investors are dumping shares. Sharp drops on such big volume through key support levels like the 50 -day moving average also suggest institutional selling.
- Watch out for climax tops. A climax top occurs when a stock that has already had a huge run-up suddenly races higher and faster than it ever has before. Wide price swings, exhaustion gaps and sharp reversals typify the action of a climax run,
indicating the stock is likely overheating and headed for a fall.
- New highs on low volume are a bad sign. Sell when a stock hits new highs on low volume.


## 7 Buy when market indexes are in an uptrend. Reduce investments and raise cash when general market indexes show five days of increased volume distribution.

Here's a chicken-or-egg question: Do leading stocks make a good market or does a good market make leading stocks?

You can argue both sides. But the key point is that stocks fare best when the overall market is strong.

Three out of every four growth stocks follow the general market's direction. That's why a key lesson of stock investing is to always make sure you stay in sync with the major indexes.

Decades of research support a strategy in which you buy stocks only after at least one of the major indexes has staged a follow-through day. That's when the market confirms a fresh rally by surging about $1.7 \%$ or more, with an increase in volume over the session before.

Every rally eventually ends. A distribution day occurs when one of the major indexes falls on heavier trading than in the previous session. Three to five distribution days in a span of a few weeks should make investors wary and consider raising cash.

Breakdowns in many leading stocks are an even stronger indication you should stop buying and take profits.

Where are we now? You can get a quick take in just a minute or two. First, look at The Big Picture column and its Market Pulse feature. You'll find out whether the market is in a confirmed rally or in a correction. You'll also get a feel for how the market's leading stocks are faring in the Leaders Up In Volume and Leaders Down In Volume sections of the Market Pulse, as well as in the daily column.

What about the stocks you own during a market tumble? If a stock that you bought surged $20 \%$ or more during the first one to three weeks after its breakout, try to hold for eight weeks. If you're sitting on big gains, consider taking some profits. If your stock is falling sharply or is threatening to round-trip from a gain to a loss, sell it.

When industry leaders sell off, it's a good bet that others in the same group will go down, too.

A follow-through is the first step in seeing the market re-establish its strength. Next, you want to see other up days occur in brisk trade, further confirming the followthrough. If conditions are fertile, some high-rated stocks will be breaking out of bases.

IBD's The Big Picture column and Market Pulse track the action of the main indexes and leading stocks.

8 Read IBD's Investor's Corner and The Big Picture columns to learn how to recognize important tops and bottoms in market indexes.

Understanding the direction of the market is crucial to your investing successfully.
You can improve your timing with IBD's The Big Picture column.
The Big Picture tracks distribution days and lays out the direction of the daily market averages, the market's current outlook and the leading stocks trading in high volume. That includes leaders rising and falling in brisk trade.

Leading up to and after the market's top on March 10, 2000, The Big Picture warned readers that a market top was in sight. It also said that it was a good time to take money off the table.

Two days before the market's peak, The Big Picture said: "If Monday's sell-off didn't convince you the Dow's rally was dead, Tuesday surely drove the point home . . . (that) it's risky to jump back into blue chips before the Dow confirms a turnaround with at least a $1 \%$ rise in heavy volume."

Jump ahead to the March 13, 2000, edition, which noted that the party was over. The Big Picture said: "Stocks ran out of steam Friday. . . A short- to intermediate-term correction wouldn't be unwarranted . . . A seven-week downtrend (for the Dow) is as strong as ever."

Fast-forward to IBD's Investor's Corner on March 17, 2000: "Dozens of top stocks in other leading industries also were taking a beating. In this situation, it's usually a good idea to take some profits, get off margin or perhaps go completely into cash."

Those who didn't heed the warnings suffered severe losses. In the next two months, the Nasdaq dived $37 \%$ from its March 10 peak. It rebounded a couple of times, but was down $52 \%$ by January 2001. All told, the Nasdaq crashed $78 \%$ during the bear market of 2000-02.

9 Buy stocks with a Composite Rating of 90 or more and a Relative Price Strength Rating of 85 or higher in the IBD SmartSelect ${ }^{\circledR}$ Corporate Ratings.

IBD's stock ratings save a ton of research time by crunching vast amounts of statistics.

At a glance, investors can find out how well a company has performed in terms of earnings growth, sales growth, stock price, institutional buying and other critical factors that help determine if a stock is a leader.

Focus on stocks with Composite Ratings of 90 or higher and Relative Price Strength Ratings of at least 85 .

The Composite Rating consolidates five major IBD stock ratings: the Earnings Per Share and RS (Relative Strength) Ratings, the SMR ${ }^{\text {® }}$ Rating (Sales + Profit Margin + Return on Equity), the ACC/DIS RTG ${ }^{\circledR}$ (Accumalation Distribution Rating) and the Industry Group RS Rating. The stock's relationship to its 52 -week high is also factored into it.

Harnessing all this data, the Composite Rating works well as a comprehensive tool.

Ratings of 90 or higher mean a stock ranks within the top $10 \%$ of the market in terms of these multiple parameters.

The Relative Price Strength Rating (RS) tells you how well a stock has performed vs. all other stocks in the past 12 months, with a heavier emphasis on the three most recent months.

You may think high RS Ratings mean the stock is peaking. But keep in mind that leaders often form price consolidations after a prior advance in which they have demonstrated their strength. Thus, they often will show a strong RS Rating before a big run-up out of a new base.

10 Pick companies with management ownership of stock.

People tend to work harder when their own money is at stake.

That's why when investing you should look for companies where management owns at least some of the shares.

Because they own shares, company officers will benefit from or be harmed by the firm's performance and future.

There's no set percentage of a firm's outstanding shares management should own, just so long as it's more than zero.

Management ownership often constitutes a fairly small percentage of the total shares for big-cap firms.

On the other hand, you want to see small-cap companies that have higher percentages of management ownership of shares.

Small caps tend to be more volatile. So the managers who own shares stand to reap a bigger benefit from a firm's success, which results in a big increase in share price.

You can find information on management ownership of shares in the quarterly and annual reports that firms file with the Securities and Exchange Commission. That information is also available in Daily Graphs Online ${ }^{\circledR}$ Premium Stock Charts at Investors.com.

Some of the market's best-performing firms are run by managers who own shares in them.

11 Buy mostly in the top six broad industry sectors in IBD's New Highs List.

It's not enough to pick a stock with strong fundamentals. If it's part of a lagging industry, sooner or later the industry's weakness can undermine its member's performance.

That's why it's a good idea to scan IBD's 197 Industry Sub-Group Rankings, Leading Sectors and New Highs lists each day. The tables give valuable information as to which groups are outperforming the market. Focus on the top 20 industry groups and top six broad market sectors in IBD's New Highs list. That's where the leader-
ship lies. Keep tabs on rotation among the top groups over time. That could indicate shifts in market trends.

The New Highs list has evolved in '07. On July 3, the New Highs list was bristling with 38 stocks in the energy sector. Telecom was the next with 25 . Now few sectors have more than a couple of new highs. This reflects the market's correction.

But inevitably as the market follows through on new rallies, the number of stocks in new high ground typically increases.

Sector leadership changes. Real estate, for instance, has fallen out of favor. Medical, telecom, and food and beverage are holding up well.

The stocks within each sector are sorted by the greatest percentage increase in trading volume. Boldfaced stocks within each group carry an Earnings Per Share Rating of 95 or higher.

Some might be chart forming bases. Keep track of those. Did a company come out with a new product? Are fundamentals compelling?

By studying these lists and charts regularly, you will get an idea of the top-performing sectors, the leading stocks within each sector and those that may be worth buying. Then it's just a matter of waiting for a follow-through day in the market to confirm it's in an uptrend and for stocks in your list to break out of chart bases to new highs.

12 Select stocks with increasing institutional sponsorship in recent quarters.

Institutional investors drive perhaps three-quarters of the market's direction. When mutual funds, large pension plans, insurance companies and hedge funds buy stocks, those share prices typically will rise.

The opposite also holds true: When big-money investors decide to dump shares, you may as well run for cover.

Watching a stock's institutional sponsorship gives important cues as to whether funds are loading up on a stock or cutting bait.

Institutional investors spend a considerable amount of time researching investment candidates in detail. They usually favor companies with a solid track earnings record over more speculative plays.

When they decide to get into a stock, it will take them some time to build their positions. After all, if a fund wants to buy 1 million shares of a stock, it can't buy them
all at once. Doing so could severely alter the buying price.

As a result, mutual funds and others tend to stay away from thinly traded, cheap stocks. They simply do not provide the liquidity necessary to take on a large position.

You can find institutional ownership information in several places in IBD ${ }^{\circledR}$ and IBD's website, Investors.com. The Sponsorship Rating is based on performance of mutual funds that have invested in the stock and whether they have been buying or selling shares. The rating ranges from $A$ (best) to $E$.

The rating appears in the IBD ${ }^{\circledR}$ Timesaver Table, which highlights the day's key price action. It's also shown on the IBD ${ }^{\circledR}$ Big Cap 20 on Tuesdays and Mondays in the $\mathrm{IBD}^{\circledR} 50$.

Friday's Your Weekly Review shows the highest performing mutual fund that owns the stock, its performance rating and the size of its position. Investors.com provides several ways to track institutional support of a stock. Daily Graphs Online ${ }^{\circledR}$ weekly charts show the number of mutual funds that owned the stock during the past four quarters.

It's a great tool to see whether more funds are buying shares or exiting their positions over time. It also shows the Sponsorship Rating.

The Daily Graphs ${ }^{\circledR}$ Fund Center’s Stock Ownership tab displays all funds that own a particular stock. It also provides detailed information about each fund.

When selecting a stock, look at its institutional sponsorship. Are the number of funds and amount of shares they own rising from quarter to quarter? If so, the stock has shown increased demand by big professional investors.

## 13 Current quarterly after-tax profit margins should be improving near their peak and among the best in the stock's industry.

Sales and earnings help gauge a company's fundamental strength. But they don't always show the entire picture.

You can take a deeper look at a company's bottom line by examining profit margins, as they measure management's ability to control costs and spend efficiently.

You can calculate pretax profit by dividing net income by net sales. A company's after-tax profit margin shows the percentage of money a company actually gets from every dollar of sales after taxes.

This income-to-sales ratio, expressed as a percentage, lets you compare the profitability of different companies. Net income, an absolute number, can't do that.

Profit margins don't necessarily improve in step with earnings increases. A company could increase its sales. But if costs have also risen, profit margins will be the same or lower. Margins vary widely by industry, so companies have to be compared within their industry group. Grocery store chains tend to have lower margins, while technology firms have higher margins.

IBD's SMR ${ }^{\circledR}$ (Sales + Profit Margins + Return on Equity) Rating combines these variables to easily find companies with strong sales growth and profitability. Stocks are rated on an A to E scale, with A being the best and E the worst. An A rating means the stock is among the top $20 \%$ of all companies in terms of the three criteria.

14 Don't buy because of dividends or P-E ratios. Read a story on the company. Buy the No. 1 company in an industry in earnings and sales growth, ROE, profit margins and product quality.

There are at least two big reasons not to buy stocks based on low price-to-earnings ratios. Such a strategy often eliminates the best-performing stocks. The top IBD ${ }^{\circledR} 50$ stocks, for instance, have P-E ratios that tend to be much higher than many pundits recommend.

An investor fishing for low P/E stocks will often filter out not just the highfliers, but the second-tier winners as well. Occasionally a low P/E stock will turn into a huge winner, but it's a long shot.

Even finding modest winners can be tougher. An IBD screen run last year for low P/E stocks with three-year sales and earnings growth rates of $16 \%$ or better turned up 128 stocks. About $57 \%$ were up or unchanged for the year.

Did that figure beat the broad stock market? Hardly. Among all stocks in the IBD database, $69 \%$ were up or unchanged for the year. And that's without screening for a quality performance.

A second reason to avoid a low P/E strategy is because it can shift an investor into sectors that traditionally carry low P/Es. Those sectors may not be the best performers. Utility stocks carry lower P/Es than tech stocks, but that alone is not a good reason to buy them.

The low P/E approach can also put you in troubled sectors that are on the downside after a peak.

That low P/E screen also turned up plenty of housing stocks with their highs well behind them.

Meanwhile, some investors are drawn to a high-dividend strategy. That approach also can backfire.

A big dividend can be a sign of trouble. It may belong to a company whose stock has fallen for reasons that should keep you out. Such firms also may be on the cusp of cutting or eliminating the dividend.

It's better to focus on a top firm in a leading group.

## 15 Pick companies with a superior new product or service.

Some companies spark earnings by cutting costs. While that might beat a poke in the eye with a sharp stick, it's far better if the stocks you purchase are growing earnings because of a superior service or product.

Eventually the cost cutters run out of areas to slash. But companies with new gadgets and services are more likely to have a bigger impact on their bottom lines.

Consider some of the companies with new products or services in recent history.
Apple (AAPL) has beaten earnings views every quarter for more than three years, thanks largely to the iPod, and more lately, the iPhone.

Ugg boots maker Deckers Outdoor (DECK) beat views for eight straight quarters, from March 2003 to December 2004.

Las Vegas Sands, (LVS) the first non-Asian casino operator in Macau, beat views for five quarters. It topped or met views every quarter since its December 2004 IPO, until it missed in its most recent period.

While all companies work to contain costs, that wasn't the main driving force behind the run-ups in the stocks of the companies above.

Another reason dynamic growers succeed is that they can afford to hire top talent and invest more in research and development.

The companies that have no strategy beyond cutting costs and waiting for conditions to improve are looking at an uncertain future.

If you see a stock with exploding top- and bottom-line growth, check to see if the company has a new product or service that's catching on with customers. This can boost your confidence that the company's growth can be sustained.

Use IBD's The New America and Internet \& Technology pages to start your search for
companies with something new. The sections dissect promising young companies as well as established workhorses that develop new ways to get things done.

IBD's writers and editors sift through the paper's database of 8,000 stocks, looking for companies with the right fundamentals.

## 16 Invest mainly in entrepreneurial New America companies. Pay close attention to those with an IPO in the past eight years.

Youths experience their greatest physical growth in their early years. Height and weight gains slow in the late teens. Later in life, it's only the weight that grows.

Stocks work the same. They tend to have their biggest gains when they're new to the market. IBD research shows the biggest market winners tend to notch their biggest gains in the first one to eight years following an IPO.

Looking at the stories behind these market winners, you find reason to believe in the Young Turks. Often a company rises to prominence because it offers a new, innovative product or service that quickly develops a big following.

Web surfers turned to Yahoo! (YHOO) to help navigate the sprawling Internet in the 1990s. Google's (GOOG) new spin on surfing has energized a new generation of investors.

In their salad days, growth stocks often are in the early and most dramatic stages of their development. Sharp sales growth and earnings growth draw the attention of mutual funds and other major investors.

As firms mature, their growth tends to slow. The numbers that made year-ago comparisons easily become harder to sustain.

Many companies add girth to their midsection, and their efficiency suffers. In the worst cases, companies can grow into complacent, mismanaged enterprises.

Sometimes they remake themselves and start a new long-term advance. Apple (AAPL) landed on the scene as the maker of the popular MacIntosh computers.

In recent years, the company has become almost as well known for its iPod digital music players. It unveiled the new iPhone a few months ago, hoping to nab even more consumers.

The New America section of IBD ${ }^{\circledR}$ covers companies with the youthful drive and innovative spirit that can turn their stocks into winners

17 Check into companies buying back $5 \%$ to $10 \%$ of their stock and those with new management (what is management's background?).

Company A often buys back shares in the open market. But Company B has yet to set a buyback. Which would you rather own?

If both companies sport strong fundamentals and are leaders in their industry groups, Company A may be a better choice. Buybacks often indicate a firm's bullishness about its future and expectations of improved sales and profit. A company also needs to have cash on hand to buy back shares, so such announcements can indicate strong cash flow as well.

Look for firms planning to buy back $5 \%$ to $10 \%$ of their shares. This reduces the amount of stock in the marketplace. As a result, net income gets divided by a smaller number of shares. The result is higher earnings per share. Stronger profit growth is the primary driving forces behind winning stocks. Think of the C in the CAN SLIM ${ }^{\circledR}$ Investment System; it stands for current earnings growth.

But share buybacks should not be the main reason to buy a stock. It must first meet all your usual buy criteria. That includes having a sound chart base; stellar sales, earnings growth and profit margin; and ample institutional support. A buyback announcement is a plus.

New management also can spur a potential turnaround for a troubled firm. You might notice a former leader starting to spring back to life. Dig a little deeper and you often will find a catalyst such as new management, new products, a restructuring or bullish industry trends.

Again, don't rush to buy shares for any of the above reasons if the stock doesn't meet all your other ingredients to qualify. A change in leadership doesn't automatically mean a company's business, and its stock, will pick up. Give the stock time to prove itself.

Look for strong profit growth for at least two quarters in a row and improvement in other fundamentals.

Likewise, a stock buyback program doesn't always yield great results.
Rambus (RMBS) announced a buyback in January 2006. The stock topped in April.

18 Don't try to bottom guess or buy on the way down. Never argue with the market. Forget your pride and ego.

Everyone loves a bargain. But when it comes to stocks, investors are better off buying on the way up in a rising market, not on the way down.

IBD research shows that winning stocks tend to keep rising and outperforming their peers. Laggards usually keep falling.

That's why it's risky to buy a stock as it's heading south. You might think a former leader is just in a temporary correction, and therefore a good buy at a lower price.

But if you're wrong, your loss could snowball rapidly.
To buy properly, look for a new buy point as a stock breaks out from a sound base. Track the stock's price and volume action each day so you can find an entry point or spot warning signs that keep you out.

Of course, you also want to make sure all the fundamentals meet your buy criteria. If the stock's earnings are suffering, for instance, you'd want to wait until the company has recovered with a few quarters of strong growth.

Don't buy in just any market, either. Since three out of four stocks eventually follow the market's trend, you'll incur higher risk by buying during a downturn.

Just flash back to the 2000-02 bear market. The Nasdaq plunged 78\%, while the S\&P 500 sank $51 \%$. It was tough to find stocks that could buck the severe downdraft.

At such times it's better to raise cash and keep an updated watch list so you can jump in after a powerful follow-through day, which confirms the market's in an uptrend. Your odds for success should be much better.

The M in the CAN SLIM ${ }^{\circledR}$ Investment System stands for market direction. Watch what the major market indexes do each day. Are there warnings such as distribution days or downward reversals on heavy trade? Does the market look poised for a followthrough? Is it in the early weeks after a follow-through, a prime time for catching breakout?

Reading The Big Picture each day can help you stay on top of the market's action.

19 Find out if the market currently favors big-cap or small-cap stocks.

In the stock market, it pays to be able to spot a trend.

Sometimes small-cap stocks lead the market. At other times their big-cap brethren take the reins.

Figuring out which flavor of stock is in favor can help you zero in on the next crop of market leaders. Large caps are stocks with market capitalizations of $\$ 10$ billion or more. Small caps have market capitalizations of less than $\$ 1$ billion.

To see which type is leading, check out the Big-Cap Growth Funds vs. Small-Cap Growth Funds chart in IBD's Mutual Fund section.

The chart shows you how mutual funds that invest in big-cap stocks are performing against funds buying into small-cap stocks.

If the line tilts upward, big caps are outperforming. If the line slants downward, small caps are leading.

Another way to gauge which way the market's winds are blowing is to keep an eye on the S\&P 500 and S\&P 600 indexes.

The latter index serves as a proxy for small-cap stocks, while the former index contains a number of big-cap stocks.

A chart of the S\&P 500 appears daily on the How's The Market? page.

Other indexes and gauges can also help your market analysis. The Russell 2000, like the S\&P 600, keeps tabs on small caps.

IBD's Big Cap 20 shows large-cap stocks with top fundamental and technical ratings. The Big Cap 20 runs in IBD ${ }^{\circledR}$ every Tuesday.

Small - and midcap stocks fared best during much of the bull market that began in mid-March 2003.

But bigger-cap stocks have come on strong this year. Stuffed with big caps, the Dow is the current leader among the major indexes.

Remember, you shouldn't buy a stock simply because of the size of its market cap. Rather, you should look at market capitalization as another factor in tallying up a stock's pluses and minuses when deciding whether or not to buy.

Always opt for stocks with solid fundamentals and chart patterns, regardless of

Also, don't pass on a stock just because its size doesn't fit the stock market's taste at the moment. Sometimes the winners are the ones that buck the trend.


#### Abstract

Do a post-analysis of all your buys and sells. Post on charts where you bought and sold. Evaluate and develop rules to correct your major mistakes. It's what you learn after you think you know what you're doing that's vital. That's how to improve your results.


The best traders learn from their investing mistakes.

Analyzing your past trades and determining what you did right and where you went wrong will help you zero in on your weaknesses and avoid bad moves in the future.

After all, if you make 100 trades, 51 good, 49 bad, you will come out ahead provided you keep your losses small.

By focusing on what went wrong in the 49 trades that brought you losses, you can also learn how to avoid such pitfalls in the future.

Even the best investors make mistakes. The trick is learning what caused the error, examining how you reacted and figuring out how you'll handle such situations if they come up again.

Keep track of your trades in a notebook or on a computer spreadsheet. In separate columns, list the stock ticker, the date you bought and the price you paid. In addition, list the stock's fundamental characteristics at the time of your purchase.

You also should track whether the stock was breaking out of a base or pulling back to a key benchmark, such as its 10 -week moving average. When you sell the stock, list the date and the price at which you sold, and your reason.

After a few months, tally up your gains and losses, then go back and analyze your trades. Print out the daily and weekly charts of the stocks on your list.

Did you sell too soon or hang on too long? How did the stock behave after you sold? How was it acting when you got on board?

Did you let your emotions take over and stubbornly stay invested in a sinking stock rather than cut your losses?

How was the overall market acting? Was it in a bullish uptrend or a bearish downturn?

By looking at your trading behavior, you can refine your skills and avoid repeating your mistakes.

Did you stay on top of your stocks when traveling?

