



Profits over pitfalls

Investing is full of traps – *Shares* got some experts together to discuss how to avoid them

Russ Mould

Even the most experienced traders, brokers, fund managers and retail investors have found the going difficult over the past two years. Market sentiment has whipsawed from bearish to bullish and back with dazzling speed, often catching the unwary totally off guard and with entirely unsuitable positions for the next market move. Yet these wild swings have also created tremendous opportunity for profit. Those brave souls who went against the prevailing consensus at Christmas and bought mining stocks, retail stocks, copper and sterling against the euro would be in clover by now, yet it would have been all too easy to cave in, go with what seemed like a 'safe' consensus at the time – and then get cleaned out.

Novice investors will have found life even harder. To help them navigate a profitable path through to the end of 2009 and beyond, *Shares* convened a meeting between three highly experienced market experts. Nick Raynor of The Share Centre, Joshua Raymond of City Index and Greg Secker of Knowledge to Action all took time to provide investors with useful tips and insights on how to approach the markets. We asked them to focus in particu-

lar on how to avoid the classic mistakes rookie investors can make when they first start putting their hard-earned cash to work.

Know your goals

Shares asks Nick Raynor whether he thinks investors spend enough time thinking about *why* they are investing and what they are seeking to achieve and over what time period by doing so. He is not so sure. 'Typically, we find investors using our advice service give more thought to their investments and time horizons. However, we have definitely witnessed an increase in the level of less market-savvy investors since the collapse of the banks,' he says. 'These less experienced investors have a very different attitude to investing; they believe there is easy money to be made. Of course, you may be lucky enough to call the bottom of the market and make a huge profit, but you could just as easily lose everything'.

'Trading the financial markets can look all too easy from the outside when stock markets are rising but in truth, trading is somewhat more complicated than that,' adds Raymond. 'Having a specific trading strategy before you enter any trade is critically important

and this is what we try and teach our new clients to contracts for difference (CFDs) at City Index. You want the markets to rise but equally you have to know when to get into a market, when to leave and how much to risk. This is where having a trading strategy can be invaluable,' he explains.

'The most important thing a new investor should learn is risk management,' agrees Greg Secker. 'It is so important we teach this at our free seminars held across the UK every week.'

Know your risks

Balancing risk with reward is what every investor should be seeking to achieve and this also requires a systematic approach.

'As our investors mainly trade in CFDs and spread bets they tend to speculate on short-term market movements and this can negate the value of a diversified portfolio a little. However, the way the financial markets have behaved over the last 18 months has shown having a diversified portfolio of investments can help to minimize risk,' confirms Joshua Raymond. 'One of the first rules you learn when trading is not to put all of your eggs in one basket and this rule has become even more relevant in recent

market conditions. If you put all of your risk in just one equity, then you live and die by that one equity.'

'We tend to find seasoned investors have a more balanced portfolio. This is usually because they have already experienced many stock market ups and downs and have sought advice for how to diversify their portfolio. Customers of The Share Centre can call our advice team at no extra cost. We work with customers to educate them on the benefits of diversification and help them to maintain their portfolio,' explains Nick Raynor. He adds: 'One of the quickest and perhaps cheapest ways for investors to diversify their portfolio is by investing in collective investments such as funds, OEICs [open ended investment companies] and unit trusts.'

Know your broker

Every investor needs to have a broker, either to get advice, research or simply execute those all-important trades, so choosing the firm most suitable for your needs is a vital issue.

'The correct way to choose a broker is to decide on a trading strategy first, and then select a broker that will offer a level of service that will support your strategy,' explains Greg Secker. 'For example, we show our delegates how to automate their trading so that if their profit target or their stop loss level is hit, the broker automatically gets them out'.

'It's important to get your choice of stockbroker right as you are likely to stay with them for some while, so it's doubly important to think about the relationship you would like to have as well as looking at the costs. The ideal stockbroker partner for you is one offering the functionality, help and advice that empowers you as an investor,' confirms Raynor.

Raymond agrees a methodical approach is required. 'First the investor should list the three most important aspects to them and then choose the provider that best meets those aspects. Typically for a novice investor they should be strong education tools, high customer service and an easy to use platform,' he says.

Know your limits

The market meltdown on 2008 saw battle-hardened and tyro traders alike caught out but banks, industrial companies and executives also suffered if they had used too much debt to fund them-

selves or their investment activities. Many major stakeholders in firms found themselves forced sellers of stock as they had to repay debts or meet margin calls, having broken not one but two of the market's golden rules: only invest cash you can afford to lose and never used borrowed money.

The Share Centre's Nick Raynor is concerned some still have to take these lessons on board: 'The poor return offered on cash Isas (Individual Savings Accounts) means a lot of people are willing to move assets from more secure investments to fund riskier ventures. In the past we have spoken to investors who have considered applying for credit cards in order to fund stock market investments. This is an incredibly high-risk strategy and not one we would recommend as the investment return would need to exceed the interest rate on the credit card,' he warns. 'Our advice is to only invest what you can afford to lose. Investors should also consider setting limits and alerts as they can be a useful way to help maximise investments'.

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Joshua Raymond

Joshua is Market Strategist at leading CFD and spreadbetting provider City Index and heads up the Client Education Programme.



Nick Raynor

The Share Centre. Nick has over 11 years' experience in personal finance and has been an investment adviser at The Share Centre since 2002.



Greg Secker

Knowledge to Action. Greg is chief executive officer of Knowledge to Action, Europe's largest trader coaching company.



'Regardless of whether we are in a bull or bear market you should never invest anything more than you are willing to lose. This lesson is relevant in all forms of investing and has become even more relevant given the market conditions over the last 18 months,' agrees Raymond. 'We strongly recommend keeping investing exposures to comfortable levels. One of the main benefits of CFD trading at City Index is you can short sell or profit from markets falling just as much as they rise. This means traders can be much more flexible with the markets and potentially profit from any market move, whether that's up or down'.

Know your stocks

Some stocks and industries seem particularly good at catching out the unwary, with technology and biotechnology often proving treacherous as firms and products appear and disappear with disconcerting regularity. Investing in something they do not understand is a common novices' mistake and one against which the entire panel offers a clear warning.

'You wouldn't drive blindfolded and to trade a stock you don't know or understand would be similar,' smiles Raymond. 'Some may not necessarily have the time or access to delve into company balance sheets or review the last three quarters earnings performances but I highly recommend to try and gauge some understanding of the investment you are about to make and this goes hand in hand with developing a trading strategy.'

For example, if you didn't know a spike in crude oil prices may put pressure on **British Airways' (BAY)** share price, you are fighting a losing battle. This can give you a basic understanding of the potential scenarios your investment may confront. The all important reason for doing so is to gain a basic understanding of the risks of trading that share so you can react as and when prices are influenced by a certain situation'.

Greg Secker has a different take on this issue. 'We remove the need for these types of decisions at our Traders University programme by teaching our delegates to select only from the FTSE 350 and then further select based on technical analysis supported by strict risk management,' he explains. 'Our

typical trade is usually between three and ten days so we are looking for a set up that suggests a strong probability of a sudden move, up or down’.

‘We always advise customers to do some research first and then use our Advice team as a sounding board. Most investors value a second opinion, but just because you seek advice it doesn’t mean you have to take it,’ adds Raynor. ‘Some investors prefer to conduct their research online and many brokers now provide share tips and advice on larger stocks on their websites. Customers of The Share Centre can access our opinions on all FTSE 100 companies via www.share.com and we send regular share and fund recommendations by email.’

Know your numbers

Investment jargon can be bewildering, particularly when it comes to the issue of how to value a stock, and decide whether it is ‘cheap’ or ‘expensive’. Novice investors often trip up here, even confusing the *price* at which a share trades with the *valuation* this implies for the quoted firm overall.

Nick Raynor is quick to clearly draw this distinction. ‘Investors shouldn’t just focus on one figure or ratio as they need to understand the bigger picture and what might be affecting the company and its performance. The ‘valuation’ or price/earnings ratio (PE) is not straight forward as a high PE can be both good or bad depending on the company and how it is performing in relation to its sector,’ he explains. ‘For example, a low PE could mean the company is producing high profits, but this might mean it has reached its peak profit potential. On the other hand a very high PE may mean the company has only just started making a profit and therefore there is potentially more to come; equally it could mean that profits are falling. Investors should use a number of tools to assess a company’s potential, such as charts to determine how the company is performing and how it has performed in the past – the ‘trend is your friend’ as we say. Earnings per share and dividend cover should also be considered’.

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Know your strategy

This takes us to the subject of tactics and strategy. American investment guru Warren Buffet once said his favourite holding period for a stock was ‘forever’. Some investors prefer to ‘buy-and-hold’ for long-term returns, riding out short-term squalls, while others take a more active approach.

Greg Secker advocates employing a highly disciplined, shorter-term strategy. ‘Buy and hold is dead! This was popular in the 1980s and 1990s because it actually worked then,’ he exclaims. ‘Most

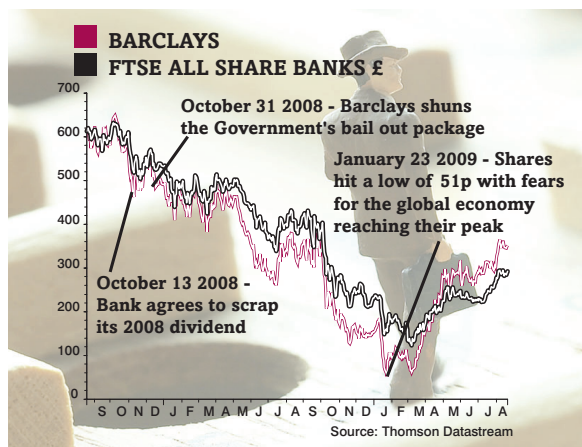
ed well you could benefit from a constant dividend yield and income stream by holding onto your shares. However, if you’re waiting for your shares to pick up, your cash could be working harder for you by investing in a company that is currently performing better,’ he says. ‘Shares need constant monitoring, particularly in volatile times. No-one can predict what is going to happen in twenty years for example, we only have to look to the past for examples of investments that crashed – Marconi, Railtrack and Northern Rock’.

‘One of the main reasons the traders that do lose on a short term strategy is just that; they run their losses until they reach a point where they can no longer risk that their positions go against them any further and they are forced to take a hefty loss,’ jumps in Joshua Raymond. ‘Warren Buffet is quite different to the average investor. The average investor is unlikely to have the influence or the capital base behind them to wait forever for the stock to turn in their favour. The toughest battle an active trader faces is their own trading psychology. Choosing when to leave a position in profit or more importantly, when in a loss, and this is one of the toughest decisions a trader can make’.

Know your returns

There is no doubt money won is twice as sweet as money earned, but many investors can focus too much on capital gains – share prices rising (or falling for those brave enough to go short) – and often neglect the powerful long-term impact dividend payments can have. *Shares* asks the panel if income investing is a worthwhile methodology.

‘Again this can change with your strategy. A long-term equity holder will focus more on consistent dividends, whilst this becomes less important for the short-term speculator, who will focus more on achievable capital gains,’ explains Raymond. ‘For the long-term equity holder who will value dividends, they should certainly take a look at historic yields as this generally gives an indication of what they can expect going forward. However, there have been quite a few instances over the last few earnings seasons whereby dividends have been cut or even removed due to



other 20-year period returns are just either side of 0% or worse, with some showing big losses, like 1960 to 1979 or 1900 to 1919. The private investor needs to go beyond merely selecting the stock market as an investment vehicle. It is crucial to have a defined strategy to decide which stocks, when to get in and when to get out – whether the trade goes to plan or not’.

Nick Raynor is less dogmatic. ‘In principle the buy-hold strategy can be very successful. On the plus side if you select-



changing market conditions and so you cannot 100% rely on historic payments for future trends’.

Greg Secker agrees an income strategy should be deployed with every bit as much care as one seeking capital appreciation. ‘I remember early last year when **Barclays (BARC)** was tumbling and becoming too tempting to the “buy the bargain” crowd [see chart, page 26]. A guy who came to one of our seminars said he was going to buy it because the dividend yield was amazing,’ he points out. ‘Obviously it was because the share price had plunged and the dividend data used to calculate the yield was relating to a pre-plunge period, so if he had followed through he would have found himself with a big loss. So definitely investors need to check the sustainability of historic yields’.

Know your costs

Investing cannot be done without incurring costs which, if not managed carefully, can eat into hard-won profits. The inexperienced investor can often forget about broker commission fees, dealing spreads and even stamp duty when placing trades, but the shrewd market punter will pay just as much attention to these issues as he or she would to their stock selection.

‘I think these aspects can be quickly forgotten. Certainly when choosing what provider to go with, this is one of the more important comparisons,’ agrees Raymond. ‘However, once you start to trade multiple positions over a week and really get into it, costs can quickly escalate and be forgotten until you see your monthly statement. I would always factor into any trade the amount I have

been charged to make that trade. If I have made £2,000 on a trade I always know that my net returns are £2,000 minus my trading costs’.

‘At the moment a lot of people are shopping around for cheaper online trading. And, the advancement of social technology such as forums and social networking means investors are regularly discussing cheaper trading options and swapping stock tips. As such, I think the average investor is savvier about transaction costs, spreads, commission and stamp duty,’ comments Raynor.

Know your tax position

If dealing costs can eat into profits, the tax man is always on the lookout for his piece of the action too. To conclude the discussion, *Shares* asks the experts if investors put enough time into tax planning when it comes to their portfolios.

‘I think the average investor is confused about tax planning. There are definitely advantages of being aware of your tax situation and the best wrappers for your investments, particularly if you’re a higher rate taxpayer,’ acknowledges Nick Raynor. ‘Isas are a good way to protect your investments from the tax man. If you pay tax at the basic rate, outside an Isa you would usually pay 20% tax on your savings rate and if you pay tax at a higher rate you would usually pay tax at 40%. Those paying tax at a higher rate could also protect their dividend income by investing through an Isa; you would normally pay tax on dividend income at 32.5%. Although you won’t get back the 10% dividend tax credit which is applicable regardless, by investing in an Isa you will save by not having to pay any additional tax.

You can also make capital gains tax (CGT) savings by investing through an Isa. If you make gains of more than £10,100 from the sale of shares and certain other assets in the tax year, you would normally have to pay CGT. However, you do not have to pay any CGT on gains from an Isa, though losses on Isa investments can’t be used to reduce CGT on gains from investments outside the Isa.’

‘We believe the best way to manage tax is not to pay any!’ interjects Greg Secker. ‘Legally of course – this is one of the reasons why we teach spread betting – the greatest advantage the British investor has is spread betting’s tax free status. Not to mention the fact you can use spread betting to trade a falling market, too.’

Joshua Raymond also points out some investment tools are more tax-efficient than others. ‘If you are a regular investor and place multiple trades throughout the tax year, your tax returns can get quite complicated and expensive,’ he adds, before he concludes the discussion by saying: ‘At City Index you can speculate on financial markets by placing a spread bet and the biggest advantage spread betting has over regular share dealing is that currently in the UK all profits are free from CGT, although tax laws are subject to change and you should seek independent advice. This immediately saves the investor 18% of their profits being paid in CGT and the inconvenience of a potentially long and drawn out tax assessment at the end of the tax year. I would also strongly advise if any trader is unsure about whether they have paid the right amount of tax, that they seek tax advice’. ■