

18 mistakes people make

Contributed by Travis Morien

This list makes up a chapter in *How to Make Money in Stocks*. As far as O'Neil is concerned these are the top 18 blunders and misapprehensions made by investors and traders.

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Most investors never get past the starting gate because they do not use good selection criteria. They do not know what to look for to find a successful stock. therefore, they buy fourth-rate "nothing-to-write-home-about" stocks that are not acting particularly well in the marketplace and are not real market leaders.

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A good way to ensure miserable results is to buy on the way down in price; a declining stock seems a real bargain because it's cheaper than it was a few months earlier. For example, an acquaintance of mine bought International Harvester at \$19 in March 1981 because it was down in price sharply and seemed a great bargain. This was his first investment, and he made the classic tyro's mistake. He bought a stock near its low for the year. As it turned out, the company was in serious trouble and was headed, at the time, for possible bankruptcy.

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An even worse habit is to average down your buying, rather than up. If you buy a stock at \$40 and then buy more at \$30 and average out your cost at \$35, you are following up your losers and mistakes by putting good money after bad. This amateur strategy can produce serious losses and weigh you down with a few big losers.

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The public loves to buy cheap stocks at low prices per share. They incorrectly feel it is wiser to buy more shares of stock in round lots of 100 or 1,000 shares, and this makes them feel better, perhaps more important. You would be better off buying 30 or 50 shares of higher-priced, sounder companies. You must think in terms of the number of dollars you are investing, not the number of shares you can buy. Buy the best merchandise available, not the poorest. The appeal of a \$2, \$5, or \$10 stock seems irresistible. But most stocks selling for \$10 or lower are there because the companies have either been inferior in the past or have had something wrong with them recently. Stocks are like anything else. You can't buy the best quality at the cheapest price!

It usually costs more in commissions and markups to buy low-priced stocks, and your risk is greater, since cheap stocks can drop 15 to 20 percent faster than most higher priced stocks. Professionals and institutions will not normally buy the \$5 and \$10 stocks, so you have a much poorer grade following and support for these low-quality securities. As discussed earlier, institutional sponsorship is one of the ingredients needed to help propel a stock higher in price.

(Note to aus.invest FAQ readers, in USA blue chip stocks are often a few hundred dollars per share and generally a high priced share is individually worth a lot of money. In Australia we have stock splits more often and you can't make conclusions regarding a company by the individual unit share price. Perfectly good companies trade for a few dollars in Australia, and there aren't too many stocks higher than \$50.)

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First-time speculators want to make a killing in the market. They want too much, too fast, without doing the necessary study and preparation or acquiring the essential methods and skills. They are looking for an easy way to make a quick buck without spending any time or effort really learning what they are doing.

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Mainstream America delights in buying on tips, rumours, stories, and advisory services recommendations. In other words, they are willing to risk their hard-earned money on what someone else says, rather than knowing for sure what they are doing themselves. Most rumours are false, and even if a tip is correct, the stock ironically will, in many cases, go down in price.

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Investors buy second rate stocks because of dividends of low price/earnings ratios. Dividends are not as important as earnings per share; in fact, the more a company pays in dividends, the weaker a company may be because it may have to pay high interest rates to replenish internally needed funds that were paid out in the form of dividends. An investor can lose the amount of a dividend in one or two days' fluctuation in the price of a stock. A low PER, of course, is probably low because the company's past record is inferior.

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People buy company names they are familiar with, names they know. Just because you used to work for General Motors doesn't make General Motors necessarily a good stock to buy. Many of the best investments will be names you don't know very well but could and should know if you did a little studying and research.

Most investors are not able to find good information and advice. Many, if they had sound advice, would not recognise or follow it. The average friend, stockbroker, or advisory service could be a source of losing advice. It is always the exceedingly small minority of your friends, brokers, or advisory services that are successful enough in the market themselves that merit your consideration. Outstanding stockbrokers or advisory services are no more frequent than are outstanding doctors, lawyers, or baseball players. Only one out of nine baseball players that sign professional contracts ever make it to the big leagues. And, of course, the majority of ballplayers that graduate from college are not even good enough to sign a professional contract.

Over 98 percent of the masses are afraid to buy a stock that is beginning to go into new high ground, pricewise. It just seems too high for them. Personal feelings and opinions are far less accurate than markets.

The majority of unskilled investors stubbornly hold onto their losses when the losses are small and reasonable. They could get out cheaply, but being emotionally involved and human, they keep waiting and hoping until their loss gets much bigger and costs them dearly.

In a similar vein, investors cash in small, easy-to-take profits and hold their losers. This tactic is exactly the opposite of correct investment procedure. Investors will sell a stock with a profit before they will sell one with a loss.

Individual investors worry too much about taxes and commissions. Your key objective should be first to make a net profit. Excessive worrying about taxes usually leads to unsound investments in the hope of achieving a tax shelter. At other times in the past, investors lost a good profit by holding on too long, trying to get a long-term capital gain. Some investors, even erroneously, convince themselves they can't sell because of taxes - strong ego, weak judgement.

Commission costs of buying or selling stocks, especially through a discount broker, are a relatively minor factor, compared to more important aspects such as making the right decisions in the first place and taking action when needed. One of the great advantages of owning stock over real estate is the substantially lower commission and instant marketability and liquidity. This enables you to protect yourself quickly at a low cost or to take advantage of highly profitable new trends as they continually evolve.

The multitude speculates in options too much because they think it is a way to get rich quick. When they buy options, they incorrectly concentrate entirely in shorter-term, lower-priced options that involve greater volatility and risk rather than in longer-term options. The limited time period works against short-term option holders. Many options speculators also write what are referred to as "naked options", which are nothing but taking a great risk for a potentially small reward and, therefore, a relatively unsound investment procedure.

Novice investors like to put price limits on their buy and sell orders. They rarely place market orders. This procedure is poor because the investor is quibbling for eighths and quarters of a point, rather than emphasising the more important and larger overall movement. Limit orders eventually result in your completely missing the market and not getting out of stocks that should be sold to avoid substantial losses.

Some investors have trouble making decisions to buy or sell. In other words, they vacillate and can't make up their minds. They are unsure because they really don't know what they are doing. They do not have a plan, a set of principles, or rules to guide them and, therefore, are uncertain of what they should be doing.

Most investors cannot look at stocks objectively. They are always hoping and having favourites, and they rely on their hopes and personal opinions rather than paying attention to the opinion of the marketplace, which is more frequently right.

Investors are usually influenced by things that are not really crucial, such as stock splits, increased dividends, news announcements, and brokerage firm or advisory recommendations.