

Profiting from Wealth Winners® in These Turbulent Times

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Now is the best time to maximise your wealth in the share market. Now, more than ever, there are Wealth Winners® on sale at discount prices.¹

Before explaining in more detail why this is the right time to invest, and how to do it, let's have a look at the current situation.

We live in turbulent times. Consider some recent headlines: "Stocks to drop on European debt woes", "Market buoyed by bond news", "Year of pain to hit shops and banks", "China data to result in some big movements", "Moderate falls expected on bourse as euro crisis deepens", "Rising yields tempt investors back into equities", and "Stocks to rise on employment results."

One day the headlines are saying that the market is on the way up. The next day they are saying the complete opposite. And the reasons can be anything from the war in Afghanistan to the increasing employment in the US, from the level of Greek debt to the strength of the Chinese economy.

More than ever every writer and analyst states their opinions. The problem is that rarely are these opinions looked at later to see if they were accurate.

When this is done, the results are telling. On average 50 percent of the time they were right and 50 percent of the time they were wrong. In other words, the opinions of the "experts" are no better than tossing a coin.

Consider managed funds. On average, in any year approximately two thirds actually underperform the market. It's even worse for individual investors. A twenty year study showed that they underperformed the market on average by more than 5 percent per year. Putting it simply, most people bought at the wrong time, and then made it worse by nervously selling at the wrong time.

Proven Investment Principles

If both managed funds and individual investors are losing money compared to the market, then who is actually making money? Someone must be, right? The general answer is easy: those few people who follow proven investment principles. These are the investment principles that have been proved over the years to make money.

What are these principles? And why do so few people know them, and even fewer follow them?

¹ The concept of Wealth Winners®, and how to find them, is more fully explained at Teaminvest Information Sessions. Wealth Winner®, Conscious Investor® and STAEGR® are registered trademarks.

In this article I briefly describe a few of them. You can get more details by attending a Teaminvest Information Session described later.

These are not my principles. These are the principles of the world's greatest and most successful investors such as Benjamin Graham, Warren Buffett, Philip Fisher, Charlie Munger and Peter Lynch.

The exciting news is that when there is maximum turbulence, uncertainty and rumour-hopping – such as now – maximum profits can be made using these principles. Conversely, without using these principles, the wrong decisions in these times can magnify the losses.

The second piece of exciting news is that these principles – and many more – are built into the Teaminvest approach to investing.

Earnings, Earnings, Earnings!

The fundamental principle in real estate is position, position, position. The equivalent principle in the share market is earnings, earnings, earnings.

If you were running your own business, which many of you have done or are doing right now, you know the importance of the bottom line. Without a healthy, and preferably growing, bottom line, it is not really a business.

It is the same in the share market. The most important number in the financial statements is earnings per share (EPS). This is the amount of profit the company makes for every share that you own in the business. Think of it as the money that the business makes on your behalf for every share that you own.

The reason why we focus on EPS is that to a high level of certainty as EPS grows so does the share price. If earnings double in five years, so will the price. If they treble, so will the price.

Warren Buffett made this plain when he wrote a few years ago: “Put together a portfolio of companies whose aggregate earnings march upward over the years, and so also will the portfolio's market value.”

He continued, “Though it's seldom recognized, this is the exact approach that has produced gains for Berkshire [Hathaway] shareholders.”

It couldn't be much clearer than that.

When there is high volatility it is even better.

Suppose the price of a share is around \$10 and you are confident that earnings per share will double over the next five years. If the share price also doubles to around \$20 the return is approximately 15 percent per year excluding dividends.

Now suppose the market has one of its crazy dips and the price drops to \$5.00. With the earnings growing as before, as just explained the price in five years will still be around \$20.00. This means a capital growth of around 31 percent per year! And dividends are a bonus on top of this.

Will Earnings Continue to Grow?

Of course, earnings growth in the past is one thing. What is even more important is confidence about the growth of the earnings in the future.

One way to help ensure this is to find companies that delivered stable growth in the past. Despite a wide range of economic and business environments, these companies have shown their ability to rise above such variations and grow their profits year upon year.

The investment software Conscious Investor® that comes with membership of Teaminvest has a proprietary feature called STAEGR®. It measures the level of stability of the growth of sales and earnings. I have carried out large scale studies on databases of Australian and US stocks. They show that when companies have high stability as measured by STAEGR®, we can be more confident that past growth will continue into the future.

DEBT is a Four-Letter Word

Most public companies have debt. But in some cases the debt is so high that even the smallest difficulty can send the company crashing down, and perhaps out of existence.

Consider Babcock and Brown (BNB), for years the darling of the financial press. Not many took any notice that it had a debt to equity ratio of over 450 percent. Could you imagine running your business, or your life, this way?

In round figures, BNB had equity of \$2.5 billion and owed \$11.6 billion in interest-bearing debt. How much interest? During 2007 the company paid an interest bill of \$505 million from its revenues of approximately \$2 billion. Bonuses paid to management came to another \$573 million, but that is another story.

BNB was an accident waiting to happen! With any tightening of general credit, let alone the global financial crisis, the company would suffer badly. This is exactly what happened. From a high of around \$35.00, the shares crashed to \$0.14 before being delisted in June 2009.

More recently JB Hi-Fi grew its debt from approximately \$34 million a year ago to over \$232 million. Over this same time the price has been cut in half!

High debt levels may also mean that the company cannot move quickly to take advantage of favourable acquisition opportunities.

Putting it bluntly, always stay away from companies with debt that is too high. This is particularly true in the current times when there is so much uncertainty about credit and a higher possibility of loans being recalled.

All That Glitters Is Not Gold

Most people end up investing in more or less the same stocks as everyone else. This is because they usually read the financials in the same newspapers or watch the same investment TV shows. These are what I call the “glitter” stocks: over-publicised and over-priced.

To find Wealth Winners® you need to examine carefully every stock. How? The problem is there are over 2,000 stocks on the ASX and thousands of items of data for all these stocks. So it's impossible to do such an examination looking at them one by one.

In contrast, Conscious Investor® seeks Wealth Winners® which are often companies that other people have never heard of, or have dropped out of fashion. It does this by scanning every stock on the ASX using literally millions of calculations based on ten years of data.

Is Your Portfolio Stress Tested?

Benjamin Graham, Warren Buffett's mentor, continually used the phrase "margin of safety" throughout his book *Security Analysis*, but it was not until *The Intelligent Investor* that he talked about it as the "central concept of investment." He made it the sole focus of the final chapter of the book, declaring that if he had to "distil the secret of sound investment into three words," then those words would be "margin of safety."

In broad terms a margin of safety is a buffer against forecasts that end up not being met by the performance of the company. It is also a buffer against the market not responding to performance levels of a business to the degree that was anticipated.

Although many analysts talk about margins of safety, they tend to apply them haphazardly and too late in the investment process. In contrast, Teaminvest uses methods based on procedures developed by engineers and architects who use computer models to stress test designs for bridges and buildings before starting construction. This ensures their safety under extreme conditions.

Similarly, through proprietary tools in Conscious Investor®, margins of safety are used to stress test potential investments before any decisions are made. Computer procedures automatically identify weaknesses in the financial data of a company that may not be discernible by simply reading the financial statements and company reports. Such weaknesses are then used to strengthen the safety requirements. This testing is carried out in the areas of business growth, market opinion and the board dividend policy.

Is Management Acting Honestly, Rationally and in Your Best Interests?

This is where the collective wisdom and experience of Teaminvest members really comes to the fore. In carefully designed workshops members work together to establish the future risks of the business in terms of the likelihood of their occurrence and how much this could inhibit its continuing success.

Members also discuss whether the board and management have the experience and ability to handle these risks should they occur. Finally, members look at evidence whether management is honest, rational and acting in the best interest of shareholders, the real owners of the business. For example, are the remuneration levels appropriate for the size and complexity of the business? Do they reward activities that are in the best interests of shareholders or do they promote self-serving behaviour at the expense of genuine profitability of the business?

Philip Fisher expressed these ideas in terms of stewardship stating that he would only invest in companies with a board and senior management that had an attitude of stewardship towards the shareholders.

If management is not honest, rational and acting in the best interests of shareholder, investing in the company will always be stressful, worrying and probably unprofitable, no matter what price is paid. Teaminvest with its membership structure is unique in its ability to avoid such companies.

Find Out More at a Teaminvest Information Session

These are just a few of the principles that are built into the Teaminvest approach. Teaminvest is a private membership organisation for those who prefer to control their own money well, rather than paying others to do it badly for them. Membership is by invitation only.

The best way to find out more is to attend one of the regular Teaminvest Information Sessions. Details and times are available on the website www.teaminvest.com.au.

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