THE TEN COMMANDMENTS OF INVESTING

The biblical Ten Commandments were intended to act as a driver's manual for the road of life. "Thou shalt not kill." "Thou shalt not lie." These are life's version of the stop-at-the-red-light-and-advance-when-safe rules of the road. In other words, they are all guidelines to keep people out of trouble. Because life's highways are full of potholes, blind turns and bad drivers, the investing world also suffers from scandals, scams and dishonest companies. Here are 10 commandments for the investing world designed to help keep investors – and their money – safe:

1. Thou shalt set clear goals.

If you don't have a purpose or a set of goals to guide your investment strategy, don't invest. This sounds harsh, but there are so many types, styles and flavors of investing that, without a particular destination, you will be lost at sea.

2. Thou shalt put thy financial house in order.

To become a successful investor, you have to make sure that your personal finances are in order first. Investing without a purpose is bad, but investing when you have high-interest debt is much worse. If you are drowning in overdue bills and credit card payments that you can't meet, take care of those more serious problems before getting too deep into investing.

3. Thou shalt question authority.

Investing is more about the art of asking and answering the right questions than it is about deciding when to buy and when to sell. CEOs, CFOs, CPAs, CFAs and all the other acronyms that we use to classify Wall Street's professional caste can't hide the fact that they are human, and that humans sometimes lie. Analysts get kickbacks, CEOs get stock options and recent accounting scandals, such as Arthur Anderson LLP's conduct regarding Enron, show that impartial accounting is not guaranteed.

To question authority, you will need to educate yourself, especially on the subject of financials. Press releases are flakes of snow that rain down on investors and melt away, but financials stick around. Although financials can be tampered with, there is always a trail left behind.

4. Thou shalt not follow sheep.

Herd mentality is leading to more and more destructive rampages down Wall Street. Investing passively by sticking to funds, indexes and other mainstays of the coach potato portfolio is a perfectly acceptable practice. The danger comes when people move from passive investing to an active portfolio, but stick with the behavior of a passive investor.

There is a lot of available information for such investors – much of which is true – but accepting it with an uncritical eye and neglecting to check it yourself is what leads to herding. This includes getting the latest and greatest stock tip from your Uncle George.

A person can effortlessly become one of the investors that the analysts shepherd into various "must-buy stocks" after they have become overpriced. This is how investors find themselves in the herd when skittish investors flee, causing the stock to plunge farther than it should have (whereupon a more astute investor buys a bargain off your loss).

When people buy cars, they try to find the best value for the lowest price; when people buy stocks, they only see the price and, ironically, gravitate toward rising prices. If you are going to invest, you have to check things for yourself in order to find the true value and get the bargains. This takes more time, and it could even cause you to miss out on early gains, but it will tell you when to stay out or when to sell well before the herd hears the bell.

5. Thou shalt be humble.

If you take the first four commandments to heart, there is a good chance that you will perform better than the majority of individual investors and many of the professionals. But sometimes, particularly during a bull market, gains are not dictated by investor actions as much as by having money in the market, so don't allow yourself to become overconfident. Overconfidence often leads to overtrading, taking unnecessary risk and eventual losses when the bull turns bear. Also remember that you incur commissions every time you trade – this expense can often erase profits or increase losses.

6. Thou shalt be patient.

Patience is a virtue for a good reason: It pays for itself. When the market dips, or even when a particular stock dips, there are always investors who panic and sell. Selling should be treated just as seriously as buying. If it is just a bump, ride it out. If it is truly a problem with the stock, take your time as well – you may find a way to use it in a gain-loss transaction that will save you taxes. By the time you hear it, bad news has already settled in – taking your time isn't going to make it much worse.

7. Thou shalt show moderation.

Investing too much is not a problem many people have, but it can happen. It is said that the pain of a loss has twice the emotional strength of the pleasure of a gain. For some people, this results in them pulling out of the market prematurely, as mentioned above.

For others, losing propels them into successively riskier ventures in an all-or-nothing attempt to win those losses back. Losses are hard to take, but look on the bright side: You can sell a loss to offset a gain in another sector or, if it is in a retirement account, you can use it as a tax write-off. Concentrating your money too much in one area, either by sector, risk level, or even keeping it all in the stock market, is a sure way to see more nothing than all in an all-or-nothing game.

8. Thou shalt not ogle thy investment.

There is nothing like a market correction or a general upswing to change perfectly normal investors into fanatics who have market updates text messaged to their cell phones every five minutes. As with fidelity, the axiom, “look, don’t touch” is insufficient because the more you look, the more you want to mess around with your investments. It is not clear if it is a symptom or a cause, but this rabid over-monitoring almost always leads to unnecessary churning in sufferers’ portfolios.

9. Thou shalt not court or spurn risk.

You should never put everything you have into futures, but you also shouldn’t hold everything in Treasury bills. There is an appropriate level of risk for investors of every age and creed.

10. Thou shalt not make heroes of mere men.

There are no perfect investors. Warren Buffett, George Soros and Peter Lynch have all slipped up from time to time. That doesn’t stop them from being great investors who are worth studying and learning from. That said, you should never mimic an investing strategy that you do not fully understand.

There is too much guru-ism going on among investors – so much so that credentials are often lost beneath book titles in which the word “rich” is prominently featured. As with the early caution against trusting authority, you have to question everything. Even if a strategy works for a certain period of time, once it becomes widespread, it skews the system. For example, the publication of Lynch’s tenbagger strategy has led to too many people searching for those stocks, leading prices to become inflated to adjust for the nonmarket driven demand. Skeptics survive on Wall Street much longer than believers.

Conclusion

Praying or getting behind the wheel expecting everyone else to follow the same rules you do are both acts of faith. Investing, in contrast, requires practice. To be a good investor, you have to make doubt a part of your creed and a make of ritual of double-checking. These guidelines should help you on your way. Happy driving.

by **Andrew Beattie**

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