# Investment Strategies

**Introduction**

If you are investing for retirement, I strongly recommend doing your investment through a tax-deferred account. If you don't know whether your employer offers a defined contribution plan you should ask. These plans are usually referred to as a 401-K plan by businesses and as a 403-B plan by non-profit organizations. If you are self-employed, either full-time or part-time, you should consider establishing a simplified employee pension plan (SEP) for yourself. All of these plans allow you to reduce your current tax liability, and defer taxes on your dividends and capital gains. These accounts are usually set-up through an investment company such as one of the families of mutual funds or through a brokerage firm. Whether your account is with a fund family or a broker, you will be responsible for making investment decisions. If the account is with a fund family, your choices will be limited to the offerings of that investment company. A retirement account at a brokerage firm will generally give you greater flexibility. If you are already have one of the above accounts or can't do one of them, I recommend that you do your investment through an IRA account. With a traditional IRA, you should be able to reduce your current tax liability and defer taxes on dividends and capital gains, until retirement. With a Roth IRA, you will be able to eliminate future tax liability on dividends and capital gains. You can set-up an IRA through most mutual fund families and through most brokers. If you are investing for reasons other than retirement or think there is a high probability that you will need your money before you reach retirement age, don't use a tax-deferred account for your investments.

**Investment Strategies**

1. **Buy and Hold.** This hardly deserves to be called a strategy but it is the easiest approach to employ and is often used as a benchmark against which to compare other strategies. Buy and Hold means simply what its name implies. For example, you have $10,000 dollars to invest and you purchase $10,000 worth of an equity fund and forget about it for some extended period of time. To be effective a Buy and Hold strategy should probably be combined with Value Investing.

2. **Value Investing.** This strategy entails a careful study of stock offerings to identify stocks that have good fundamentals and are under valued. The objective here is to build a portfolio of such issues and hold them until their true value is reflected in their price. There are a number of services that analyze stock fundamentals and valuations and then make recommendations to their clients. One free, value-stock screening service is the Magic Formula Investing site based on the approach developed by Joel Greenblatt.

(https://www.magicformulainvesting.com/)

3. **Dollar Cost Averaging.** This is a fairly simple strategy that entails selecting a mutual fund, ETF (exchange traded fund) or stock and then investing fixed amounts at set intervals of time. The most common implementation is to invest a fixed sum, e.g.,

$500.00 every month in a mutual fund or ETF. If you have a lump sum to invest, the strategy would be to divide the money into equal portions and invest a portion at some set interval, e.g., $10,000 divided into ten $1000 portions that are then invested monthly or quarterly until all the money is invested. By following this strategy your fixed sum of money will purchase shares at different prices at each investment interval. Sometimes the shares will be expensive and you will only get a few shares. At other times, the shares will be cheap and you will get a lot of shares. Over time, your average cost per share will be lowered relative to the overall valuation of the market. Most advisors recommend that you have a time horizon of at least five to ten years when employing this strategy.

Dr. Robert Persons, in his book Handbook of Formula Plans in the Stock Market, has shown that a dollar cost averaging program begun at the market high in 1929 would have doubled in value by the time the Dow got back to its pre-crash high. Keep in mind, however, that this took nineteen years, which is a bit longer that the five to ten year time frame often cited by advisors. Also, keep in mind that doubling your money in 19 years is no great feat. One professional investor with an excellent record, Jimmy Rogers, has suggested that believing that over the long-term stocks always go up is a dangerous myth (Barron's, May 20, 1996). A discussion of the dollar cost averaging strategy is available in Everyone's Money Book by Jordan Goodman and Sonny Bloch (Dearborn Financial Publishing; 520 N. Dearborn St.; Chicago, IL 60610-4354) and can be purchased from online book seller like Amazon http://www.amazon.com or Barnes and Noble http://www.barnesnoble.com

If you think you want to use the dollar cost averaging approach, I would recommend that you invest in either a large highly diversified company like General Electric or an exchange traded fund (ETF) that tracks one of the stock indexes (e.g., see the **Index Trading** section on this site). There are a number of ETFs that focus on different segments of the market, e.g., small cap, mid cap, large cap, growth, value, dividend paying stocks, etc. If you want to be more aggressive, you might consider using sector ETFs. Since with the dollar cost averaging approach your funds are always exposed to the risk of market declines, using a fund that takes a more conservative approach to investing your money will reduces your risk somewhat. You can learn more about ETFs at the following site:

http://www.marketwatch.com/tools/etfs/html-home.asp?siteid=mktw

4. **Position Averaging.** Somewhat related to the dollar cost averaging approach is the position averaging approach that was initially developed by Robert Lichello. This approach is a systematic system for increasing a position by buying as price declines and decreasing a position by selling as price increases. The strategy can be implemented using individual stocks, ETFs or mutual funds. There are a number of software products that have been developed to help implement this strategy. You can learn more about this approach at the following site: http://www.aim-users.com/

5. **Momentum Trading.** This strategy invests in whatever stock or fund is increasing the most rapidly in price. The basic idea is that stocks in a strong up move will continue up for a period of time. The strategy tries to identify stocks with strong upward momentum and then ride them up. If this appeals to you, one advisory service that employs this strategy is the *Cabot Top Ten Report* that can be found at: (http://www.cabot.net/info/ctt/cttjb05.aspx?source=wp50)

Here is a simple do-it-yourself approach to selecting a momentum fund or stock. Keep data on a least three stocks or funds that aren't highly correlated with one another. Next, compare the rate of change in each of these issues to a broad index such as the Wilshire 5000 index or the NYSE index. Move your money between the three issues depending on which is out performing the broad index. If more than one is out performing the broad index, use the one that is the strongest. When the market is in a downtrend, move your money into a money market fund. One simple way of estimating the trend of the market is to compare a broad index to its 89-day simple moving average. When the index is above the average, you should be invested. When the index is below the average, you should be in a money market fund. A book on technical analysis will explain how to compute rate of change values and simple moving averages (see section 8 below for a couple of references).

6. **Swing Trading.** This is also known as **Channel Trading**. By whatever name, the strategy buys a stock or fund that is considered oversold and then sells it when it becomes over bought. How this is determined is variable. Some traders do this using a relative strength indicator, some use a stochastic indicator and others use trading bands computed in various ways. To follow this strategy one should have a diversified pool of stocks or funds that are evaluated regularly. Ideally, one wants to find issues that are in regular up and down cycles rather than trending. There is software available that can help one identify stocks or funds that are in a cycle mode (http://www.walterbressert.com/). This type of trading also requires some knowledge of technical analysis and software tools (see section 8 below for a couple of references).

7. **Seasonality.** This strategy is based on research that shows that there are identifiable periods when there is an increased probability of upward movement in the stock market. Probably the first to discuss this strategy was Yale Hirsch in his book Don't Sell Stocks on Monday. Norman Fosback the author of Stock Market Logic offers a basic seasonality strategy. His strategy entails switching between a growth fund and a money market fund. Basically, the strategy has you invested during the last two trading days of a month and the first three trading days of the next month. While the strategy is a bit more complicated than this description, you would be following the strategy pretty closely by employing the above rule. This strategy has performed very well, and it significantly reduces your risk by having you out of the market most of the time. Ultra Financial Systems sells software (http://ultrafs.com) that contains several sophisticated seasonal timing systems.

Mark Vakkur discusses a variation on the seasonality approach in an article in the magazine, *Technical Analysis of Stocks and Commodities* (June 1996). Dr. Vakkur studied a simpler form of the seasonality strategy based on being invested only during specific months. Following his strategy, you would be invested in a growth fund nine month out of each year. You would invest all of your funds during the months of November through January and March through April. You would invest half of your money during the months of October, August and February and keep the other half in a money market fund. You would keep all of your money in a money market fund during the months of May through June and September. His study showed that $10,000 invested in the S&P 500, using his seasonality strategy, would have grown to $997,620 between 1950 and 1996. By comparison, $10,000 invested in the S&P 500, using a buy and hold strategy, would have grown to $327,388 between 1950 and 1996. While this seasonality strategy is simpler to follow than Fosback's strategy, you should recognize that it entails more risk because your money is exposed for longer periods of time to market fluctuations.

8. **Business Cycle Investing.** This strategy is based on selecting the optimal sectors of the market to be invested in at different points in the business cycle. Normally, the economy goes through a cycle of growth and contraction. As this cycle progresses, different industries are benefited. If you understand this cycle and its effects on business, you can move your investments around to obtain the maximum effect. This is the easiest to do employing sector funds. The largest offering of sector funds available is through Fidelity Investments (http://www.fidelity.com/) another option is Rydex Funds (http://www.rydexfunds.com/) . Rydex also offers a sector rotation fund (RYSRX) that is dynamically managed. That is the fund manager makes the decision about the appropriate sector or sectors for investing and changes the fund's allocation to reflect the decision. There is also a wide range of sector funds available as ETFs (see the links above at the end of section 2). This strategy requires a considerable knowledge of economics and investing to employ on your own. You can learn more about the approach by reading the book Strategic Market Timing: Investing at Predictable Turning Points in the Business Cycle by Robert Bowker (New York Institute of Finance; 70 Pine St.; New York, NY 10270-0003) or an article on sector investing by Sam Stovall in *Technical Analysis of Stocks and Commodities* magazine (March 1996) or his book *Standard and Poor's Guide to Sector Investing* (McGraw-Hill; 11 West 19th St.; New York, NY 10011) Sam Stovall's research shows that this strategy beats either buy and hold and some market timing systems. Stovall's study of the three approaches employed over a ten year period had the following results.

$1000 invested with the buy and hold strategy grew to $6,000 in ten years*
$1000 invested with a market timing strategy grew to $150,000 in ten years**
$1000 invested with the business cycle strategy grew to $630,000 in ten years***

*The buy and hold strategy was fully invested in the S&P 500 Index.

**The timing criteria used assumed that all market moves of 10% or greater were called correctly. Funds were invested in the S&P 500 Index when the market was moving up and held in cash when the market was moving down. The timing strategy did not short a declining market.

***The sector strategy invested all funds in one of six sectors: energy, financial services, gold, health care, technology or utilities at the beginning of each year.

Sam Stovall's employer, Standard and Poor, publishes a newsletter, *S&P Industry Reports* focused on this approach. Ultra Financial Systems (http://www.ultrafs.com) has software that employs a sector rotation strategy that is based on technical analysis rather than business cycle analysis.

9. **Market Timing.** Simply put, market timing means predicting when the market will rise and when it will fall and moving in and out of the market accordingly. This is perhaps the most difficult strategy to successfully employ. This approach is generally believed to require that your predictions be right at least 70% of the time to beat a buy and hold strategy. Obviously, if you can call the market with great accuracy, you can maximize your profits by only being invested on the long side when the market is moving up and on the short side when the market is moving down. There are also a few mutual funds, e.g., Prudent Bear Fund (http://www.prudentbear.com/) and Rydex Inverse Funds (http://www.rydexfunds.com/) that short the market. There are also some ETFs that short the market (http://www.proshares.com). Most investors that try to make money from a declining market do this through selling individual stocks short or buying put options on individual stocks or indexes. You can learn more about this aspect of investing by reading Tools of the Bear by Charles Caes (Probus Publishing).

Most market timers use what is known as technical analysis to make their predictions. If you want to use technical analysis, you should study the approach. Here are a couple of books on the topic of technical analysis: The New Science of Technical Analysis by Thomas DeMark (John Wiley & Sons) and The Visual Investor by John Murphy (John Wiley & Sons). Another worthwhile book on technical analysis applied to trading is Come into My Trading Room by Alexander Elder (John Wiley & Sons).

I would recommend that you use a computer program designed for technical analysis. There are many such programs on the market. Three that I have found to be useful are WaveWi$e a spreadsheet specifically designed for use in technical analysis from Jerome Technology (http://mysite.verizon.net/jtiware/index.htm). Ultra Stock Market Timing Systems, a collection of timing strategies mostly based on technical analysis (http://ultrafs.com) and OmniTrader Software from Nirvana Systems that scans stock lists for issues meeting various technical criteria and flags them as potential trades (http://www.omnitrader.com/). You must have a basic understanding of technical analysis in order to use WaveWi$e. You do not need to understand technical analysis in order to use the Ultra or OmniTrader programs. There are also fee based advisory services available that do all the analysis work and alert you to trades. One example is Gorilla Trades (http://www.gorillatrades.com/).

If you are going to use technical analysis, you will need an electronic data service. These are services that you can connect to through the Internet. Once you establish the connection you can either download data to update your database or you can add historical data on a new issue to expand your database. One data service that I have found to be useful is Worden Brothers (http://www.tc2000.com/). Worden Brothers supplies you with a program called TC2000 that handles data transfers for you and which has charting and technical analysis capabilities. Another similar service is CSI and their Unfair Advantage program and service (http://www.csidata.com/index.html). WaveWi$e as well as most other programs will read the TC2000 and CSI databases. Another alternative is to use a conventional spreadsheet such as Excel or Quatro Pro that can be purchased from any software retailer. You can also download stock and fund data for free on the Yahoo financial site (http://finance.yahoo.com/). One option available is to download the data in Excel format. There is also a very handy program available that pretty much automates the downloading process, which is especially important if you're downloading and updating data for many issues (http://www.1free-historical-stock-quotes-downloader.com/).

**Conclusion**

While there may be other strategies that could be employed, the above covers most of the major strategies available to the fund or stock investor. Of course, you could develop a hybrid strategy by combining strategies or elements of strategies. Before you begin investing, you should decide on a method of selecting your funds or stocks and the strategy that you wish to employ while investing in those funds or stocks. The strategy you select should be determined by your objectives, time horizon, specialized knowledge or access to same and personal temperament. Once you have settled on a plan of action, you should learn as much about the approach as you can before implementing it. You also need to be sure you have the discipline to follow the plan consistently for a sufficient period of time to obtain satisfactory results. On this last note, you might find it interesting to do a bit of self-examination to see what type of investment personality you have. One resource that will help you do this is The Psychology of Smart Investing: Meeting the 6 Mental Challenges by Ira Epstein and David Garfield, M.D. (John Wiley & Sons; Professional, Reference and Trade Group; 605 3rd Ave.; New York, NY 10158-0012.