

Share Market Risk Management

Useful Tips for Managing Risk

Robert Brain
February 2012

Brainy's Share Market Toolbox — www.robertbrain.com
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Version 3c

Introduction


About this version

This version of the presentation "Useful Tips for Managing Risk" (February 2012) is based on the January 2012 version which was presented to the Melbourne ATAA; but is expanded with additional slides, and with updated CommSec online broker slides to demonstrate the Query tool for stock selection (since CommSec have upgraded their web site).

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Introduction

Managing Risk in the Markets



It's easy to lose money in the share market.
It's easier to lose lots of money (like money down the drain).


1. **Can we** reduce the risks in the share market?
2. **Is it easy** to reduce the risks?
3. **What** are the risks that we face?
4. **How** can we reduce the risks?



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Introduction

Mobile phones?



Please turn phones to silent or off

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Introduction

Session Outline

1. How do we define “success” in the markets?
2. How can we increase our chance of success (and decrease the risks)?
3. Wins and Losses — a fact of life
4. Quality Watchlist — “cut and dice” the market
5. Risk management options:
 - Liquidity — watch out or else!
 - Position size — optimise performance!
 - Stop loss — imperative!!

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Introduction

Novice or experienced?

1. Experienced and successful investors and traders might consider the material in this presentation to be basic.
2. Whether experienced or not, it can be useful to remember the basics.
3. Novices in this game will find this material immensely useful.


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Introduction

Questions?

Interactive presentation!


Questions welcome.




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Introduction

Important Notice — No Advice!



1. This presentation does not include any advice.
2. For proper advice, your personal financial situation needs to be considered.
3. This presentation is pure education, only for your general awareness. 
4. There are no recommendations to take any action, or to invest any money in any way.
5. Always consult a properly licensed advisor before making investment decisions.



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Introduction

Important Notice





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ATAA – Member Benefits

Potential members, and existing members, are reminded of the benefits of being a member of this very useful Australia-wide organisation:-

- 1) Regular opportunities for networking with peers, including international affiliations (IFTA).
- 2) Extensive free video and DVD library on many Technical Analysis topics.
- 3) Access to web-based INO-TV for streaming audio and video presentations.
- 4) Extensive ATAA website resources — many past journal articles, presentations from past meetings and more.
- 5) Annual ATAA Conference (speakers + networking).
- 6) Lots of member discounts — bookshops, email newsletters, memberships, etc.
- 7) Learn about Technical Analysis, including:
 - (a) risk assessment and money management
 - (b) market entry and exit timing
 - (c) market timing and cycle analysis
 - (d) complementing different trading styles
 - (e) trade and strategy back-testing
 - (f) trading and investment psychology.

Introduction

About... Robert Brain

Consultant, educator and part-time* share trader.
Web-based sharemarket-support business

- Many years experience as trainer, presenter, conference facilitator (Scouts)
- Share Market – active 12+ years*
- Chartist ie. technical analyst (ATAA member and national director)
- Provide tuition and support to traders and investors
Bralny's Share Market Toolbox
- Engineering Degree (structured thinking with an eye for charts and diagrams)
- 30+ years – professional experience (IT and management)
- **Do not hold AFS license! (Can't give advice)**
- BullCharts software (convenor Australian BullCharts User Group and authorised reseller (with special pricing))
- Member Mensa



* - Not yet enough capital to live off the proceeds of trading (after trading as a toby until a career change in 2008).




Introduction

Promotions & Endorsements

- Robert is an ATAA member, and office-bearer (Melbourne chapter Vice-Pres, and national director), and so he will actively endorse the ATAA www.ataa.com.au
- But, Robert's own personal views about investing, trading, technical analysis and the markets do not necessarily represent those of the ATAA.

Introduction


BTW (by the way)...

Without yelling out the answer,

with regard to the
Fibonacci number sequence,

**do you know the
first 3-digit number
in the sequence?**

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Introduction

BTW (by the way)...


The Fibonacci number sequence

**0, 1, 1, 2, 3, 5, 8, 13,
21, 34, 55, 89...**



What is the first 3-digit number?

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Introduction


BTW (by the way)...

The Fibonacci number sequence

**0, 1, 1, 2, 3, 5, 8, 13,
21, 34, 55, 89...**

55 + 89 = 144

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How to increase success?

How to increase "success"?

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How to increase success?

QUESTION:

What can we do to increase our chance of success in the markets?

BUT!!!

What is "success"?

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How to increase success?

What is "success"?

- More money?
- More winning trades?
- Bigger wins?
- Fewer losing trades?
- Smaller losses?
- Reduced costs? (interest charges, brokerage)
- Reduced slippage?
- (other?)


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How to increase success?

QUESTION:

So...

What sorts of things can we do to increase our chance of success in the markets?



(input welcome here...)

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How to increase success?



21. Strategies — get more
1. Avoid "bomb" stocks!
24. Clarify my objectives:
• capital growth?
32. Avoid high-debt stocks
• short term or long term?
33. Trade/invest only in liquid stocks
25. Clarify my strategy (write it!)
26. Forget the
18. More testing of my
36. Improve my Stop Loss method
37. Strictly implement my Stop Loss approach
30. Use a shorter watchlist (to focus on fewer stocks)
31. Use a longer watchlist (for more possibilities) review and address
35. Emotions — get under control
34. Stocks with history of good performance
35. Optimise position size

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How to increase success?

Here are 10 ideas:



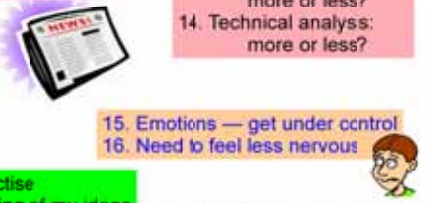
1. Avoid "bomb" stocks
2. Stock picking — better
3. Better system / setups / triggers
4. Better entry and exit strategies
5. More time
6. Better use of time
7. Better tools (get a smart phone)
8. Better charting
9. Position sizing — better / smarter
10. Avoid the day traders "toys"

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How to increase success?

Here are some more

- 11. Listen to the news
- 12. Ignore the news
- 13. Fundamental analysis: more or less?
- 14. Technical analys: more or less?
- 15. Emotions — get under control
- 16. Need to feel less nervous
- 17. More practise
- 18. More testing of my ideas and my "system"
- 19. Share ideas with others
- 20. Build my network of contacts



How to increase success?

And a few more:

- 21. Strategies — get more ideas
- 22. Buy a prover trading system
- 23. My weaknesses — review and address
- 24. Clarify my objectives:
 - capital growth?
 - income?
 - short term or long term?
- 25. Clarify my strategy (write it down!)
- 26. Forget the buy-and-hold approach
- 27. Blue chip stocks — focus on
- 28. Ignore blue chip stocks



How to increase success?

Some special actions:

- 29. Accept that there will be losses
- 30. Use a shorter watchlist (to focus on fewer stocks)
- 31. Use a longer watchlist (for more possibilities)
- 32. Avoid high-debt stocks
- 33. Trade/invest only in liquid stocks
- 34. Stocks with history of good performance
- 35. Optimise position size
- 36. Improve my Stop Loss approach
- 37. Strictly impement my Stop Loss method



Share Market GEM? or furphy?

BTW... food for thought


Share Market
"GEM"
or
furphy?

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Share Market GEM? or furphy?

GEM? or furphy?

A rising tide:
(a) lifts **all** boats? or
(b) lifts ~~all~~ **many** boats?



And conversely:
A falling tide lowers many boats
(but it doesn't lower **all** boats)

And see more Share Market GEMS here:
www.robertbrain.com/gems/

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Share Market GEM? or furphy?

Falling market conclusion?


In a falling market,
or a range-trading market,
some stocks might be rising!

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Share Market GEM? or furphy?

“A falling tide...”

For a falling tide, what are some risk mitigation actions?



- (a) Avoid the market completely?
- (b) Be more selective with stock selection?
- (c) Avoid high-risk stocks?
- (d) Tighter Stop Loss?
- (e) Review holdings more frequently?

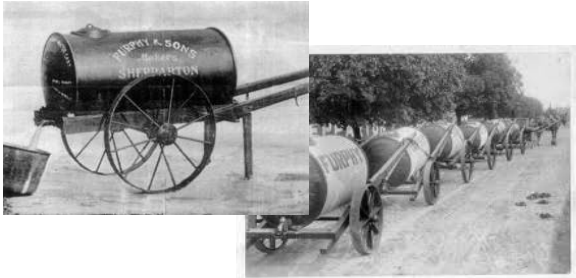
A falling tide lowers many boats (but not all).

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Share Market GEM? or furphy?

Beware...

Beware of the GEMS that are actually furphies...



Wins and Losses?

Wins
and
Losses

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Wins and Losses?

Wins and Losses

Investing / trading **FACT:-**
We need to accept that there will be some losses.

Nobody gets investment decisions 100% right!

But we need our overall result to be profitable.

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Wins and Losses?

The "Win/Loss Ratio"

It is very useful to keep a tally of the number of investment/trading "wins" versus the number of "losses".

eg. 7 wins for every 3 losses
= **Win/Loss Ratio** of 7:3

This can still be profitable.

But:

- What is a good **Win/Loss Ratio**?
- And what is an acceptable value?

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Wins and Losses?

Win / Loss Ratio

Which of these ratios are acceptable?

- 10:0 — ie. 100% wins
- 9:1 — ie. 90% wins (ie. 9 wins out of 10)
- 7:3 — ie. 70% wins and 30% losses
- 6:4 — ie. 60% wins
- 5:5 — ie. 50% wins
- 4:6 — ie. 40% wins
- 3:7 — ie. 30% wins and 70% losses

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Wins and Losses?

Win / Loss Ratio

4 wins : 6 losses — is this acceptable?
That is, for every 10 "trades", only 4 are winners, and 6 are losers.

This can be acceptable!
Provided losses are small
and profits are **big**.

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Wins and Losses?

Discussion?

- ? What do you think about this?
- ? What does it feel like to have a few losing investments?
- ? What about a few consecutive losses?

→ Emotion and psychology play a big part

→ Cognitive biases prevent us from accepting it.



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Wins and Losses?

The Win / Loss Ratio

We must detach the emotion and accept the facts — there will be losses.

**Remember the:
Win / Loss Ratio**

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Quality watchlist...

Quality watch list?

How to slice and dice the market...



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Quality watchlist...

Be carefully selective 

- Many successful investors/traders watch only a handful of stocks, and not the whole market.
- For example:
 - Top 200 (XJO)
 - Small Ordinaries index stocks (XSO ~200 stocks)
 - Mining stocks (GICS code = 15104000)
 - Bio-tech stocks (GICS = 35201010)
 - etc.

It can be useful to understand and use the GICS numbering system.

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Quality watchlist...

BTW

How does each Australian index “map” onto each other index?

- Is the Small Ords index similar to the S&A/ASX 300 (XKO)?

See the table on next slide as at Dec 2010.
A diagrammatic list of all stocks sorted by Market Capitalisation.

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Diagrammatically illustration of the composition of the key indexes. For more details, see quarterly reports are available from the slides (except All Ordinaries).

All Ordinaries - AO	S&P/ASX 200 - S200	S&P/ASX 100 - S100	S&P/ASX 50 - S50	S&P/ASX 25 - S25	All Ordinaries - AO	S&P/ASX 200 - S200	S&P/ASX 100 - S100	S&P/ASX 50 - S50	S&P/ASX 25 - S25
4	BHP	13148	4	4	4	BHP	13148	4	4
13	CSA	7162	3	1	13	CSA	7162	3	1
3	WBC	8502	3	1	3	WBC	8502	3	1
36	FDL	1108	25	1	36	FDL	1108	25	1
21	BUS	6522	21	1	21	BUS	6522	21	1
91	AWC	865	46	1	91	AWC	865	46	1
48	BNK	523	47	1	48	BNK	523	47	1
87	TOL	404	38	1	87	TOL	404	38	1
187	COO	143	126	1	187	COO	143	126	1
193	PPT	123	127	1	193	PPT	123	127	1
268	SWP	74	1	1	268	SWP	74	1	1
68	MET	22	1	1	68	MET	22	1	1
104	SW	2	1	1	104	SW	2	1	1
125	MSC	1	1	1	125	MSC	1	1	1
138	FVE	23	1	1	138	FVE	23	1	1
138	RCY	1	1	1	138	RCY	1	1	1

(effective Dec 2010)

[See more information about market indexes here: www.robertbrain.com/share-market](http://www.robertbrain.com/share-market)

Quality watchlist...

Be carefully selective

How can we build / reduce our own watchlist to minimise the risks?

ie. What is a good way to "slice and dice" the market?

Any ideas or suggestions?

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Quality watchlist...

Aussie stocks — some facts...

- There are about 2,300+ "stocks" on the Australian market.
- Many are tiny-cap
=> best avoided?
- Many have high debt levels
=> high risk → best avoided
- Many are not liquid
=> difficult to trade quickly → best avoid


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Quality watchlist...

How to slice and dice?

Should we:

- Sector-focused?
- *Value* versus *growth*?
- History of good performance — good ROE?
- Low PE ratio (ie. Price to Earnings)?



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Quality watchlist...

Market Capitalisation — top 20*

Rank	Code	Company Name	Mkt Cap
1	BHP	BHP Billiton Limited	116,166,867,268
2	CBA	Commonwealth Bank Of Australia	79,000,770,426
3	WBC	Westpac Banking Corporation	63,030,945,962
4	ANZ	ANZ Banking Grp Ltd	58,110,105,362
5	NAB	National Australia Bank Limited	51,536,662,401
6	TLS	Telstra Corporation Limited	42,430,883,557
7	WOW	Woolworths Limited	30,660,101,302
8	RIO	RIO Tinto Limited	30,189,364,122
9	WES	Wesfarmers Limited	29,741,212,376
10	IVE	Ishares Msci Eafe Cdi 1:1	29,525,904,000
11	WPL	Woodside Petroleum Limited	28,335,470,313
12	NCM	Newcrest Mining Limited	26,314,624,000
13	MBL	Macquarie Bank Limited	22,310,431,871
14	WDC	Westfield Group Ord/Unit Stapled Sec	19,326,234,071
15	FMG	Fortescue Metals Group Ltd	17,488,410,477
16	IEM	Ishares Msci Em MkTS Cdi 1:1	17,360,046,000
17	RIN	Rinker Group Limited	16,369,775,887
18	CSL	CSL Limited	15,906,267,790
19	NWS	News Corporation	15,044,134,755
20	IIV	Ishares S&P 500 Cdi 1:1	14,779,940,500

* — as at 14 Feb 2012

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Quality watchlist...

The bottom 20*

Rank	Symbol	Name	Market Cap (\$)
1	WTG	Wintech Group Limited	1,607
2	FTD	FTD Corporation Ltd	18,247
3	NFL	Natural Fuel Limited	43,755
4	OHL	Omnitech Holdings Limited	49,489
5	RMA	Realtime Media Limited	51,862
6	AOP	Apollo Consolidated Limited	139,907
7	GRP	GRP Corporation Limited	221,335
8	CAG	Cape Range Limited	226,966
9	...	...	...
10	...	...	...
11	...	...	...
12	...	...	...
13	...	...	...
14	AJU	Amcbl THR	540,603
15	XXL	Xiaoxiao Education Limited	613,713
16	EIM	EI Corporation Limited	618,711
17	PMX	Palamedia Limited	639,918
18	QL	Quon (Int) Limited	669,896
19	MTI	Montec International Limited	712,377
20	AIY	Authorised Investment Fund Limited	725,684

Imagine trying to buy \$10,000 worth of any of these... (or \$100,000 worth)

* — as at 14 Feb 2012

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Quality watchlist...

Avoid tiny-capitalisation stocks

Rank	Symbol	Name	Market Cap (\$)
2135	WTO	Wintech Group Limited	1,307
2101	OM	OMI Holdings Limited	994,281
2100	RSL	Resource Star Limited	1,211,227
2022	CGU	Commissioners Gold Limited	1,983,815
2021	TDI	Tidewater Investments Limited	2,004,484
1744	KSO	King Solomon Mines Limited	4,988,827
1743	BPH	BPH Energy Ltd	6,004,206
1487	SRG	Stane Resources Australia Limited	9,963,116
1486	ONP	Orion Petroleum Limited	10,549,348
		... Ltd	20,023,629
		... NL	20,212,487
		... Limited	40,930,403
		... Limited	60,221,440
		... Limited	60,267,581
		... Limited	70,112,251
		... Limited	81,322,181
675	ALM	Aral Mining Limited	90,312,800
649	ROR	Reed Resources Ltd	90,312,800
617	PAY	Payca Consolidated Limited	90,127,117
495	PTL	Payroll Limited	200,447,496
361	BCC	Braggville Copper Limited	300,796,876
314	SPL	Staghorn Holdings Limited	401,447,406
279	DMP	Domino's Pizza Enterprises Limited	500,824,640
261	PLG	Playgroup Limited	600,628,907
238	SU	Solares GLS Health Csh 1:1	701,568,000
214	SIL	Southern Cross Media Group Limited	801,244,914
192	OBT	OneSteel Limited	1,006,796,187
30	FGL	Foster's Group Limited	18,467,238,571

eg. There are about 617 stocks worth more than \$100 million to choose from.

Quality watchlist...

Serial poor performers

ROE, ROI, ROS*...

- Some companies produce poor returns year after year.
- The cause might be industry-related, or management-related, or...
- But why persist? Why invest in them?
- Increase our chance of success by eliminating poor performers from our watchlist.

* — Equity, Investment, Shareholder funds

Quality watchlist...

High debt companies

- Many businesses borrow money to grow the business — that's okay
- A highly-gearred company can be put under pressure
- Severe financial stress
 - => failure (eg. in 2008!), or
 - => private equity take-over!

But, how to spot them?

Quality watchlist...

High debt companies

How to spot them?
 A clue:- the Debt/Equity ratio:-
 < 50% not too bad
 > 50% risky
 > 75% very risky

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Quality watchlist...

Debt/Equity > 50%?

At 15 Feb 2012, there were 227 stocks*.
 Here are the "winners":

Code	Company Name	Debt/equity ratio (industrial)
ONL	One North Entertainment Limited	25,459.9%
RUB	Rubicor Group Limited	13,910.7%
CMV	CMA Corporation Limited	3,764.9%
AAV	AAVL Holdings Limited	3,323.5%
HOM	HomeLoans Limited	996.1%
SRE	Stirling Resources Limited	957.6%
RCT	Reef Casino Trust	858.3%
MNW	Mint Wireless Limited	813.5%
FWA	Farmworks Australia Limited	795.2%
MTI	Montec International Limited	657.6%
HYO	Hyro Limited	603.3%

* According to CommSec (online query tool)

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Code	Company Name	Debt/equity ratio (industrial)	Code	Company Name	Debt/equity ratio (industrial)
CGF	Challenger Limited	573.6%	COF	Coffey International Lim	124.2%
MGG	Macquarie Group Limited	475.4%	PSH	Pemice Soda Holdings	119.1%
DUE	DUET Group	444.7%	UCW	UnderCoverWear Limits	119.0%
CF	Challenger Infrastructure	429.9%	TLS	Telstra Corporation Lim	117.3%
ENV	Envestra Limited	360.7%	LLC	Lend Lease Group	115.4%
NAM	Namoi Cotton Co-Operat	261.4%	TCL	Transurban Group	114.1%
FXL	FluxGroup Limited	253.1%	HST	Harvie Group Limited	113.0%
FUN	Fantastic Limited	246.5%	FPA	Fisher & Paykel Applia	113.1%
PHS	Pulse Health Limited	222.6%	MMS	McMillan Shakespear	113.1%
FMS	Fortescue Metals Group	200.1%	PEM	Pearily Limited	109.7%
BCS	BrisConnections Unit Tr	199.8%	SFC	Schaffer Corporation Li	108.2%
IFN	Indigen Energy	195.4%	CCL	Coca-Cola Amalt Limit	107.4%
ELX	DelixGroup Limited	199.0%	AHE	Automotive Holdings G	105.9%
VAH	Virgin Australia Holdings	177.0%	WSA	Western Areas NL	104.6%
DDR	Dicker Data Limited	170.6%	SLM	Salmat Limited	100.3%
TTI	Traffic Technologies Ltd	164.2%	PRT	Prime Media Group Lin	100.2%
GCN	GoConnect Limited	163.8%	DAN	Dantas Airways Limite	96.1%
BOY	Bump Holdings Limited	161.1%	BJG	Butlerin Ginger Limite	95.7%
ALL	Aristocrat Leisure Limite	161.0%	RHC	Ramsay Health Care Li	94.5%
PGC	Paragon Care Limited	160.1%	TPI	Transpacific Industries	94.1%
IVC	InvoCare Limited	159.4%	ELD	Elders Limited	93.5%
AGI	Aurwooth Game Techno	156.9%	AMC	Ancor Limited	92.7%
IM	IM Medical Ltd	154.8%	TEL	Telecom Corporation of	90.9%
SH	SH Hi-Fi Limited	152.7%	SEK	Seek Limited	86.4%
SPN	SP AusNet	152.7%	FRM	Farm Pride Foods Limi	86.4%
ENE	Energy Developments Li	150.3%	SKC	Sky City Entertainment	84.5%
CWO	Central West Gold NL	148.1%	TRS	The Reject Shop Limite	83.6%
HDF	Hastings Diversified Unit	139.3%	AZ	Air New Zealand Limite	83.4%
BBB	Brimbles Limited	138.0%	AJO	Accion Limited	82.9%
SYD	Sydney Airport	125.3%	ASB	Austal Limited	82.6%

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Code	Company Name	Debt:equity ratio (industrial)	Code	Company Name	Debt:equity ratio (industrial)
CPU	Computershare Limited	82.4%	MRN	Macquarie Radio Netw	59.9%
SWM	Seven West Media Lim	82.1%	GNS	Gunns Limited	59.6%
EGY	Energy Technologies L	80.9%	WTP	Watpac Limited	59.3%
CLH	Collection House Limit	80.0%	BRN	Bradken Limited	58.2%
LEI	Leighton Holdings Limit	79.9%	CSV	CSG Limited	58.0%
TAH	Talcorp Holdings Limit	79.7%	NVT	Navitas Limited	57.8%
SP3	Spark Infrastructure Gr	75.0%	GPG	Guinness Peat Group f	56.8%
AFN	AFN News and Media l	74.9%	IDL	Industree Limited	56.8%
GFF	Goodman Fielder Limb	74.5%	PDH	Paladin Energy Ltd	56.6%
GDO	Gold One International	74.4%	WHS	Warehouse Group Limi	55.0%
GRB	Gage Roads Brewing C	74.2%	NLF	Nularm Limited	54.9%
GBT	GBST Holdings Limitec	73.7%	TCL	Tell Holdings Limited	54.8%
YRL	Village Roadshow Limit	72.8%	FBU	Fletcher Building Limite	54.8%
SPT	Spotless Group Limitec	68.7%	AAC	Australian Agricultural r	54.7%
PSA	Petsec Energy Limited	68.1%	RFG	Retail Food Group Limi	54.6%
SHL	Sonic Healthcare Limb	68.0%	THO	Thomas & Coffey Limb	53.8%
AGG	AngloGold Ashanti Lim	67.8%	ORI	Orica Limited	53.8%
SAI	SAI Global Limited	67.6%	PPT	Perpetual Limited	53.7%
AAI	Alcoa Inc	67.6%	RHL	Ruralco Holdings Limit	53.3%
GGG	Gindalbie Metals Ltd	65.5%	NWS	News Corporation	52.5%
RCI	Rocklands Richfield Lir	65.4%	SRH	Safeways Holdings Lin	52.0%
PPX	PaperlinX Limited	64.6%	BBG	Billabong International l	51.4%
AAL	AJ Lucas Group Limite	63.9%	DOW	Dowser EDI Limited	50.8%
WOW	Woolworths Limited	63.6%	MLB	Melbourne IT Limited	60.7%
BQA	Bega Cheese Limited	62.3%	BKL	Blackmones Limited	50.6%
MTS	Metcash Limited	60.7%			

Quality watchlist...

Careful selection criteria

Some online brokers have tools to help find stocks meeting certain criteria.

- CommSec and others have an online "query tool"
- Example, filter for:
 - High ROE
 - Low Debt/Equity ratio
 - Low PEG ratio (implies "cheaper") (PEG ratio = PE / annual EPS growth)

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CommSec example

eg. Use CommSec Query tool

For example, select stocks matching these criteria:

METRIC TYPE *	ITEM	VALUE
Performance	ROE	> 15% pa
Risk	Debt/equity ratio	< 50%
Value	PEG ratio	< 1

* — Metric Type = CommSec "Category"

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CommSec example

Logon to CommSec, and select...

1. Quotes & Research
2. Research Tools
3. Company Search
(see details next slide)

CommSec example

Company search query

Use the **drop-down fields** and the “Add Criteria” button to build a multi-line query.

CommSec example

Select:

4. Category = *Performance...*
5. Field = *Return on Equity*
6. Option = *Greater than* and enter value
7. Click on the *Add Criteria* button

CommSec example

Repeat for other selection criteria

4. Select Category = Performance...

5. Select Field = Return on Equity

6. Select Option = Greater than

METRIC TYPE *	ITEM	VALUE
Performance	ROE	> 0.15 pa
Risk	Debt/equity ratio	< .50
Value	PEG ratio	< 1

CommSec example

Running the Query

These steps can build a "query" comprising a list of several criteria.

Edit or delete these criteria if required.

Click on "Search" button.

CommSec example

The result...

- A list of stocks to download and save
- Save (or "copy") the list into a Watch List
- Import the list into a spreadsheet (eg. OpenOffice Calc, or Microsoft Excel).

Quality watchlist...

Slice and dice — Summary:

- Avoid tiny-cap
- Go with good historical performance
- Avoid high debt level stocks
- Low PEG ratio

AND:

- Avoid “illiquid” stocks?... (see next slides)

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Stock Liquidity

Stock Liquidity

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Stock Liquidity

Definition?

What do we mean by “low stock liquidity”?

- Very few *trades* in a day (or week)
- Low *volume* in a day (or week)
- Low *dollar turn-over* in a day (or week)

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Stock Liquidity

How important?

What could happen if we invest/trade in illiquid stocks?

- stuck with falling share prices
- can't sell at our preferred sell price
- loss of value
- lose funds

Remember:

For every successful seller, there needs to be a buyer.

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Stock Liquidity

Avoid the consequences

Let's consider each of the following:

- Trades — the number of transactions
- Volume — the number of shares
- Sales value — the dollar value of shares

Each of these may, or may not, be important!

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Stock Liquidity

Why invest/trade in these...

- A stock that **trades** only once or twice each week.
- A stock with **daily volume** less than 10 times the intended position size (eg. intended position = 10,000 and daily volume = 50,000)
- A stock with **daily sales value** less than 10 times the intended position size

Eliminate these from your watchlist!

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Stock Liquidity


But, take care...

eg. criteria:-
Trades > 50 per day

There are some stocks that trade >50 per day "for most days".

Include this stock? or exclude?

Q: How to select this stock when scanning all stocks?




Stock Liquidity

Careful scan/search

Try scanning for stocks with:

Moving Average of Trades
greater than 50 for several days
(easy with good software)

This test will capture this stock for your watch list.



Stock Liquidity

Watch for illiquid stocks

More information on this (*volume* and *value*), related to position sizing in next few slides...

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Optimise position size?

Position Size
Is it important?

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Optimise position size?

Minimum and maximum?

Should we consider a:

- *minimum* position size?
- *maximum* position size?

Is it useful to consider this? or not?



What do you think?

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Optimise position size?

Case study samples

Consider, different position sizes
from \$500 up to \$10,000 (before costs)

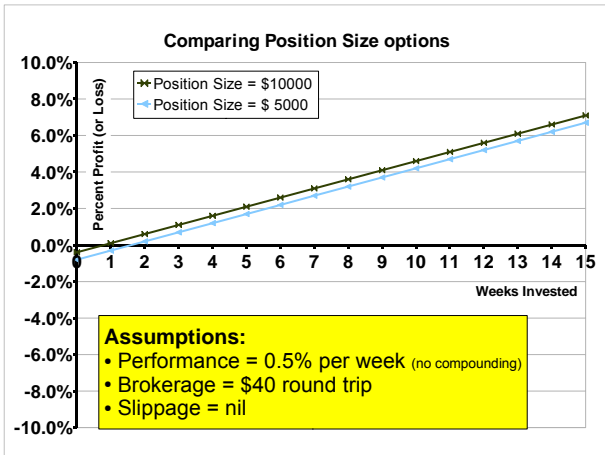
Assumptions:

- consistent performance of 0.5% each week
- brokerage = \$20 each way (ie. \$40 total)
- slippage = nil



**What do you think this will show?
Is a \$500 position size viable?**

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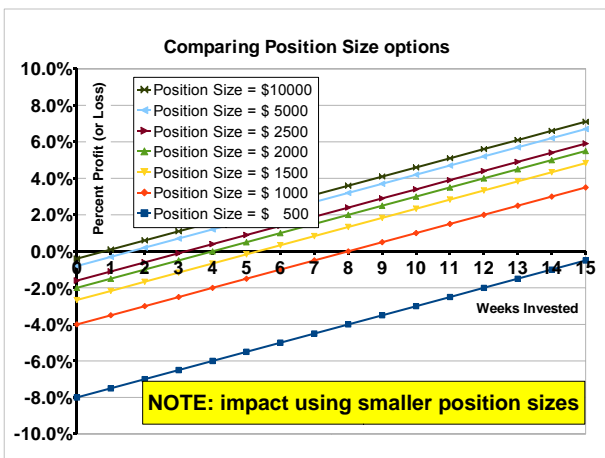


Optimise position size?

Smaller position sizes

- What if we reduce position size?
- Down to \$1,000 or \$500?
- Is there an optimum position size?

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Optimise position size?

Don't forget our assumptions:

Assumptions:

- Performance = 0.5% per week (no compounding)
- Brokerage = \$40 round trip
- Slippage = nil

- This performance is optimistic
- Slippage is often > \$0

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Optimise position size?

Maximum position size?


For example:

- company XYZ has:
daily Volume = 10,000 shares
daily Value = \$10,000


Question:

Would it be wise to take a position:

- of 5,000 shares?
- of \$5,000 in value?



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Optimise position size?

Maximum position size?

Consider limiting position size to:

- < 5% of daily volume:
 - If stock turns over 100,000 shares per day, then limit to 5,000 shares max
- < 5% of daily sales value:
 - If stock turns over \$100,000 in value per day, then limit to \$5,000 worth of shares

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Stop loss — imperative

Stop Loss?
Is it useful?

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Stop loss — imperative

“Stop Loss!”

- **FACT:**
A good **Stop Loss** strategy is a key element of many successful trading strategies
- Remember the Win/Loss Ratio!
Even a W/L ratio of 4:6 can be successful
=> The Stop Loss helps this work.

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Stop loss — imperative

The challenges

The challenges:

- **How to calculate** a Stop Loss level?
 - based on a chart pattern?
 - below recent support level?
 - indicator (P-SAR, ATR-based, etc.)?
- **How to implement it?**
 - conditional sell order placed in the market?
 - manual sell at end-of-day (or end-of week)?

Remember:- **“A stop is a stop!”**

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Stop loss — imperative

The reality

Some of the ways we fail:

- Forget to check positions regularly — a time management problem (or priorities)!



=> Check open positions regularly
Set some sort of alert by SMS or email.

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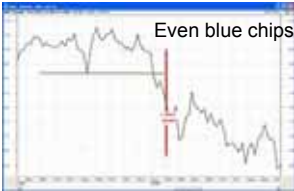
Stop loss — imperative

The reality

Some of the ways we fail:

- *"I will just lower the stop a little, because the price will come back."*
But this is a mistake!!

=> A stop is a stop!



Even blue chips can fail (eg. AMP)

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Stop loss — imperative

Stop loss — No question!

- We can reduce the risks by using a sound Stop Loss approach
- Address the challenges and short-comings:-
 - (a) Use a sound Stop Loss approach
 - (b) Check open positions regularly
 - (c) Use some sort of "alert" service
 - (d) Never relax a stop!
"A stop is a stop!"

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Summary & Wrap up

Summary

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Summary & Wrap up

Summary

- A falling tide lowers **many** boats (but not all)
- Wins and Losses — accept a fact of life
- Quality watchlist — be very selective
- Liquidity — watch out, or else
- Optimise position size — optimise performance
- Stop Loss — imperative

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Summary & Wrap up

Understand the charts...

Need to learn how to interpret the price charts

Technical Analysis:

- Books, courses, seminars, newsletters
BUT beware of information overload and over-complication
- The ATAA
(Australian Technical Analysts Association)
www.ataa.com.au
(a not-for-profit Australia-wide organisation run by volunteer members)
- Robert's **Share Market Toolbox**
www.robertbrain.com/ta/



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Summary & Wrap up



Seminars

At Vermont South Community House:

- **Share Market 101** (boot camp)
Saturday 17 March 2012
- **Price Charts — Unlocking the secrets**
Saturday 31 March 2012

Both seminars:

- 6 hours from 10am to 4:30pm
- Only \$195 each
- Includes: 100+ pages handbook + light lunch



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Summary & Wrap up

We need to...

*Protect our hard earned capital;
and
Watch out for the sharks in the ocean!!*



The free stuff follows...

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Summary & Wrap up

Share Market Toolbox

*Arsenal of weapons
to help you tackle
the share market*



Robert's Web-based business:

- Free stuff — www.robertbrain.com/free
- plus more stuff reserved for *Toolbox Members*



Complete list of Toolbox features:
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Summary & Wrap up

About this presentation 

- This presentation is just one of many items in Brainy's **Share Market Toolbox**
- These slides are available to download from the **Toolbox**: www.robertbrain.com/presentations/
- And a more detailed version of the slides complete with **Speaker Notes** is available for Toolbox Premium Members.

 **Brainy's Share Market Toolbox**

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Share Market Risk Management

THE END

THANK YOU 

(now feel free to re-enable your phone)

(backup slides follow)

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