

LEARNING MADE EASY



INVESTING

IN

STOCKS

PAUL MLADJENOVIC

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Investing in Stocks

by Paul Mladjenovic

for
dummies[®]
A Wiley Brand

Investing in Stocks For Dummies®

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Contents at a Glance

Introduction	1
Part 1: Getting Started with Stock Investing	5
CHAPTER 1: Introducing the World of Stock Investing	7
CHAPTER 2: Assessing Your Current Financial Situation and Goals	15
CHAPTER 3: Defining Different Approaches to Stock Investing	33
CHAPTER 4: Understanding Risk and Volatility	45
Part 2: Doing Some Digging Before You Buy Stocks	65
CHAPTER 5: Gathering Information on Investments	67
CHAPTER 6: Choosing Winning Stocks with Basic Accounting	91
CHAPTER 7: Deciphering Company Documents to Pick Stocks	111
CHAPTER 8: Working with Brokers	125
Part 3: Understanding Essential Stock Strategies and Tactics	139
CHAPTER 9: Investing in Stocks for Long-Term Growth	141
CHAPTER 10: Investing in Stocks for Income and Cash Flow	153
CHAPTER 11: Exploring Exchange-Traded Funds	171
CHAPTER 12: Surveying Emerging Sector and Industry Opportunities.....	181
CHAPTER 13: Looking at Brokerage Orders and Trading Techniques.....	195
CHAPTER 14: Handling Taxes on Stock Investments	213
Part 4: The Part of Tens	227
CHAPTER 15: Ten Hallmarks of a Great Stock	229
CHAPTER 16: Ten Investment Strategies That Work Well with Stocks	239
Index	247

Table of Contents

INTRODUCTION	1
About This Book	1
Foolish Assumptions	3
Icons Used in This Book.....	3
Where to Go from Here	4
 PART 1: GETTING STARTED WITH STOCK INVESTING	5
 CHAPTER 1: Introducing the World of Stock Investing	7
Understanding the Basics	8
Preparing to Buy Stocks	9
Knowing How to Pick Winners	9
Recognizing stock value	10
Understanding market capitalization and stock value.....	10
Sharpening your investment skills.....	12
 CHAPTER 2: Assessing Your Current Financial Situation and Goals	15
Establishing a Starting Point by Preparing a Balance Sheet	16
Step 1: Make sure you have an emergency fund.....	17
Step 2: List your assets in descending order of liquidity	18
Step 3: List your liabilities	21
Step 4: Calculate your net worth.....	23
Step 5: Analyze your balance sheet.....	23
Funding Your Stock Program	25
Step 1: Tally up your income	27
Step 2: Add up your outgo	28
Step 3: Create a cash flow statement.....	29
Step 4: Analyze your cash flow.....	30
Another option: Finding money to invest in tax savings.....	30
Setting Your Sights on Your Financial Goals	31
 CHAPTER 3: Defining Different Approaches to Stock Investing	33
Matching Stocks and Strategies with Your Goals	34
Investing for the Future	35
Focusing on the short term	36

Considering intermediate-term goals	37
Preparing for the long term.....	38
Investing for a Purpose.....	39
Making loads of money quickly: Growth investing	39
Steadily making money: Income investing	40
Investing for Your Personal Style	42
Conservative investing	42
Aggressive investing	43
CHAPTER 4: Understanding Risk and Volatility.....	45
Exploring Different Kinds of Risk.....	46
Financial risk.....	46
Interest rate risk.....	48
Market risk.....	52
Inflation risk.....	53
Tax risk	54
Political and governmental risk.....	54
Personal risk	55
Emotional risk.....	56
Getting the Scoop on Volatility	58
Minimizing Your Risk.....	59
Gaining knowledge	59
Staying out until you get a little practice.....	60
Putting your financial house in order.....	60
Diversifying your investments.....	61
Weighing Risk against Return	62
PART 2: DOING SOME DIGGING BEFORE YOU BUY STOCKS	65
CHAPTER 5: Gathering Information on Investments	67
Looking to Stock Exchanges for Answers.....	68
Grasping the Basics of Accounting and Economics	69
Accounting for taste and a whole lot more	70
Understanding how economics affects stocks.....	71
Staying on Top of Financial News.....	76
Figuring out what a company is up to.....	77
Discovering what's new with an industry.....	77
Knowing what's happening with the economy	77
Seeing what public officials are doing.....	78

Checking for trends in society, culture, and entertainment.....	79
Reading (and Understanding) Stock Tables	79
52-week high	80
52-week low.....	81
Name and symbol.....	81
Dividend	81
Volume	82
Yield	84
P/E.....	84
Day last.....	85
Net change.....	85
Using News about Dividends.....	85
Looking at important dates	85
Understanding why certain dates matter	87
Evaluating Investment Tips	88
 CHAPTER 6: Choosing Winning Stocks with Basic Accounting	 91
Recognizing Value When You See It	92
Understanding different types of value	92
Putting the pieces together	95
Accounting for Value.....	96
Breaking down the balance sheet	97
Looking at the income statement.....	101
Tooling around with ratios	105
 CHAPTER 7: Deciphering Company Documents to Pick Stocks	 111
A Message from the Bigwigs: Reading the Annual Report.....	112
Analyzing the annual report's anatomy	113
Going through the proxy materials	117
Dig Deeper: Getting a Second Opinion.....	118
Company documents filed with the SEC.....	118
Value Line.....	120
Standard & Poor's	120
Moody's Investment Service	121
Brokerage reports: The good, the bad, and the ugly	121
Do It Yourself: Compiling Your Own Research Department	123

CHAPTER 8: Working with Brokers	125
Defining the Broker's Role	125
Comparing Full-Service and Discount Brokers	127
At your disposal: Full-service brokers	128
Just the basics: Discount brokers	130
Choosing a Broker	132
Discovering Various Types of Brokerage Accounts	132
Cash accounts	133
Margin accounts	134
Options accounts	134
Judging Brokers' Recommendations	135
Understanding basic recommendations	135
Asking a few important questions	136

PART 3: UNDERSTANDING ESSENTIAL STOCK STRATEGIES AND TACTICS..... 139

CHAPTER 9: Investing in Stocks for Long-Term Growth	141
Becoming a Value-Oriented Growth Investor	142
Choosing Growth Stocks with a Few Handy Tips	143
Looking for leaders in megatrends	144
Comparing the growth of a company versus an industry	145
Considering a company with a strong niche	146
Checking out a company's fundamentals	146
Evaluating a company's management	147
Noticing who's buying and/or recommending a stock	149
Making sure a company continues to do well	151
Heeding investing lessons from history	151

CHAPTER 10: Investing in Stocks for Income and Cash Flow	153
Understanding the Basics of Income Stocks	154
Getting a grip on dividends and dividend rates	154
Recognizing who's well suited for income stocks	155
Assessing the advantages of income stocks	156
Heeding the disadvantages of income stocks	156
Analyzing Income Stocks	158
Pinpointing your needs first	159
Checking out yield	160

Looking at a stock's payout ratio	162
Studying a company's bond rating	163
Diversifying your stocks	164
Exploring Some Typical Income Stocks	164
It's electric! Utilities	165
An interesting mix: Real estate investment trusts.....	165
Business development companies.....	167
Covered Call Writing for Income	168
Writing Puts for Income.....	169
CHAPTER 11: Exploring Exchange-Traded Funds	171
Comparing Exchange-Traded Funds and Mutual Funds	172
The differences.....	172
The similarities	174
Choosing an Exchange-Traded Fund	174
Bullish ETFs	175
Bearish ETFs	177
Taking Note of Indexes.....	178
CHAPTER 12: Surveying Emerging Sector and Industry Opportunities.....	181
Telling the Difference between a Sector and an Industry	182
Interrogating the Sectors and Industries	183
Which category does the industry fall into?	183
Is the sector growing?.....	185
Will demand for the sector's products and/or services see long-term growth?	186
What does the industry's growth rely on?	187
Does the industry depend on another industry?.....	188
Who are the leading companies in the industry?	188
Is the industry a target of government action?.....	188
Outlining Key Sectors and Industries.....	189
Robotics and artificial intelligence	190
Ecommerce	190
Commodities	191
Precious metals.....	191
Cryptocurrency opportunities.....	192
Driving it home.....	193

CHAPTER 13: Looking at Brokerage Orders and Trading Techniques.....	195
Checking Out Brokerage Orders	196
Time-related orders.....	196
Condition-related orders	198
Advanced orders.....	205
Buying on Margin	205
Examining marginal outcomes.....	206
Maintaining your balance	208
Striving for success on margin	208
Going Short and Coming Out Ahead	209
Setting up a short sale.....	210
Oops! Going short when prices grow taller	211
Feeling the squeeze	212
CHAPTER 14: Handling Taxes on Stock Investments.....	213
Paying Up: The Tax Treatment of Different Stock Investments	214
Understanding ordinary income and capital gains	214
Minimizing the tax on your capital gains	216
Coping with capital losses.....	218
Evaluating gains and losses scenarios	218
Sharing Your Gains with the IRS.....	219
Filling out forms	220
Playing by the rules.....	221
Discovering the Softer Side of the IRS: Tax Deductions for Investors.....	221
Investment interest	222
Miscellaneous expenses	222
Donations of stock to charity	223
Items that you can't deduct	223
Using Tax-Advantaged Retirement Investing.....	224
Individual retirement accounts	224
401(k) plans.....	226
PART 4: THE PART OF TENS	227
CHAPTER 15: Ten Hallmarks of a Great Stock	229
The Company Has Rising Profits	230
The Company Has Rising Sales.....	230
The Company Has Low Liabilities.....	231

The Stock Is at a Bargain Price.....	232
Dividends Are Growing.....	233
The Market Is Growing.....	234
The Company Is in a Field with a High Barrier to Entry.....	234
The Company Has a Low Political Profile	235
The Stock Is Optionable.....	236
The Stock Is Benefiting from Favorable Megatrends.....	236
CHAPTER 16: Ten Investment Strategies	
That Work Well with Stocks	239
Covered Call Options	240
Put Options	240
Cash	241
EE Savings Bonds.....	242
I Bonds.....	242
Sector Mutual Funds.....	243
Physical Gold and Silver.....	243
Bearish Exchange-Traded Funds.....	244
Dividend Yield Exchange-Traded Funds	245
Consumer Staples Exchange-Traded Funds	246
INDEX.....	247

Introduction

Successful stock investing takes diligent work and acquired knowledge, like any other meaningful pursuit. This book can definitely help you avoid the mistakes others have made and point you in the right direction. It gives you a heads-up about trends and conditions that are found in few other stock investing guides. Explore the pages of this book and find the topics that most interest you within the world of stock investing. Let me assure you that I've squeezed more than a quarter-century of experience, education, and expertise between these covers. My track record is as good as (or better than) the track records of many experts who trumpet their successes. More important, I share information to avoid common mistakes (some of which I made myself!). Understanding what not to do can be just as important as figuring out what to do.

In all the years that I've counseled and educated investors, the single difference between success and failure, between gain and loss, has boiled down to two words: *applied knowledge*. Take this book as your first step in a lifelong learning adventure.

About This Book

The stock market has been a cornerstone of the investor's passive wealth-building program for over a century and continues in this role. Recent years have been one huge roller-coaster ride for stock investors. Fortunes have been made and lost. With all the media attention and all the talking heads on radio and television, the investing public still didn't avoid losing trillions in a historic stock market debacle. Sadly, even the so-called experts who understand stocks didn't see the economic and geopolitical forces that acted like a tsunami on the market. With just a little more knowledge and a few wealth-preserving techniques, more investors could've held onto their hard-earned stock market fortunes.

Cheer up, though: This book gives you an early warning on those mega-trends and events that will affect your stock portfolio. Other books may tell you about stocks, but this book tells you about companies' performance and financial condition and how their stock prices are affected.

This book is designed to give you a realistic approach to making money in stocks. It provides the essence of sound, practical stock-investing strategies and insights that have been market-tested and proven from more than 100 years of stock market history. I don't expect you to read it cover to cover, although I'd be delighted if you read every word! Instead, this book is designed as a reference tool. Feel free to read the chapters in whatever order you choose. You can flip to the sections and chapters that interest you or those that include topics that you need to know more about.

Sidebars (gray boxes of text) in this book give you a more in-depth look at a certain topic. Although they further illuminate a particular point, these sidebars aren't crucial to your understanding of the rest of the book. Feel free to read them or skip them. Of course, I'd love for you to read them all, but my feelings won't be hurt if you decide to skip over them.

The text that accompanies the Technical Stuff icon (see the forthcoming section "Icons Used in This Book") can be passed over as well. The text associated with this icon gives some technical details about stock investing that are certainly interesting and informative, but you can still come away with the information you need without reading this text.

Investing in Stocks For Dummies is also quite different from the "get rich with stocks" titles that have crammed the bookshelves in recent years. It doesn't take a standard approach to the topic; it doesn't assume that stocks are a sure thing and the be-all, end-all of wealth building. In fact, at times in this book, I tell you *not* to invest in stocks (or even to bet against them!).

This book can help you succeed not only in up markets but also in down markets. Bull markets and bear markets come and go, but the informed investor can keep making money regardless. To give you an extra edge, I've tried to include information about the investing environment for stocks. Whether it's politics or hurricanes (or both), you need to know how the big picture affects your stock investment decisions.

One last note: Within this book, you may note that some web addresses break across two lines of text. If you're reading this book in print and you want to visit one of these web pages, simply key in the web address exactly as it's noted in the text, pretending

as though the line break doesn't exist. If you're reading this as an e-book, you've got it easy — just click the web address to be taken directly to the web page.

Foolish Assumptions

I figure you've picked up this book for one or more of the following reasons:

- » You're a beginner and you want a crash course on stock investing that's an easy read.
- » You're already a stock investor, and you need a book that allows you to read only those chapters that cover specific stock-investing topics of interest to you.
- » You need to review your own situation with the information in this book to see whether you missed anything when you invested in that hot stock that your brother-in-law recommended.
- » You need a great gift! When Uncle Mo is upset over his poor stock picks, you can give him this book so he can get back on his financial feet. Be sure to get a copy for his broker, too. (Odds are, the broker was the one who made those picks to begin with.)

Icons Used in This Book

Useful icons appear in the margins of this book; here's what they mean.



REMEMBER

When you see the Remember icon, I'm reminding you about some information that you should always keep stashed in your memory, whether you're new to investing or an old pro.



TECHNICAL
STUFF

The text attached to the Technical Stuff icon may not be crucial to your success as an investor, but it may enable you to talk shop with investing gurus and better understand the financial pages of your favorite business publication or website.



TIP

The Tip icon flags a particular bit of advice that just may give you an edge over other investors.



WARNING

Pay special attention to the Warning icon because the advice can prevent headaches, heartaches, and financial aches.

Where to Go from Here

You may not need to read every chapter to make you more confident as a stock investor, so feel free to jump around to suit your personal needs. Because every chapter is designed to be as self-contained as possible, it won't do you any harm to cherry-pick what you really want to read. But if you're like me, you may still want to check out every chapter because you never know when you may come across a new tip or resource that will make a profitable difference in your stock portfolio. I want you to be successful so that I can brag about you!

A large, white, stylized number '1' is centered vertically on a light gray background. The number has a slight 3D effect with a soft shadow cast to its right.

Getting Started with Stock Investing

IN THIS PART . . .

Brush up on stock basics, including how to calculate market capitalization and pick winners.

Find out what you should do before you invest your first dollar in stocks. Evaluate your current financial goals and situation.

Know the different approaches to stock investing and which approach may be right for you.

Figure out the risks of stock investing and discover the best ways around them. Understand the concept of volatility.

- » Knowing the essentials of stock investing
- » Getting ready to purchase stocks
- » Using what you know to pick successful stocks

Chapter 1

Introducing the World of Stock Investing

I think that there are great stock investment opportunities in virtually any time — even for newbies. There are great stocks to help you build your wealth (or provide dividend income) in both up and down markets. In fact, a *bear market* (a long period of falling prices) can be a great time to buy stocks because they're cheaper (think “sale!”). The key is knowing what to do (and even why), but that's what this book is for!

Today's stock market is a little puzzling, but it can still be rewarding. I can only promise that if you follow the advice in this book, you'll do *much* better than the average investor. Note that patience and discipline count now more than ever.

The purpose of this book is not only to tell you about the basics of stock investing but also to let you in on solid strategies that can help you profit from the stock market. Before you invest, you need to understand the fundamentals of stock investing, which I introduce in this chapter. Then I give you an overview of how to put your money where it will count the most.

Understanding the Basics

The basics of stock investing are so elementary that few people recognize them. When you lose track of the basics, you lose track of why you invested to begin with. This book helps you grasp these basics:

- » **Knowing the risk and volatility involved:** Perhaps the most fundamental (and, therefore, most important) concept to grasp is the risk you face whenever you put your hard-earned money in an investment such as a stock. Related to risk is the concept of volatility. *Volatility* refers to a condition in which there is rapid movement in the price of a particular stock (or other security); investors use this term especially when there's a sudden drop in price in a relatively short period of time. Find out more about risk and volatility in Chapter 4.
- » **Assessing your financial situation:** You need a firm awareness of your starting point and where you want to go. Chapter 2 helps you take stock of your current financial status and your goals.
- » **Understanding approaches to investing:** You want to approach investing in a way that works best for you. Chapter 3 defines the most common approaches to investing.
- » **Seeing what exchange-traded funds (ETFs) have to offer:** ETFs are like mutual funds, but they can be traded like stocks. I think that every stock investor should consider ETFs as a positive addition to their portfolio strategies. See Chapter 11 for the lowdown on ETFs.



REMEMBER

The bottom line in stock investing is that you shouldn't immediately send your money to a brokerage account or go to a website and click a Buy Stock button. The first thing you should do is find out as much as you can about what stocks are and how to use them to achieve your wealth-building goals.

Before you continue, I want to clarify exactly what a stock is. *Stock* is a type of security that indicates ownership in a corporation and represents a defined portion (measured in shares) of that corporation's future success. The two primary types of stocks are common and preferred:

- » **Common stock:** This type of stock, which I cover throughout this book, entitles the owner to vote at shareholders' meetings and receive any dividends that the company issues.
- » **Preferred stock:** This type of stock doesn't usually confer voting rights, but it does include some rights that exceed those of common stock. Preferred stockholders, for example, have preferential treatment in certain conditions, such as receiving dividends before common stockholders in the event of a corporate liquidation or bankruptcy. Additionally, preferred stock seeks to operate similarly to a bond for investors seeking stable income.

In this book, I mostly cover common stock. I also cover ETFs because they can be a valuable part of the stock investor's portfolio.

Preparing to Buy Stocks

Gathering information is critical in your stock-investing pursuits. You should gather information on your stock picks two times: before you invest and after you invest. Obviously, you should become more informed before you invest your first dollar, but you also need to stay informed about what's happening to the company whose stock you buy, as well as about the industry and the general economy. To find the best information sources, check out Chapter 5.

When you're ready to invest, you need to open a brokerage account. How do you know which broker to use? Chapter 8 provides some answers and resources to help you choose a broker. After you've opened a brokerage account, it pays to get familiar with the types of orders you can implement inside that account; find out more in Chapter 13.

Knowing How to Pick Winners

When you get past the basics, you can get to the meat of stock picking. Successful stock picking isn't mysterious, but it does take some time, effort, and analysis. And the effort is worthwhile because stocks are a convenient and important part of most

investors' portfolios. Read the following sections and be sure to leapfrog to the relevant chapters to get the inside scoop on hot stocks.

Recognizing stock value

Imagine that you like eggs, and you're buying them at the grocery store. In this example, the eggs are like companies, and the prices represent the prices that you would pay for the companies' stock. The grocery store is the stock market. What if two brands of eggs are similar, but one costs \$2.99 a carton and the other costs \$3.99? Which would you choose? Odds are that you'd look at both brands, judge their quality, and, if they're indeed similar, take the cheaper eggs. The eggs at \$3.99 are overpriced.

The same is true of stocks. What if you compare two companies that are similar in every respect but have different share prices? All things being equal, the cheaper price represents a better buy for the investor.

But the egg example has another side. What if the quality of the two brands of eggs is significantly different, but their prices are the same? If one brand of eggs is stale, of poor quality, and priced at \$2.99 and the other brand is fresh, of superior quality, and also priced at \$2.99, which would you get? You would take the good brand because they're better eggs. Perhaps the lesser eggs are an acceptable purchase at \$1.99, but they're overpriced at \$2.99.

The same example works with stocks. A poorly run company isn't a good choice if you can buy a better company in the marketplace at the same — or a better — price.



REMEMBER

Comparing the value of eggs may seem overly simplistic, but doing so does cut to the heart of stock investing. Eggs and egg prices can be as varied as companies and stock prices. As an investor, you must make it your job to find the best value for your investment dollars. (Otherwise, you get egg on your face. You saw that one coming, right?)

Understanding market capitalization and stock value

You can determine a company's value (and, thus, the value of its stock) in many ways. The most basic way is to look at the company's market value, also known as market capitalization (or

market cap). *Market capitalization* is simply the value you get when you multiply all the outstanding shares of a stock by the price of a single share. Calculating the market cap is easy; for example, if a company has 1 million shares outstanding and its share price is \$10, the market cap is \$10 million.

Small cap, *mid cap*, and *large cap* aren't references to headgear; they're references to how large a company is as measured by its market value. Here are the five basic stock categories of market capitalization:

- » **Micro cap (less than \$300 million):** These stocks are the smallest and, hence, the riskiest available. (There's even a subsection of micro cap called *nano cap*, which refers to stocks under \$50 million, but they're not appropriate for this book.)
- » **Small cap (\$300 million to \$2 billion):** These stocks fare better than the micro caps and still have plenty of growth potential. The key word here is *potential*.
- » **Mid cap (\$2 billion to \$10 billion):** For many investors, this category offers a good compromise between small caps and large caps. These stocks have some of the safety of large caps while retaining some of the growth potential of small caps.
- » **Large cap (\$10 billion to \$200 billion):** This category is usually best reserved for conservative stock investors who want steady appreciation with greater safety. Stocks in this category are frequently referred to as *blue chips*.
- » **Ultra cap or mega cap (more than \$200 billion):** These stocks obviously refer to companies that are the biggest of the big. Stocks such as Google and Apple are examples.



REMEMBER

From a safety point of view, a company's size and market value do matter. All things being equal, large-cap stocks are considered safer than small-cap stocks. However, small-cap stocks have greater potential for growth. Compare these stocks to trees: Which tree is sturdier, a giant California redwood or a small oak tree that's just a year old? In a great storm, the redwood holds up well, whereas the smaller tree has a rough time. But you also have to ask yourself which tree has more opportunity for growth. The redwood may not have much growth left, but the small oak tree has plenty of growth to look forward to.

For beginning investors, comparing market cap to trees isn't so far-fetched. You want your money to branch out without becoming a sap.



REMEMBER

Although market capitalization is important to consider, don't invest (or not invest) based solely on it. It's just one measure of value. You need to look at numerous factors that can help you determine whether any given stock is a good investment. Keep reading — this book is full of information to help you decide.

Sharpening your investment skills

Investors who analyze a company can better judge the value of its stock and profit from buying and selling it. Your greatest asset in stock investing is knowledge (and a little common sense). To succeed in the world of stock investing, keep in mind these key success factors:

- » **Understand why you want to invest in stocks.** Are you seeking appreciation (capital gains) or income (dividends)? Turn to Chapters 9 and 10 for information on these topics.
- » **Timing your buys and sells does matter.** Terms like *overbought* and *oversold* can give you an edge when you're deciding whether to purchase or sell a stock. *Technical analysis* is a way to analyze securities through their market activity (past prices and volume) to find patterns that suggest where those investments may be headed in the short term.
- » **Do some research.** Look at the company whose stock you're considering to see whether it's a profitable business worthy of your investment dollars. Chapters 6 and 7 help you scrutinize companies.
- » **Understand and identify what's up with "the big picture."** It's a small world after all, and you should be aware of how the world can affect your stock portfolio. Everyone from the bureaucrats in Europe to the politicians in the U.S. Capitol can affect a stock or industry like a match in a dry haystack. Chapter 12 gives you lots of guidance on sector opportunities.
- » **Use investing strategies like the pros do.** I'm very big on strategies such as trailing stops and limit orders, and fortunately, today's technology gives you even more tools to help you grow or protect your money, so head on over to Chapter 13 for insights on ways to transact stock.

» **Look outside the U.S. stock market for opportunities.**

It's easier than ever before to profit from stocks offered across the globe! Find out more about investing in international stocks through American depositary receipts (ADRs) and international ETFs.

» **Consider buying in smaller quantities.** Buying stocks doesn't always mean that you must buy through a broker and that it must be 100 shares. You can buy stock for as little as \$25 using programs such as dividend reinvestment plans.

» **Do as others do, not as they say.** Sometimes, what people tell you to do with stocks is not as revealing as what people are actually doing. This is why I like to look at company insiders before I buy or sell a particular stock. This includes insider trading done by Congress.

» **Keep more of the money you earn.** After all your great work in getting the right stocks and making the big bucks, you should know about keeping more of the fruits of your investing. I cover taxes in Chapter 14.

Every chapter in this book offers you valuable guidance on some essential aspect of the fantastic world of stocks. The knowledge you pick up and apply from these pages has been tested over nearly a century of stock picking. The investment experience of the past — the good, the bad, and some of the ugly — is here for your benefit. Use this information to make a lot of money (and make me proud!).