

Investment Club Monthly Educational Lessons: The First Two Years

In the beginning, we were just interested in what it meant to be part of an investment club. We spent the first two years learning the BetterInvesting stock study tools. Here we are, 18 years later, and education is still one of our monthly segments. I don't feel like a club should ever totally eliminate education. We are continually learning.

--Betty Sinnock¹
Member--Beardstown
Ladies Investment Club

Introduction to Educational Lessons

The educational component of an investment club is essential to the continued learning and building of investment knowledge and experience. Each month, your club should dedicate appropriate time to investment education. The following lessons can be used in the educational component of your monthly club meeting during its first two years. In addition, we encourage you to include your own material and information to supplement the educational experience for all members.

Be sure to incorporate BetterInvesting's online educational information and programming provided on the BetterInvesting website at www.betterinvesting.org in your educational efforts. Educational programs such as the Introduction to the Stock Selection Guide series and Adding Judgment to Your Stock Selection Guide series should be taken by all club members. Online educational resources such as First Cut, Online Stock Study Series and Ticker Talk provide a wealth of insight and ideas that will value your club immensely. Have all club member's view each educational session found in Step 10 and practice the BetterInvesting stock selection methodology using our online tools with fellow club members. Be sure to contact the BetterInvesting chapter in your area to see what's going on close to you. Our chapter volunteers are always ready to provide the support you need to invest successfully.

Building investment knowledge and experience is the ultimate key to long-term investment success for your club and its members. Be sure to take full advantage of all the resources available to you and your club through your BetterInvesting membership.

Teaching Guidelines

Here are some helpful tips to get the most out of your education session:

The club's vice president should oversee the educational component of your investment club, ensuring that the club continues a regular educational program each month to increase investment knowledge.

Select 2-3 leaders within the club who will learn the use of BetterInvesting's online stock selection tools, guiding principle and stock investing methodology. These educational leaders will then support the learning of your other club members.

Devote 20-30 minutes each month to the educational component of your club meeting. The Educational Content section in each lesson serves as a foundation for preparing your lessons by presenting topics and terms in outline tool.

We strongly recommend that each club member obtain a copy of the *BetterInvesting Stock Selection Handbook*. We also urge your club to use BetterInvesting's online stock selection and club accounting tools to analyze investments and manage your club accounting and record keeping needs. Use of these applications will help to ensure accuracy and will save you hours each month in club meeting preparation. The BetterInvesting Web Site also offers a wealth of information to use in your monthly education segment and for ideas on stock selection. Visit us regularly at www.betterinvesting.org

Monthly Educational Lesson Outline

A typical monthly meeting lesson should include the following elements:

Goals for the monthly educational lesson. Announced by the meeting's educational leader, goals set the tone for the lesson. Members will know upfront what is expected of them, and indeed, what they can expect to come away with.

New financial terms and educational content. Members will add to their financial vocabulary, building a sound base of knowledge as well as functional experience.

LESSON ONE:

Basics of Stock Investing

*Rule Number One: Never lose money.
Rule Number Two: Never forget Rule Number One.
--Warren Buffett*

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

Today's lesson will introduce each of us to the stock market and to the concept of investment clubs. We'll explore the benefits of long-term investing, and how these benefits can be best derived through the kind of disciplined approach that's put into practice by thousands of BetterInvesting-affiliated clubs registered nationwide. We'll also talk about our investment goals, and then begin our journey to achieve them together.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Bear market	A market where stock prices have declined 20 percent from a recent high.
Bull market	A market in which prices have or are generally rising.
Buying power	The value of money relative to the goods and services it can purchase. Also referred to as purchasing power.
Compounding	A process in which earnings that are generated from the return on an investment.
Diversification	The practice of spreading investments among a range of different securities to reduce risk.
Dollar cost averaging	Buying a set dollar amount of a security at stated intervals.
Inflation	An increase in the cost of consumer goods, which leads to a decline in the purchasing power of the dollar.
Interest	A payment made to a creditor by a borrower for the use of money.
Investment	The purchase of stocks, bonds or other property.
Return	The percentage of gain reported by a security in a given period; that is, income plus capital gains.
Risk	The possibility of suffering a financial loss on an investment.
Rule of 72	A method of calculating the rate of return required to

	double an investment in a given number of years. Conversely, it can be used to calculate how many years an investment will take to double if the rate of return is known.
Savings	That portion of income not spent.

EDUCATIONAL CONTENT

An Overview of the Stock Market

The first “stock exchange” was created in 1790 in what was then the nation’s capital city, Philadelphia. Silver bars and gold doubloons were cut into eight pieces, hence the term “pieces of eight.” Up until just a few years ago, stocks were traded using one-eighth as the smallest fraction of computation for a stock’s value. The early 1800s, New York City became the nation’s capital for making an **investment**. In 1863, the New York Stock Exchange moved into the Wall Street building that it still occupies today. Principal stock exchanges are the NYSE, the American Stock Exchange (AMEX) the National Association of Securities Dealers Automated Quotation (NASDAQ) system and the Over-the-Counter (OTC) market.

Why Invest? The Benefits of Long-term Investing

The benefits of investing in general are many. The rewards can last a lifetime—and the lifetimes of your heirs. As an investor, time is on your side. There are good times (**bull market**) and bad (**bear market**). But over the long haul, stocks have always gone up. Investing can help beat **inflation**. **Diversification** and **dollar cost averaging** are strategies that reward the typical investor even more, so that your **return** will outpace your **risk**. By reinvesting earnings, investors also enjoy the “magic” of **compounding**. This is one dramatic difference between building on an investment and merely accruing **savings** and **interest**. When you invest, you are taking intelligent steps to make your money grow over time. Investing is also a way of owning a piece of corporate America. Lastly, it’s fun!

Investing Goals

BetterInvesting recommends that your investment objective should be to double your money every five years. This is accomplished by obtaining a 15% (actually, 14.87%) total return on your investment, consisting of price appreciation plus dividend income, compounded annually. This reflects the **Rule of 72**, which says that if an asset grows x% a year, its value will double in $72 \div x$ years. Divide 72 by the annual rate of return to see how long your investment will take to double. (NOTE: the inverse is also true, enabling you to find out what percentage of total return you’ll need to earn to double your investment in a given number of years. To double your investment in six years, you would need to earn $12\% = 72 \div 6$.)

Investing Styles and Risks

The BetterInvesting approach to investing is a long-term strategic buy-and-hold method that's not as popular with hotshot "advisors" and "planners" as other pie-in-the-sky approaches. It is founded on a fundamental analysis of a company (i.e. focusing on company sales/revenues, earnings, P/E ratio and how management is driving growth), rather than just a technical analysis of stock performance (i.e. focusing on stock price movement, market momentum or short-term indicators). It revolves around BetterInvesting's four basic investment principles, which are: invest on a regular basis over a long period of time; reinvest all earnings, dividends and profits; buy growth stocks; and diversify your portfolio to reduce risk.

LESSON TWO: Starting Your Investment Club And Accounting Basics

A nickel ain't worth a dime anymore.
--Yogi Berra

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

An investment club can be a lot of fun to be part of. But let's face it: the reason we're all in it is to make a profit on our investment. To accomplish that, we have to treat the few hours a month that we're together appropriately. Today, we'll explore the proper investment club environment and learn how a business agenda and correct organizational procedures contribute to promoting a successful club. The treasurer is ultimately responsible for club record keeping, but since it is highly recommended that each member becomes somewhat familiar with the process, we'll review it together.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Annual Report	A report issued by a company or mutual fund detailing the performance, expenses and holdings during a particular year. Contact the company to request a report, or go to its Web site—many companies post them online.

Assets	Any items of economic value, especially those which could be converted to cash.
Capital account	An account in which expenditures on capital items are recorded.
Capital gain/loss	Profit/loss from the sale of an asset, such as securities.
Compounded Annual Growth	The growth rate of an investment computed over a number of years.
Cost basis	The purchase price, including sales commissions, that will be reported when figuring tax liabilities such as capital gains and losses.
Dividend Reinvestment Plan (DRIP)	A service that provides shareholders with the option to automatically invest any interest, dividends and capital gain distributions.
Dividends	A payment a company makes, in cash or stock, to its shareholders.
Employer Identification Number (EIN)	A number assigned to partnerships, corporations and other legal entities for use in tax reporting.
IRS Form 1065	A tax form that must be filed by all investment clubs operating as partnerships.
IRS Form SS-4	The IRS form used to properly register an investment club or other legal entity for tax purposes and to obtain an Employer Identification Number (EIN).
IRS Schedule K-1	The document used by investment clubs to report the partner's share of income. One K-1 is filled out by the club treasurer for each member. Members include the information in their own tax returns.
Liabilities	A financial obligation, debt, claim or potential loss.
Net Asset Value (NAV)	The market value of a fund's assets, less any liabilities and fund expenses, divided by the number of shares outstanding.
Street name	The term given to securities held in the name of a brokerage on behalf of a customer, usually done to facilitate subsequent transactions.
Total Return	The return on an investment, including dividends and interest, figured over a standard period of time such as one year.
Valuation Statement	A statement displaying the securities owned by the club and their total current value, the amount of cash on hand, the current value of one Valuation Unit and the number of Valuation Units that can be purchased with \$10.00.
Valuation Unit	The basic measurement of the BetterInvesting accounting system, used by investment clubs to calculate each member's share of ownership. The value of one Valuation Unit is determined by

	dividing the dollar value of club assets by the number of valuation units issued by the club.

EDUCATIONAL CONTENT

Understanding the Club Environment

As members of an investment club, we all need to be in agreement on the purpose of the club and what we expect from it. Fun, education and profit are certainly among the goals. But do we need to sacrifice the first goal—fun—in order to achieve the other two? Hopefully not. We do have to realize, however, that an investment club is a legal entity. For example, we had to submit an IRS **Form SS-4** in order to secure an **Employer Identification Number (EIN)**. We also have to conduct our meetings as business meetings, and the best way to do that is by having an agenda.

Club Record Keeping and Accounting

We've said that an investment club is like a small business, and nowhere is that more evident than in the way records are kept and monies accounted for. For example, each year the club will file tax returns using **IRS Form 1065**. Club members must file their own club tax returns using the information from **IRS Schedule K-1**. The club treasurer will be able to refer to the Investment Club Accounting Handbook for assistance on pretty much every type of transaction the club will encounter. BetterInvesting even has its own online club accounting application myICLUB. The treasurer maintains records of the club's financial affairs, while the assistant treasurer maintains records of the members' share ownership of the club's assets. The club in our example will be using the BetterInvesting accounting system. The system uses as its basis the **Valuation Unit**. This system is similar to the one used by mutual funds. If you're a fund investor, you know that a fund's share price is the market value of its assets, less any liabilities and fund expenses, divided by the number of shares outstanding. This is the share's **Net Asset Value (NAV)**, and it's what you would pay for one share of that fund. In this system of Valuation Units, our club is a capitalized enterprise issuing stock (shares) of its assets, and selling these to a limited clientele. The value of one Valuation Unit is determined by dividing the dollar value of club assets by the number of Valuation Units issued by the club. (See BetterInvesting *Investment Club Operations Handbook*). At each meeting, a **Valuation Statement** is distributed to members. The treasurer also processes any withdrawals from the club, which means keeping track of each member's **cost basis**. As the withdrawal itself is treated as a sale of an investment, other factors will come into play such as **capital gains/losses**, expenses and income from **dividends**.

LESSON THREE:

Getting Started Investing—An Overview of BetterInvesting Investment Analysis Tools

Anyone who says money doesn't buy happiness doesn't know where to shop.
--Anonymous

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

Making money on your money isn't easy. BetterInvesting's biggest accomplishment over the years has been to make it less difficult. This month's lesson will emphasize the importance of putting stock analysis before stock investing. By applying a few essential tests, we'll increase our chances of achieving 100 percent appreciation every five years (in other words, set a goal to double our money every five years). Today, we'll look at how to look at reports published by Value Line and Standard and Poor's, as well as annual reports released by the companies themselves. Finally, we'll begin the process by using BETTERINVESTING's analysis tools.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
10-K Report	An annual report showing a company's financial condition.
10-Q Report	A financial report filed quarterly with the S.E.C.
13-D Report	The report that any investor who acquires five percent of a company's stock must file.
8-K Report	A document announcing changes within a public company such as a merger, name change or bankruptcy.
American Stock Exchange (AMEX)	Once the second-largest stock exchange in the U.S., it has merged with NASDAQ, although the exchanges operate independently.
Balance Sheet	A financial statement detailing a company's assets, liabilities and capital and indicating the company's strength and solvency. Assets minus liabilities equals net worth (the equity of the company's stockholders).
Dow Jones Industrial Average (DJIA)	An index of 30 blue chip U.S. stocks, maintained by the editors of the <i>Wall Street Journal</i> .
Income Statement	A financial statement detailing a company's performance over a specified period. Shown on the

	statement are figures such as income, expenses and resulting profit.
National Association of Securities Dealers Automated Quotation (NASDAQ)	A system that provides up-to-date bid and asked prices on thousands of over-the-counter stocks and some listed stocks. All trading is executed electronically over telephones and computers.
New York Stock Exchange (NYSE)	The largest auction market securities exchange in the nation.
Securities and Exchange Commission (SEC)	The federal agency that regulates the securities business and protects the interests of the investing public.

EDUCATIONAL CONTENT

Finding Stocks to Study—Value Line and Standard & Poor’s Reports

Research is absolutely critical to the success of any BetterInvesting member investment club. Few investors confine their purchases to the 30 stocks that comprise the high-profile **Dow Jones Industrial Average (DJIA)**. The **New York Stock Exchange (NYSE)** and **NASDAQ** together are comprised of more than 8,000 issues, with thousands more still on the **American Stock Exchange (AMEX)**. Fortunately for investors today, there’s no lack of information or places to obtain it. Public corporations are required by law to disclose financial information and provide it to shareholders and to the general public. Such research tools include a company’s annual **10-K Report** and the quarterly **10-Q Report**. Both are available on the Web Site of the **Securities and Exchange Commission (SEC)**. **Forms 8-K** and **13-D** disclose important news about the company or its stockholders, respectively. *Value Line* and *Standard and Poor’s Stock Reports* are particularly excellent sources of the information. Typically, you can find both of these resources at your local library, and if you’re lucky the library will offer them online.

Annual Reports

The annual report is an investor’s primary source of financial intelligence about a company. Written by the company itself, the report offers information about the company, its products or services, its employees and customers and its future outlook. Financial highlights to look for in the report include the company’s historical performance figures, the most recent **Balance Sheet** and **Income Statement**, and an independent auditor’s report.

LESSON FOUR: Getting Started Investing—The BetterInvesting Stock Check List

*Money frees you from doing things you dislike. Since I dislike
doing nearly everything, money is handy.*
--Groucho Marx

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

The process of analyzing a company to determine whether it's a good investment begins with BetterInvesting's Stock Check List, the focus of this lesson. When it's complete, you'll know more about a company than most investors who merely take another person's advice. But that's just the first step. The Stock Check List, while valuable and easy to work with, does not provide enough information on which to base an investment decision. It is, however, a stepping stone to completing the BetterInvesting's Stock Selection Guide, a premier stock selection method.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Compound annual growth rate	The growth rate of an investment computed over a number of years.
Cyclical business	An industry that follows a boom-bust pattern in a regular market cycle.
Earnings per share (EPS)	A company's net income divided by the number of shares of common stock outstanding.
Growth stock	Companies that show higher than average growth in sales and earnings. Growth is fueled by a number of different elements, including superior management, new products, expanding markets or the discovery of new resources
Income stock	A stock offering an above-average cash dividend yield.
Past sales record	Section 1 of BetterInvesting's Stock Check List. Shows sales figures of recent years, increase in sales and Compound annual rate of sales growth.
Price earnings ratio (P/E)	The market price of a security divided by the earnings per share. Used to determine if a stock represents

	value at a given price.
Price record	Section 3 of the BetterInvesting Stock Check List. High and low stock prices, earnings per share and price earnings ratios for the most recent five-year period are used to project future high and low price earnings ratios.

EDUCATIONAL CONTENT

The Stock Check List (SCL) and Stock Selection Guide (SSG)

These resources are both stock study tools. Some people, however, like to ease into finances the way they get into a cold swimming pool. The SCL is ideal, because there's less data to find, fewer calculations to make and less judgment required. The SCL gauges how fast a company has grown over a recent five-year period. Remember, BetterInvesting recommends choosing a high-quality **growth stock**, rather than an **income stock**. So let's ease on in and get in the swim!

Section One: **Past Sales Record**

Sales make things happen in a company. The money left over after covering costs can end up as dividends paid to shareholders or earnings reinvested in the company to promote even more growth. Either way, shareholders like to see sales and the **earnings per share** increasing, because that bodes well for more growth, higher stock price and higher dividends. The computations in Section One determine the percentage increase in sales over a five-year period. Then, you'll use the computation table to find the **compound annual growth rate** for sales.

Section Two: Past Earnings Per Share Record

Determining the earnings per share growth is accomplished in a similar fashion as Section One. Just use the numbers in the "Earnings per Sh" line of the Value Line sheet instead of "Sales." Then, use the conversion table to find the compound annual growth rate for the increase in EPS. A company's sales and earnings usually don't grow at the same rate. Past growth itself may have causes that are one-time events, such as a merger or new product. Or, growth could happen in spurts because the company under consideration is a **cyclical business**.

Section Three: **Price Record**

The price record of the stock being studied compares the price and earnings per share over the past five years. The **price earnings ratio (P/E)** can indicate whether the stock is a good value at its current price.

Section Four: Conclusion

There are no hard and fast rules to deciding whether a stock is a good investment. Be as objective as you can when answering the questions in this section, but consider the club's agreed-upon objectives.

LESSON FIVE: Introduction to The BetterInvesting Stock Selection Guide

*"Everyone has the brainpower to follow the stock market.
If you made it through fifth-grade math, you can do it."
--Peter Lynch*

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

With this month's lesson, we'll look at and learn about the single most important tool for BetterInvesting club members: the Stock Selection Guide (SSG). Like the Stock Check List, the SSG helps you to learn facts about a company's past, evaluate how it's doing in the present, and form a judgment about its likely value in the future. Beginning with the front side of the SSG, we'll fill in company information and recent quarterly figures, and create a visual analysis of its historical and projected growth rates by using "trend lines." If it's true that you have to crawl before you can learn to walk, then today we're ready to hang onto each other's arms and take our first real steps.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Capitalization	The total value, as stated in a company's books, of bonds, preferred and common stock and retained earnings.
Common stock	A representation of ownership in a corporation.
Data	Numbers and figures used in a study, such as the Stock Selection Guide.
Debt	A liability owed from one person to another payable on an agreed-to date.
Dilution	The effect on earnings and book value per share when number of shares issued by a company increases disproportionately to growth in company earnings or assets.
Preferred stock	An equity security that pays shareholders a dividend at a specified rate.
Volatility	The penchant for a company to experience wide price fluctuations.

EDUCATIONAL CONTENT

Understanding The Stock Selection Guide

Simple enough for an amateur analyst to use, yet sophisticated enough to offer the same tests applied by professionals, the BetterInvesting Stock Selection Guide is, more than anything else, an outstanding aid to good, solid judgment. Using similar **data** as what you input into the Stock Check List, the SSG provides a wider review of the rate of growth of sales and earnings per share, as well as price information. In addition, the SSG allows us to evaluate the company's management and consider the investment characteristics of the company and its broader industry. One of the greatest dangers of buying a growth stock is paying too much for it. The SSG is specifically designed not only to help us determine whether the company we're considering is a growth company, but also whether it appears to be reasonably priced.

The Front Side of the SSG

The SSG header identifies some basic information about the stock under study. The person preparing the form must fill in the name of the company, date of the study, the preparer's name, the data source, the exchange where the stock is traded and the stock's industry. The **capitalization** section identifies the level of risk for a company. **Volatility, debt** and **dilution** present risk to shareholders. The number of shares outstanding affects the volatility of a stock's price. Holders of **preferred stock** shares are usually entitled to specific dividend rates. Such shareholders have "first rights" to distribution of assets if the company closes its doors. If a company offers preferred shares, holders of **common stock** could see their investment become worthless if the company goes out of business. The amount of corporate debt is shown in millions in the Capital Structure section of the Value Line sheet. The SSG also has an area to enter recent quarterly figures for sales and earnings per share.

Charting Stock History—Understanding the SSG Logarithmic Graph

The SSG's Visual Analysis of Sales, Earnings and Price (Section 1) is a snapshot of the company's recent financial history. Upon completing this picture, you'll be positioned to decide if the company merits your further consideration. The SSG uses a special kind of graph called a semi-logarithmic graph. It is also known as a ratio chart. There are two principles to the semi-log graph. First, equal percentage changes appear as equal amounts vertically on the graph. Second, there is no zero on this graph. Therefore, zero earnings and losses cannot be plotted. The graph serves to level out the playing field in a financial sense, making possible valid comparisons of different companies by comparing growth rates in addition to raw sales and earnings gains.

LESSON SIX:

The BetterInvesting Stock Selection Guide

Section 1—Visual Analysis of a Stock

*With money in your pocket you are wise and you are handsome
and you sing well, too.*
--Yiddish proverb

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

During our last lesson, we looked at one of BetterInvesting's most important tools, the Stock Selection Guide (SSG). It's helped members make informed investment decisions for over fifty years, and today we'll start to see why. In Section 1 of the SSG, we'll see how to record sales, earnings and price figures for the past decade. By doing so, we'll produce trend lines that reveal whether the stock under consideration merits further study. That's just one reason why the SSG itself merits further study!

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Estimated future earnings per share growth	An estimate of the average annual growth rate of earnings per share for the next five years.
Estimated future sales growth	An estimate of the average annual growth rate of sales for the next five years.
Historical earnings per share growth	The average annual growth rate of earnings per share over a given time period. This number represents the company's past performance in terms of an average growth rate.
Historical sales growth	The average annual growth rate of sales over a given time period. This number represents the company's past performance in terms of an average growth rate.
Outliers	Specific data that differs significantly from or is not representative of a company's overall performance.
Trend	A general course or movement of prices or rates.

EDUCATIONAL CONTENT

Plotting a Visual Analysis of Sales, Earnings and Price

The Stock Check List was devoted exclusively to analyzing the sales, earnings per share and price-earnings records for a limited period of time. The SSG provides a wider review of the rate of growth of sales and earnings per share as well as price information. All of these factors are recorded on the Visual Analysis part of the SSG. A semi-log graph is used, in which equal percentage changes appear as equal amounts vertically. Note that there is no zero on the graph; you cannot plot zero earnings or losses. Section 1 of the SSG already shows five straight lines fanning out from the lower left-hand corner—the point of origin—across to various spots on the right-hand margin. These lines illustrate a **trend**. They depict the compounded rates of growth indicated: 5, 10, 15, 20, 25 and 30 percent. If you follow the “25%” trend line from left to right, each time it crosses a heavy vertical line it produces a 25 percent increase over the previous vertical line. These established trend lines will be used for comparison purposes for growth in sales and earnings per share.

Developing the Trend: Sales and EPS

Numbers growing at a constant rate appear as a straight line on the graph, which makes it easy to spot a quality growth company. Lines for historical sales, EPS and pre-tax profit that climb the graph like railroad tracks—nice and straight and parallel to each other—represent the consistent performance produced by an experienced management team. The angle of these lines shows whether the company’s growth is strong enough to meet the club’s investment objectives. And while a good-looking graph doesn’t make the company a sure thing, an “ugly” graph is a sure sign of problems. Section 1 makes certain trends such as slowing growth, erratic growth and slumps in growth easy to spot. Completing Section 1 is accomplished with ease by using BetterInvesting online tools.

Projections for Sales and EPS

Trend lines indicate the direction over the past 10 years. They make it possible to document **historical sales growth** and **historical earnings per share growth**. Projection lines can then be drawn, representing **estimated future sales growth** and **estimated future earnings per share growth** for the next five years. The future EPS contribute to calculating an estimated future high price, which is one factor in whether the stock is selling at a good price. One caution: you may decide to eliminate or overlook certain data because it isn’t indicative of the company’s performance. Figures or years that distort the overall perspective are called **outliers**. It’s suggested that you remove outliers only if their removal will reduce the historical growth rate to create a more conservative SSG.

LESSON SEVEN:

The BetterInvesting Stock Selection Guide

Section 2—Evaluating Management

That some should be rich shows that others may become rich, and hence is just encouragement to industry and enterprise.

--Abraham Lincoln

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

The BetterInvesting approach to sound investing is founded on a fundamental analysis of a company. And almost nothing is more indicative of a company's worthiness than how its management is driving growth. Sections 2A and 2B of the Stock Selection Guide screen management's performance in two vital areas: pre-tax profit margins and return on equity. In today's lesson we'll learn what these important indicators mean, and see how regular working folks get to turn the tables by putting the bosses to the test.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Equity	An ownership interest held by shareholders in a corporation.
Percent (%) earned on Equity	Net earnings divided by total capitalization, less any debt. The bigger the return, the better.
Pre-tax profit on sales	Net earnings or income before taxes.
Profit margin (pre-tax)	Profit before taxes divided by sales.

EDUCATIONAL CONTENT

Why do we evaluate management?

Section 1 of the Stock Selection Guide—a Visual Analysis—showed whether the company had a record of moving sales and earnings per share ahead at an acceptable rate. However, the performance of an investment is usually produced by management. Judging that ability is one of our major challenges. Brokerage firms can conduct on-site visits with company managers and make close examinations of their financial statements. We can't. But we do have access to data that can separate above-average management from average and below-average management. After visually checking sales and earnings per share growth, we then look at two statistical

measures that tell a lot about management's quality: **pre-tax profit margin** and **percent earned on equity**.

The BetterInvesting Stock Selection Guide—Section 2A

The pre-tax profit margin for a given year is computed by dividing **pre-tax profit on sales** (that is, net income before taxes) by sales or revenues. This shows us how much money the company retains from every sales dollar after paying all expenses of doing business except income taxes (which are, as with each of us, beyond one's direct control). Figures (expressed as a percentage) are entered into the row of boxes in Section 2A. You're looking for a steady upward trend that is also above average for the industry. But be careful of a big jump; it could indicate a short-term improvement at the expense of long-term performance.

The BetterInvesting Stock Selection Guide—Section 2B

Percent earned on equity is the return that management achieves on your investment in their company—your **equity**. Don't confuse this with the return on your investment. Instead, it is a measure of how much money is produced by the plant and equipment of the company. Value Line calculates percent earned on stockholders' equity under the heading "% Earned Net Worth" or "% Earned Shr. Equity." Enter the figures into the second row of Section 2. You are looking for trends over time, expecting low return on equity to improve and high values to remain high and above industry averages.

Projections and Judgment

After calculating pre-tax profit margin, you can corroborate your estimate of EPS five years out using the BetterInvesting Preferred Procedure. This is a method for calculating EPS from sales using estimates for a company's future profit margins, taxes, dividends from preferred shares and the number of common shares outstanding. Judgment can be applied to each step.

Before Moving On

Before tackling Section 3, review your findings for the first two sections. Is the company growing sales and EPS at a consistent pace, and fast enough for a company that size? Are pre-tax profit margins and return on equity above the industry averages and increasing steadily? If the answers don't meet expectations, consider ending your study and starting fresh with another prospective investment.

LESSON EIGHT:

The BetterInvesting Stock Selection Guide

Section 3—Price Earnings History

Capital is to the progress of society what gas is to a car.
--James Truslow Adams

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

BetterInvesting's Stock Selection Guide is so valuable because it puts the past into perspective, making a reasonable projection of the future entirely possible. In Section 3 of the SSG, we'll see how the historical price-earnings data of a company is recorded and interpreted. In the beginning, it may feel like you're reading an Agatha Christie novel. But look for the clues in those numbers. Watch for the danger signals. Spot the patterns. And the answers will become clearer and clearer.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Dividend per share	The total dividend paid divided by the number of shares of common stock outstanding.
Payout	Percentage of earnings distributed to shareholders as dividends. Payout may be calculated by dividing the dividend per share by earnings per share.
Price-earnings history	As computed in Section 3 of the Stock Selection Guide, it shows the high and low prices of the company's stock in a specific year, relative to the EPS for that year.
Yield	The per-share cash dividend divided by the per-share market price of a stock or fund. Also called dividend yield.

EDUCATIONAL CONTENT

The BetterInvesting Stock Selection Guide—Section 3

Price earnings ratios, like fashions, often come around full circle given time—or never go out of style at all. By studying **price-earnings history** in Section 3 of the SSG, we can separate the short-term fad from the timeless classic. What's more, unlike with fashions, we can forecast the future

direction of a company's PEs. In this way, we can determine whether today's price is reasonable.

Putting History into Perspective: What Does the Data Mean?

The overall purpose of Section 3 is to allow you to assess the value of a potential investment. This is done by analyzing the patterns. That is, eliminating fleeting results, using dependable numbers and judging the endurance of trends. The information it's all readily available using BetterInvesting's online tools. A dramatically increasing payout ratio might indicate that a company is trying to hang onto its shareholders by making dividends more attractive, but at the expense of future growth. The percent of high **yield** is calculated by dividing column F by column B (low price). We want to look at high yield in order to determine a low price in Section 4 for companies that pay large dividends. BetterInvesting online tools will save you considerable time to let you devote more energy toward putting a company's history into perspective.

LESSON NINE:

The BetterInvesting Stock Selection Guide

Section 4 and 5—Evaluating Risk and Reward

He who wishes to be rich in a day will be hanged in a year.
--Leonardo da Vinci

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

One of the biggest investing mistakes made by individuals and clubs is paying too much for stocks. Worse yet is the fact that it's so easily correctable. Section 4 of the Stock Selection Guide provides data that will put the price of a stock to three safety tests. Test One shows the probability of getting out even. Test Two stacks the odds in the investor's favor. Test Three applies three standards to help investors avoid loss. After this evaluation of risk, we're ready to evaluate the real potential of the stock to double its value in five years. This we do in Section 5, and we'll tackle both sections in today's lesson.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Appreciation	The advance in price of a security.
Average annual return	The increase in the value of an investment over a multi-year period, shown as a percentage rate per year and not considerate of compounding over this time.
Boom	A period of rapid growth for businesses and services.
Price target	A projected price to execute a securities transaction.
Recession	A decline in business spending for a specified period.
Total return	The performance of an investment, including dividends interest, capital gains distributions and changes in net asset value. The total return is the change in value of an investment during a given period of time.
Upside-downside ratio	A measurement of risk. Divides the upside potential by the downside risk.
Zoning	Section 4 (C) of BetterInvesting's Stock Selection Guide, used to estimate the price ranges over which to decide whether to buy, hold or sell a stock.

EDUCATIONAL CONTENT

The BetterInvesting Stock Selection Guide—Section 4

Section 4 of the SSG uses the output of the price-earnings history in Section 3 to determine the value of a potential investment. How much value? More than enough to offset the risks. All investments carry risk, but quality growth companies produce fewer surprises over the long term. Conservative judgment helps your chances because you purchase strong companies at excellent prices. Every step of an BetterInvesting stock study aims to reduce the probability of disaster and thereby increase your reward. Section 4 focuses on the magnitude of risk ahead. You'll be forecasting high and low prices for the next five years, assuming one **recession** and one **boom** period during that time. The low price is subtracted from the high price, and the numerical difference is broken up into three parts. This **zoning** creates price ranges for the recommended action: buy, hold or sell. Section 4(D), the **Upside-downside ratio**, compares the potential price increase to the potential price drop as another indicator of a stock's current suitability as a "buy." The last part of Section 4—**price target**—uses the stock's forecast high price and its present price to show potential price **appreciation**. Our objective, remember, is to purchase stocks with potential to earn 15% average annual return and to therefore double our investment in five years.

The BetterInvesting Stock Selection Guide—Section 5

Each section of the Stock Selection Guide helps to filter out stocks that don't have the potential to double in five years. Section 5 shows the return that the stock under study might achieve from both price appreciation and dividends—the **total return**. This section also quantifies the expected **average annual return** over the next five years. To conclude whether the company might meet our five-year goal for it, the Conversion Table translates simple return into a compound annual rate of return, which should meet or exceed the minimum return you would expect for the company's size.

LESSON TEN: The BETTERINVESTING Stock Selection Guide— Sharpening Your Skills

Investor: one who bought stocks that went up.
--Malcolm Forbes

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

The purpose of the Stock Selection Guide is simple: to assist in the selection of a quality growth company at a fair price. The eight questions that comprise the test portion of the SSG are designed to help us reach a decision based on the results we have calculated as to whether this company is the kind of investment we are looking for. That decision, however, is not dependent on numbers alone. Good judgment can be just as important. In today's lesson, we'll see how the two cannot work apart, but when applied together, make a truly rewarding combination.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Rule of 5	A rule for investors stating that for every five stocks purchased, one will experience unforeseen difficulties, three will perform more or less as expected, and one will far exceed what was forecast for it.
Rule of 72	A method of calculating the rate of return required to double an investment in a given number of years. Conversely, it can be used to calculate how many years an investment will take to double if the rate of return is known.

EDUCATIONAL CONTENT

The BetterInvesting Stock Selection Guide and Report—Evaluating a Company and Developing Judgment

Stock selection, even with all the proven help that the SSG provides, is still more art than science. Making calculations is a science; interpreting them is

an art. That said, however, there is still a science to learning what to look for in the first place.

Evaluating a Good Company—Sections 1 and 2

Section 1 is a visual analysis of the company under consideration that can tell a trained observer if the company has grown strongly and consistently. Remember to look for railroad tracks—almost parallel lines of sales and EPS growth—at an upward angle. What about price? If the price has trended up along with sales and EPS, that usually indicates investor confidence. But if the price has trended sideways, does that mean the opposite? Other factors must be considered and weighed to make a studious conclusion. Certainly management is a driving force behind any company's performance. You must ultimately decide if management has what it takes to maintain or increase the rate of sales expansion, profit margin and percent earned on stockholder's equity. And if not, why?

Evaluating Price—Sections 3, 4 and 5

A company might be a powerhouse of growth and quality, but what good does it do investors who get in just as it peaks? Review PE ratios and past prices in Section 3, and forecast high and low prices for the next five years in Section 4 to see whether the stock price can increase enough to meet your objectives. Explain any outliers in PE ratios or price. Assess the upside-downside ratio to see if there's enough of a potential price increase to offset a price drop. Finally, evaluate the forecast compound annual rate of return in Section 5 in terms of company size, not just the raw figure.

Keep in Mind...

The **Rule of 72** makes it possible to calculate the rate of return required to double an investment in a given number of years. Or, you can easily calculate how many years an investment will take to double if the rate of return is known. But despite all your hard work—or perhaps because of it—the **Rule of 5** almost always applies: for every five stocks purchased, one will experience unforeseen difficulties, three will perform more or less as expected, and one will far exceed what was forecast for it.

LESSON ELEVEN: The BetterInvesting Stock Selection Guide— Review and Presentation

*If only (someone up there) would give me some clear sign.
Like making a deposit in my name in a Swiss bank account.
--Woody Allen*

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

In the last lesson, we learned how the evaluation of a company using the Stock Selection Guide isn't enough; it must be combined with our own judgment regarding the company's future potential and its appropriateness to our objectives. Today, we'll continue the process. If the SSG indicates that a company is indeed sound and sells at a fair price, we must still ask ourselves whether it meets the club's own criteria. For example, does it make products or provide services we would not be comfortable supporting financially? As this is very much a group decision, we'll also work on our individual presentation techniques.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Demographic	Socioeconomic groups, usually divided by age, sex, geographic location, income, education or other categories.
Due diligence	An investigation of a business or other entity, usually in conjunction with a prospective sale or investment.
Same-store sales	Sales to stores that have been open for at least one year. Using this figure, it can be determined how much income was derived from recently opened stores.

EDUCATIONAL CONTENT

Developing Judgment in the Use of the SSG

You've heard the expression "think outside the box." The Stock Selection Guide is a tool without peer, but it won't work to its fullest capacity if you don't look outside the box. Before you act on numbers alone, it's vital that you consider the qualitative features of the company. For example, a company must have at least five years of history for you to forecast growth using the SSG. How limited are its services or products—is it subject to unplanned obsolescence or competition? Don't overlook the power of dividends—they can add up big time, especially in a down market. How does the company grow its business—are they strategically placed to introduce new products or maintain **same-store sales**? Are there any economic, **demographic** or technological issues that might adversely influence the company's future?

How to Present a Stock to the Club Using the SSG

You've spent considerable time researching your stock. Now you've got to present your report to the club. Public speaking is one of the greatest fears of mankind. But at the next meeting, the floor will be all yours and all eyes will be on you. Fortunately, you're not alone; you've got a great presentation partner in the Stock Selection Guide. So DO: make copies of your completed Guide for all the members. But DON'T: hand them out beforehand. Instead, have your neighborhood copy store blow up each page of the guide to a size large enough—16x20 will do it—to put on an easel one page at a time. (Better yet, you can order 17x22 "Giant Stock Selection Guides and Stock Comparison Guides" from your BetterInvesting Member Catalog). This is so you can control the pace of your presentation and not have to talk to the tops of heads because your audience is looking down at your handouts. Begin with some information that's not on the form to pique interest, such as the company's significant accomplishments (a groundbreaking product or idea) or a surprising fact. Follow up with a brief look at the company and weave your way into the meat of the presentation. You've got a compelling story to tell, but don't make it numbers alone. Do your **due diligence** by reading the company's annual report and their Web Site. Then, work some human interest into the speech whenever you can. Bottom line: make your presentation something that you yourself would want to hear.

LESSON TWELVE: The BetterInvesting Stock Selection Guide— Review and Judgment

All the money in the world is no use to a man or his country if he spends it as fast as he makes it. All he has left is his bills and the reputation for being a fool.
--Rudyard Kipling

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

We've spent several meetings refining our stock-picking techniques using the Stock Selection Guide. We've seen that the raw numbers, along with the eight-point test applying those numbers, will be immensely valuable in our decision. However, that information must always be weighed against the goals and objectives that we've set for ourselves as a club. Does the company measure up in those respects? In today's lesson, we'll continue to apply what we've learned individually and become better prepared to evaluate companies together.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Balance sheet	A financial statement detailing a company's assets, liabilities and capital and indicating the company's strength and solvency. Assets minus liabilities equals net worth (the equity of the company's stockholders).
Book value	The total assets of a company minus intangible assets and liabilities (such as debt). The company's actual market value might be more or less than its book value.
Debt	A liability owed from one person to another payable on or before an agreed-to date.
Earnings per share	A company's net income divided by the number of shares of common stock outstanding.
Growth stock	Companies that show higher than average growth in sales and earnings. Growth is fueled by a number of different elements, including superior management, new products, expanding markets or the discovery of new resources
Trend	A general course or movement of prices or rates.

EDUCATIONAL CONTENT

Practice Using the Stock Selection Guide

Investment clubs use the Stock Selection Guide in support of their primary objective: to find quality **growth stocks**. Although past growth is no guarantee of future growth, it is a logical place to begin. It is growing sales and **earnings per share** that make a stock price go up and the company's **book value** increase. The SSG provides proven tests on growth, management and price so as to be a valuable aid in the club's decision-making process. Completing your first Guide may require several hours. After some experience, you should be able to "knock it out" in far less time, and you'll find that the numbers will actually become easier to understand. As you're finding out, the Stock Selection Guide is exactly that—a guide to judgment, and it's only as useful as the interpretation you make from it.

Work on Judgment and the Use of the SSG

Stock Selection Guide compiles a great deal of valuable data for your interpretation and use. However, it cannot be and is not all-inclusive. For example, the SSG does not refer to any **balance sheet** items, which aid in determining the financial strength of a corporation. Your investigation into a company should make such a judgment prior to opening the SSG. One important factor you should not overlook is corporate **debt**. If you consider financial condition and debt structure together, you may discover threats to the company's long-term progress. Practice using the partially completed SSG in *Better Investing* each month. Once you're into filling out the SSG, always look for a **trend** that could be a deciding factor in whether or not to recommend the stock.

THE SECOND YEAR
OF YOUR INVESTMENT CLUB

LESSON THIRTEEN:
Celebrating The First Anniversary

If you can count your money, you don't have a billion dollars.
--J. Paul Getty

**HOLD A CLUB PARTY WITH SPOUSES OR FAMILY
TO CONGRATULATE YOUR CLUB ON ITS FIRST
SUCCESSFUL YEAR!**

HOLD BRIEF BUSINESS MEETING FOR CLUB MEMBERS
(also to allow visitors and guests to experience a short version of your club meeting)

Collect checks from all members

Club treasurer distribute club valuation statements

Review club valuation statement for club portfolio

Club officers provide brief update and report

Review the portfolio to date (brief review and comments)

Discuss the accomplishments of the club in the first year

Ask members to think about the challenges the club
has had over the first year

What resources does the club need to succeed?

What education do club members need?

Does the club want to include new members?

What local BetterInvesting Chapter events are available for the
club's benefit?

CLUB MEMBERS CAN NOMINATE NEW OFFICERS OR AGREE TO REELECT CURRENT OFFICERS FOR A SECOND YEAR (depending on your club operating agreement)

EDUCATIONAL CONTENT

Review and Use of the Stock Selection Guide

The Stock Selection Guide focuses on numerous areas critical to the club's investment decision, two of these being management and price. Weighing the company's record on both issues and then factoring in your own judgment regarding its potential future will allow you to present a solid picture to your colleagues. Remember that there are an infinite number of variables that can influence the stock market in general, and a specific industry or stock in particular. Weighing these variables is important, but it's important, too, to keep them in proper balance. The information you put into and get out of the SSG has been shown, over many decades of use, to furnish the most valuable foundation in the intelligent selection of investments.

Work on Presenting a Stock to the Club Using the SSG

In the previous discussion on SSG presentations (Lesson Eleven), we suggested that you make it something that you would pay attention to if someone else was up there instead. Keep that in mind at all times; you won't get much better advice. Otherwise, it's like painting a picture in your basement and never inviting anyone over. You'll have an audience of one in either case. And while it's true that the club should vote based on the story, not the storyteller, you might find that selling the sizzle along with the steak will put the presentation over the top. So make it memorable by throwing in some show-bizzy extras that are not gimmicks so much as creative props with which to get your point across. If the company makes a product, buy it and show it. If the product is food, get some for everyone. Prepare handouts—in addition to copies of the SSG—that your club mates can review as they consider your recommendation. These may include newspaper articles on the company or a photo layout from their annual report. The result may or may not be a vote of confidence in your company, but it'll do wonders for your confidence in yourself.

LESSON FOURTEEN: Introduction to the BetterInvesting Stock Comparison Guide

*There are two times in a man's life when he should not speculate:
when he can't afford it and when he can.*
--Mark Twain

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

Unlike so many things in life, picking stocks is not like comparing apples to oranges. Oftentimes we'll be comparing apples to apples. Two growth stocks in the same industry that rate nearly identical in major trends, for example. In cases like this, it may be several small differences that make all the difference. By using BetterInvesting's Stock Comparison Guide, we'll be able to view values of five stocks side by side for up to thirty criteria. On the single side of one page, we'll see very clearly how similar stocks stack up in areas of growth, management and price...and we'll start doing so today.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Estimated future earnings per share growth	An estimate of the average annual growth rate of earnings per share for the next five years.
Estimated future sales Growth	An estimate of the average annual growth rate of sales for the next five years.
Historical earnings per share growth	The average annual growth rate of earnings per share over a given time period. This number represents the company's past performance in terms of an average growth rate.
Historical sales growth	The average annual growth rate of sales over a given time period. This number represents the company's past performance in terms of an average growth rate.
Industries	General or specific business categories that describe how companies earn their revenue.
Profit margin (pre-tax)	Profit before taxes divided by sales.

EDUCATIONAL CONTENT

Learning the BetterInvesting Stock Comparison Guide

As we noted in the Goal for this lesson, logical stock selection involves stock comparison. You should buy a stock not only because it's a good buy, but also because it's a better buy than another prospect. The BetterInvesting Stock Comparison Guide weighs up to thirty separate values for up to five different companies. It is most effective when comparing companies in the same **industry**. This is because firms in the same field will generally have commonalities that make measurements such as **pre-tax profit margin** more meaningful. Drug companies can boast profit margins of 20 percent or more; those of grocery stores rarely exceed 5 percent. An investor's homework should therefore include a review of industry averages. The SCG is divided into four sections; each one references the area of the Stock Selection Guide where the information to be input can be found. You'll be making comparisons in the broad categories of Growth, Management, Price and Other. The Growth category, for example, matches up **historic** and **future sales growth**, as well as **historic** and **future earnings per share growth**. BetterInvesting software makes data entry a snap!

LESSON FIFTEEN: The BetterInvesting Stock Comparison Guide: Part One

*There are more important things in life than a little money,
and one of them is a lot of money.*
--Anonymous

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

We began to look at the Stock Comparison Guide as part of the last lesson. We saw that it can be a terrific tool to take the bias out of our stock selection. By scoring up to thirty different attributes using information from the Stock Selection Guides that we've already completed, the "winner" becomes clearly evident. In today's lesson, we'll delve deeper into the first two sections of the Stock Comparison Guide, which match up sales and EPS growth, profit margins and return on equity—important indicators of company growth and quality of management. We'll also brush up on your presentation techniques using both the SSG and the SCG.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Data	Numbers and figures used in a study, such as the Stock Selection Guide .
Earnings per share (EPS)	A company's net income divided by the number of shares of common stock outstanding.
Percent (%) earned on Equity	Net earnings divided by total capitalization, less any debt. The bigger the return, the better.
Total Return	The return on an investment, including dividends and interest, figured over a standard period of time such as one year.

EDUCATIONAL CONTENT

The BetterInvesting Stock Comparison Guide—Part 1

The first two sections of the Stock Comparison Guide assess the more significant data—sales and **EPS** growth, profit margins and **return on equity**. Comparisons in the Growth category are straightforward. They come from the historical and estimated future projections below the graph in Section 1 of the Stock Selection Guide. The “winner” is the highest growth rate. However, bear in mind that projected growth is more important than historical growth because it is future growth that will determine stock price and therefore the all-important **total return** on your investment. In comparing Management, the SCG evaluates data from Section 2 of the SSG. Profit margins trending upward and higher than those of the competition indicate that management not only can contain costs and grow sales, but also can do it better. Higher returns on equity indicate quality management. The two sections covered in this lesson are more significant than the other two because they evaluate growth and quality—the keys to a successful investment.

How to Present New Stocks to the Club Using the SSG and SCG

Tips on presenting the Stock Selection Guide have been discussed in Lessons Eleven and Thirteen. If more than one member is making a presentation during the same meeting, the membership may have to eliminate companies based on how they stack up against each other. It may be best, therefore, to submit your SSG information in advance to the club secretary, treasurer or other designate who would prepare a Stock Comparison Guide for all the stocks being presented at that meeting. The SCGs would be handed out following the final presentation, and a large, presentation-size Guide would be displayed and discussed. Note, however, that the SCG is best when used to compare companies in the same industry.

LESSON SIXTEEN: The BetterInvesting Stock Comparison Guide: Part Two

*Money is a guarantee that we may have what we want in the future.
Though we need nothing at the moment, it insures the possibility
of satisfying a new desire when it arises.*
--Aristotle

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

One of the many benefits of being in this investment club, aside from the obvious financial rewards, is that many of us will find that we've become better public speakers. Presenting complex facts and figures to an audience of Doubting Thomases requires that we develop our powers of persuasion. But there is a downside. In some cases, club members may vote for the best presentation, not the best stock. That's why we absolutely must use the Stock Comparison Guide (SCG), which uses reason rather than emotion. In today's lesson, we'll wrap up our study of the SCG by looking at the second half of this important tool. We'll see how similar companies stack up on price and other comparisons.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Common shares Outstanding	The shares of a company that have been issued to the public.
Debentures	A bond not secured by any specific property but backed only by the general credit of the issuing company.
Dilution	The effect on earnings and book value per share when the number of shares issued by a company increases disproportionately to growth in company earnings or assets.
Options	A contract to buy or sell shares of stock at a set price and with a set deadline for the transaction.
Warrants	A certificate entitling the bearer to purchase a set number of securities at a set price during a defined

EDUCATIONAL CONTENT

The BetterInvesting Stock Comparison Guide—Part 2

The comparisons on Price encompass information from Sections 3, 4 and 5 in the Stock Selection Guide. They look at EPS, PE ratios, price zones, upside-downside ratio, yield and more. The “winner” in each area may not be as easily discernable as in the Growth category (the highest figure) and may require more intense discussion. For example, the best performer in Line (8)—Estimated Total Earnings Per Share For Next 5 Years—is not the company with the highest total earnings, but the company whose current price is closest to those earnings. The Other criteria include number of **common shares outstanding**, potential **dilution** from **debentures, warrants** and **options**, and percent of payout. There are two additional rows to add your own measures, depending on the type of companies under consideration.

Making the Comparison

What we want is the faster growing, lower risk and least expensive stock. Since these traits tend to be mutually exclusive, what we have to do is evaluate each and compromise to decide which is the best buy. Growth and consistency should come first, so the “winner” in the Growth and Management categories should merit more consideration than the best-looking stocks in the categories covered by this lesson, because we can always wait for the price to drop into the more attractive buy zone. After eliminating criteria we don’t want, we circle the winner in each row. In most cases, the company with the most circles wins. We should, however, be sure and look further into companies that do well in PE or relative value but not, as just noted, in growth and management comparisons. The reasons such companies are selling at a discount may be exactly the reasons to avoid them.

LESSON SEVENTEEN: The Challenge Tree

I don't like money, actually, but it quiets my nerves.
--Joe Louis

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

Because the Stock Comparison Guide works best when comparing companies in the same industry, we'll learn, in this lesson, how to compare such stocks when replacing one company with another.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Bear market	A market where stock prices have declined 20 percent from a recent high.
Bull market	A market in which prices have or are generally rising.
Upside-downside ratio	A measurement of risk. Divide the upside potential by the downside risk.
Zoning	Used to estimate the price ranges over which to decide whether to buy, hold or sell a stock.

EDUCATIONAL CONTENT

What is the Challenge Tree?

The Challenge Tree Kit is an offshoot of BetterInvesting's Stock Comparison Guide. Its purpose is to provide you with a proven, consistent method for analyzing your holdings and making informed decisions. Originally conceived as a game, the Challenge Tree concept helps new and low-experience investors avoid some of the pitfalls of trying to time your moves into and out of specific stocks. For the experienced investor, the Challenge Tree helps improve results.

How Does it Work?

The Challenge Tree utilizes a five-year estimate of a stock's future price range, which was introduced in Lesson Nine as **zoning**, to guide you to companies with good management that should earn more and be worth

more in the coming five years. The five-year period is chosen because it assumes that both a **bull market** and a **bear market** will occur. It steers money into companies with good management that should earn more and be stronger in the years ahead, and it aids in the selection of stocks at prices low enough to show substantial performance profit performance over five-year periods. It uses the five-year **upside-downside ratio** and quality considerations to upgrade the user's portfolio, casting off a disappointing performer.

Guidelines

The two main guidelines for Challenge Tree investing when making a purchase are:

1. A stock should be selling in the lower 1/3 of its estimated Five-Year Price Range and meet the 100 percent appreciation potential; and
2. There should be sound reasons for the stock advancing in price substantially in the next six to eighteen months.

Mistakes to Avoid

Investors commonly make two mistakes that should be avoided. First, they hold lesser-quality stocks as a bull market winds down. Only stronger companies survive the depths of a downturn that follows in the cycle. By raising quality with each Challenge Tree exercise, you increase your chances for better results. Second, investors often assume that simply because a stock has doubled in value, it cannot continue in the same direction. Superior growth companies can and do. When your current stock is growing 12 percent or more per year, it is dangerous to trade out of it. But as always, numbers alone should not dictate your decision. Become thoroughly familiar with the "challenger" company, and be sure you're up to date on the stock you've been holding; a change in management or product lineup could have accounted for its recent performance.

LESSON EIGHTEEN: The BetterInvesting Portfolio Management Guide—Part I

Beware of little expenses. A small leak will sink a great ship.
--Benjamin Franklin

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

An investor can make no mistake more serious than assuming that the stock purchased yesterday is the same stock owned today. Knowing what to buy is hard enough, but even more difficult is knowing when to sell or hold. Fortunately, BetterInvesting is there for us with the Portfolio Management Guide. With it, we can remain up to date on important factors like quarterly earnings and P/E ratios. We can also compare these present values to the projections we made for the company in our Stock Selection Guide. In this lesson, we'll learn how to complete the front of the form, which consists of three sections and some new terminology: Price-Earnings Ratio Zones, Price Zones, and Cumulative Earnings and Current Price-Earnings Ratio Computations. But you can relax: it takes about as long to describe the tool as it does to fill it out. Are you ready to discover the fundamentals of portfolio management?

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Cumulative earnings	Section 3 of BetterInvesting's Portfolio Management Guide. Actual earnings, not annualized, over a period of time.
Price earnings zones	Section 1 of BetterInvesting's Portfolio Management Guide, indicating high and low P/E guidelines, which should be considered with existing market and economic conditions.
Price zones	Section 2 of BetterInvesting's Portfolio Management Guide. The computed range signals buy or sell prices for the analyzed security.

EDUCATIONAL CONTENT

The BetterInvesting Portfolio Management Guide—Side 1

The Portfolio Management Guide uses information you've previously entered into the Stock Selection Guide and enables you to keep current on quarterly earnings and monthly price and price-earnings ratios. The PMG uses two criteria: current price compared to the projected price range you've set for it, and the price-earnings ratio compared to the pattern for the last five years. The front of the PMG consists of three sections: **price earnings zones**, **price zones** and **cumulative earnings** and current P/E ratio computations. Sections 1 and 2 establish buy, hold and sell guidelines (zones), while Section 3 accumulates quarterly earnings, price and P/E data. This last section provides an early warning signal of a potential downturn in company fortunes. If a slump seems inevitable and likely to be lengthy, the club must consider whether to hold or sell. The PMG is there to help.

LESSON NINETEEN: The BetterInvesting Portfolio Management Guide: Part II

The entire essence of America is the hope to first make money—then make money with money—then make lots of money with lots of money.

--Paul Erdman

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

We've learned that it's a lot of work to buy stocks. The problem is, there's a tendency to concentrate on those new purchase decisions and take the existing portfolio for granted. Big mistake. Think of it this way: when we started, each of our monthly contributions was a large part of our holdings. A \$50 monthly contribution is ten percent of a \$500 portfolio. If that portfolio has grown to \$5000, that \$50 is just one percent. Shouldn't the other 99 percent of your portfolio merit more attention? That's why maintaining the Portfolio Management Guide is so important. Today, we'll complete our study of the Guide by plotting the chart on side 2. It will help us decide whether a stock at its present price and price-earnings ratio represents a buy, sell or hold situation. Remember again that holding a stock must be an active decision on our part, not a result of our inaction.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Price earnings zones	Section 1 of BetterInvesting's Portfolio Management Guide, indicating high and low P/E guidelines, which should be considered with existing market and economic conditions.
Price zones	Section 2 of BetterInvesting's Portfolio Management Guide. The computed range on BetterInvesting tools that signals buy or sell prices for the analyzed security.
Trend	A general course or movement of prices or rates.

EDUCATIONAL CONTENT

The BetterInvesting Portfolio Management Guide—Side 2

The report is updated and reviewed monthly to visually see when both the price and the P/E are in the buy, hold or sell ranges. When a stock reaches the sell range, an updated Stock Selection Guide should be done. One caution should be followed in the maintenance of your PMG, which has to do with P/E ratios. Due to the fact that you're keeping track over a five-year period, you may find that its current P/E is out of sync with the **trend** of the rest of the market, or at least its own industry. Recognize where the stock is in the current range to forecast where it's headed. If it's near the top of the range, a change in the trend may be near and the next five years may see lower trends. Also pay close attention that your quarterly earnings data reflects such things as stock splits and dividends.

LESSON TWENTY: BetterInvesting Tools--Painting the Complete Picture, Part I

*The two most beautiful words in the English language are "Check enclosed."
--Dorothy Parker*

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

Today's lesson goal is simple: we'll review, summarize and clarify anything we're still fuzzy about. The best way to do that is to pick up and review some of the tools we've all come to know and love: the Stock Check List, the Stock Selection Guide, the Stock Comparison Guide and the good old Portfolio Management Guide. As we do, we'll undoubtedly become reacquainted with the financial terms listed below.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Cumulative earnings	Section 3 of BetterInvesting's Portfolio Management Guide. Actual earnings, not annualized, over a period of time.
Dilution	The effect on earnings and book value per share when number of shares issued by a company increases disproportionately to growth in company earnings or assets.
Earnings per share (EPS)	A company's net income divided by the number of shares of common stock outstanding.
Equity	An ownership interest held by shareholders in a corporation.
Estimated future earnings per share growth	An estimate of the average annual growth rate of earnings per share for the next five years.
Estimated future sales growth	An estimate of the average annual growth rate of sales for the next five years.
Historical earnings per share growth	The average annual growth rate of earnings per share over a given time period. This number represents the company's past performance in terms of an average growth rate.
Historical sales growth	The average annual growth rate of sales over a given time period. This number represents the company's past performance in terms

	of an average growth rate.
Past sales record	Section 1 of BetterInvesting's Stock Check List. Shows sales figures of recent years, increase in sales and compound annual rate of sales growth.
Percent (%) earned on equity	Net earnings divided by total capitalization, less any debt. The bigger the return, the better.
Price earnings ratio (P/E)	The market price of a security divided by the earnings per share. Used to determine if a stock represents value at a given price.
Price earnings zones	Section 1 of BetterInvesting's Portfolio Management Guide, indicating high and low P/E guidelines, which should be considered with existing market and economic conditions.
Price record	Section 3 of the BetterInvesting Stock Check List. High and low stock prices, earnings per share and price earnings ratios for the most recent five-year period are used to project future high and low price earnings ratios.
Price target	A projected price to execute a securities transaction.
Price zones	Section 2 of BetterInvesting's Portfolio Management Guide. The computed range on BetterInvesting tools that signals buy or sell prices for the analyzed security.
Price-earnings history	As computed in Section 3 of the Stock Selection Guide, it shows the high and low prices of the company's stock in a specific year, relative to the EPS for that year.
Profit margin (pre-tax)	Profit before taxes divided by sales.
Upside-downside ratio	A measurement of risk. Divide the upside potential by the downside risk.
Volatility	The penchant for a company to experience wide price fluctuations.
Zoning	Section 4 (C) of BetterInvesting's Stock Selection Guide, used to estimate the price ranges over which to decide whether to buy, hold or sell a stock.

BetterInvesting INVESTMENT ANALYSIS TOOLS

TOOL	DESCRIPTION
Stock Check List (SCL)	This tool helps the new investor review the basic financial information of a stock and form an opinion of its current value. It serves as an introduction to the Stock Selection Guide.
Stock Selection Guide (SSG)	BetterInvesting 's most popular guide to stock analysis. It is designed to help you review the financial history and record of a particular stock and, using your judgment, make an informed investment decision.
Stock Comparison Guide (SCG)	This guide helps you make an intelligent comparison of several stocks, such as similar stocks within the same industry. It is designed to aid in the selection of the best potential investment.
Portfolio Management Guide (PMG)	Once you have purchased a stock, follow its sales and earnings record by plotting and graphing stock data over time. The PMG helps you make buy and sell decisions for each stock in your portfolio.

Note: BetterInvesting provides online tools that allow you to complete your investment analysis.

LESSON TWENTY-ONE: BetterInvesting Tools--Painting the Complete Picture, Part II

*The surest way to establish your credit is to work yourself
into the position of not needing any.*

--Maurice Switzer

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

As we did last time, we'll devote today's lesson to reviewing BetterInvesting's invaluable tools. We'll include those discussed in the last lesson—The Stock Check List, Stock Selection Guide, Stock Comparison Guide and Portfolio Management Guide—and add the Portfolio Evaluation Review Technique and Challenge Tree. As we do, we'll also become reacquainted with the financial terms listed below. In the coming lessons we'll be moving on to other tools and services that BetterInvesting offers, so let's try today to clear up any misunderstandings or uncertainties. Together we can make it happen.

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Capitalization	The total value, as stated in a company's books, of bonds, preferred and common stock and retained earnings.
Dividend per share	The total dividend paid divided by the number of shares of common stock outstanding.
Payout	Percentage of earnings distributed to shareholders as dividends. Payout may be calculated by dividing the dividend per share by earnings per share.
Pre-tax profit on sales	Net earnings or income before taxes.
Total Return	The return on an investment, including dividends and interest, figured over a standard period of time such as one year.
Yield	The per-share cash dividend divided by the per-share market price of a stock or fund. Also called dividend yield.

BetterInvesting INVESTMENT ANALYSIS TOOLS

TOOL	DESCRIPTION
Stock Check List (SCL)	This tool helps the new investor review the basic financial information of a stock and form an opinion of its current value. It serves as an introduction to the Stock Selection Guide.
Stock Selection Guide (SSG)	BetterInvesting 's most popular guide to stock analysis. It is designed to help you review the financial history and record of a particular stock and, using your judgment, make an informed investment decision.
Stock Comparison Guide (SCG)	This guide helps you make an intelligent comparison of several stocks, such as similar stocks within the same industry. It is designed to aid in the selection of the best potential investment.
Portfolio Management Guide (PMG)	Once you have purchased a stock, follow its sales and earnings record by plotting and graphing stock data over time. The PMG helps you make buy and sell decisions for each stock in your portfolio.
Portfolio Evaluation Review Technique (PERT)	With PERT and PERT Worksheets A and B, investors can follow the monthly progress of all stocks in their portfolio. Track sales, earnings, stock price and more—an essential record of all your securities and portfolio performance.
Challenge Tree Kit (CTK)	This kit and set of tools allows the experienced investor to determine whether or not to continue holding a stock or to replace it with one appearing to have greater potential.

Note: BetterInvesting provides online tools that allow you to complete your of the investment analysis.

LESSON TWENTY-TWO:

Important BetterInvesting Tools For Your Club

*Another advantage of being rich
is that all your faults are called eccentricities.*
--Anonymous

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

As a pioneer of modern investment clubs in the United States, BetterInvesting has helped millions of people start and operate profitable clubs. We've devoted our lessons in the past to learning BetterInvesting's investment analysis tools, because of their obvious importance. Today, we turn our attention to the multimedia and multi-faceted collection of tools that are available to us through BetterInvesting. From educational books, and guides...to online stock selection tools, portfolio management and screening tools... ..to even more tools like the Portfolio Evaluation Review Technique. Each of these is the best of its kind, and will prove indispensable to our investing expertise as individuals and as a club. In this lesson, we also highlight the services available to us as a club and as individuals. BetterInvesting provides local support and education through 69 Regional Chapters across the country. Chapters offer programs, seminars, workshops and events for all levels of investors. BetterInvesting online resources and the BetterInvesting Web Site present a wealth of educational content, study tools, articles, even software demos and downloads. Don't miss out on any of them!

BetterInvesting

EDUCATIONAL TOOLS FOR BETTER INVESTING

BetterInvesting offers a variety of online stock selection tools, educational products and services designed to help individuals and investment clubs build investment knowledge and skill.

For a complete list and description of BetterInvesting online tools and educational resources visit www.betterinvesting.org

LESSON TWENTY-THREE: Weeding and Feeding Your Club Portfolio

A fool and her money are soon courted.
--Helen Rowland

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

The name of this lesson is so very appropriate: “Weeding and Feeding” is just what our club portfolio needs after almost two years of operation. Today, we’ll discuss how best to evaluate our portfolio, appraise the results we’ve achieved so far, and make decisions that will, as the old song goes, “accentuate the positive and eliminate the negative.”

FINANCIAL TERMS IN THIS LESSON

TERM	DEFINITION
Asset allocation	Dividing your portfolio among various investment categories.
Diversification	The practice of spreading investments among a range of different securities to reduce risk.
Industries	General or specific business categories that describe how companies earn their revenue.
Large cap	A company with over \$5 billion capitalization.
Mid cap	A company with capitalization of from \$1 billion to \$5 billion.
Sector analysis	Collecting data on a group of securities representing the same investment category or industry.
Small cap	A company with capitalization of from \$250 million to \$1 billion.

EDUCATIONAL CONTENT

Evaluating Our Portfolio

For almost two years, our club members have been educating themselves on how to select stocks for which bright futures seem reasonably certain. But as Albert Einstein educated us all, time is relative. One stock's bright future could come next week; another's five years from now; another's not at all (remember the Rule of Five!). In short, buy and hold doesn't mean buy and forget--it means buy and watch. That goes for the portfolio as a whole. Our primary objective is to buy quality growth stocks at attractive prices. These should be **diversified** by size (**large-cap, mid-cap and small-cap** stocks) and by **industry**, with appropriate **sector analysis**. In other words, faithfully executing **diversification**.

When to Sell a Stock

There's a good reason it's called "playing" the stock market: as in any sport, a strong defense can often more than make up for a sagging offense. In our case, that means protecting ourselves from losses. We do so by watching the signs. Some of them, such as slowing growth, increasing debt or declining profit margins, will show up on our Stock Selection Guide or PERT reports. Other signals, such as management changes or industry-wide problems, require keeping a close eye on the news. Another way to identify a stock on the wane is by looking for the opposite of the reasons we buy. When the PE is significantly higher than the stock's five-year average, when the upside-downside ratio is below 1, when projected total returns drop below our expectations, that's when the hammer must fall. Speaking of "when," timing in the market is a fool's game, but there are tactics nevertheless that can help us avoid the traps of waiting too long to sell and selling too soon. BetterInvesting's many portfolio management tools will prove their worth time and time again.

Building Our Portfolio

As we weed our portfolio, we'll be simultaneously feeding it. That's the offensive end of our game plan. It is, however, the more difficult of the two strategies. After all, it's easy to cast off a stock that unfortunately tanked. How to replace it with one that'll skyrocket as soon as our buy order's been executed? BetterInvesting tools and services can't guarantee any such performance, but by using them to the best of their—and our—abilities, trading poor performance for potential rewards becomes easier and more profitable in the long term.

LESSON TWENTY-FOUR: Keeping the Interest High In Your Club!

*It requires a great deal of boldness and a great deal of caution
to make a great fortune, and when you have got it,
it requires ten times as much wit to keep it.*

--Ralph Waldo Emerson

GOALS: WHAT WILL WE LEARN IN THIS LESSON?

Well, here we are, two years later. It's been an interesting journey, to say the least. In our last lesson, we discussed the necessity of evaluating our club portfolio. Now that that's done, what's next? What changes do we need to make? And while we're at it, shouldn't we now evaluate the club as a whole? Let's ask ourselves if we're doing all we should be at this stage. Are we fulfilling the educational, social and investment goals we set for ourselves? Should we consider revising any of the duties and responsibilities of members? One thing's for sure: if we use all we've learned and experienced during the last two years, the next two could be extraordinarily fulfilling for each of us!

EDUCATIONAL CONTENT

Social Aspects of the Club

The social aspects are, we all agree, a good part of why we came together. In evaluating where we stand today, we have to ask ourselves whether we're still on the course we first charted. Is our people portfolio doing as well as our stock portfolio? Are there prospective members who really want in, while some current members have become dead wood? Are we still agreed on a similar investment philosophy, or have our meetings been reduced to non-productive bickering? Have meeting times and places proved to be convenient? Most of all: are we having fun yet?

Rotation of Club Duties and Responsibilities

Club officers ran and were elected on the basis (as written in our Operating Procedures) that their terms would eventually end. If we've been counting too long on the patience of our president...if the education chairperson has run out of field trip ideas...if the treasurer is counting valuation units in her sleep...then our engine's overdue for a tune-up. Each member is obliged to be in charge of something, and by now confidence should be running high and fear no longer a factor. But before we deal with personnel, we should examine whether each job function has proven to be correctly aligned with its job title. Does one of our officers need an assistant and should it be amended into the Operating Agreement as a permanent office? Should we form standing committees to carry out certain tasks such as planning the annual meeting? Have we gone along without a Computer Contact and now find that we need one? This is the time to, pardon the pun, take stock of ourselves and make sure we're good to go for another year...and beyond.

Continuing the Club's Educational Program

The Educational Contact is a particularly pivotal post, as the person who holds it must not only be right on top of the market news, but must also be able to bring it to the club in an ever-changing way. Training club members on the use of BetterInvesting materials and tools is essential to the survival of the club. *BetterInvesting* magazine is a good source of educational programs. Pick a specific topic and research it using BetterInvesting's website. Planning trips, youth education programs and other activities makes the club even more rewarding. This is not, as so often the case, one of those thankless jobs; the benefits of enjoyment and education will pay off for all of us as our club becomes better, stronger and—yes—richer, in so many ways.

Continuing the Journey:

Your Investment Club Two Years and Beyond

HOLD A PARTY WITH SPOUSES AND FAMILY TO CONGRATULATE YOUR CLUB ON ITS SECOND SUCCESSFUL YEAR!

Discuss the accomplishments of the club in its second year

Ask members to think about the challenges the club has had during its second year

What resources does the club need to continue to succeed?

What education do club members need?

Does the club want to include new members?

Outline a 1-2 year future plan:

- Set goals for the club's educational program

- Set goals for the club's portfolio

- Define accomplishments to be met

- Review the club's Operating Agreement and Partnership Agreement

- Consider starting other clubs in your community

- Consider taking club field trips to a local brokerage firm, stock exchange or companies of potential investment interest

- Define other considerations for the club

- Continue to explore BetterInvesting Chapter programs and events

**CONGRATULATIONS ON
YOUR CLUB'S
CONTINUING SUCCESS!**