Mastering Stock Market Investing

From Macro Analysis to Portfolio Management and Risk Mitigation

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Company Number 547242

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1. Introduction

Welcome to the exciting world of stock market investing! Whether you're a novice looking to build a strong financial foundation or an experienced investor seeking to enhance your skills, this comprehensive Stock Market Investing Course is designed to empower you with the knowledge and strategies needed to navigate the dynamic landscape of financial markets.

Investing in the stock market offers unparalleled opportunities for wealth creation, but it also comes with its challenges and complexities. This course is crafted to demystify the intricacies of stock market investing, providing you with a solid understanding of fundamental concepts, risk management techniques, and proven strategies employed by successful investors.

Our goal is to empower you to make informed and strategic investment decisions, equipping you with the skills to navigate market fluctuations and capitalize on opportunities. Whether you aspire to grow your wealth for retirement, fund education, or achieve financial freedom, this course will provide you with the tools and confidence to embark on your investment journey.

Get ready to embark on an enriching learning experience that will not only enhance your financial literacy but also pave the way for a successful and rewarding future in stock market investing. Let's dive in and unlock the potential of your financial future together!

What You'll Get From This Course

Throughout this course, we will explore key topics via text and video links such as:

1. ‘Traders’ Vs ‘Investors’ and Investor Profiling
2. Stock Market Basics
3. ‘High Level’ drivers of stock prices
4. Basic Stock Market Metrics
5. How to Analyze a company and get access to free historical data
6. How to estimate the future value a Stock
7. Portfolio Construction & Risk Management

You will gain insights into different investment styles, learn how to evaluate companies, and discover the art of building a diversified portfolio tailored to your financial goals and risk tolerance.

2. Traders Vs Investors

Here's a breakdown of the key differences between traders and investors in the stock market:

2.1. Traders

- **Time Horizon:** Traders have a shorter time horizon, often ranging from minutes to a few months. They aim to capitalize on short-term market fluctuations and price movements.
- **Goal:** The primary goal of traders is to profit from market volatility. They may use various strategies such as day trading, swing trading, or momentum trading to take advantage of short-term price movements.
- **Frequency of Transactions:** Traders execute frequent transactions, buying and selling stocks or other financial instruments within a relatively short period. They closely monitor market trends, news, and technical indicators.
- **Risk Tolerance:** Traders generally have a higher risk tolerance as they engage in more speculative and short-term strategies. They are prepared to accept higher levels of risk in pursuit of quick gains.
- **Analysis Tools:** Traders rely heavily on technical analysis, charts, and indicators to make decisions. They often use quantitative tools and algorithms to identify entry and exit points.

2.2. Investors

- **Time Horizon:** Investors have a longer time horizon, typically measured in years or even decades. They focus on the long-term growth of their investment portfolio.
- **Goal:** The primary goal of investors is to build wealth over time through the appreciation of their investments, dividends, and compound interest. They are less concerned with short-term market fluctuations.
- **Frequency of Transactions:** Investors execute fewer transactions compared to traders. They tend to buy and hold assets for the long term, believing in the fundamental strength of the companies they invest in.
- **Risk Tolerance:** Investors usually have a more conservative risk tolerance. They are willing to endure short-term market volatility with the expectation that their investments will grow over time.

- **Analysis Tools:** Investors rely on fundamental analysis, studying the financial health, earnings, and growth potential of a company. They may also consider macroeconomic factors and industry trends.

In summary, while both traders and investors participate in the stock market, their approaches, goals, and time horizons differ significantly. Traders seek short-term gains through active market participation, while investors focus on long-term wealth accumulation by holding onto their investments through market ups and downs.

This course is skewed towards ‘investors’ and not ‘traders’. However, traders should still understand the fundamental drivers of the stock market. We would also recommend that traders consider indices, etf’s, currencies, futures and options as opposed to trading individual stocks. Our mentoring service provides daily market trading opportunities and insights. Click Here to book a free mentoring session.

2.3. Investor Profiling

The most important step when investing in the stock market is to assess your appetite for risk and reward. This is the process of you 'self assessing' your appetite for risk, reward and balancing this with your investment objectives and your current level of wealth.

Identifying your Investor Profile now will help you focus your energy towards stocks that are aligned with your tolerance for risk and reward. This process will save you time, effort and money! There is no point in you investing in high risk growth stocks if you have a low tolerance for risk. Also, there is no point in you investing in mature cash cows that pay dividends if you are a high risk investor looking for the next Tesla or Amazon.

We have prepared an **investor profile questionnaire** that will take less than 5 minutes to complete. When completed you will receive a personalised investor profile report within 1 business day. This report will outline the type of stocks and investments that you should be looking for.

Bonus: We will also provide you with a rate of return calculation for your investment goals. So, make sure you answer the last question if you want this in the report. **Click Here** to take the Investor Profile Questionnaire.

3. Stock Market Basics

3.1. Why should I Invest in the Stock Market?

- **Historical Returns** - The stock market is the best performing asset class by far. Over the past 100 years the average annual return of the S&P 500 stock market index has been 10.7% per annum!
- **No Large Lump Sum Required** - Unlike other investments you do not require a large amount of money to get started. You can start from as little as €10.
- **Cost effective Online Brokers** - Online brokers have revolutionized how people invest in the stock market. Now you can invest from a computer, a tablet and even your mobile phone! And the best part....the trading commissions are a fraction of what banks and traditional stock brokers charge.
- **Easy Liquidation** - You can sell stocks in a matter of seconds turning your assets into cash quickly.
- **It's easy to do!** - Investing in stocks is not rocket science ...in fact it's quite easy. All you need to do is follow a simple 'step by step' process for building a suitable investment portfolio for you.

3.2. Who are the key players in the stock market?

The stock market is a complex and dynamic environment with numerous participants, but some key players and entities include:

1. **Investors:** These are individuals or institutions that buy and sell stocks in the market. They can range from small retail investors to large institutional investors like mutual funds, pension funds, and hedge funds.
2. **Stock Exchanges:** These are the platforms where stocks are bought and sold. In the United States, the major stock exchanges include the New York Stock Exchange (NYSE) and the Nasdaq Stock Market. Each country often has its own primary stock exchange.
3. **Brokers:** Brokerage firms act as intermediaries between investors and the stock exchanges. They execute trades on behalf of their clients and provide various services, such as research and investment advice.
4. **Market Makers:** Market makers are financial institutions or individuals that facilitate trading by providing liquidity. They do this by constantly quoting bid and ask prices for specific stocks, ensuring that there's always a market for them.
5. **Regulators:** Government agencies like the Securities and Exchange Commission (SEC) in the United States oversee and regulate the stock market to ensure fairness, transparency, and investor protection.

6. **Listed Companies:** These are businesses that have issued their stocks for public trading on stock exchanges. Shareholders in these companies include both institutional investors and individual investors.
7. **Analysts:** Financial analysts and research firms provide information and analysis on stocks and the overall market. Their reports and recommendations can influence investor decisions.
8. **High-Frequency Traders (HFTs):** HFTs are traders who use computer algorithms to execute large numbers of trades in milliseconds. They often profit from tiny price differences and provide liquidity to the market.
9. **Central Banks:** Central banks can influence the stock market indirectly through monetary policy decisions that affect interest rates and the overall economy.
10. **Media:** Financial news outlets and social media platforms play a significant role in disseminating information about the stock market. News and rumors can impact investor sentiment and stock prices.
11. **Options and Futures Traders:** These traders use derivative instruments like options and futures contracts to speculate or hedge their positions in the stock market.
12. **Day Traders and Retail Investors:** Individual investors who actively buy and sell stocks in the short term, often trying to profit from price fluctuations. The rise of online trading platforms has made it easier for retail investors to participate in the stock market.

It's important to note that the stock market is a complex ecosystem, and the influence and roles of these players can change over time. Additionally, global financial markets may have different participants and dynamics depending on the region and market structure.

3.3. How does a company get listed on a stock exchange?

Getting listed on a stock exchange is like a company taking a big step to become a part of the larger financial world. Let's break down the process in simple terms:

- **Company Readiness:** A company needs to be in good financial shape and meet certain requirements to be considered for listing. These requirements often include having a solid financial track record, a minimum number of shareholders, and meeting specific accounting standards.
- **Choosing the Stock Exchange:** The company decides which stock exchange it wants to be listed on. Different exchanges have different rules and regulations,

and companies usually choose the one that aligns best with their goals and business model.

- **Hire Advisors:** The company typically hires financial advisors, like investment banks or underwriters, to guide them through the listing process. These advisors help the company navigate the regulatory requirements and prepare for the listing.
- **Due Diligence:** Before listing, the company undergoes a thorough examination called due diligence. This involves a detailed review of the company's financial health, operations, and management to ensure that all information presented to potential investors is accurate.
- **IPO (Initial Public Offering):** The most common way for a company to get listed is through an Initial Public Offering (IPO). In an IPO, the company issues new shares of stock to the public for the first time. This is like a company's "debut" on the stock market.
- **SEC (or Relevant Regulatory Authority) Approval:** In many countries, including the United States, the Securities and Exchange Commission (SEC) or a similar regulatory authority reviews the company's documents and financial information to ensure compliance with disclosure requirements. Once approved, the company can move forward with its IPO.
- **Setting the IPO Price:** The company, with the help of its financial advisors, determines the initial price at which its shares will be offered to the public. This is often based on the company's valuation, financial performance, and market conditions.
- **Going Public:** On the day of the IPO, the company's shares become available for purchase by the public on the chosen stock exchange. Investors can buy these shares through their brokerage accounts.
- **Post-Listing Requirements:** After listing, the company must continue to meet the ongoing requirements of the stock exchange, including regular financial reporting and compliance with listing standards.

Getting listed on a stock exchange is a significant milestone for a company. It opens up new avenues for raising capital, enhances visibility, and allows the public to become shareholders in the company. While the process involves careful planning and

adherence to regulations, it ultimately provides the company with opportunities for growth and expansion.

3.4. Test Your knowledge - Quiz 1

Click Here and take the test your knowledge quiz. You will get instant feedback on your knowledge.

4. Macro 'High Level' Drivers of Stock Prices

4.1. Supply and Demand

It might sound very simplistic but it is true, the price of a stock boils down to the laws of supply and demand. Put simply, if the volume of buy orders (Demand) is greater than the volume of sell orders (Supply), share prices will rise. Conversely, if the volume of sell orders (Supply) is greater than the volume of buy orders (Demand), share prices will fall.

Supply and demand play a fundamental role in determining the prices of stocks in the stock market. The interaction of supply and demand for a particular stock or the overall market influences its price. Here's how it works:

1. Supply of Stocks: The supply of stocks represents the number of shares of a particular company's stock that are available for sale in the market. These shares come from various sources, including the company itself (through IPOs or additional stock issuances) and existing shareholders (such as insiders, institutional investors, and retail investors) who decide to sell their shares.

2. Demand for Stocks: The demand for stocks represents the interest and willingness of investors to buy shares of a particular company. Demand is influenced by factors such as investor sentiment, economic conditions, company performance, news, and market trends.

3. Price Determination: Stock prices are determined by the equilibrium between supply and demand. When demand exceeds supply (i.e., more people want to buy the stock than there are shares available for sale), the price tends to rise. Conversely, when supply exceeds demand (i.e., more people want to sell the stock than there are buyers), the price tends to fall.

4. Market Orders and Limit Orders: Investors place market orders or limit orders to buy or sell stocks. Market orders are executed at the current market price, while limit orders specify a specific price at which the investor is willing to buy or sell. These orders interact with the supply and demand dynamics to determine the actual transaction price.

5. Liquidity and Bid-Ask Spread: The spread between the highest price a buyer is willing to pay (the "bid" price) and the lowest price a seller is willing to accept (the "ask" price) reflects the current supply and demand for a stock. A narrow spread indicates high liquidity and a more efficient market, while a wide spread suggests lower liquidity and potentially less trading activity.

6. News and Events: External factors like corporate earnings reports, economic data releases, geopolitical events, and news related to a specific company can significantly influence supply and demand for a stock. Positive news may increase demand, while negative news may increase supply.

7. Market Sentiment: Investor sentiment, which is influenced by emotions, market psychology, and perceived risk, can impact demand for stocks. Bullish sentiment tends to drive prices up, while bearish sentiment can lead to selling pressure.

8. Institutional Influence: Institutional investors, such as mutual funds, hedge funds, and pension funds, often manage large portfolios. Their buying or selling decisions can have a significant impact on supply and demand for specific stocks.

In summary, the stock market is a marketplace where supply and demand interact to determine stock prices. Various factors, including economic conditions, company performance, investor sentiment, and external events, influence the balance between supply and demand, which in turn affects stock prices. Traders and investors analyze these dynamics to make informed decisions about buying and selling stocks.

4.2. Fund Managers and Share Prices

Who can buy and sell stocks in large volumes? Fund Managers! They control massive amounts of money. If they decide to start selling stocks en masse, share prices will fall. If they decide to start buying stocks in mass then share prices will rise.

Fund managers get paid to deliver returns to investors and they get paid pretty hefty bonuses to outperform the broader market index. Therefore, a fund manager will move their money around in order to maximize the potential of the fund.

The performance of other asset classes will be a determining factor in deciding where a fund manager invests. Put yourself in the shoes of a Fund Manager. Just ask yourself

one simple question, where can I get a return on investment that satisfies my investment goals with the least risk?

4.3. Economics, Government Bonds and Interest Rates

A Government Bond is basically a loan that you give to the government. The Government takes your money and they use it to build roads, pay public sector salaries etc…. In return you get an interest rate (also knows as the coupon) every year. Bonds can be offered over different time frames e.g. 3 year, 5 year, 10 year and 30 year. At the end of the agreed timeframe you get your initial loan amount back.

In established economies like the US and German economies, government bonds are considered **'Risk Free'**. In other words, there is no chance that the government will default on paying you back.

A Government Bond is considered by many investors to be very attractive because of its zero risk profile (in the majority of cases).

What does this mean for stocks?

Government bonds and interest rates can have a significant impact on stock prices. The relationship between these factors is complex and can vary based on several factors, including the economic environment and investor sentiment. Here's how government bonds and interest rates can influence stock prices:

1. **Interest Rates and Bond Yields:** When central banks raise interest rates, it typically leads to an increase in yields on government bonds and other fixed-income securities. As bond yields rise, they become more attractive to investors seeking a safe and predictable income stream.
2. **Alternative Investment Options:**Investors often compare the potential returns from stocks to those from bonds and other fixed-income investments. When interest rates are low, as is often the case during periods of monetary easing, bonds may offer relatively lower yields. In such situations, stocks may become more attractive to investors seeking higher returns.
3. **Discounted Cash Flow (DCF) Analysis:** Stock prices are often determined by estimating the present value of future cash flows generated by the company.

Higher interest rates can increase the discount rate used in DCF models, reducing the present value of those future cash flows. This can put downward pressure on stock prices.

4. **Borrowing Costs for Companies:** When interest rates rise, the cost of borrowing for companies may increase. Higher borrowing costs can reduce corporate profits, which can lead to lower stock prices if investors anticipate reduced earnings growth.
5. **Consumer and Business Spending:** Interest rates can influence consumer and business borrowing costs. When rates are low, consumers may be more inclined to borrow and spend, which can boost corporate earnings and support higher stock prices. Conversely, rising interest rates can discourage borrowing and spending.
6. **Inflation Expectations:** Rising interest rates can be a response to expectations of higher inflation. Investors may adjust their portfolios in response to inflation concerns. Stocks of companies with pricing power or those in sectors that can benefit from inflation, such as commodities, may see increased demand during inflationary periods.
7. **Market Sentiment:** Market sentiment and perception play a crucial role. Sometimes, investors interpret rate hikes as a sign of a strong economy, which can bolster confidence and lead to higher stock prices. In other cases, rate hikes may be seen as a response to inflationary pressures, causing concerns and stock market declines.
8. **Duration Sensitivity:** The sensitivity of different stocks to interest rate changes can vary based on factors like the company's debt level, growth prospects, and industry. Stocks with longer durations (higher sensitivity to interest rate changes) may see more significant price fluctuations when interest rates change.

It's essential to remember that the relationship between government bonds, interest rates, and stock prices is not always linear or predictable. It depends on a variety of factors and can vary over different economic and market cycles. Investors and analysts closely monitor interest rate trends and their potential impact on both bonds and stocks when making investment decisions. Additionally, market reactions to interest rate changes can vary, as they are influenced by investor sentiment and expectations.

Let's look at 3 scenarios as examples:

- **Scenario 1:** 10 year US Bond is paying an annual interest rate of 2%. Would that be attractive enough? Given that we know that on average the stock market returns about 10% per annum and pays an annual dividend of 2%, I would say not. Investors will most likely choose stocks over the low interest Government bonds. Effect on stock prices of Low Interest Rates: Usually Higher Stock Prices
- **Scenario 2:** 10 year US Bond is paying an annual interest rate of 5%. Would that make Government Bonds more attractive than stocks? Now there is a choice. In a nutshell yes, at the very least a Fund Manager would start rotating out of stocks into the safer government bond. Effect on stock prices: Falling stock prices.
- **Scenario 3:** 10 year US Bond is paying an annual interest rate of 8%. Would that be attractive enough? Absolutely. Stocks would be sold heavily by the fund managers in order to purchase the attractive government bond. Effect on stock prices: Heavy falls

This is why you should keep an eye on US, German and UK Government Bonds. All yields are low now (2019) which is why stocks are at record highs. But keep an eye out when they start rising, whilst the economy will be doing well fund managers will start looking at rotating into safer assets like the government bonds.

This poses another question, what factors affect bond yields? Let's talk about the economic environment.

4.4. Macroeconomics, Interest Rates & Stock Prices

Most economies go from one extreme to another...Boom to Bust. The stock market reacts in different ways than you might think during the economic swings. In fact, the **best time to invest** in the stock market is during the **late stage of a recession**.

Recession: As we mentioned before the best possible time to invest in the stock market is during a recession. Here are a couple of explanations as to why:

Investors tend to be focused on the future profit growth potential for companies. In fact, studies have shown that stock prices typically reflect investor expectations for economic growth by 6-9 months into the future. This usually means that the recession is fully priced into stocks which creates value. Supply is usually at its peak.

Further to this savvy investors are starting to buy back into this
value in the anticipation that brighter days are ahead and recovery is on the way. Also, dividend yields from companies are typically higher because share prices have fallen making stocks attractive to large institutional investors. Demand starts to increase from a very low base.

Interest rates are usually falling at this point as central banks try to stimulate their economies by weakening their currency and making credit cheaper to access. This means that Bond Yields are also falling which results in demand falling for Bonds. The money moving out of Bonds starts moving into stocks thus increasing demand again.

The most recent example of this was in March 2009. The S&P 500 stock market index reached its bottom. By October 2009 it was up 60%. But most global economies were officially in full recession. The chart below illustrates the rise very well.

Recovery: The opposite tends to be through for the peak of economic recovery:

Stock prices have usually risen very quickly making value hard to find. Demand is usually at its peak. As investors start to consider a downturn in economic activity into the future demand for stocks starts to weaken and supply starts to rise.

Dividend Yields get lower as share prices have risen. This makes it unattractive for institutional investors to invest fresh money into the stock market. Demand starts to fall.

Interest Rates are usually rising as central banks try to cool their economies and manage inflation (price rises for goods and services). This makes Government Bonds attractive again and causes institutional investors to rotate their money out of stocks into safer government bonds.

A great example of the relationship between Government Bonds and stocks is in the chart below. The blue line represents the returns on the 10 year US government bond and the candles represent the returns on the stock market index. You can clearly see the inverse relationship between bond yields and stock prices.

Important Note: As this course was written in 2014-2021, interest rates and quantitative easing by central banks are at unprecedented levels. After the crash of 2007-2008 the real risk was that the entire financial system would collapse. Central Banks went into fire fighting mode trying to stop the collapse. Then we had the Covid 19 epidemic which has led to even greater leniency from central banks. What we have experienced with low interest rates was unprecedented and not normal!

Update 2023: From 2022 onwards Central Banks started to raise rates again in the fight against inflation.

4.5. Economic & Stock Prices

Several economic data points and indicators can significantly impact stock prices because they provide insights into the overall health of the economy, corporate profitability, and market sentiment. Here are some key economic data releases that can influence stock prices:

1. **Gross Domestic Product (GDP):** GDP measures the total economic output of a country. A strong GDP growth rate can be seen as a positive sign for the economy and may boost investor confidence. Conversely, weak or negative GDP growth can lead to concerns about a recession.
2. **Employment Reports:** Employment data, including non-farm payroll numbers and the unemployment rate, provide insights into the labor market's health. Low unemployment and strong job creation can be bullish for stocks, as it indicates consumer spending power.
3. **Inflation Reports:** Measures of inflation, such as the Consumer Price Index (CPI) and the Producer Price Index (PPI), can influence stock prices. High inflation can erode purchasing power and lead to higher interest rates, which may negatively impact stocks.
4. **Interest Rates:** Decisions by central banks regarding interest rates, such as the Federal Reserve's Federal Funds Rate in the United States, can significantly affect stock prices. Lower interest rates can make equities more attractive than fixed-income investments, potentially boosting stock prices.
5. **Corporate Earnings:** Company earnings reports, including quarterly and annual financial statements, are fundamental to stock price movements. Positive earnings surprises often lead to stock price increases, while disappointing results can lead to declines.

6. **Consumer Confidence:** Consumer sentiment and confidence surveys provide insights into consumer spending patterns. High consumer confidence is generally positive for stocks, as it indicates a willingness to spend and invest.
7. **Trade and Economic Policy:** Announcements related to trade agreements, tariffs, and economic policy changes can have a direct impact on the stock prices of companies affected by these policies, especially in industries with high international exposure.
8. **Retail Sales:** Retail sales data indicate the strength of consumer spending, which is a crucial driver of economic growth. Strong retail sales figures can boost confidence in consumer-driven stocks.
9. **Housing Market Data:** Housing market indicators, such as housing starts and home sales, can provide insights into the health of the real estate market. A robust housing market can have positive spillover effects on related industries and stocks.
10. **Business and Manufacturing Surveys:** Surveys like the Institute for Supply Management's (ISM) Manufacturing and Non-Manufacturing Purchasing Managers' Index (PMI) provide insights into the health of the business and manufacturing sectors, which can impact stocks in those industries.
11. **Government Policies and Fiscal Stimulus:** Announcements of government stimulus packages, tax policy changes, and infrastructure spending plans can impact stock prices, particularly in sectors expected to benefit from such policies.
12. **Commodity Prices:** The prices of commodities like oil, gold, and metals can affect the profitability and stock prices of companies in the energy, mining, and manufacturing sectors.

It's important to note that the impact of economic data on stock prices can vary depending on the overall market conditions, investor sentiment, and the specific industry or sector in question. Traders and investors often analyze a combination of economic indicators, along with technical and fundamental analysis, to make informed decisions about buying or selling stocks.

4.6. Inflation Data Metrics

Inflation data metrics are statistical measures used to quantify and analyze inflation, which is the sustained increase in the general price level of goods and services over time. Inflation metrics provide insights into the rate of price changes in an economy,

helping policymakers, businesses, and individuals make informed decisions. Here are some key inflation data metrics and explanations for each one:

1. **Consumer Price Index (CPI):**
    - Explanation: As mentioned earlier, the CPI measures the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. It reflects the cost of living for the typical consumer.
    - Use: CPI is widely used to track consumer inflation, adjust wages, pensions, and government benefits for inflation, and make policy decisions. It provides insights into changes in prices for various goods and services.
2. **Producer Price Index (PPI):**
    - Explanation: PPI measures the average change over time in the selling prices received by domestic producers for their goods and services. It reflects inflation from the producer's perspective, showing cost pressures faced by businesses.
    - **Use**: PPI helps businesses assess pricing strategies, production costs, and profitability. It can serve as an early warning of potential inflationary pressures in the economy.
3. **Personal Consumption Expenditures Price Index (PCEPI):**
    - Explanation: The PCEPI is an inflation measure similar to CPI but focuses on personal consumption expenditures, which include a broader range of goods and services than the CPI basket. It is often favored by policymakers.
    - Use: PCEPI is used by the U.S. Federal Reserve as its preferred inflation gauge and informs monetary policy decisions. It provides insights into inflation trends that may not be captured by the CPI.
4. **Core Inflation:**
    - Explanation: Core inflation is a measure that excludes volatile components of the CPI or other inflation indices, such as food and energy prices. It focuses on underlying price trends.
    - Use: Core inflation helps analysts and policymakers identify long-term inflation trends by removing short-term price fluctuations driven by factors like energy price spikes or seasonal food prices.
5. **Inflation Rate:**

- Explanation: The inflation rate represents the percentage change in a chosen inflation metric (e.g., CPI, PCEPI) over a specific period (typically a month, quarter, or year).
- Use: The inflation rate is the most straightforward way to assess the current rate of price increase in the economy. It informs individuals, businesses, and policymakers about the state of inflation.

4.7. Cyclical Vs Defensive Stocks

Cyclical and defensive stocks are two broad categories of stocks that behave differently in response to changes in the economic environment. Investors often consider these categories when constructing their portfolios to balance risk and potential returns.

Cyclical Stocks:

Cyclical stocks are shares of companies whose fortunes are closely tied to the overall health of the economy. They tend to perform well during economic expansions and less well during economic downturns. Key characteristics of cyclical stocks include:

1. **Sensitivity to Economic Cycles:** These stocks are highly sensitive to changes in economic conditions. They typically do well when the economy is growing, unemployment is low, and consumer and business spending is strong.
2. **Industry Examples:** Industries such as manufacturing, construction, consumer discretionary (e.g., automotive, travel, and entertainment), and technology hardware tend to have cyclical stocks. For example, an automaker's sales tend to rise during economic booms but can decline during economic recessions.
3. **Higher Beta:** Cyclical stocks often have a higher beta, which means their prices tend to be more volatile than the overall market. They can experience larger price swings in response to economic news.
4. **Earnings Variability:** These companies may experience significant fluctuations in earnings. Their profitability can soar during good times but suffer during downturns.
5. **Dividend Policies:** Cyclical companies may have inconsistent dividend policies. They might pay higher dividends when profits are strong but cut or eliminate dividends during downturns to conserve cash.

Defensive Stocks:
Defensive stocks, on the other hand, are shares of companies that tend to be more resilient during economic downturns. They offer a degree of stability and safety to investors, even when the broader economy is struggling. Key characteristics of defensive stocks include:

1. **Stability and Reliability:** Defensive stocks are known for their stability and reliable performance, regardless of economic conditions. They are often less sensitive to economic cycles.
2. **Industry Examples:** Industries such as utilities, healthcare, consumer staples (e.g., food, beverages, and household products), and telecommunications are typical sources of defensive stocks. These sectors provide products and services that people continue to need, even during economic downturns.
3. **Lower Beta:** Defensive stocks typically have a lower beta, indicating lower price volatility compared to the overall market. They tend to experience smaller price fluctuations.
4. **Earnings Stability:** Companies in defensive sectors often have more stable and predictable earnings. Their products and services are considered essential, so demand remains relatively constant.
5. **Dividend Consistency:** Defensive companies often have a history of paying consistent dividends. They may be more likely to maintain or even increase dividends during economic downturns, making them attractive to income-seeking investors.

Investors often allocate their portfolios to include both cyclical and defensive stocks to manage risk. During periods of economic expansion, they may favor cyclical stocks for growth potential. In contrast, during economic contractions or when market uncertainty is high, they may shift toward defensive stocks for stability and income.

It's important to note that the classification of stocks as cyclical or defensive can vary, and some stocks may exhibit characteristics of both categories. Additionally, individual company dynamics, industry trends, and market conditions can influence how specific stocks behave over time. Investors should conduct thorough research and consider their investment goals and risk tolerance when making investment decisions involving cyclical and defensive stocks.

As an investor you now know that you can rotate into safer defensive stocks when you are unsure of future economic growth. The final part in our economic analysis is understanding how stocks in the different industries perform relative to the economic cycle.

4.8. Sector Rotation & Economic Cycles

- **Economic Cycle 1: Full Recession:** Buy Stocks. Typically during the full recession stage GDP is falling, interest rates are falling, consumer expectations are at their worst and the yield curve is normal. Industries that perform best include:
  - Cyclicals and Transport (near the end)
  - Technology
  - Industrials (near the end)
- **Economic Cycle 2: Early Recovery:** Buy stocks. Things are starting to improve. Unemployment is falling, consumer expectations are rising, interest rates are at their lowest and the yield curve is steepening. Industries that perform best include:
  - Industrials - near the end
  - Basic Materials
  - Energy near the end
- **Economic Cycle 3: Late Recovery:** Hold/Sell stocks or become defensive. At this stage consumer confidence is at its peak and falling. Interest rates are rising rapidly and industrial production is flat. Industries which perform best:
  - Energy near the beginning
  - Consumer Staples
  - Services (near the end)
- **Economic Cycle 4: Early Recession:** Hold stocks and start buying towards the end. Consumer expectations are at their worst, interest rates are at their peak, the yield curve is flat or inverted. Historically the following industries perform best:
  - Services (near the beginning)
  - Utilities
  - Cyclicals and transports near the end

This might be hard to grasp at the beginning...why does it make sense to invest in cyclical stocks during the full recession phase? You need to remember that investors are always trying to price future profit growth with companies. Take

Fedex for example..they are a transportation company. If you think logically about it ... during a recession they are probably shipping less parcels but investors see a brighter future ahead. During the recovery Fedex will ship more parcels and hence profits will rise. Investors start pricing this into the share price in advance of the recovery (the full recession stage).

It is important for you to understand the Macro or 'Big picture' reasons why stock prices rise and fall.

But now it's time to start learning about analyzing stocks.

4.9. Test your Knowledge - Quiz 2

Click Here to take the quiz and get instant feedback.

5. Stock Market Terminology Basics

Before we move onto the 3 step process in building your stock portfolio we are going to share some basic stock market terminology with you. These will include:

1. Market Capitalisation other wise known as 'market cap'
2. Dividends
3. Earnings per share otherwise known as EPS
4. Price to Earnings otherwise known as 'PE'
5. Long & Short

5.1. Market Cap

Market capitalization, often referred to as "market cap," is a fundamental metric used to measure the size, value, and relative importance of a publicly traded company in the stock market. It is calculated by multiplying a company's stock price by the total number of its outstanding shares. Market cap is a key indicator for investors and analysts, as it provides insights into a company's scale, potential risk, and its significance in a particular market or index. Here's how to calculate and interpret market capitalization:

Market Capitalization = Stock Price × Outstanding Shares

1. **Stock Price:** The current market price of one share of the company's stock. This is determined by supply and demand in the open market, where buyers and sellers set the stock's price.

2. **Outstanding Shares:** The total number of shares of the company's stock that are currently held by investors. This includes shares held by institutional investors, retail investors, company insiders, and more.

Market capitalization is typically categorized into several different ranges, which can help investors quickly assess the size and profile of a company:

- **Micro-Cap:** Typically, companies with a market cap of less than $300 million are considered micro-cap stocks. These are the smallest publicly traded companies and often have limited financial resources and liquidity.
- **Small-Cap:** Small-cap companies have a market cap between $300 million and $2 billion. They are larger than micro-caps but still considered relatively small in the investment universe.
- **Mid-Cap:** Mid-cap companies have a market cap between $2 billion and $10 billion. They are larger and more established than small-caps but not as large as large-cap companies.
- **Large-Cap:** Large-cap companies have a market cap of over $10 billion. These are typically well-established, mature companies with significant resources and market presence.
- **Mega-Cap:** Mega-cap companies are the largest in terms of market cap, often exceeding $200 billion or more. They are industry leaders with global reach and extensive resources.

Investors use market capitalization as a factor in various aspects of their investment strategies:

- **Portfolio Diversification:** Investors may allocate their portfolios to different market cap categories to achieve diversification and manage risk. Each category can have different risk-return profiles.
- **Investment Style:** Different investment styles, such as growth, value, or income investing, may focus on specific market cap ranges. For example, growth investors may favor smaller companies with higher growth potential.
- **Benchmarking:** Market cap is used to construct market indices and benchmarks. It helps investors and fund managers compare their portfolio performance to the broader market.
- **Risk Assessment:** Smaller-cap stocks often carry higher risk due to their greater susceptibility to economic and market fluctuations. Larger-cap stocks are generally considered less risky but may offer lower growth potential.

Market capitalization is a useful tool for investors, but it's important to note that it's just one of many factors to consider when making investment decisions. Other factors, such

as a company's financial health, growth prospects, industry
dynamics, and competitive position, should also be evaluated to make informed investment choices.

5.2. Dividends

Dividends are payments made by a company to its shareholders as a distribution of profits. They are typically paid out of a company's earnings and are a way for shareholders to receive a portion of the company's profits in cash. Dividends can be a significant component of an investor's total return, especially for income-focused investors. Here's an explanation of key dividend-related terms and the dividend process:

5.2.1. Dividend Yield

- The dividend yield is a percentage that represents the annual dividend income an investor receives relative to the current market price of the stock. It is calculated as follows:
- Dividend Yield = (Annual Dividend Per Share / Current Stock Price) × 100
- For example, if a stock pays an annual dividend of $2 per share, and the stock's current price is $40, the dividend yield is (2 / 40) × 100 = 5%.

5.2.2. Ex-Dividend Date:

- The ex-dividend date is a crucial date for investors. It is the first day on which a stock trades without the right to receive the most recently declared dividend. In other words, if you buy a stock on or after the ex-dividend date, you will not receive the upcoming dividend payment.
- The ex-dividend date is typically set by the stock exchange and occurs a few days before the record date (discussed below). It allows time for the stock transaction to settle before the record date.

5.2.3. Record Date:

- The record date, also known as the "date of record," is the date on which a company determines the list of shareholders who are eligible to receive the dividend. If you own shares as of the record date, you are entitled to the dividend, regardless of when you purchased the shares.

5.2.4. Reporting Date:

- The reporting date is not a standard dividend-related term but may refer to the date on which a company announces its dividend payments. This announcement

often includes the dividend amount, ex-dividend date, record date, and payout date.

5.2.5. Payout Date

- The payout date, also known as the "payment date" or "dividend payment date," is the date on which the company distributes the dividend payments to eligible shareholders. This is when shareholders receive their dividend income in cash or reinvest it in additional shares, depending on their preferences.

Example: Suppose Company ABC announces a quarterly dividend of $0.50 per share with the following dates:

- Ex-Dividend Date: October 15
- Record Date: October 16
- Payout Date: November 1
- If you own Company ABC shares on or before the ex-dividend date (by October 15), you will be eligible to receive the dividend.
- The record date (October 16) is when the company determines the list of eligible shareholders.
- The payout date (November 1) is when you will receive your dividend payment.

If you purchase shares of Company ABC on or after October 16 (the record date), you will not receive the upcoming dividend payment. The dividend will go to the previous owner of the shares.

It's important for investors to be aware of these dates and consider them when planning their dividend income strategies. Additionally, not all companies pay dividends, and dividend amounts can vary widely among companies and industries.

5.2.6. Dividend Payout Ratio

The dividend payout ratio is a financial metric that measures the proportion of a company's earnings that are paid out to shareholders in the form of dividends. It is expressed as a percentage and is calculated using the following formula:

Dividend Payout Ratio = (Dividends Per Share / Earnings Per Share) × 100

- **Dividends Per Share (DPS):** This represents the total dividends paid to common shareholders divided by the total number of outstanding common shares. It gives the amount of dividends paid per share of stock.
- **Earnings Per Share (EPS):** This is the company's net income (profit) divided by the total number of outstanding common shares. EPS reflects the company's profitability on a per-share basis.

The dividend payout ratio is an important financial metric that provides insights into a company's dividend policy and its sustainability. Here's what different payout ratios indicate:

1. **Low Dividend Payout Ratio (Less than 30%):** A low payout ratio suggests that the company retains a significant portion of its earnings to reinvest in the business for growth and expansion. It may be a sign that the company prioritizes reinvestment over dividend payments.
2. **Moderate Dividend Payout Ratio (30% to 50%):** A moderate payout ratio indicates a balance between returning profits to shareholders and retaining earnings for growth. Companies with moderate ratios may have more stable and sustainable dividend policies.
3. **High Dividend Payout Ratio (More than 50%):** A high payout ratio means that the company distributes a large portion of its earnings as dividends. Such companies may be mature, with limited growth opportunities, and they often prioritize providing income to shareholders.
4. **Payout Ratio Above 100%:** In some cases, a company may have a payout ratio exceeding 100%, indicating that it is paying out more in dividends than it is earning in profits. This situation is not sustainable in the long term and may require the company to either reduce dividends or find additional sources of income.

Investors use the dividend payout ratio to assess the sustainability and attractiveness of a company's dividend policy. A low payout ratio suggests the potential for future dividend growth, while a high ratio may indicate limited room for dividend increases.

However, it's essential to consider the context and industry norms when evaluating a company's payout ratio. Some industries, such as utilities and consumer staples, tend to have higher payout ratios, while technology and growth-oriented companies often have lower ratios. Additionally, a company's specific circumstances, such as its growth prospects and capital needs, can influence its optimal payout ratio.

5.3. Earnings Per share (EPS)

EPS, or Earnings Per Share, is a fundamental financial metric that represents the portion of a company's profit attributable to each outstanding share of common stock. It is widely used by investors, analysts, and companies themselves to assess profitability on a per-share basis and evaluate a company's financial performance. EPS is typically calculated for a specific time period, such as a fiscal quarter or year. Here's how to calculate and interpret EPS with examples:

5.3.1. EPS Formula:

EPS is calculated using the following formula:

$$\frac{\text{(Net Income - Dividends on Preferred Stock)}}{\text{Weighted Average Number of Outstanding Shares}}$$

- **Net Income:** This is the company's total profit after deducting all expenses, taxes, interest, and preferred stock dividends.
- **Dividends on Preferred Stock:** If a company has issued preferred stock, it may be required to pay dividends to preferred shareholders before calculating EPS for common shareholders. This amount is subtracted from net income.
- **Weighted Average Number of Outstanding Shares:** This represents the average number of common shares outstanding during the reporting period. The number of outstanding shares can change due to factors like stock issuances, buybacks, or stock splits. The weighted average accounts for these changes over time.

5.3.2. Basic EPS Calculation:

Let's say Company A reported a net income of $10 million for the fiscal year and had no preferred stock. During the year, the company had 1 million common shares outstanding. To calculate the basic EPS:

EPS = ($10,000,000) / (1,000,000) = $10 per share

In this example, Company A's basic EPS for the year is $10 per share.

5.3.3. Diluted EPS Calculation:

Diluted EPS takes into account potential dilution of earnings from securities that could be converted into common shares, such as stock options, convertible bonds, or convertible preferred stock. The calculation is more complex because it considers the impact of these potentially dilutive securities.

Suppose Company B reported a net income of $12 million for the fiscal year and had no preferred stock. Additionally, it had 1 million common shares outstanding and 500,000 stock options outstanding, with an exercise price of $5 per share. The options are dilutive because they can be converted into common shares.

To calculate diluted EPS, you must determine the number of additional common shares that would be created if all potentially dilutive securities were exercised. In this case:

- 500,000 stock options x (Exercise Price / Average Market Price) = 500,000 x ($5 / $10) = 250,000 additional shares

Now, add the potential shares to the weighted average number of common shares:
Weighted Average Number of Outstanding Shares (Diluted) =

1,000,000 (existing shares) + 250,000 (potential shares) = 1,250,000 shares

Then, calculate diluted EPS:

Diluted EPS = ($12,000,000) / (1,250,000) = $9.60 per share

In this example, Company B's diluted EPS for the year is $9.60 per share, which accounts for the potential dilution from stock options.

EPS is a critical metric for assessing a company's financial performance and comparing it to industry peers. It can also be used in valuation models, such as the price-to-earnings (P/E) ratio, to determine whether a stock is undervalued or overvalued in the market.

5.4. Price to Earnings Ratio (PE)

The Price-to-Earnings (P/E) ratio is a widely used financial metric that helps investors assess the relative value of a company's stock by comparing its current market price to its earnings per share (EPS). It provides insights into how much investors are willing to pay for each dollar of a company's earnings. Here's how to calculate and interpret the P/E ratio with examples:

5.4.1. P/E Ratio Formula:

P/E Ratio = Market Price per Share / Earnings Per Share (EPS)

- **Market Price per Share:** This is the current market price of one share of the company's stock, as determined by supply and demand in the open market.
- **Earnings Per Share (EPS):** EPS represents the portion of a company's profit allocated to each outstanding share of common stock. It is calculated as Net Income divided by the weighted average number of outstanding common shares.

Example 1 - Basic P/E Calculation: Let's say Company A's stock is currently trading at $50 per share, and its last reported EPS is $5 per share. To calculate the basic P/E ratio for Company A:

P/E Ratio = ($50) / ($5) = 10

In this example, Company A has a basic P/E ratio of 10, indicating that investors are willing to pay $10 for every $1 of earnings.

5.4.2. Interpretation of P/E Ratios

- A high P/E ratio may suggest that investors have high expectations for a company's future growth potential. It could indicate that the stock is perceived as overvalued if those expectations are not met.
- A low P/E ratio may suggest that investors have lower growth expectations or higher risk perceptions for a company. It could indicate that the stock is undervalued if the company's future prospects are better than what the P/E ratio suggests.
- P/E ratios can vary significantly across industries. For example, technology companies often have higher P/E ratios due to their growth potential, while mature industries like utilities may have lower P/E ratios.

5.4.3. Forward P/E Ratio:

The P/E ratio can also be calculated using future earnings estimates instead of historical earnings. This is known as the forward P/E ratio. For instance, if Company B is expected to have earnings of $6 per share in the next fiscal year, and its stock is currently trading at $60 per share, the forward P/E ratio is:

Forward P/E Ratio = ($60) / ($6) = 10

In this case, investors are willing to pay $10 for every $1 of expected earnings in the upcoming year.

5.4.4. Trailing P/E vs. Forward P/E:

Trailing P/E uses historical earnings data, while forward P/E uses future earnings estimates. Investors often compare these two ratios to assess whether a stock is valued based on its past or expected future performance. A stock with a lower forward P/E than its trailing P/E may suggest that the market expects lower earnings growth in the future.

Keep in mind that the P/E ratio is just one tool for evaluating a stock's valuation. It should be used in conjunction with other financial metrics and a thorough analysis of the company's fundamentals, industry trends, and economic conditions to make informed investment decisions. Additionally, different industries and companies may have varying P/E ratio norms, so it's essential to consider context when interpreting P/E ratios.

5.5. Price to Sales Ratio

The Price-to-Sales (P/S) ratio is a financial metric used to evaluate the valuation of a company's stock by comparing its current market price per share to its revenue per share. Unlike the Price-to-Earnings (P/E) ratio, which uses earnings per share (EPS), the P/S ratio focuses on a company's top-line revenue rather than its profitability. The P/S ratio is often used to assess the relative valuation of companies, especially when they may have negative or fluctuating earnings. Here's how to calculate and interpret the P/S ratio with examples:

5.5.1. P/S Ratio Formula:

P/S Ratio = Market Price per Share / Revenue Per Share

- **Market Price per Share:** This is the current market price of one share of the company's stock, as determined by supply and demand in the open market.
- **Revenue Per Share:** This represents the total revenue (sales) generated by the company divided by the total number of outstanding shares.

Basic P/S Calculation: Let's say Company A's stock is currently trading at $50 per share, and its last reported revenue is $10 per share. To calculate the basic P/S ratio for Company A:

P/S Ratio = ($50) / ($10) = 5

In this example, Company A has a basic P/S ratio of 5, indicating that investors are willing to pay $5 for every $1 of revenue generated by the company.

5.5.2. Interpretation of P/S Ratios

- A lower P/S ratio suggests that investors are paying less for each dollar of a company's revenue, which may indicate that the stock is undervalued or that the company's sales are not yet fully reflected in its stock price.
- A higher P/S ratio may imply that investors are paying a premium for each dollar of a company's revenue, possibly because they expect strong future growth or believe the company has a competitive advantage.
- P/S ratios are often used for companies that have negative or fluctuating earnings, such as startups or companies in industries where profitability is inconsistent.

Example 3 - Comparing P/S Ratios: Investors often compare a company's P/S ratio to those of its peers or competitors in the same industry. For example, if Company B and Company C are both in the same industry, and Company B has a P/S ratio of 3, while Company C has a P/S ratio of 7, it suggests that investors are willing to pay more for Company C's revenue, possibly because they expect it to outperform its peers.

Example 4 - Historical and Industry Norms: Analyzing a company's P/S ratio over time and comparing it to industry averages can provide insights into its valuation trends. For instance, if Company D's P/S ratio has historically been lower than the industry average but is now rising, it may indicate a changing perception of the company's prospects.

It's important to note that while the P/S ratio can be a useful tool for assessing valuation, it has limitations. Revenue figures may vary due to accounting methods, and the P/S ratio does not consider profitability or the company's cost structure. Therefore, it should be used in conjunction with other financial metrics and a thorough analysis of the company's fundamentals and growth prospects to make informed investment decisions.

5.6. Long and Short

In the stock market, "long" and "short" are terms used to describe two different investment strategies or positions that investors or traders can take. These positions represent expectations about the future price movement of a particular stock or asset. Here's an explanation of each:

5.6.1. Long Position:

- A long position, often simply referred to as "going long," is when an investor or trader buys a security (such as a stock) with the expectation that its price will rise in the future.
- Going long is the most common and straightforward investment strategy. When you go long on a stock, you profit if its price increases. You can hold the stock for an extended period, potentially benefiting from dividend payments and capital appreciation.
- Example: You buy 100 shares of Company XYZ at $50 per share, believing that the stock's price will increase over time. If the stock rises to $60 per share, you can sell it for a profit of $10 per share.

5.6.2. Short Position:

- A short position, often referred to as "shorting," is when an investor or trader sells a security they do not own with the expectation that its price will decrease in the future.
- Shorting is a way to profit from a declining market or to hedge against potential losses in a long position. In a short sale, you borrow shares from a broker or another investor and sell them in the market. Later, you buy back the shares at a lower price to repay the loan, and if the price has indeed fallen, you profit from the difference.
- Example: You believe that Company ABC's stock, currently trading at $50 per share, will decline in value. You borrow 100 shares from your broker and sell them in the market. If the stock falls to $40 per share, you can buy back 100 shares at the lower price to repay the loan, resulting in a $10 per share profit.

Short selling involves significant risks and potentially unlimited losses if the stock's price rises instead of falling. Because of this, it requires a margin account and carries a higher level of risk than going long on a stock.

Key Considerations:

- Going long is typically seen as a bullish strategy, where you profit from rising prices.
- Shorting is generally considered a bearish strategy, used to profit from falling prices.
- Both long and short positions can be used for various purposes, including speculation, hedging, and portfolio management.
- Investors and traders should have a solid understanding of the risks and mechanics associated with both long and short positions before engaging in these strategies.
- Shorting may involve borrowing costs and margin requirements that can erode profits or lead to losses if the trade goes against the investor.

It's essential to conduct thorough research, use proper risk management techniques, and consider your investment goals and risk tolerance when deciding whether to go long or short on a particular stock or asset.

6. Historical Company Analysis - A case study with Alaska Airlines

6.1. Introduction

So far, we've looked at the broader market perspective. Now, we're shifting our focus to individual stocks and how to conduct basic financial analysis. Our case study is Alaska Airlines (ALK). Historical research involves examining a company's past performance. If a company has consistently delivered results in the past, it may provide confidence in its future performance. However, this doesn't guarantee future results, but it helps us rule out companies with no track record. The upcoming modules will include video presentations. So, if you need privacy, grab your headphones!

Finally, we have created a checklist for the research. If you would like a copy please email info@sharenavigator.ie.

6.2. Alaska Airlines Historical research introduction

Click Here to view.

6.3. How to access company information for Free?

Click Here to view.

6.4. Sales Growth Analysis

The first step in your analysis is to identify whether or not the company has a track record of sales growth. The bottom line is that you want to see that there is demand for the products and services that the company offers. You want to see evidence of sales growth year on year for the most part in the last 5 years.

CLICK HERE to view sales growth analysis for Alaska Airlines.

6.5. EPS & Net Profit Growth Alaska Airlines

We would also like to see a track record of profit growth over the past 5 years. EPS and Net Profit growth is important. But both are not the same. Net Income is the overall profit for the company. But EPS is the Net income attributable to each share on issue.

Sometimes a company can increase its EPS without increasing its
Net Profit by repurchasing its own shares. Whilst this is a positive for investors, we want to make sure that financial engineering is not the only source of EPS growth.

CLICK HERE to view EPS and Net Profit Growth analysis for Alaska Airlines.

6.6. Operating Margins Alaska Airlines

We want to see company operating margins stable. The operating margin is an important measure of a company's overall profitability from operations. It is the ratio of operating profits to revenues for a company or business segment.

Expressed as a percentage, the operating margin shows how much earnings from operations is generated from every $1 in sales after accounting for the direct costs involved in earning those revenues. Larger margins mean that more of every dollar in sales is kept as profit.

CLICK HERE to view operating margin analysis for Alaska Airlines.

6.7. Dividend Analysis

Dividends may or may not be important to you as an investor. It will really depend on your investor profile. But it is still good to see if a company has a track record of paying out dividends and also raising its dividend year on year.

CLICK HERE to view dividend analysis for Alaska Airlines.

6.8. Debt and Debt to Equity

Companies need to find a balance between having too much debt and having too little debt. From your perspective as an investor you want to see companies borrowing a sustainable amount of debt on the basis that they can use the capital raised to grow the company and its profits. Too much debt can lead to problems with profit growth if interest payments rise etc...

There are many different ways of looking at debt. But we are going to look at two ratios:

1. **Total Debt**
2. **Debt to Equity**

The Debt to Equity ratio is a 'gearing' ratio that tells you how much a company is financing its business operations via debt versus wholly owned funds. The higher the ratio the higher the debt levels in that company.

Debt to Equity Formula:
This ratio is calculated for you by most financial websites but here is the Formula:

Total Debt
divided by
Total Shareholder Equity

As with anything in life, higher debt equals higher risk. But it is not that simple with stocks.

- When looking at Debt to Equity you must look at the company industry that the stock operates. For example the car manufacturing industry requires massive amounts of capital whereas the computer software industry does not. Therefore you would expect car manufacturers to have higher debt to equity ratios.
- So it is very important that when analysing debt to equity that you look at competitors within the same industry. Make sure you are comparing 'apples to apples'.

What is Shareholders equity?
Total Assets minus Total Liabilities. In other words if the company liquidated in the morning, how much would be left over for the shareholders to share? As a rule of thumb High Debt to equity is generally considered more risky. But it is not that simple as sometimes a High Debt to Equity Ratio can be good if the company is efficient at generating free cash flow from the borrowings.

CLICK HERE to view debt to equity analysis with Alaska Airlines.

6.9. Share Buyback Schemes with Alaska Airlines

Share buybacks, also known as share repurchases, occur when a company purchases its own shares from the open market or from its shareholders. This process effectively reduces the number of outstanding shares, which can have several implications for the company and its shareholders:

1. **Earnings Per Share (EPS) Increase:** By reducing the number of outstanding shares, the company's earnings are divided among fewer shares, which can increase the earnings per share (EPS). This can make the company's stock look more attractive to investors.
2. **Return on Equity (ROE) Increase:** Since the number of shares outstanding decreases, the company's equity (the amount of money that would be returned to shareholders if all assets were liquidated and all debts were paid off) increases. This can lead to an increase in the return on equity (ROE), a measure of how efficiently a company uses its shareholders' equity to generate profits.
3. **Signal of Confidence:** Companies may repurchase shares to signal confidence in their future prospects. This can be seen as a positive sign by investors.
4. **Tax-Efficient:** Share buybacks can be a tax-efficient way for a company to return capital to shareholders, especially when compared to dividends, which are typically taxed at a higher rate.
5. **Flexibility:** Share buybacks provide companies with flexibility. They can repurchase shares when they believe their stock is undervalued, or they can use buybacks as a way to return excess cash to shareholders.
6. **Potential Risks:** While share buybacks can have benefits, they also come with risks. If a company uses debt to finance the buyback and the stock price declines, the company may be left with more debt and fewer assets.

It's important to note that share buybacks are not always a sign of a healthy company. Some companies may use buybacks to artificially inflate their stock prices or to offset the dilution caused by the issuance of stock options to executives. Investors should carefully consider the reasons behind a company's decision to repurchase shares before making investment decisions.

CLICK HERE to view share buyback analysis with Alaska Airlines.

6.10. Newsflow and Understanding Historical Data.

CLICK HERE to view a summary of historical data and look out for news flow with Alaska Airlines.

7. Mastering Stock Valuation: 3 Simple methods with Alaska Airlines

The stock market is forward looking. It really doesn't care about past performance when it comes to stock prices. Investors are looking for stocks that continue to grow sales and profits into the future. During this research we will show you how to identify future guidance and future share price targets.

There are many share price formulas that you can use to estimate the current and future fair price value for a stock. Some are very straightforward and others are more complicated. For the purposes of this course we will focus on three simple valuation techniques:

1. **Analyst Estimates**
2. **Valuation based on PE** (most commonly used technique for companies with a solid track record of earnings growth and reasonable predictability of future earnings growth).

Share Price = EPS * PE

3. **Valuation based on Price to Sales** (this is more commonly used by investors for companies who do not have a stable track record of EPS growth or for companies that are making losses).

Share Price = Sales Per Share * P/S

CLICK HERE to view a short video explaining our approach to estimating future share prices.

7.1. Target Share Price based on Analyst Estimates

CLICK HERE to view where and how to get analyst target share price for Alaska Airlines.

7.2. Target Share Price based on Price to Earnings (PE)

CLICK HERE to view how to estimate the future share price of a company based on estimated EPS and PE.

7.3. Target Share Price based on Price to Sales (PS)

CLICK HERE to view how to estimate the future share price of a company based on expected Sales and Price to Sales.

7.4. Average Estimates

CLICK HERE to view a video outlining taking an average of all three estimates for the target share price.

7.5. Test your knowledge - Quiz 3

CLICK HERE to test your knowledge.

7.6. A word of Caution

These target prices are derived from estimates, which are subject to constant change. To validate these estimates, you must engage in qualitative research. This process involves evaluating the company's competitive landscape, legal challenges, competitive advantages, and more.

8. Portfolio Building

During this chapter we will take you through a process of building a portfolio of stocks that is right for you. We will discuss:

1. Risk and Risk Management using Beta
2. Strategy Allocation
3. Stock Allocation
4. Screening for Stocks
5. Completing the Portfolio

Finally, in our experience the best way to learn is 'to do'. In the stock market you need to get 'real world experience' in order to learn. Access your personal simulated trading account.

We will give you a real time live simulated account which will allow you to get started immediately buying and selling shares. Contact us to get a username and password for your own personal simulated trading account. The process of buying and selling shares will help you to understand the stock market.

8.1. An Introduction to Risk

In the Long Term, the stock market is the best performing Asset Class. But in the short term stock markets rise and fall, sometimes substantially. This short term volatility usually triggers two emotions:

1. Fear
2. Greed

It is important for you to master those two emotions (which is easier said than done!). The key to mastering your emotions in the stock market is to Understand risk, Learn how to measure risk and finally Manage risk.

The 'word' risk should not have a negative connotation. In fact, you
should view it positively. Because it will stop you from looking at potential investments through 'rose tinted' glasses. 'Confirmation bias' is when you make your mind up about something and then look for any reason possible to prove you are correct even when you are wrong.

This chapter is designed to get you into the habit of building an investment portfolio on 'fact' rather than 'emotion'. You will learn to avoid the most common mistakes made by retail investors including but not limited to:

1. Buying stocks on a tip from a friend
2. Not knowing anything about the stock you invest in
3. Not having enough stocks in your portfolio
4. Having the wrong types of stocks in your portfolio

Paying attention here could make and save you a lot of money in the future! This chapter will tie it all together for you.

8.2. Diversification

Most important rule in the stock market: Diversify your risk.

Diversification is a fundamental strategy in the stock market that involves spreading your investments across a variety of assets or securities to reduce risk. The goal of diversification is to minimize the impact of poor performance in any single investment or asset class while potentially enhancing the overall risk-adjusted return of your portfolio. Here's why diversification is important, along with some examples:

8.2.1. Risk Reduction

Diversification helps reduce the overall risk of your portfolio. By holding different types of assets with varying risk profiles, you decrease the chance that a poor-performing investment will significantly impact your entire portfolio.

Example: Imagine you have a portfolio consisting solely of technology stocks, and the tech sector experiences a significant downturn. Your portfolio's value could plummet. However, if you also hold bonds, healthcare stocks, and real estate investment trusts (REITs) in your portfolio, the negative impact of the tech sector's decline is offset by the performance of other assets.

8.2.2. Smoother Returns

Diversification can lead to more stable and consistent returns over time. While some investments may be volatile or underperform in certain periods, others may perform well, helping to balance out your overall portfolio returns.
Example: In a year when the stock market experiences significant fluctuations, a diversified portfolio with assets like bonds and dividend-paying stocks may still provide positive returns, even if the stock market as a whole is down.

8.2.3. Protection Against Specific Risks

Diversification can help protect against specific risks associated with particular industries, companies, or sectors. For instance, if you're heavily invested in one industry and it faces regulatory challenges or technological disruptions, your portfolio could suffer. Diversifying can mitigate this risk.
Example: Suppose you hold shares in multiple healthcare companies. If one of these companies faces a lawsuit or regulatory issues, the impact on your overall portfolio is limited because you have exposure to other healthcare firms that may perform well.

8.2.4. Improved Risk-Return Tradeoff

Diversification can enhance your portfolio's risk-return tradeoff. By spreading your investments across assets with different risk levels and return potential, you can achieve a more balanced portfolio that aligns with your risk tolerance and financial goals.
Example: If you have a long-term investment horizon but want to manage risk, you can diversify by including a mix of equities (stocks), fixed-income (bonds), and alternative investments (e.g., real estate) in your portfolio. This diversified approach aims to provide a reasonable balance between risk and potential return.

8.2.5. Lower Correlation

Diversification often involves selecting assets that have lower correlation with each other. In other words, they don't move in lockstep. This can lead to more efficient risk reduction.
Example: Stocks and bonds typically have a negative correlation. When stocks perform well, bonds may underperform, and vice versa. By holding both in your portfolio, you can reduce the overall volatility.

8.2.6. Geographic Diversification

Geographic diversification involves investing in different regions or countries. It helps protect your portfolio from risks specific to a particular location, such as political instability or economic challenges.
Example: If you primarily invest in U.S. stocks and the U.S. economy experiences a downturn, your portfolio could be adversely affected. However, by including international stocks in your portfolio, you can reduce your exposure to the U.S. market's ups and downs.

In summary, diversification is a crucial strategy for managing risk and improving the risk-return profile of your investment portfolio. By spreading your investments across different asset classes, industries, geographic regions, and investment styles, you can build a more resilient portfolio that can weather various market conditions and help you achieve your long-term financial goals.

Most retail investors do not have enough stocks in their portfolio. This exposes the retail investor to the '**Unique Risks'** associated with those companies. Unique risks are risks that are specific to a particular company or industry that you invest in.

8.3. An example of 'Unique' Risk: Volkswagen

A great example of Unique Risk (2015) was in the car manufacturing industry and the scandal with Volkswagen. No investor could have predicted that Volkswagen would be accused on tampering with emissions gauges on their engines. The stock dropped over 30% in 4 days! This is a clear example of unique risk.

Let's pretend you invested all of your money in Volkswagen…. your portfolio would be down 30% in 4 days! Ouch!!!!

But don't panic just yet.... What if you diversified your risk?

8.3.1. Diversifying the risk with Volkswagen

Let's imagine now that Volkswagen only accounted for 5% of our portfolio. In other words we only had 1/20th of our money invested in Volkswagen. What would this mean for us? The answer is that the Volkswagen incident would have affected our portfolio by around 1.5% (30%/20). Now that's a lot easier to handle, isn't it?

Now imagine that you had invested the rest of your cash in 19 other stocks. 5% into each stock. Many stocks went up whilst Volkswagen was falling so the profits from these would offset the losses in Volkswagen. This is called 'Diversification'.

8.3.2. Key Lesson

Do not put all of your eggs in one basket! Read the next lesson to find out approximate allocation guidelines in each stock.

8.4. Stock Allocation guidelines

Stock allocation is the process of building a portfolio of stocks. The types of stocks you choose will greatly depend on your Investor Profile. Thereafter you must be careful not to put too much into any one stock. Even Warren Buffet gets it wrong at times…..he said one of the worst investments he ever made was in Irish Banks!

Here are some very brief guidelines as to how much you should invest in any one stock.

1. **Mega Cap High Dividend Stocks** - Maximum of 5% in each stock
2. **Large Cap Value Stocks** - Maximum of 5% in each stock
3. **Growth stocks** - Maximum of 2.5% in each stock

CLICK HERE to watch the video with examples of allocation.

8.5. BETA as a measure of risk in stocks

At this stage you should know that you should only invest a small percentage into each stock. This helps reduce risk. You should also know that you can increase or reduce risk even further again. Let us explain further…

A common measurement of risk in stocks is 'Beta'.

Beta, often denoted as β, is a financial metric used in the stock market to measure a stock's sensitivity to overall market movements. It quantifies the relationship between the price movements of a particular stock and those of a broader market index, typically

the S&P 500 in the United States. Beta is a tool that investors use to assess and manage risk in their portfolios. Here's how beta works and how to use it to manage risk.

8.5.1. Interpreting Beta Values:

- **A beta of 1** indicates that the stock tends to move in line with the market. It's considered market-neutral.
- **A beta greater than 1** suggests higher volatility, meaning the stock is expected to be more sensitive to market movements, both up and down.
- **A beta less than 1** indicates lower volatility compared to the market, implying that the stock is expected to be less sensitive to market swings.

8.5.2. Using Beta to Manage Risk:

- **Diversification:** Beta can help investors achieve diversification by identifying stocks with different levels of sensitivity to market movements. Combining stocks with varying betas in a portfolio can reduce overall portfolio risk.
  Example: If you have a portfolio consisting of high-beta stocks, you may consider adding low-beta or market-neutral stocks to balance the risk.
- **Risk Assessment:** Beta can be used to assess the risk profile of individual stocks within a portfolio. Higher-beta stocks can contribute to greater portfolio risk, so understanding each stock's beta can help you gauge the potential impact on your portfolio.
  Example: If you hold a high-beta stock and are concerned about its impact on your portfolio's overall risk, you may decide to reduce your exposure to that stock or hedge it with lower-beta assets.
- **Hedging:** Investors can use stocks or assets with specific beta values to hedge their portfolios. For example, if you hold a portfolio of high-beta stocks and want to reduce overall market risk, you can use low-beta or negative-beta assets to offset potential losses during market downturns.
  Example: Buying put options or inverse ETFs with negative beta values can serve as a hedge against market declines when holding high-beta stocks.
- **Asset Allocation:** Beta can inform asset allocation decisions. Depending on your risk tolerance and investment goals, you can allocate your investments to achieve a desired risk-return balance.
  Example: A conservative investor may allocate a larger portion of their portfolio to low-beta assets, while an aggressive investor may favor high-beta stocks for potential higher returns.

- **Benchmarking:** Beta can be used to compare the performance of a stock or portfolio to a market benchmark. It helps you assess whether your investments are achieving the desired level of risk and return. **Example:** If your portfolio has a beta higher than the market index, you should expect higher volatility but potentially higher returns. Conversely, a lower beta portfolio may provide more stability but potentially lower returns.

It's important to note that beta is just one tool in a comprehensive risk management strategy. While it provides insights into a stock's relationship with the broader market, it does not consider company-specific risks or provide a complete picture of a stock's risk profile. Therefore, investors should use beta in conjunction with other risk assessment methods.

In summary, High Beta stocks are considered Higher Risk for Higher Reward. Lower Beta stocks are considered Less Risk for Less Reward. Now we are going to show you how to build a lower risk and higher risk portfolio using Beta.

CLICK HERE to watch a video showing you how to measure portfolio risk using Beta.

8.6. Investment Strategy Allocation

For the purposes of this course we are going to pretend we have a 'medium risk' profile as a result of our Investor Profiling. During this step we need to allocate the 'weightings' or 'allocations' for each type of investment strategy. Because we are 'medium risk' we decide to place the following allocation into each type of Investment Portfolio:

Investment Strategy	% Allocation	Risk Level
High Dividend Stocks	40%	Low
Large Cap Value Stocks	30%	Medium
Growth Stocks	15%	High
Cash	15%	Lowest

Now we need to decide on an allocation for each strategy.

8.7. Stock Allocation

Now that we know how we are going to split up our money in terms of investment strategies it's time to start considering how much we are going to invest in each stock. For this we are going to pretend we have €5,000 to invest. The investment breakdown might look something like this:

Investment Strategy	% Allocation	€ Allocation	% of Portfolio in each stock	€ Investment into each stock	No of Stocks
High Dividend	40%	€2,000	5%	€250	8
Value	30%	€1,500	5%	€250	6
Growth	15%	€750	2.50%	€125	6
Cash	15%	€750	100%	NA	NA
Totals	**100%**	**€5,000**			**20**

Remember we are basing this on an investment of €5,000 in the stock market. The amounts above will change if we have more or less to invest. Here is a step by step walkthrough of the chart above.

High Dividend Stocks:

1. We are only investing 40% into High Dividend Stocks
2. This equals a total investment of €2,000 (40% of €5,000)
3. We will only invest 5% of the Portfolio in any one High Dividend Yield stock
4. We will only invest €250 in a stock (5% of €5,000 = €250)
5. We will only invest in 8 High Dividend Stocks (€2,000/€250).

Large Cap Value Stocks:

1. We are only investing 30% into Large Cap Value Stocks
2. This equals a total investment of €1,500 (30% of €5,000)
3. We will only invest 5% of the Portfolio in any one Value Stock
4. We will only invest €250 in a stock (5% of €5,000 = €250)
5. We will only invest in 6 Value Stocks (€1,500/€250).

Growth Stocks:

1. We are only investing 15% into Growth Stocks
2. This equals a total investment of €750 (15% of €5,000)
3. We will only invest 2.5% of the Portfolio in any one Growth stock
4. We will only invest €125 in a stock (2.5% of €5,000 = €125)
5. We will only invest in 6 Growth Stocks (€750/€125).

Cash: We are going to leave €750 in cash for opportunities if they arise.

8.8. Access Our Watchlists

If you've reached this point, you likely understand the significant time and effort needed to construct a stock portfolio. You can expedite this process by exploring our watchlists, which contain hundreds of stocks vetted from a quantitative standpoint. Your task then becomes conducting qualitative research. We offer watchlists for various regions and sectors, including EU, US, UK stocks, Energy, Metals, and more. To access these watchlists, **sign up for a 14-day free trial** of our mentoring service.

8.9. Earnings Season

Earnings season is a period during which publicly traded companies release their quarterly financial reports to the public, typically on a set schedule following the end of each fiscal quarter. These reports include information about the company's financial performance, such as revenue, earnings, expenses, and other key metrics. Earnings season is a significant event for investors, analysts, and the financial markets as a whole. Here's an explanation of earnings season:

8.9.1. Timing of Earnings Season

- Earnings season typically occurs four times a year, following the end of each fiscal quarter. The most common quarters for reporting are:
  - Q1 (First Quarter): January to March
  - Q2 (Second Quarter): April to June
  - Q3 (Third Quarter): July to September
  - Q4 (Fourth Quarter): October to December
- Companies have specific deadlines for reporting their quarterly earnings, and these deadlines are regulated by financial authorities like the Securities and Exchange Commission (SEC) in the United States.

8.9.2. Contents of Earnings Reports

- Earnings reports, often referred to as quarterly earnings releases or financial statements, provide a comprehensive overview of a company's financial health during the preceding quarter. Key components of these reports include:
  - **Revenue:** The total amount of money generated from the sale of goods or services.
  - **Earnings per Share (EPS):** The company's profit divided by the number of outstanding shares of common stock.
  - **Net Income:** The company's total profit after deducting expenses, taxes, and other costs.
  - **Operating Income:** Profit from the company's core operations, excluding non-operating items.
  - **Expenses:** Breakdown of operating costs, such as research and development, marketing, and administrative expenses.
  - **Guidance:** Forward-looking statements or forecasts provided by the company's management about future performance.
  - **Balance Sheet:** Information about the company's assets, liabilities, and shareholders' equity.

- **Cash Flow Statement:** Details on the company's cash inflows and outflows.

8.9.3. Earnings Calls and Analysts' Estimates

- In addition to publishing their financial reports, many companies hold earnings conference calls with analysts, investors, and the media to discuss the results, provide context, and answer questions.
- Analysts often provide earnings estimates before the reports are released. These estimates serve as market expectations against which a company's actual results are compared. A significant deviation from these estimates can lead to stock price movements.

8.9.4. Impact on Stock Prices

- Earnings season often leads to significant stock price movements. Positive earnings surprises (when a company's results exceed expectations) can drive stock prices higher, while negative surprises can result in declines.
- Market reactions can vary widely, depending on the company's performance, guidance, and the broader economic and market conditions.

8.9.5. Importance for Investors

- Earnings reports are crucial for investors as they provide insights into a company's financial health and future prospects. Investors use this information to make informed decisions about buying, holding, or selling stocks.
- Earnings season can also influence market sentiment and overall market trends, impacting various asset classes.
- Earnings season is a key event in the financial markets, as it provides investors with updated information about the performance and outlook of publicly traded companies. It plays a vital role in shaping investment decisions, portfolio management, and market dynamics.

8.10. Test Your Knowledge - Quiz 4

CLICK HERE to test your knowledge

9. Mentoring Plan - 14 Day Free Trial.

Our comprehensive mentoring plan offers guidance and resources across a spectrum of trading instruments, including Options, Futures, FX, and Commodities.

Embark on your trading journey with us and gain access to a wealth of knowledge, tools, and support tailored to your needs. Whether you're a seasoned trader looking to expand your portfolio or a novice eager to explore new avenues, our platform provides the resources you need to succeed.

And here's the exciting part: we're offering a 14 -day free trial to our Share Navigator Options, Futures, FX, and Commodities trading mentoring program. This trial period gives you the opportunity to experience the full range of benefits our platform has to offer, completely risk-free. No credit card required for signup!

During your trial, you'll have access to ‘one to one’ live mentoring sessions, stock watchlists, daily market analysis, and personalized support from our team of experts. Whether you're interested in investing in stocks, mastering options strategies, delving into the world of futures trading, exploring foreign exchange markets, or diving into commodity trading, our platform has you covered.

So why wait? Take advantage of this exclusive offer and embark on your trading journey with confidence.

Sign up for your 14 day free trial

Invest with confidence.