Build Wealth with Stocks

7 Proven Strategies from Beginner to Pro

LEO VIAN

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This book is written for informational purposes only; it does not constitute a solicitation, offer, advice, counselling, or recommendation to invest as such it is not intended to incentivize the purchase of assets in any way.

Epigram

Strategy creates the plan. Discipline delivers the profit.

— *Leo Vian*

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Preface

"*Build Wealth with Stocks: 7 Proven Strategies from Beginner to Pro*" is an updated edition of my original book, "*Beat the Inefficient Market: Investing in Stocks*," which became a bestseller in the United States and Canada.

You may wonder: "If you share your strategies, won't the market become more efficient, and won't that reduce opportunities to outperform it?"
This has never been the case, and it never will be. Most people don't struggle in the market because of a lack of knowledge, but because of a lack of discipline and humility to choose a strategy that matches where they are right now.

In this book, you'll find seven related strategies (systems) with gradually increasing complexity and potential profitability. My hope is that you will always choose the one that's right for you at the time.

I want all of you to succeed — because wider success leads to a more equal distribution of wealth, a better-performing economy, and ultimately a happier world. Wouldn't it be fantastic to live in a world where everyone has plenty? A world where money no longer matters as much as contribution? A world where people don't act out of fear, but out of purpose? A world at peace.

You have the power to help create that world. Focus on your prosperity, and the rest will follow.

I wish you the very best of luck!

— Leo Vian

What's original in this book (and across its editions):

System One:

- The rule that investors should invest in an index fund over a defined minimum period and at a defined frequency, unless they can determine the relative value of the overall stock market.

System Two:

- A formula for calculating the investment amount for any given year based on the relative value of the overall stock market, which cannot be determined by price alone.

System Three:

- A simple investment formula.
- The principle of using a random algorithm (combined with a minimum number of stocks), rather than trying to identify the best company to invest in without sufficient knowledge (addressed in more advanced systems).

System Four:

- An advanced investment formula.
- A definition of a stable company based on five ratios.
- The finding that reasonably priced, stable companies tend to significantly outperform the stock market.
- The finding that "stable bargain companies" can be further screened to identify even more profitable investments.

System Five:

- Use of the formula combined with “non-financial statement analysis” in a prescribed manner.

System Six:

- Shortlisting known, meaningful fundamental strategies, clearly explaining them, and combining them into one methodology with additional inputs.

System Seven:

- Like System Six, but with the addition of technical analysis.

Praise for the First Edition

Sandra Moss
Author
Innovative Investment Insights

Beat the Inefficient Market: Investing in Stocks by Leo Vian is a good addition to investment literature. With fresh theories and methodologies, this book stands out from the crowd. It's a compelling read for both beginners and seasoned investors, offering accessible insights backed by experiments. Leo Vian's courage to challenge conventional wisdom and present original ideas makes this book a valuable asset. Prepare to conquer the stock market with newfound knowledge and inspiration. A good addition to an investor's bookshelf.

Harvey Stills
Investor
A Definitive Guide to Mastering the Stock Market

Beat the Inefficient Market: Investing in Stocks by Leo Vian is an exceptional book that stands as a definitive guide for anyone seeking to navigate the complexities of the stock market. Leo Vian's expertise in investing shines through in this comprehensive and invaluable resource, making it a must-read for both beginners and seasoned investors.

What sets this book apart is its clarity and accessibility. Leo Vian skillfully breaks down complex investment concepts into easily digestible pieces, ensuring that readers can grasp the fundamentals and build a strong foundation in stock market investing. The book is written in a conversational style that engages the reader from the very first page.

Beat the Inefficient Market is not just a theoretical guide; it is a practical handbook that equips readers with actionable strategies and insights. Leo Vian provides a step-by-step approach to analyzing stocks, making informed decisions, and building a well-diversified portfolio. The book is filled with real-world examples that illustrate the principles, making it easy to apply the concepts to one's own investment journey.

One of the most valuable aspects of this book is its focus on beating the inefficiencies of the market. Leo Vian's approach is grounded in evidence-based investing, challenging traditional notions and exposing common pitfalls. His emphasis on long-term investing and maintaining discipline resonates with readers looking for a sustainable approach to wealth building.

Moreover, *Beat the Inefficient Market* empowers readers to take control of their financial future. Leo Vian emphasizes the importance of educating oneself about the market and making well-informed decisions rather than relying on external sources. The book instills confidence in readers to navigate the market with a clear and rational mindset.

As a seasoned investor myself, I found *Beat the Inefficient Market* to be a refreshing and enlightening read. Leo Vian's insights and strategies have transformed the way I approach investing, leading to better-informed decisions and improved portfolio performance.

In conclusion, *Beat the Inefficient Market: Investing in Stocks* by Leo Vian is a five-star masterpiece that deserves a place in every investor's library. Whether you're a novice looking to start your investment journey or an experienced investor seeking to refine your approach, this book is an indispensable resource. Leo Vian's expertise and passion for investing are evident on every page, making this book a must-read for anyone seeking financial prosperity through

the stock market. Prepare to be enlightened, inspired, and equipped with the knowledge to navigate the market with confidence and success.

Brett G.
Reviewer
A Fantastic Resource!

Beat the Inefficient Market: Investing in Stocks is a groundbreaking and refreshing guide that brings a new perspective to investing in the stock market. Authored by Leo Vian, this book is a must-read for both novice investors and those who have experienced setbacks in their stock market journey.

What sets this book apart from others in the genre is its originality. Leo Vian presents a wealth of investment methodologies, financial theories, and views that are entirely unique. Unlike other investment books that seem to echo the same advice, *Beat the Inefficient Market* dares to break free from convention and presents fresh and innovative ideas. By challenging traditional investment wisdom, Vian offers readers a transformative approach to navigating the stock market.

One of the book's standout features is the extensive use of experiments to back up its claims. Leo Vian provides a solid foundation for his theories by conducting thorough experiments, ensuring that the concepts presented are not mere conjecture but have been tested and proven. This emphasis on empirical evidence lends credibility and authenticity to the book, making it a reliable resource for readers.

Beat the Inefficient Market caters to a wide range of readers. It appeals not only to seasoned investors seeking new strategies but also to beginners who may be skeptical

about investing or have struggled in the past. Vian's writing style is clear, accessible, and engaging, making complex concepts easy to understand for readers of all levels of expertise. With practical advice and actionable tips, the book empowers readers to take control of their investments and make informed decisions.

Leo Vian's passion for investing shines through every page of this book. His enthusiasm is contagious, inspiring readers to view the stock market as a realm of opportunity rather than an insurmountable challenge. By instilling confidence and providing readers with the tools they need to succeed, *Beat the Inefficient Market* encourages individuals to embrace the world of investing and unlock their financial potential.

Beat the Inefficient Market: Investing in Stocks is a game-changing book that offers a fresh perspective on stock market investing. With its original ideas, backed by experiments, and its ability to cater to a diverse audience, Leo Vian has created a true standout in the investment genre. Whether you are a beginner or an experienced investor, this book will equip you with the knowledge and confidence to navigate the stock market efficiently. It is a must-read for anyone seeking to achieve financial success through strategic investments.

Introduction

The stock market is inefficient and always will be; therefore, opportunities will always exist to outperform it.

This book is for everyone who is investing or considering investing in the stock market. This includes people who believe investing is not for them and those who have not been very successful in stock investing in the past. The material also presents new market theories backed up by experiments.

This book presents and explains seven stock investment systems with increasing complexity, profit potential, and demands on an investor's resources, such as time.

Systems One through Four are stock investment systems that are based exclusively on investment formulas (with increasing complexity and profitability). They can be applied mechanically and practically by anyone who becomes familiar with them, regardless of their investment talent, which is not needed and will not make any difference in the investment results.

Systems Five through Seven are stock investment systems with further increasing complexity, profit potential, and space for actualizing someone's investment talent.

This book aims to be as practical and helpful as possible, with real examples and links to helpful resources.

7 Stock Investment Systems: At a Glance

System	Description	Complexity	Target Return
System 1	Index Funds	Low	7%
System 2	Beating Index Funds with Index Funds	Lower	8.5%
System 3	Simple Formula	Lower	12%
System 4	Advanced Formula	Moderate	15%
System 5	Formula + Nonfinancial Statements Analysis	Moderate	17%
System 6	Deep Financial Statements Analysis + Nonfinancial Statements Analysis	High	20%
System 7	Technical Analysis + Deep Financial Statements Analysis + Nonfinancial Statements Analysis	High	20%+

A Brief Introduction to the Stock Market

Common Share

If anyone owns a common share of a company, they own a fraction of that company. Anyone who owns 100 common shares of a company with 1,000 outstanding shares owns 10% or 1/10 of that company.

The owner of a common share can earn dividends if the company decides to distribute (part of) its profits to shareholders, and they can also benefit from the increasing price of the shares, often a result of the company's growth through successful reinvestment of its profits.

Owners of a common share have voting rights as they can vote in shareholder meetings and, therefore, have some influence on the running of the company. The more shares they have, the more votes and, therefore, the more influence on the running of the company a shareholder has.

The average return (profit) of one common share of a large US company, which is part of the S&P 500 stock index (dividends + profit from increasing share price), has been around 10.5% between 1923 (when the index was established) and 2021, which means it takes only seven years for an investment in the stock market to double its value if the return of the overall stock is at its long-term average. The price of stocks has gone up these days. Nevertheless, even if the stock delivered 7% per annum, it would take just ten years and three months to double the amount invested in stocks. This makes investing in common shares the most profitable form of investment. One-third of the profits from the shares came from dividends (profits distributed to shareholders), and the

remaining two-thirds came from an increase in the share's price (typically as a consequence of company growth).

This book focuses on investing in common shares, which are referred to as "shares." When the financial press mentions "share," it usually means common share.

Preferred Share

Preferred shares pay fixed dividends. For example, suppose one preferred share of a company costs $25.00, and it pays fixed dividends of 10% per annum. In that case, the holder of such a preferred share is entitled to receive $2.50 per year if the company makes enough profits to pay the whole amount of fixed dividends which preferred shareholders are supposed to receive. If the company hasn't made enough profits to pay fixed dividends to its preferred shareholders, it is in arrears and needs to do so as soon as possible.

Preferred shareholders are paid before common shareholders.

Fixed dividends on preferred shares (or anything that is in arrears) must be paid before dividends can be paid to owners of common stock. In case of bankruptcy, preferred shareholders are paid first, and then common stock shareholders are paid if anything is left. Owners of preferred shares typically don't have any voting rights.

Bonds

Some companies issue bonds to raise capital. A bondholder is a creditor to the company who is supposed to receive the bond's interest rate and, after a certain number of years, the original price of the bond back (when the bond reaches

'maturity'). Bondholders don't have any voting rights and are paid first, even before preferred shareholders.

Stock Exchange

A stock exchange is a place where publicly traded company shares can be bought or sold. Transactions typically take place electronically these days. Most retail traders are buying or selling shares from the comfort of their homes using their computers connected to the internet, or this could also often be done even on smartphones these days.

Stock Derivatives

There are other financial products called stock derivatives. This could be misleading for newbie investors. For example, if anyone buys a stock derivative of Apple, they don’t own a fraction of the Apple company. Nevertheless, a trader can make a profit if the price of the Apple company increases and they sell the stock derivative, which was originally bought for a lower price. Suppose the company or broker that is selling stock derivatives becomes bankrupt. In that case, the customers of that company (owners of stock derivatives bought from the company) will lose (part of) their money. Buying stock derivatives is usually perceived as betting on the stock price or speculation rather than investing. It is strongly recommended that newbie investors check with the financial authority of the particular country whether they are dealing with a company that is selling (or facilitating the selling of) real shares as opposed to financial derivatives.

Stock Investment System One

Complexity of the system	very low
Profitability (approximate; on average)	+7% annualized return

The simplest, least time-consuming, and more or less secure way of investing in the stock market is by investing in the stock market as a whole via investing in suitable stock index funds over sufficiently long periods in regular and short enough intervals.

An index fund is a fund with a portfolio constructed to match the components of a financial market index.

A market index is a hypothetical portfolio of investment holdings representing a segment of the financial market.

Every market segment (part of the market) has specific characteristics.

This book focuses on stock indexes created to represent a geographical segment of the market, such as those that track stocks in various countries such as the United States, the United Kingdom, Canada, Australia, and so on. These benchmarks can be a good representation of the overall stock market of a particular country.

For example, the three most popular stock indexes for tracking the performance of the U.S. market are:

- S&P 500 Index (500 U.S. large stocks by market capitalization)

- The Dow Jones Industrial Average (DJIA) (30 large U.S. companies representing the overall U.S. stock market)
- Nasdaq Composite Index (all of the stocks on the Nasdaq exchange; over 3,000 companies)

Other examples of popular stock market indexes representing countries:

- Canada: S&P/TSX Composite Index (around 250 of Canada's largest public companies)
- Australia: S&P/ASX 200 Index (200 largest stocks in Australia)
- United Kingdom: FTSE 100 Index (100 largest stocks in the UK)

Other types of stock market indexes include those representing industry sectors. And there are stock market index funds following these indexes. Nevertheless, investing in stock market index funds following indexes representing industry sectors cannot be considered investing in the stock market as a whole.

Investing in the stock market as a whole means (in this book) investing in at least one index fund based on following at least one market index representing the stock market of at least one geographical segment of a size of at least one country.

The most common, much more preferred form of a stock index fund is an exchange-traded fund (ETF) rather than a mutual fund. An ETF is an investment company whose shares can be bought on exchanges just like shares of any other company.

Investing in the stock market as a whole could be as simple as buying shares of exchange-traded funds (ETFs), which follow market indexes representing stocks in various countries.

As a citizen of a developed and economically stable country, it makes sense to invest in an index fund based in an investor's country and follow a stock market index representing that country's stock.

Economies of different countries correlate. For example, if the USA was in a phase of economic growth, Canada or Australia would likely be in the phase of economic growth too, so investing in one index fund or exchange-traded fund (ETF), which follows a market index representing the stock of one country is more or less sufficient to invest in the stock market as a whole. Nevertheless, if even greater diversification of investment is desirable, an investor may choose to invest in multiple index funds following market indexes representing stocks of various countries.

A well-known example of an ETF that tracks the S&P 500 Index (500 large stocks in the U.S. by market cap) is the SPDR S&P 500 ETF (SPY).

Buying one share of SPDR S&P 500 ETF equals investing in around 500 large stocks in the U.S. To buy one share of SPDR S&P 500 ETF, an investor will need $417.68 (as of June 7, 2022), which is considerably less than they would need to invest in each of those 500 companies. SPDR S&P 500 ETF will keep a small fee because it is an investment company and needs to make some profit; nevertheless, the fees ETFs charge are very low. In the case of SPDR S&P 500 ETF, the charge is less than 0.1% per year of the capital under their management, which is the monetary value of all stocks the fund has under management (gross expense ratio of 0.0945%). This charge is not paid directly but will

be reflected in the value of the SPDR S&P 500 ETF share. The S&P 500 ETF is being used as an example as it is probably the most known index fund; nevertheless, there are ETFs following the S&P 500 stock index with even lower expense ratios, such as Vanguard S&P 500 ETF with an expense ratio of 0.03%. These fees do not include any broker fees or commissions. The price of one share of Vanguard S&P 500 ETF is very similar to SPDR S&P 500 ETF, so they are both affordable.

Other examples of popular ETFs that track stock market indexes representing countries:

- Canada: iShares S&P/TSX Capped Composite Index ETF
- Australia: SPDR S&P/ASX 200 ETF
- United Kingdom: Vanguard FTSE 100 UCITS ETF

There is one more extremely important thing to know to invest in the stock market as a whole to earn the stock market's average profit (or close to it). Investing over a longer time, such as ten years or more, is crucial. Investing once per year is sufficient; nevertheless, an investor may choose to invest in shorter intervals, such as every quarter of the year (three months) or even monthly if they have enough money to do that. It is good to be prepared. The stock market will go up and down, but by investing over a longer period, someone is supposed to harvest the average performance (profits) of the stock market.

Inflation

Inflation is defined in the Cambridge Dictionary as an increase in prices over time, causing a reduction in the value of money.

Some investors prefer to define their future investments in today's money (including inflation) rather than in nominal terms.

For example, if an investor decides to invest $10,000 in today's money each year, they will have to increase the amount by the rate of inflation each year. If the inflation rate after the first year was 2% (which is a typical level), their second investment increment would be $10,000 + 2% = $10,200 because $10,000 today would be equivalent to $10,200 in one year's time. If the inflation remained the same the second year, the third investment increment would be $10,200 + 2% = $10,404 because $10,404 would buy the same amount of goods in two years' time as $10,000 today.

Inflation typically causes everything to go up: the prices of goods, services, rents, and wages; therefore, it makes sense to invest in today's money rather than in nominal terms.

Inflation is bad news for those who keep their savings in cash because inflation will erode their money over time. Stock investment is a great way to protect investments against inflation.

Opposite to inflation is deflation, which is very rare and typically indicates the economy is in trouble.

Note: Every stock investment system in this book has its hard rules. A hard rule does not mean an investor is subject to some kind of obligation. An investor is free to do whatever they please. The purpose of using ‘hard rules’ in this book is to highlight key considerations for the reader and investor.

Investment Methodology (System One)

Key Principles

Investing in suitable index funds over an active investment period of at least ten years at regular intervals, once a year or more often.

1. Deciding on the geographical segment(s) of the stock market in which an investor wants to invest.

Example:
U.S. stock market

2. Choosing the index fund that follows the stock market index representing the geographical segment of the market an investor wants to invest in.

Example:
Index fund SPDR S&P 500 ETF (SPY) (index fund following the S&P 500 stock index representing 500 large U.S. companies in various industries.)

3. Determining the active investment period, frequency of investing, and the sum of money an investor wants to invest during this period. The active investment period should be at least ten years, and the frequency of investing should be at least once per year as a hard rule of the system.

Example:
Active investment period of 10 years, frequency of investing once per year, sum of money to invest over the whole active investment period is $100,000 (or $100,000 in today's money if inflation is taken into account).

Note:
Investors seeking instant investment or a shorter active investment period should use a more advanced stock investment system such as System Two or above in this book.

4. Calculating the amount of money to be invested.

Example:
An investor wants to invest $100,000 over 10 years while investing once per year; therefore, the amount of money to be invested each year will be $10,000 because $100,000 / 10 = $10,000.

5. Investing the calculated amount of money into the chosen index fund.

Example:
Buying 24 shares of SPDR S&P 500 ETF (SPY) for $9,977.76 ($415.74 each, as of June 7, 2022)

Note:
The value of the stock index and the price of one share of the Exchange Traded Fund following the stock index (form of index fund) do not need to be the same. The current value of the S&P 500 index was $4,160.68 on June 7, 2022, and the price of one share of SPDR S&P 500 ETF (SPY) was $415.74 on the same day. A stock market index cannot be purchased despite the fact the value of the index is in currency units (although some brokers offer the possibility to speculate and bet on various indexes). Investment is possible in stock index funds following the particular index if such a fund exists.

6. Possible switching to a different stock investment system.

The current stock investment system with an uncompleted active investment period and remaining capital that hasn't been invested yet can be switched to a different system at any time. How to do this will be explained later in this book.

Key Takeaways (System One)

- The easiest and relatively safe way to invest in the stock market is by investing in the stock market as a whole via a suitable **index fund** that follows a stock index representing a geographical segment of the size of at least one country.
- Investing in an **index fund** can be as simple as buying shares of an *ETF (exchange-traded fund)*.
- The **hard rules** of *Stock Investment System One* include:
  - An **active investment period** of at least **ten years.**
  - Regular **investment intervals** of **once per year or more frequently.**
  - Investing in an **index fund** that follows a **stock market index** representing a **geographical segment** of the size of at least **one country.**

Stock Investment System Two

Complexity of the system	low
Profitability (approximate; on average)	+8.5% annualized return +125% in 10 years*

*Compounded profits

(Compounding is a powerful investing concept that involves earning returns on both the original investment and the returns received previously. For compounding to work, an investor needs to reinvest their returns.)

The simple and more or less secure way to outperform the stock market while investing gradually over time is to invest less in suitable index funds when the stock is relatively expensive and more when the stock is relatively cheap.

Determining the Relative Value of the Stock

From a long-term perspective, the world economy is continuously expanding, and so is the price of stocks. Therefore, looking at the price of the stock market index does not provide information on whether the stock is cheap or expensive, even if someone compares the current price of the stock index with its average over a certain time period. Another factor contributing to the increase in stock prices is the inflation of money.

To determine whether the price of a stock is relatively cheap or expensive, one needs to look at the value of the price-to-earnings (P/E) ratio of the stock index, not at its price.

Definition of Price to Earnings Ratio

The P/E ratio is calculated as the price of the company divided by the reported earnings (profits) of that company over the last 12 months.

price to earnings = price of a company / net profits (earnings) over the period of the last 12 months

price of a company = price of one share x number of all shares of the company

(If someone bought all the shares of a company, they would own the whole company.)

For example, a P/E ratio of 20 means that the price of a company is 20 times higher than the reported earnings (profits) the firm made over the last 12 months. Alternatively, it could also be said that earnings per share is 1/20 or 5% of the share's price.

The lower the P/E ratio, the cheaper the company from the perspective of this simple ratio.

Please note: The P/E ratio alone is insufficient to determine whether a company's stock is overvalued or undervalued; many other factors, such as expected company growth, must also be considered, as will be explained later in this book.

The P/E ratio of a stock market index can be calculated too. If a stock market index (e.g., S&P 500) has a P/E ratio of 20, it means that the earnings of stocks that are part of the index are 20 times less than the price of the index (or 1/20 or 5% of the price of the index).

(Note: The methods of how stocks are weighted in a stock index can differ. The most common is the market cap weighting method (e.g., S&P 500): Stocks are weighted by the proportion of their market cap to the total market cap of all the stocks in the index.)

The P/E ratio of a stock market index determines whether the index is overvalued or undervalued more reliably than it does for a single stock.

To decide whether the current P/E ratio of the S&P 500 index is relatively high or low, an investor needs to calculate the average P/E ratio for a certain period, such as the last 15 years (recommended period), and compare the current value of the P/E with it.

Calculation of Investment Amount Adjusted to the Value of the Overall Stock

(To effectively invest more when the overall stock is relatively cheap and vice versa.)

Formula:
adjusted investment amount = unadjusted investment amount x (average P/E ratio of the relevant stock market index over the last 15 years / current P/E ratio of the stock market index)

An investor decides to invest $100,000 in U.S. stocks over the intended active investment period of 10 years with investment intervals once per year. The current value of the P/E ratio of the S&P 500 (index consisting of 500 large U.S. companies) is 21.03 (Jun 7, 2022), and the average value of the P/E ratio of the same index over the last 15 years is 22.58.

Note: It is natural that the actual active investment period (contrary to the intended period) could be a bit shorter (if the stock is cheaper overall compared to the past period) or vice versa, a bit longer. The actual period is supposed to mostly range between 8-12 years if the intended period is 10 years; in other words, +/- 20%.

unadjusted investment amount = $100,000 / 10 = $10,000

adjusted investment amount (to the value of the overall stock) = unadjusted investment amount x (average P/E ratio of a suitable stock market index over the last 15 years / current P/E ratio of the stock market index)

adjusted investment amount (to the value of the overall stock) = $10,000 x (22.58 / 21.03) = $10,000 x 1.0737 = $10,737

The current, monthly, and yearly values of P/E ratios of the S&P 500 index can be found at:

https://www.multpl.com/s-p-500-pe-ratio/table/by-year

Note:
Most investors investing in stocks of countries other than the U.S. may not find any resources with values of P/E ratios of a stock index representing the stock market of that particular country. Because the prices of stocks correlate among countries, it seems reasonable to use data from the S&P 500 index to calculate the adjusted investment amount (to the value of the overall stock) as the second best.

Calculation of Average P/E Ratio of the S&P 500 Index

The recommended period for calculating the average P/E ratio is the last 15 years*. Investors who invest more

frequently than once per year do not need to calculate the average value every time they invest. Recalculating and updating the average annually is sufficient. For this reason, our example used 15 values from the 1st of January of each year. Although monthly values are available, yearly values are used to demonstrate that they are perfectly sufficient.

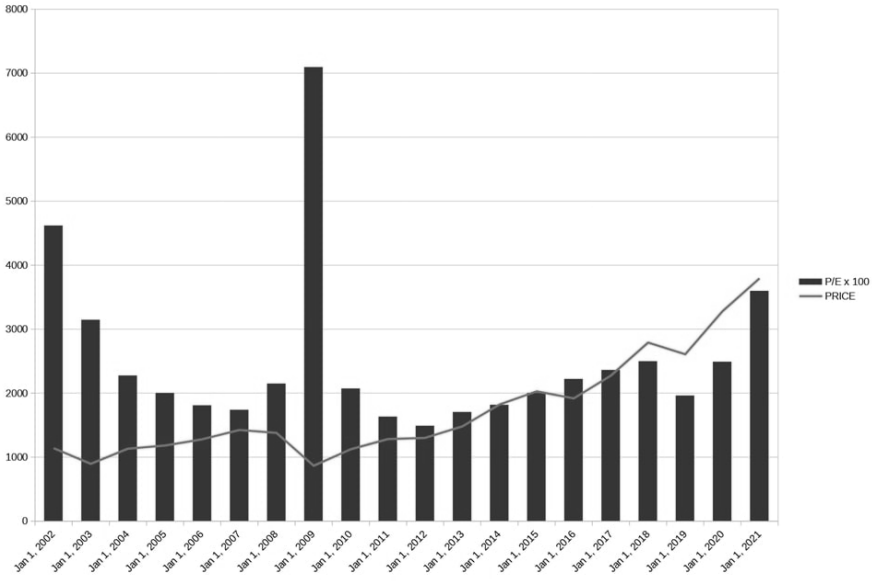
*The recommended period of the last 15 years is chosen because the typical duration of an economic cycle is around 7 years. However, it can sometimes extend to be longer, e.g., 10 years.

	P/E ratio of S&P 500
Jan 1, 2022	23.11
Jan 1, 2021	35.96
Jan 1, 2020	24.88
Jan 1, 2019	19.6
Jan 1, 2018	24.97
Jan 1, 2017	23.59
Jan 1, 2016	22.18
Jan 1, 2015	20.02
Jan 1, 2014	18.15
Jan 1, 2013	17.03
Jan 1, 2012	14.87
Jan 1, 2011	16.3
Jan 1, 2010	20.7
Jan 1, 2009	70.91
Jan 1, 2008	21.46
Average	**24.92**

The chart below illustrates the relationship between the price and the P/E (price-to-earnings ratio) of the S&P 500 index. Please note the P/E values were multiplied by 100, so the relationship between the two values is much more noticeable on the chart.

Upon careful examination of the chart, it can be concluded:

- The price of the index tends to rise more steeply if the P/E is increasing, and vice versa (Jan 1, 2012 – Jan 1, 2018).
- The price of the index can increase despite a falling P/E. However, the price increase is not as steep (Jan 1, 2003 – Jan 1, 2007).
- There can be rare exceptions when the price of the index falls despite a rising P/E (Jan 1, 2008 – Jan 1, 2009). This usually indicates a problem in the economy, as the companies are making fewer profits, which increases the P/E (reported GDP on Dec 31, 2008, was -2.54%, indicating an unusually strong contraction of the US economy).



Experiment

S&P 500 Performance and Returns

Note: Performance refers to the profit from price changes only, while return includes both profits from price changes and dividends.

YEAR	PERFORMANCE	RETURN
2021	20.56%	28.71%
2020	15.73%	18.4%
2019	25.73%	31.49%
2018	-6.54%	-4.38%
2017	22.62%	21.83%
2016	18.58%	11.96%
2015	-5.40%	1.38%
2014	11.29%	13.69%
2013	23.10%	32.39%
2012	13.83%	16%

P/E ratio of the S&P 500 index

DATE	P/E	P/E 15Y AVG.	P/E 15Y AVG. / CURRENT P/E
Jan 1, 2022	23.11	24.92	1.08
Jan 1, 2021	35.96	24.53	0.68
Jan 1, 2020	24.88	23.34	0.94
Jan 1, 2019	19.6	23.01	1.17
Jan 1, 2018	24.97	23.22	0.93
Jan 1, 2017	23.59	23.65	1
Jan 1, 2016	22.18	25.16	1.13
Jan 1, 2015	20.02	25.52	1.27
Jan 1, 2014	18.15	26.12	1.44
Jan 1, 2013	17.03	27.1	1.59
Jan 1, 2012	14.87	27.59	1.86
Jan 1, 2011	16.3	26.59	1.63

The table below illustrates the implementation of System One. Investors invest a sum of $100,000 over 10 years, investing $10,000 each year.

DATE (investments)	MONEY INVESTED	RETURN (end of year)	BALANCE $ (end of year)
Jan 1, 2021	10,000	28.71%	259,545.81
Jan 1, 2020	10,000	18.4%	191,651.63
Jan 1, 2019	10,000	31.49%	151,867.93
Jan 1, 2018	10,000	-4.38%	105,497.7
Jan 1, 2017	10,000	21.83%	100,330.17
Jan 1, 2016	10,000	11.96%	72,352.59
Jan 1, 2015	10,000	1.38%	54,623.61
Jan 1, 2014	10,000	13.69%	43,880.07
Jan 1, 2013	10,000	32.39%	28,596.24
Jan 1, 2012	10,000	16%	11,600

The table below illustrates the implementation of System Two. An investor decided to invest a sum of $100,000 over the intended period of 10 years, investing more when the overall stock price is lower and less when it is higher. Because the stock turned out to be cheaper, the actual active investment period was two years shorter. Please note the last investment amount is the remaining balance of the $100,000 sum rather than the full adjusted amount, which would have been $11,739.80 instead of the remaining $7,728.89.

DATE (investments)	P/E 15Y AVG. / CURRENT P/E	MONEY INVESTED	RETURN (end of year)	BALANCE $ (end of year)
Jan 1, 2021	0.68	0	28.71%	312,759.79
Jan 1, 2020	0.94	0	18.4%	242,995.72
Jan 1, 2019	1.17	7,728.89	31.49%	205,232.87
Jan 1, 2018	0.93	9,299.16	-4.38%	148,353.6
Jan 1, 2017	1	10,025.43	21.83%	145,849.98
Jan 1, 2016	1.13	11,343.55	11.96%	109,690.55
Jan 1, 2015	1.27	12,747.25	1.38%	86,629.43
Jan 1, 2014	1.44	14,391.18	13.69%	72,702.97
Jan 1, 2013	1.59	15,913.09	32.39%	49,557.25
Jan 1, 2012	1.86	18,551.45	16%	21,519.68

The table below illustrates what would hypothetically happen over 10 years if an investor decided to invest a total amount of $100,000 over eight years, investing the same amount each year.

DATE	MONEY INVESTED	RETURN	BALANCE $
Jan 1, 2021	0	28.71%	289,294.44
Jan 1, 2020	0	18.4%	224,764.54
Jan 1, 2019	12,500	31.49%	189,834.91
Jan 1, 2018	12,500	-4.38%	131,872.13
Jan 1, 2017	12,500	21.83%	125,412.71
Jan 1, 2016	12,500	11.96%	90,440.74
Jan 1, 2015	12,500	1.38%	68,279.51
Jan 1, 2014	12,500	13.69%	54,850.08
Jan 1, 2013	12,500	32.39%	35,745.3
Jan 1, 2012	12,500	16%	14,500

The table below illustrates the superiority of System Two over System One, as it delivered over 20% more profits over the intended active investment period of 10 years.

	BALANCE IN 10 YEARS	COMPARED WITH SYSTEM ONE
SYSTEM ONE	259,545.81	N/A
SYSTEM TWO	312,759.79	+20.50%
“8 Years Experiment”	289,294.44	+8.11%

Investment Methodology (System Two)

Key Principles

Investing in suitable index funds while investing more when the overall stock is cheap and less when the overall stock is expensive.

1. Deciding on the geographical segment (of a size of at least one country) of the stock market an investor wants to invest in.

Example:
Canada

2. Deciding on the index fund that follows the stock market index representing the geographical segment of the market (country) an investor wants to invest in.

Example: BMO S&P/TSX Capped Composite Index ETF (Index fund that closely tracks the S&P/TSX Capped Composite index. This index contains the largest Canadian companies trading on the Toronto Stock Exchange (TSX), which equals about 95% of the total Canadian equity market.)

3. Deciding on the active investment period, frequency of investing, and the sum of money an investor wants to invest during this period.

In case an investor decides to invest at regular intervals over time, the intended active investment period should be at least 10 years, and the frequency of regular investment intervals should be at least once per year as the hard rules of the system.

An investor who wants to invest the whole amount at once should do so at a time when the overall stock is undervalued or at least neutral (hard rule). If the overall stock appears currently overvalued, an investor is recommended to start investing as if they were investing over the intended period of 10 years and invest the rest of the amount once the stock becomes (sufficiently) undervalued or at least neutral (hard rule).

Note:
The reason an investor is not recommended to refrain from investing until the stock becomes undervalued (and they are prompted to start gradually investing instead) is because there is no certainty when it will happen or if it will happen at all. Waiting can lead to the possibility of getting a better price; however, it may also result in the loss of profits and cash inflation during the waiting period. The so-called best middle-way approach is especially about safety in this case. It is also supposed to pay off best in terms of profits overall.

Example:
Active investment period of 10 years, frequency of investing once per year, sum of money to invest over the whole active investment period is $100,000.

4. Calculating the unadjusted investment amount.

Example: An investor wants to invest $100,000 over the intended active investment period of 10 years (the actual period may differ) while investing once per year, and therefore, the unadjusted investment amount each year will be $10,000 because $100,000 / 10 = $10,000.

In other words, an investor would invest $10,000 if the overall stock market was neither cheap nor expensive.

5. Calculating (P/E ratio adjusted; the final) amount of money to be invested.

Formula:
adjusted investment amount = (average P/E of the stock index (last 15 years) / current value of P/E of the stock index) x unadjusted investment amount

Example:
Because there is no data available regarding the historical P/E ratios of Canadian stock indexes, data from the S&P 500 index (USA) could be used instead, as stock markets, particularly in developed countries, tend to correlate closely.

The current, monthly, and yearly values of P/E ratios of the S&P 500 index can be found at:
https://www.multpl.com/s-p-500-pe-ratio/table/by-year

adjusted (the final) amount of money to be invested = average P/E of the stock index (as it was on the 1st of January each year over the last 15 years) / current value of P/E of the stock index (Jun 7, 2022) x unadjusted investment amount (result of step 4)

Calculation:
adjusted investment amount = (22.58 / 21.03) x $10,000 = 1.0737 x $10,000 = $10,737

6. Investing the amount of money calculated in the previous step into the chosen index fund.

Buying 383 shares of BMO S&P/TSX Capped Composite Index ETF (ZCN) for $10,743.15 ($28.05 each, as of June 7, 2022)

7. Possible switching to a different stock investment system.

The current stock investment system with an uncompleted active investment period and remaining capital that hasn't been invested yet could be switched to a different system at any time. If an investor decides to do so, they should act as if the already invested capital was invested with the system it is being switched to.

8. Selling

It is recommended that an investor be aware of the value of the overall stock, especially if they are liquidating a substantial part or the entire investment portfolio.

Key Takeaways (System Two)

- The easiest way to beat the stock market while investing over time is to invest in an **index fund**, investing **more when the price of the stock is lower** and **less when the price of the stock is higher.**
- To determine whether the stock is **cheap or expensive**, someone needs to compare the **P/E ratio** of the stock index representing the overall stock market *(e.g., S&P 500 in the USA)* with the **average P/E ratio** of the same index for the last **15 years.**
- Investors considering investing in stocks of countries other than the USA could still use the **S&P 500 index data (P/E)** to determine whether the stock is **cheap or expensive** because the **prices of stocks worldwide correlate.**

Stock Investment System Three

Complexity of the system	low to moderate
Target Min. Number of Stocks in Portfolio	30 stocks
Profitability (approximate; on average)	+12% annualized return +200% in 10 years*

*Compounded profits

Systems One and Two were about investing in the stock market as a whole by investing in index funds.

System Three is different. Nevertheless, it is not complex as it could be labelled as simple formula investing.

Most active fund managers underperform the stock market average. Based on long-term statistics, 84% of active managers underperform benchmarks after 5 years, 90% after 10 years, and 95% after 20 years. (In 2021, 79% of active fund managers underperformed the S&P 500 and Dow indexes).

Outperforming the stock market is a great achievement, and this can be accomplished by simple formula investing. So why do so many professional investors fail?

Main Reasons Why an Investor Fails to Outperform the Market

An Investor is Aiming Too High

A successful investing strategy has to be in tune with an investor's abilities. Simple strategies (tested and valid) have lower profit potential. Nevertheless, they are easier to learn

and implement. More complex strategies (tested and valid) have higher profit potential. Nevertheless, they are more difficult to grasp and successfully employ. An investor should always execute strategies they fully understand and have all the resources for. For example, some investors are capable of mastering more complex strategies. Nevertheless, they don't have all the resources (e.g., time) to successfully implement them, so they have to compromise and choose a less complex and demanding strategy if they want to succeed.

Someone doesn't need superior intelligence to become a good or even exceptional investor. Nevertheless, they need common sense, which everybody has. Too much intelligence can sometimes be a liability in investing because people with exceptional intelligence are more prone to overcomplicating things while losing sight of what matters.

An Investor is Using a Strategy That Simply Doesn't Work

A profitable strategy is supposed to be not only logical but also properly back-tested. It is amazing how many investors/traders, including professional fund managers, are using the wrong strategies. A typical example is a strategy based on some technical indicators found on most trading platforms. Most technical indicators come with a manual on how they are supposed to be used to help an investor make a profit. A newbie trader typically tries to find the best technical indicator or combination of such indicators. They might be successful at the beginning if they are lucky. Nevertheless, the majority of such strategies stop working soon, and an investor eventually ends up losing their money. A strategy based on technical indicators alone is not recommended as very few traders succeed with such a strategy long-term.

The possible main reason brokers like to provide their customers with trading platforms with plenty of technical indicators is that it encourages trading, and the more transactions occur, the better for the broker.

These days, many websites are designed to help stock traders. They typically provide investors with descriptions of companies, financial summaries of firms such as 'income statements,' 'balance sheets,' and 'cash flow statements' with current and historical values, various 'financial ratios,' and stock screeners that can filter companies based on criteria inputted by the user. Additionally, many websites are increasingly offering other, often paid, features such as more advanced and complex fundamental indicators, the sentiment of traders or analysts, analysts' stock price targets, stock rankings, or price target calculations based on an endless number of financial models and complex formulas. However, the information can often be confusing, and its utility is at least questionable. This strongly resembles the previously mentioned issue with technical indicators.

Simple financial ratios work best. It is often more useful to look at several simple financial ratios rather than one complex one that is combining them all. Some complex ratios can sometimes be useful. Nevertheless, it is often vital to examine a set of simple financial ratios from which the complex one is derived or created. The same value of a complex financial ratio can reflect more or less different stories about the company. Without looking at simple ratios from which the complex one is created, someone doesn’t know what is going on in the company with sufficient depth or accuracy. Complex financial ratios or formulas in separation simply mask the space “between the lines”, or between simple ratios, which smart investors need to interpret to make more informed decisions.

The more complex the formula, the more authority it seems to communicate, the more blind reliance it generates, and the less useful guidance it provides.

The main benefit of being aware of such complex formulas is often just information that could also influence some traders' investment decisions.

Emotional Instability of an Investor

Emotional instability as a reason why traders fail is a well-known factor that impacts primarily short-term or speed traders. Nevertheless, also long-term investors can be impacted. Far too many long-term investors exhibit erratic behaviour because they simply don't know what they are doing. An investor needs to have confidence in their strategy, which they need to understand on a sufficiently deep level while being convinced about the validity of such a strategy based on evidence.

Exercise:
Try to imagine you inherited money worth a few million US dollars. You are a passionate chef, and your dream has always been to have and run your own restaurant. You would prefer buying an established and running business rather than starting from scratch. You came across someone who would like to sell their business. It is an adorable restaurant in a nice location. You feel really tempted. Please grab a pen and paper. Relax and employ your imagination. Try to list just a few key pieces of information or facts (let's say 3-5) that you would like to learn about the restaurant to decide whether it is worth buying. Once you are ready, you could try to rank each item in order of importance. Please stop reading and do it now.

Perhaps the most important information for most people will be the price of the business, in our case, the restaurant.

That’s very obvious. Nevertheless, price alone doesn’t say too much apart from whether someone can afford the purchase.

End of the Book Sample

To continue reading, purchase the full book at:

www.leovian.com