Standard

Online Share Trading

Education newsletter

Issue # 33
9th June 2009

In the business world, the rearview mirror is always clearer than the windshield.

Warren Buffett

NEW FEATURE
Dividends now available on ex-date

We have added new functionality to our system to add the proceeds of cash corporate events (i.e. dividends, capital reductions, share buy-backs etc) to the Available Trading Cash balance on the morning of the ex-date, thus allowing clients to use this cash for further investment prior to the actual cash being received.

Up to now, clients only had access to these cash corporate events on the pay-date, which is 5 business days after they became entitled to them, because the settlement cycle for corporate events is 5 business days from the Last Day to Trade date (LDT).

Note that this cash can still only be withdrawn from the pay-date and that clients will NOT be charged interest if this cash is used for further purchase transactions. This simply because the settlement of any purchase transaction which used this cash will occur on or after the actual cash is received on the pay-date.

To get a detailed breakdown of any such adjustments to your Available Trading Cash balance select "My account" then "Detailed cash balance".

Client courses for the next few weeks

These courses are *exclusively for Online Share clients* and all are free. To book for one of these courses log onto Online Share Trading and go to; Help & Education ➔ Face to face classes

Johannesburg
- Half day detailed warrants course (13 Jun)
- Introduction to technical analysis (part 2) (04 Jul)
- Understanding Share Instalments (14 Jul)

Cape Town
- Introduction to Futures (24 Jun)
- Understanding Share Instalments (25 Jun)
- Half day detailed warrants course (27 Jun)

Durban
- Introduction to technical analysis (part 1) (20 Jun)
- Trade to trade well (25 Jun)

Pretoria
- Introduction to investing (20 Jun)

TALK
From the editor

We're running our Investment Outlook presentation during June and there are a very limited number of seats left. For those unable to attend we will place the audio file and PDF of the PowerPoint on the website for download during the third week of June.

Simon Brown
Head: Education & Media
Standard Online Share Trading

MARKETS
Company Fundamentals

All businesses share the goal of profitability and the overriding intention in all their decisions is that of generating profit for the providers of capital.

Thus, the fundamental analysis of a company's profitability is critical to better understanding what you are investing in and how risky it is.

While there are numerous ratios and measures of profitability, the five most important ones for stock market investors are:

(Various) earnings per share: "(various) net profit / weighted average number of ordinary shares"

Earnings per share ("EPS") shows what profit (or loss, if the value is negative) that is attributable to the providers of risk capital. The long and short of investing is that it really is this number that drives all share prices in the long-term: if the EPS keeps going up then so will the share price.

The various types of EPS include Headline EPS (excludes "once-off" items from the profit figure to try to determine the core earnings). The various Dilute EPS (includes potentially issuable dilutive shares that, if they had been in issue in the past financial year, would have dropped the denominator of the equation and lowered EPS).

Return on Equity ("RoE"): "Profits / Equity" or "EPS / NAV per Share"

RoE really tells you is how profitable shareholders funds are being applied. The best way to view this number is in terms of alternatives: if shareholders had never given the company their money and had invested it at a bank/fixed deposit…would they have made more money?

Comparing a RoE of 10% to a fixed deposit of 15% means that the investor could have made a further 5% (with probably less risk) by putting his money into the fixed deposit.

Thus, the RoE should be as high as possible.

Return on Assets ("RoA"): "Profits / Assets"

The RoA takes into account the debt-funding aspect of a business' capital structure (which RoE would've ignored) and answers the question of how effectively and efficiently the business' assets are being used to generate profit.

Said differently, the RoA shows you how profitably all funds are being applied.

A company with zero debt would have its RoE equal to its RoA, but those that are highly geared (and profitable) would have a RoA vastly lower than their RoE.

The RoA of a company should also be as high as possible and, whenever possible, as close to the RoE as possible (implying low debt and low risk).

Gross Profit Margin: "Gross profit / Turnover"

Gross profit is the first measure of a company's true profitability in terms of its ability to turn its primary sales into profits. If this figure is negative, then there is little hope for the business and it probably won't be around long.

Businesses with a large gross profit margin tend to be industry leaders and/or in non-competitive industries and/or have strong competitive advantages that allow them some form of pricing power.

Whereas, a low gross profit margin indicates a highly competitive industry and/or a weak product/service proposition with lacking demand and/or many alternatives.

Net Profit Margin: "Net Profit / Turnover"

While the gross profit margin shows the business's first line of profitability, the net profit margin shows the business's ability to efficiently turn that initial profit into its valuable bottom line profit (tax efficiently too).

Sometimes companies will have healthy gross profit margins, but—because of inflated executive pay, impairments, depreciation, extravagant operating expenses etc.—their net profit margin takes a significant knock (perhaps even turning into a loss).

In this way (while the gross profit margins shows the competitiveness of the business) the net profit margin shows the efficiency of the business and should be as high as possible.

In conclusion, profits are the true drivers of both business and share prices, thus for a stock market investor a thorough analysis of them is critical to making an informed decision.

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TRADING
Moving Averages: Strategies

Different investors use moving averages for different reasons. Some use them as their primary analytical tool, while others simply use them as a confidence builder to back up their investment decisions. In this section, we'll present a few different types of strategies - incorporating them into your trading style is up to you!

Crossovers
A crossover is the most basic type of signal and is favored among many traders because it removes all emotion. The most basic type of crossover is when the price of an asset moves from one side of a moving average and closes on the other. Price crossovers are used by traders to identify shifts in momentum and can be used as a basic entry or exit strategy. As you can see in Figure 1, a cross below a moving average can signal the beginning of a downtrend and would likely be used by traders as a signal to close out any existing long positions. Conversely, a close above a moving average from below may suggest the beginning of a new uptrend.

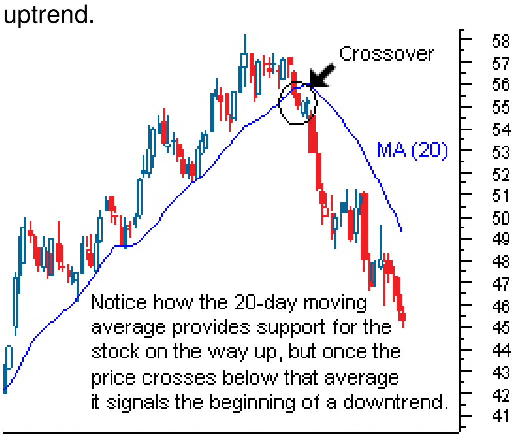


Chart by MetaStock Copyright © 2006 Investopedia.com

The second type of crossover occurs when a short-term average crosses through a long-term average. This signal is used by traders to identify that momentum is shifting in one direction and that a strong move is likely approaching. A buy signal is generated when the short-term average crosses above the long-term average, while a sell signal is triggered by a short-term average crossing below a long-term average. As you can see from the chart below, this signal is very objective, which is why it's so popular.

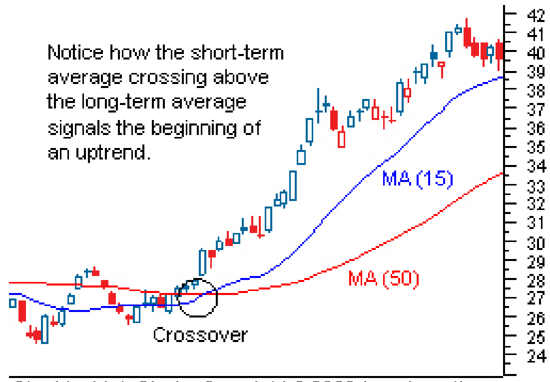
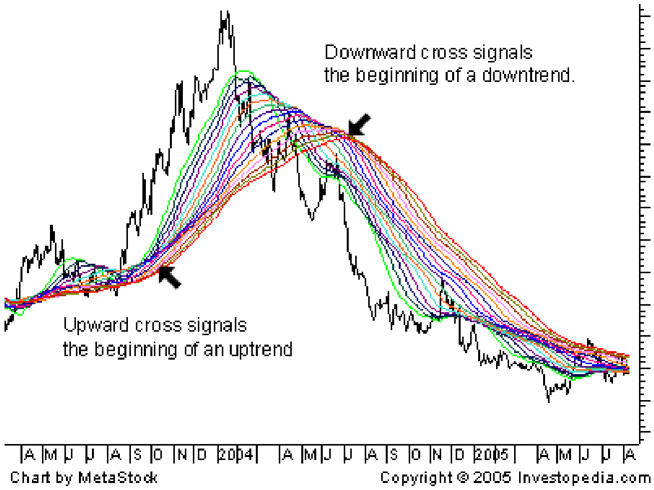


Chart by MetaStock Copyright © 2006 Investopedia.com

Triple Crossover and the Moving Average Ribbon
Additional moving averages may be added to the chart to increase the validity of the signal. Many traders will place the 5-, 10-, and 20-day moving averages onto a chart and wait until the five-day average crosses up through the others – this is generally the primary buy sign. Waiting for the10-day average to cross above the 20-day average is often used as confirmation, a tactic that often reduces the number of false signals. Increasing the number of moving averages, as seen in the triple crossover method, is one of the best ways to gauge the strength of a trend and the likelihood that the trend will continue.

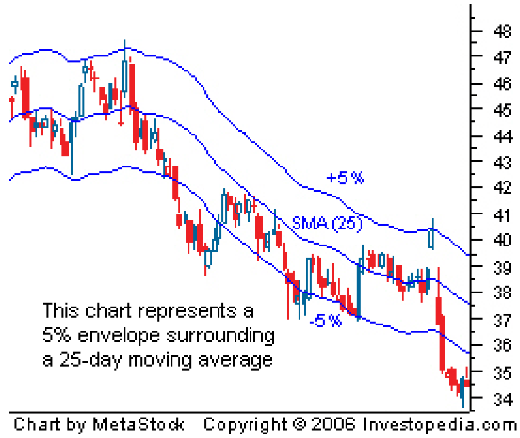
This begs the question: What would happen if you kept adding moving averages? Some people argue that if one moving average is useful, then 10 or more must be even better. This leads us to a technique known as the moving average ribbon. As you can see from the chart below, many moving averages are placed onto the same chart and are used to judge the strength of the current trend. When all the moving averages are moving in the same direction, the trend is said to be strong. Reversals are confirmed when the averages cross over and head in the opposite direction.

Responsiveness to changing conditions is accounted for by the number of time periods used in the moving averages. The shorter the time periods used in the calculations, the more sensitive the average is to slight price changes. One of the most common ribbons starts with a 50-day moving average and adds averages in 10-day increments up to the final average of 200. This type of average is good at identifying long-term trends/reversals.



Filters
A filter is any technique used in technical analysis to increase one's confidence about a certain trade. For example, many investors may choose to wait until a security crosses above a moving average and is at least 10% above the average before placing an order. This is an attempt to make sure the crossover is valid and to reduce the number of false signals. The downside about relying on filters too much is that some of the gain is given up and it could lead to feeling like you've "missed the boat". These negative feelings will decrease over time as you constantly adjust the criteria used for your filter. There are no set rules or things to look out for when filtering; it's simply an additional tool that will allow you to invest with confidence.

Moving Average Envelope
Another strategy that incorporates the use of moving averages is known as an envelope. This strategy involves plotting two bands around a moving average, staggered by a specific percentage rate. For example, in the chart, a 5% envelope is placed around a 25-day moving average. Traders will watch these bands to see if they act as strong areas of support or resistance. Notice how the move often reverses direction after approaching one of the levels. A price move beyond the band can signal a period of exhaustion, and traders will watch for a reversal toward the center average.



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REVIEW - BOOK
Common Stocks and Uncommon Profits & other writings

Common Stocks and Uncommon Profits and Other Writings
by Philip A. Fisher

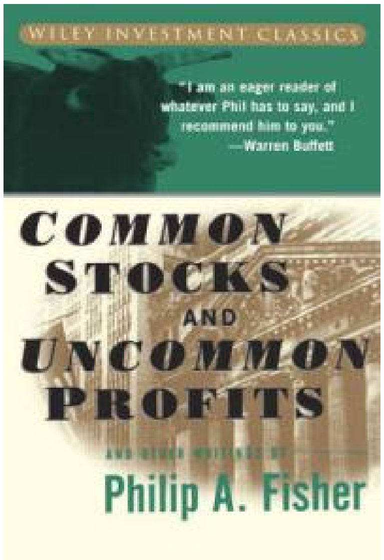
You can ignore this book, but only at your PERIL!!!!

Having been associated with Wall Street for 35 years, I was lucky enough to have been in the same room with Philip Fisher on more than one occasion. He was a completely self-contained man, extremely comfortable in his own skin. He knew who he was, what he was, and what he could be. He possessed zero airs about him. These traits seem to run freely in many MASTER investors, including Warren Buffett .

Many have mentioned that Buffett considers himself to be 85% Benjamin Graham, and 15% Philip Fisher. This needs to be updated. If you spoke with Buffett today, he would tell you that those ratios are distorted, and the reason is Charlie Munger, Warren Buffett's investing partner at Berkshire Hathaway.

Charlie Munger is cut from the same cloth as Philip Fisher. They are growth players, and willing to pay up for a stock. For decades Buffett could NEVER PAY UP for a stock. He wanted them dirt cheap, so cheap in fact that some big plays got away from him forever. I don't know how many years ago, Buffett mentioned in a meeting I attended that he once owned a considerable amount of Disney. It would be a controlling amount in today's market; it got away from him, and tens of billions of dollars in that play alone.

In the old days when Buffett was strictly Graham and Dodd, he could not buy a GROWTH stock. He still cringes at the thought. Munger however taught Buffett to pay up. An example was Flight Safety International for which Buffett paid a previously unheard price-earning ratio. There are people around Buffett who know him well who will tell you that Munger is the superior investor. What you need to know is that sometimes stocks are DIRT CHEAP because they are DIRT, to use a Munger line.



Philip Fisher like Munger is a MASTER INVESTOR worthy of spending whatever time you can spare studying. If you want to walk in the footsteps of a MASTER, you must study the MASTER, and Fisher has a tremendous amount to offer.

I have managed billions of dollars in my lifetime. I am telling you this because you need to know that the SKUTTLEBUTT method that Fisher is famous for is something that anyone can used, starting today. Most of Wall Street research or any research that I have seen over the decades is not worth the paper it is printed on. On more than one occasion I have asked if the paper is soft enough to use for toilet paper.

With the scuttlebutt method, you talk to everyone but the company you are studying. Please allow me to illustrate. If you are thinking of investing in a car company, you start visiting car dealers. You learn the lingo, you read trade periodicals, maybe even a few car magazines, but be careful. Magazines and newspapers are completely jaded in their reporting by how much advertising dollars they receive from certain companies. You didn't know that because no one will ever dare print it.

If a newspaper wants to bury an important story on a company that gives them tremendous advertising dollars, they will run the unfavorable story, but it will be in the Saturday morning edition, which is the least read edition of the week. You need to know these things. I used Scuttlebutt back in the 80's, to accumulate a massive position in Chrysler when it was near bankruptcy. The stock went from $6 to $200 after splits. It isn't hard. You don't need to be a big market player, anybody really can do it.

You do need an inquisitive mind, and I believe an innovative one as well. Fisher was a guy who thought outside the box, and that's why he was immensely rich, as is his son Ken. Philip Fisher is a guy that made a fortune in FMC Corporation, owned it for 30 or more years. He was a ground floor player in Texas Instruments, owned it and made thousands of percent on the stock. He was every bit Buffett's equal, and to Fisher's credit, he gave us the greatest gift of all. He wrote a book, and was open with his readers about how to attain great wealth in the market.

He takes the "Efficient Market Hypothesis" (EMT), and blows it out of the water. His returns and Buffett's are so many standard deviations away from the mean, that EMT can't survive an investigation based on their results.

He gives you a 15-point criteria list to identify the types of companies that meet his screening. He also gives you five don'ts, and then five more to protect you as an investor. What Fisher is really doing is giving you a TEMPLATE to used as an investor. This is what you need. This is no different than going into the Marine Corps, and spending 12 weeks in basic training. Once you're done, you have certain smart behaviors drilled into your psyche so deep that in combat, and investing is combat, you can fall back on these techniques to survive. They become automatic. No matter what investment turns up, you can put it through the filters that have stood the test of time.

In closing, I would like to say one more thing about the Scuttlebutt technique. Recently, I had to make a decision to invest a considerable amount of money in the auto sector. One of the people I consulted with, is a legend in his 90's, who is the greatest mutual fund investor of the 20th century, probably worth over a billion dollars. He says to me in passing, do you know whom Toyota, the greatest car company in the world fears? The answer is the South Korean car companies. That my friends is worth a fortune, and is a 20 year stock play that Philip Fisher would have envied.

JARGON BUSTING
Covered call

The selling of a call option while simultaneously holding an equivalent position in the underlier. This is an attempt to take advantage of a neutral or declining stock. If the option expires unexercised, the writer keeps the premium. If the holder exercises the option, the stock must be delivered, but, because the writer already owns the stock, risk is limited. This is the opposite of an uncovered call, when the writer sells a call for a stock that he/she does not already own, a dangerous strategy with unlimited risk.

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JARGON BUSTING
Socionomics

The study of social mood and its effects of social behavior. Socionomic theory suggests that trends in social actions such as the economy, financial markets and political preferences are influenced by trends in social moods.

The socionomic perspective can be applied to any area of social activity, including economics and finance. Some examples of socionomic views in contrast to traditional views of human behavior are:

- Where the traditional view would be that recessions cause businesses to become cautious, the socionomic view says that businesses become cautious and cause recessions.
- Traditionally, it is thought that a bull market makes investors optimistic. Socionomics says that optimistic investors create a bull market.
- It is thought in the traditional view that scandals make people outraged. Socionomics believes that outraged people will seek out a scandal.

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ROAD SHOWS
Getting started in shares

Online Share Trading and the JSE host a free one and a half hour educational seminar to the public. The seminar is designed to get you started on how to invest in shares and are open to the general public.

By attending one of the seminars, you will learn:

- Investing and returns
- Why invest in the share market
- How to develop an investment strategy
- Understanding the share market
- What determines the share price
- How to make money in the market
- How to choose companies to invest in
- How do you buy shares
- Next steps

Tell your friends and family and help them get started on the path to creating wealth.

Dates & cities

- Johannesburg – 01 July & 15 July
- Durban – 01 July
- Cape Town –30 June
- Pretoria – 13 July

To book go to http://courses.standardbank.co.za

All venues are central and start at 6.00pm.