Stock Picking Made Easy

Use These 17 Easy-To-Use Criteria to pick good stocks at great price

Out of 100s of stock selection criteria, here are 17 that will help you identify both, the right stock as well as the right price to buy at. This book also includes the sources of data from where you will be able to easily find the required information.

By Kunal Shah

http://www.InvestingFunda.com

"It amazes me how people are often more willing to act based on little or no data than to use data that is a challenge to assemble."

Robert J. Shiller

"Investing money is the process of committing resources in a strategic way to accomplish a specific objective."

Alan Gotthardt, The Eternal Portfolio

"If you have trouble imagining a 20% loss in the stock market, you shouldn't be in stocks."

John Bogle

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I want to thank you and congratulate you for buying the book – ‘Stock Picking Made Easy’.

This book contains proven steps on how you can identify good quality stocks. It includes qualitative as well as quantitative criteria to identify the right stocks. The book also includes examples, so understanding it is a breeze.

Thanks again for downloading this book. Hope you enjoy it!

HAPPY INVESTING

Chapter 1: Introduction

Why is stock picking so important? The answer is very simple. We have finite amount of money to invest, and we want the best possible return at the least possible risk. There are hundreds of stock-picking criteria that people use – ranging from very simple to very complex. In this book, you will learn about the most important criteria that an investor must pay attention to. The stock selection process should be simple and easy to manage. The data used to identify stocks should be easily available. The idea is to keep the process simple, but be able to *consistently* identify good quality stocks. This book is written with keeping the Indian investors in mind. The examples and the websites used for data sources are all from the Indian stock exchanges. However, the concept remains the same the same in any stock exchange.

Picking winning stocks is an *art* as well as a *science*. At the end of the day, it is all about the demand and supply. If you buy stocks in a great company, but there is no demand, the stock will not go up. On the other hand, if the company is not doing really great, but for some reason, there is a lot of demand, the stock will go up.

The stock picking strategy also depends on how long you intend to keep the stock for. In this book, you will learn about both, short term investing as well as long term investing. Short term is typically less than one year. Long term is typically more than 3 years. Sometime you buy shares of a company, with the plan to sell within a year, but you may decide to hold for a longer duration. Or, vice-versa, you may get out of an investment that you thought was a long term investment.

You will also learn about the practical tips that every investor should consider. These golden nuggets have been gleaned from years of experience of many long-time investors.

Remember the story of the blind men and the elephant? No matter how much you analyze a stock, there will always be blind spots (and hence risk) associated with stock investing.

In this book, you will learn how to reduce the blind spots and reduce the risks.

Who is this book for?

This is a book for individual investors who want to pick the right stocks and beat the market. It is not for those investors who are looking for get-rich-quick schemes. Identifying good companies and investing in them at the right time and at a right price takes efforts and discipline. This book is for you, if you are –

- Self-directed

- Disciplined
- Looking for a methodology that is simple to use and easy to follow
- Looking for sound investment strategy
- Wanting to cut thru the investing noise
- Willing to devote a few hours each week
- Serious about building wealth

This books is not for someone looking for a ‘get quick rich’ scheme.

Chapter 2: Basics of Stocks and Stock Markets

This chapter will set the stage on stock valuation. In this chapter, you will learn the key concepts that you have to keep in mind as a stock investor.

Why Invest in the Stock Market?

There are several reasons to invest in the stock market.

1. Stock markets the world over have given a reasonably good return over long periods of time.
2. Stock markets have beaten inflation hands down.
3. This is a liquid investment. One can sell the shares almost immediately in most cases and have cash in hand when required.
4. Long term capital gains tax on stocks is zero in India. If you hold stocks for over a year and sell at a profit, there is no tax liability in India.

What does a Share represent?

Each and every share of a company stock represents a fractional ownership in the company. For example, TCS has issued 1,96,00,00,000 shares. These 1,96,00,00,000 shares represent 100% ownership of the company. Hence each shareholder is a fractional owner of TCS.

What is Dividend?

The company management may decide to pass on the profits of the company to their shareholders. This profit is known as the dividend. TCS this fiscal has declared dividend three times – an interim dividend of Rs. 5/share, a special dividend of Rs. 40/share, and a second interim dividend of Rs. 5/share. Hence each TCS shareholder has received Rs. 50 for every share held. Some companies decide to pay the investors in the form of dividend, where as some companies choose to deploy the profits back into the business. The decision depends on the amount of profit, potential investment/expansion opportunities, and the growth stage of the company.

Who are the Key Players in the Stock Market?

The key players in the Indian stock markets are Foreign Institutional Investors (FII), Domestic Institutional Investors (DII), Brokers, and retail investors. In general when FIIs buy, the stock market goes up. DIIs are made up of domestic mutual funds and other big investors like Life Insurance Corporation of India. DIIs and FIIs form the bulk of the investors. Retail investors are investors like you and me who buy small number of shares at a time. Brokers and market makers provide the liquidity in the market.

What does Market Cap mean?

Market Cap stands for 'market capitalization' of a company. It is the total value of all the shares issued by a company. Going back to the TCS example, each share of TCS costs Rs. 2578. The market cap of TCS is Rs. 50,50,00,00,00,000. While comparing companies, an investor should compare the market cap instead of the absolute stock price. Hence to compare the valuation of TCS and Infosys, we should look at the total market cap to see which one is valued more (not necessarily more expensive).

Is Face Value Relevant anymore?

Face value of a share is the actual price printed on the share. The face value of shares times the number of shares issued by a company is that company's capital invested. The face value of TCS shares is Rs. 1. Hence its capital generated from sale of shares is Rs. 1,96,00,00,000. However, the face value of a share is becoming less and less relevant. That is because the shares are sold by companies at a premium to the face value. For example, Form 8-A filed by Facebook at the time of its IPO states the following:

"Facebook, Inc. (the "Registrant") hereby incorporates by reference the description of its Class A common stock, par value $0.000006 per share, to be registered…"

The shares of Facebook have a face value of $0.000006, but were offered to the general public for $28 to $35.

One primary purpose of the face value is to compare the amount of dividend paid by different companies. For example, if TCS pays a dividend of Rs. 1 per share, and if Facebook pays a dividend of $0.5 per share, which one is better? The money invested into buying 1 share of TCS is Rs. 1. Hence on percentage return on investment of one share is 1/1*100 = 100%. Similarly, return on investment on one share of Facebook is 0.5/0.000006 = 8333333%! But that is not correct, right? Investors paid $28-35 per share. Let's say the investors paid $30/share during the IPO. Hence their actual return is 0.5/30 = 15%.

In an IPO today, almost all companies today sell their shares at a premium to face value. Hence face value doesn't really matter to today's investors.

What are the Sources of Market Information?

In India, some of the large, and reliable sources of information are the stock exchanges like National Stock Exchange (NSE) and Bombay Stock Exchange (BSE), large private players like Moneycontrol.com and brokerage houses like Edelweiss, HDFC Securities, ICICI etc. You should use reliable sources like www.nseindia.com, www.bseindia.com, www.edelweiss.in, www.hdfcsec.com etc. to get financial information. If data looks incorrect, an investor should also check multiple sources. Investors can also use international sources like www.equitymaster.com and in.reuters.com to access market data. In this book, we will use www.nseindia.com, www.edelweiss.in, and www.icharts.in. Edelweiss requires a registration, but it is free.

What is NIFTY and BankNIFTY?

Nifty is a major stock index consisting of 50 large companies. It is introduced by NSE. NIFTY was coined from the two words 'National' and 'FIFTY'. The word fifty is used because the index consists of 50 actively traded stocks from various sectors. The method adopted for calculating NIFTY is the market capitalization weighted method in which weights are assigned according to the size of the company - the larger the size, higher the weightage. The base year is taken as 1995 and the base value is set to 1000.

Bank Nifty is an index that represents the 12 most liquid and large capitalized stocks from the banking sector which trade on the National Stock Exchange (NSE). It provides investors and market intermediaries a benchmark that captures the capital market performance of Indian banking sector.

Bank Nifty is more volatile than NIFTY and SENSEX.

What is SENSEX?

SENSEX is one of the oldest stock indexes in India. It was created by BSE in 1986. The Sensex is designed to reflect the overall market sentiments. It comprises of 30 stocks. These are large, well-established and financially sound companies from main sectors.

Most of the SENSEX 30 companies are also included in NIFTY. Hence, it is very typical to see both the indices moving in tandem. Investors and brokers who have been operating for years (some even before the formation of NSE) continue to track SENSEX, whereas newer investors and traders use NIFTY as it represents 50 companies instead of 30.

Chapter 3: Introduction to Stock Evaluation

Stock evaluation criteria can be divided into three categories.

1. Management Analysis
2. Fundamental Analysis
3. Technical Analysis

Management Analysis refers to the quality, trustworthiness, and performance of the management of a company. It looks at the efficiency of the management, how well they reward the investors, and how well they deploy company assets.

Fundamental Analysis refers to the analysis of the business. It looks at how the business is doing, whether the company is growing, profits are increasing, whether the company has too much debt etc.

Technical Analysis refers to the analysis of the performance of the stock price. It looks at the averages of the stock price over different durations like 7 days, 13 days, 55 days, 100 days, 200 days etc. It also looks at the volume as well as different accumulation and distribution patterns formed by the stock price.

Management Analysis

Investing in shares is similar to investing in a business, or joining a company as a partner. Before becoming a partner in a business, the first thing an investor would consider is, "are my partners trustworthy, do they have the interest of the partnership at heart?" It is same with buying shares of a company.

An investor shouldn't put his money in the stock of a company whose management cannot be trusted to make decisions in the interest of the company, regardless of how lucrative the business opportunity may be.

Next, the investor would look at the efficiency with which the current partners are running the business. If the partners are not really efficient in running the business, it doesn't make sense to invest in that business.

Management analysis is the litmus test to identify quality companies.

"*Does the management have a determination to continue to develop products or processes that will further increase total sales potentials when the growth potentials of currently attractive product lines have largely been exploited?*" **David Arturo Chaves**

Some of the management evaluation criteria are:

Company Management

The management is the single most important criteria for investing in a company's stock. An investor-friendly, honest, and efficient management is the best type of management an investor can hope for. This is a qualitative analysis, and is based on the perception of the investing population. For example, the Tata group of companies has a very long history of running clean, efficient businesses for decades. Similarly, companies like DLF have been in the news for all the wrong reasons. A stock investor has a large number of companies to pick from. It is better to stay away from names that may potentially have a poor management reputation.

It is very difficult to find qualitative analysis on management of companies. To start with, ensure that the management has a good clean image (think Tatas). Management should also not be involved in any negative news. Reading newspapers like Economic Times and websites like Moneycontrol will give investors an idea of the reputation the management has in the marketplace.

Information on the rest of the parameters in this chapter can be found at http://www.Edelweiss.in.

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Fundamental Analysis

Once an investor is comfortable with the company management, the next is the analysis of the company or the business. During fundamental analysis the investor tries to understand how the company is performing financially.

Most of the parameters below can be found on the Edelweiss website.

Fundamental analysis in conjunction with the management analysis should be used to identify if the company is good to invest in. It tells the investors if they should invest in the company.

"*Fundamental analysis: Very powerful in terms of determining long-term direction, but lacks short-term applicability.*" **John Forman**

Here are some of the key parameters to check the fundamental analysis of a company.

Earnings per Share (EPS)

EPS is the money earned for each share of the company. It is expressed as

EPS = Total Earnings / Total number of shares issued

EPS for a quarter or a year by itself doesn't mean anything. Investors should look for the EPS number to grow on a regular basis. This shows that the company is making more money year after year.

It is important to note that if a company issues bonus shares, or splits the existing shares (thereby reducing the face value), the EPS will come down as the number of shares outstanding will increase. The investor should factor this in while using the EPS.

EPS can be found on the stock overview page on the Edelweiss website. Figure 2 shows the EPS of TCS.

Also, comparing EPS of one company with another is like comparing apples to oranges.

"*Price is what you pay. Value is what you get.*" Warren Buffet

Sales Growth

'Sales' is the money a company earns during the normal course of business. It does not include money earned by selling an asset, or the interest earned on the cash in the bank account. It is important to measure the sales growth as it tells the investor if the company is able to sell its products or services. If the sales are growing, it means there is a demand for the products of the company.

Growing sales is a key parameter in evaluating a company. After all, why would you invest money in a company that is not able to sell more year after year?

Revenue is the total income of a company and may include money generated from other sources like interest income. Hence it is possible that the 'Sales' is a subset of the total revenue of a company.

Figure 1 shows the 1 and 3 year sales growth of TCS.

TCS sales grew 24% in 2011, 31% in 2012, 29% in 2013, and 30% in 2014. This shows that TCS is able to grow its sales at an average of about 30% every year.

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Technical Analysis

Technical analysis analyzes the performance of the stock price. Just as the fundamental analysis tells the investors if a company is good to buy, technical analysis helps identify when to buy. The reason technical analysis is useful is because all news, known and unknown are factored into the stock price.

"*You must remember that Technical Analysis and the use of Point and Figure is like learning to ride a horse. It's no good sitting down and reading a book on how to do it. You have to get on the horse, ride around, and perhaps fall off a few times, until you can claim to know anything.*" **Jeremy du Plessis**

Price – volume action gives a good indication of the movement of the stock price in the near future. Many experts maintain that technical analysis is not needed if the shares are bought for the long haul. However, if they help an investor in identifying a better entry point, why not use it?

The right technical analysis will help the investor buy the shares at the right time and at the right price. This helps reduce the loss of capital in case something goes wrong.

Typically, investors use multiple indicators in conjunction to identify the right time to buy or sell a stock. Individual indicators are like the men in the 'blind men and the elephant' story.

Here are some of the technical analyses that investors must consider.

Price – Volume Action

Using the stock price and the trading volume is the first criteria for evaluating an entry point. The combination of price and volume can give us the general direction of a stock.

Price – It is safe to assume that for any stock, there is always published information and unpublished information. Unpublished information is also known as insider information. Only the management and their close associates are privy to such unpublished information. Officers and employees of the company are prohibited from using insider information to transact the shares of their company. However, due to leaks and other reasons, you can always assume that there are market players who have obtained some of this insider information. The stock price reflects all the known and unknown information about the company. Sometimes investors notice that the stock has moved for no apparent reason, only to find out in a next few days that there was indeed additional information that would have caused the price movement.

Volume – The volume or the number of shares traded tells us whether there are more buyers or sellers for this stock in the market. For example, if the volume is higher than normal and the stock price goes up, means there are more buyers than sellers. Similarly, if the volume is high and the stock price goes down, there are more sellers than buyers.

The table below explains all the price-volume combinations.

Price	Volume	What it means
Going Up	High /Increasing	As long as the price is going up, and the volume is higher than average, there is upwards momentum. The moment either the price becomes flat or the volume drops, it is likely the end of the upwards momentum.
Going Up	Low	If the stock is going up, but the volume is low, it means there are not too many buyers at higher price. The high price may not sustain for long.
Going Up	Average	<<Preview Ends>>
Going Down	High	<<Preview Ends>>
Going Down	Low	<<Preview Ends>>
Going Down	Average	<<Preview Ends>>
Flat	High	<<Preview Ends>>

Flat	Low	<<Preview Ends>>
Flat	Average	<<Preview Ends>>

Investors rely on the price-volume as a guide. Price movement analysis shouldn't be treated as 'law', but more like 'rule of thumb'.

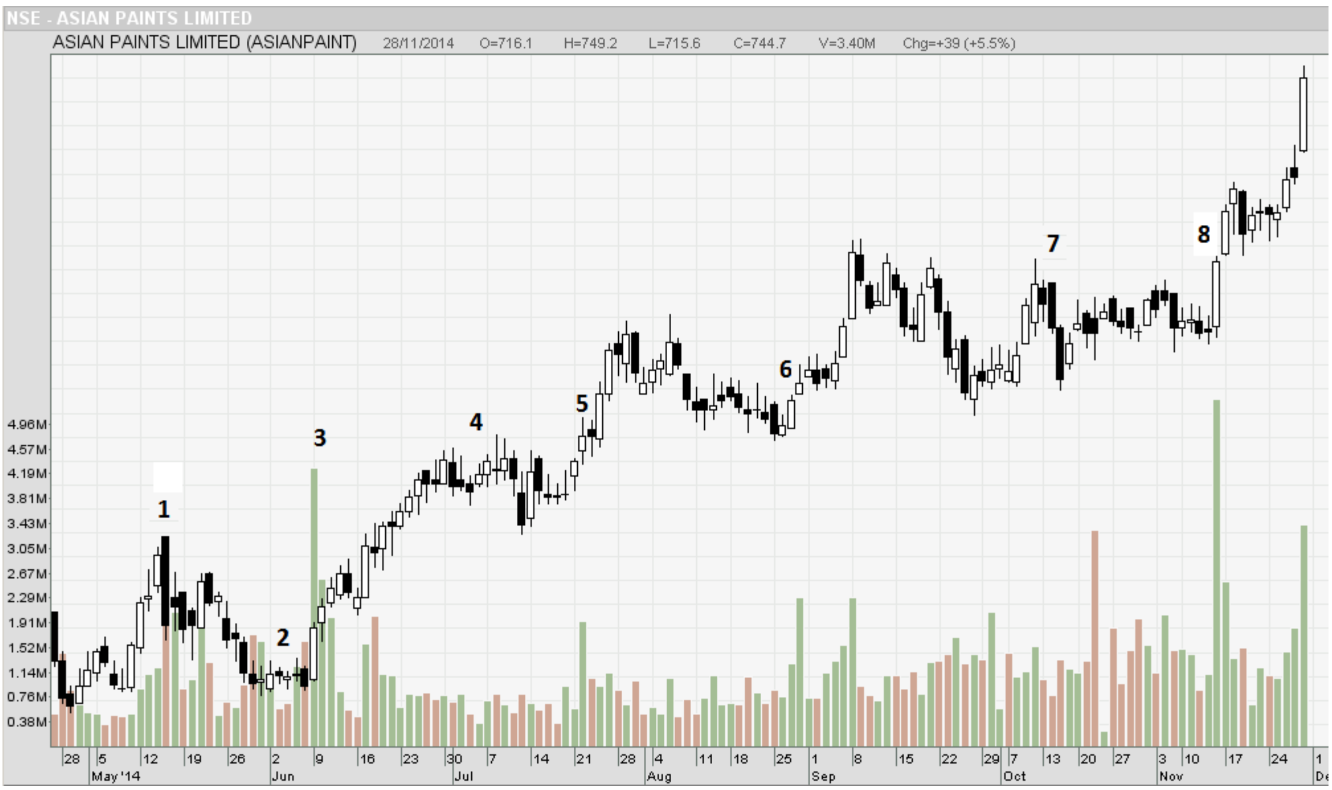

Figure 1

Figure above shows the Asian Paints chart from May - Nov 2014.

Point 1 – Falling price, with high volume – There are more sellers than buyers. The downward momentum continues to point 2.

Point 2- Flat price, with low volume – Consolidation happens as there are fewer interested buyers and sellers until point 3.

Point 3 – Raising Price, with high volume – There are more buyers than sellers. Upward momentum starts.

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The price of crude oil dropped from over $100 a barrel to about $68. Drop in crude price has a direct correlation with the cost of raw material for Asian Paints. Their costs will go down as crude oil prices have fallen, but the price at which they sell paint will remain same. Hence, there will be a good improvement in profits. This is one reason for Asian paints to move from about Rs. 550 to Rs. 750.

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Chapter 4: Stock Picking Strategy

Now that we have a fairly good understanding of the stock evaluation criteria, we will put it all together to create the stock picking strategy.

The idea is to start with a large universe of stocks, and filter down the list to identify the best possible candidates. Remember, stock picking is a combination of art and science. It is also subjective to some extent. If it were pure science, and a formula worked, everyone would use that formula, and that would be the end of the stock markets.

The objective is not to identify cheap or value companies. The objective is to find growing companies at a reasonable price. This strategy is also known as GARP (growth at reasonable price).

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Start with www.edelweiss.in. Navigate to https://www.edelweiss.in/tools/screener.aspx.

<<Preview Ends>>

Example 1

Navigate to https://www.edelweiss.in/tools/screener.aspx. Enter our stock criteria.

Example 2

Navigate to https://www.edelweiss.in/tools/screener.aspx. Enter our stock criteria.

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