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Amusing Stock Investing Rules

Stock market investing is teeming with intricacies and risk; perhaps that is why stocks provide investors with the highest potential return among the three major asset classes of stocks, bonds and money market. And perhaps to calm their nerves, investors have come up with rules of thumb that they can rely on especially during uncertain times.

In the US, a number of rules of thumb have evolved about stock investing in particular and the direction of the economy in general. Here are some of them:

Skirt Length or Hemline Theory – The shorter skirts become, the higher will be stock prices. Is there a real connection? That has yet to be seen especially with fashion changing as fast as price trends in the stock market. But there was a time when people believed that the short skirt lengths mean higher consumer confidence and apparently bolder consumer clothing preference and higher stock prices. In contrast, ladies would dress with longer skirts when there is fear and gloom in the economy, which would eventually lead to bearish stock prices.

Men's Underwear Index – Not to be outdone, investors also came up with an indicator using men's apparel. Purchasing men's underwear is a necessity. But when the economy is bad, it is believed that men would tend to delay their purchase of new underwear. After all, no one will be able to see how loose is the fit.

Conversely, a growth in the sales of men's underwear is taken as a signal of a growing economy. According to Investopedia, no less than former US Federal Reserve Chairman Alan Greenspan subscribed to this thinking. Now, whether Mr. Greenspan would actually delay the purchase of his own underwear is none of our business.

The men's underwear index can easily be distorted by many factors. One is that wives tend to buy their husbands' underwear. So, the shopping habits of wives need to be considered. In addition, being generally not into fashion but more into utility, men tend to delay buying underwear until these articles of clothing develop the phenomenon called "bacon garters."

Hot Waitress Economic Index – This index says that the greater the number of attractive servers, the weaker is the economy. The rule states that attractive people generally find it easier to land higher paying jobs during boom times. But, in really bad times, even attractive people will find it difficult to find a job and will be compelled to apply for lower paying ones like waiting on tables.

The index is obviously not only insulting but also discriminatory. More importantly, traditional economic theory states that employment is a lagging indicator.

Leading Lipstick Indicator – The indicator was put forth by no less than Leonard Lauder, the chairman of Estee Lauder. The rule states that ladies tend to forego on expensive indulgences, such as leading lipstick brands in times of uncertainty. So, if the sales performance of the leading lipstick brand picks up, it must mean that economic growth is also picking up. Surprisingly, the indicator had been fairly accurate in the past.

But at the end of the day, nothing beats solid macro and micro fundamental studies backed by shrewd technical analyses and performed with a cold heart (i.e. deprived of emotions). And one should note that these rules of thumb were devised in an American setting and may not be readily applicable in other countries.

Scam One, Scam All

The quickest way to find out if an investment offer is a scam or not is to check if the company has a secondary registration license with the Securities and Exchange Commission (SEC) to sell investment securities to the general public.

When a company is registered with the SEC, it automatically gets its primary license. But that license only allows the company to do regular business. If that company intends to sell investments to the general public, the law requires that the company apply for a secondary license to register such securities. The implementing rules of the Securities Regulation Code state that:

"No securities shall be sold or offered for sale, or distributed by any person or entity within the Philippines unless such securities are duly registered with the Commission through Form 12-1, and the registration statement has been declared effective by the Commission except of a class exempt under Section 9 of the Code or unless sold in any transaction exempt under Section 10 thereof and these Rules."

The rules on exemption from registration are very strict and specific. Changing the term of the amount being solicited from investment to donation, for example, does not automatically change the nature of the transaction if what are being solicited are investments for all intents and purposes.

And even if the registration of the securities is approved by the SEC, such approval does not constitute an endorsement of the securities by the regulator. The investor must make his own determination.

And so how does the investor assess a potential investment? There are two major parts, one being the viability of the investment itself and the other is if the benefits of the investments match the investor's return objectives and risk preference.

On the viability of the investment itself, an outline that one can follow in analyzing the investment is PMPM or production, marketing, personnel and money. These are actually the four departments in any business that need to be coordinated so that a business, which is what a person will be investing in, will run efficiently and effectively as a whole.

The following is a non-comprehensive guide in what to look for under the PMPM analysis:

- Production – product / service idea, operation design, quality control, operational milestones, bargaining power with suppliers
- Marketing – industry analysis, target customer, potential competitors, marketing plan (e.g. ads, promos, sales commissions, distribution channel management), bargaining power with customers
- Personnel - key (management) personnel, board of directors or advisers, other investors
- Money - financial projections including debt/equity financing, free cash flows, return on equity

As to the suitability of the investment offer, suitability tests can be applied. An analysis done by a financial planner can be a substitute as that financial planner can help quantify the goals of the investor and match it with the potential returns (and attendant risks) being offered.

Admittedly, the foregoing analysis is daunting to the average investor. But it is a "must" before any investor should part with his hard-earned money.

Editor's Note

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3 Important Things to Remember in Investing, and Everything Else in Personal Finance

It is so easy to be blinded by the glitter of investment returns, even if we know very well that high returns equate to a higher risk of loss. That is why it is important to remember the three factors in investing in particular, and personal finance in general.

Have a noble goal. Money is not the end. Remember that it is love of money that is the root of evil. Having a noble goal puts everything into perspective and makes us more circumspect when it comes to putting our money to work for us.

To reach that noble goal, we will need to assess the available tools at our disposal. This is where an honest and fairly accurate assessment of our net worth comes in. In finance, this is nothing more than establishing your statement of assets, liabilities and net worth. Simply put, assets minus liabilities equal our net worth. Assets are to be valued at the cash we would receive if we were to theoretically sell them. Liabilities are to be valued at the level of cash that we would need to zero them out, including all attendant charges (but excluding future interest).

We should also determine what we can save periodically to aid what we already have to reach our noble goal.

But perhaps the most important thing to remember is to understand how we behave towards money (i.e. behavioral economics) so that we can sustain our journey in reaching our goal. Otherwise, everything will be for naught.

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