

Since an investment club is about learning to invest we suggest that the final part of your meeting be an educational session. This might sound like work but if you're interested in investing, it's fun to learn new things and try them out! We'll try and give you ideas for something brief and we'll also try and give you ideas for an activity you can do to help you understand the topic better. It always helps to really learn something if you do the homework and we hope you'll have fun working on the activity together!

I thought a good topic for this month might be to begin talk further about the idea of really getting to know a company.

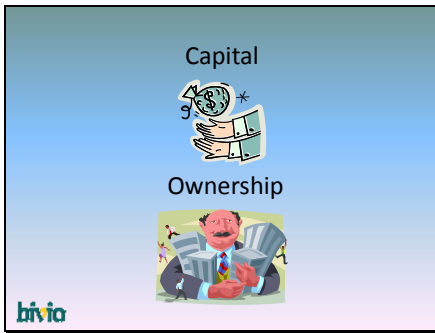


To start, I'd like to have everyone step back and refocus on why we do what we do.



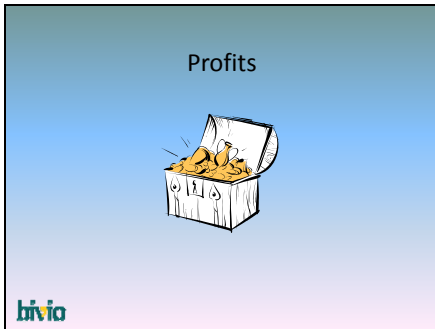
The reason we study companies the way we do is because we are interested in investing

Not gambling



To invest in a company means we provide them with capital for their operations and

In exchange, we receive partial ownership of the company.



We expect this company to manage their business in such a way that they produce profits. As an owner we expect to share in the profits



We share in profits several ways.

We might receive a dividend.

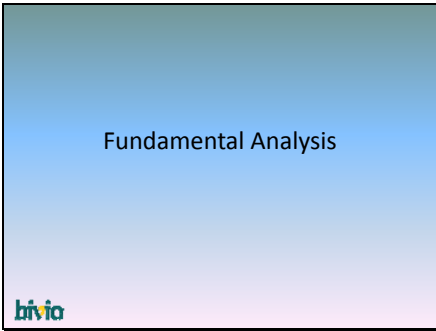
And we hope an increase in the value of our share of the company will lead to an increase in the market value of the stock



In order to determine whether a company is a good one to invest in (one that will consistently produce increasing profits)

We need to evaluate how well it is being run. One of the ways we do that is by looking at it's financial reports.

There are 4 reports a year. An annual report called a 10K and 3 Quarterly reports called 10Q's



Studying a company's financial information is called Fundamental analysis. It is called this because we are looking at the actual financial reports describing how a business is performing to decide on how good of a company it is.

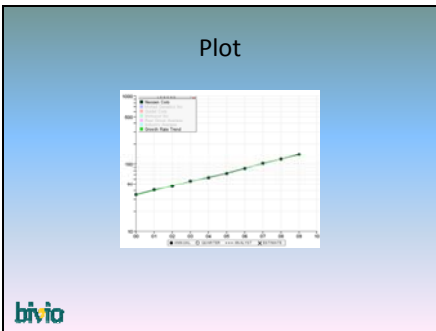
This is in contrast to technical analysis which looks at stock price movement independent of the underlying state of the companies business.



The financial reports of a well run company that will make a good, long term investment will show consistent results and

steadily increasing earnings over at least a 5 year time period.

This will help bolster our confidence that we may be able to expect them to continue into the future.



Ideally, if we plot a very basic piece of company financial information that is reported each quarter, sales, and fit a line to our data points, we'll see a nice consistent straight line that moves in an upward direction.



As investors, we like this consistency. We assume that the

price of a stock is related to the amount of

earnings a company has and how consistently it can produce those earnings.

Predictions



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To pick a stock to invest in, we try and make predictions about the future earnings growth of the company.

Mathematical Model



Future Earnings =
Future Sales*Future Profit Margin

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We try to do that in scientific manner using a mathematical model where we project

earnings growth from judgments about future sales growth and profitability.

Mathematical Model

Future Price/Earnings Ratio

P/E

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We also make judgments to project how the price of a stock will be related to it's earnings in the future. This is what we call P/E

Once we have calculated the future earnings from the first equation, we can multiply that by what we think the P/E might be and come up with a price in the future.

3 Judgments

- Sales growth rate
- Future profit margin
- Future average P/E

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So these are the three judgments we use to run our mathematical model and make our projections. They are

Sales growth rate

Future Profit Margin

Future Average P/E

Learning to Make Judgments



Whats interesting about investing is learning how to look at fundamental company data and make judgments about these items.

It's fun to do this because then the decision about whether a stock price might increase is based on our own analysis of facts. We don't just have to take someone elses word for it.