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Investment clubs yield fun, profit

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By PAMELA YIP / The Dallas Morning News

LOUIS DeLUCA/DMN
From left: Oliver Trechter, Lila Husband, Patrick Reed, Chick Martin, Dave Swierenga and Hall Martin gathered in Mr. Martin's home last week for a meeting of the North Texas Model Investment Club.

When the Good Stewards Investment Club formed in Garland in 2000, the members' goal was to become better educated about investing.

They've achieved that and more. The club has reported better than 20 percent average annual returns since its founding, and in 2003 and 2004 the Good Stewards were named the No. 1 performer out of 20,000 member clubs in the National Association of Investors Corp.

"We've always been the No. 1 club in Texas," said Carlton Bailey, the club's president. The club's method, he said, is to screen stocks for stringent performance characteristics, do further research before buying, and focus on long-term growth rather than swinging for the fences.

"One of the reasons we've done so well is because we've been willing to sell," Mr. Bailey said. "We're willing to admit mistakes."

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The benefits of such consensus decision-making is one of many reasons to start or join an investment club. Club members pool their money, time, knowledge and ideas in the pursuit of fun and profit.

An investment club isn't for everybody, but if you have some business and investing background, some friends and acquaintances with the same interests, and the time to commit to it, starting a club could be a good idea.

"It's investment education and learning how to manage your money, and it's a great opportunity," said Hall Martin, president of the North Texas Model Investment Club. The group formed recently to invest in the stock market and also to help people learn about starting an investment club.

Nationally, there are 20,000 clubs and 150,000 individual members of the National Association of Investors Corp., the umbrella group for investment clubs. The Dallas-Fort Worth chapter has more than 3,000 members.

If you're interested in forming an investment club, you have to be ready to follow the highest ethical standards, provide complete transparency of financials for the members, follow the rules agreed to by the group, and appreciate every member's opinion.

"They all bring different strengths to the club," Mr. Martin said.

Many investment clubs form among those sharing a common connection, such as church, work or neighborhood. But members must have a diversity of experience.

"You should pick a broad range of people with a broad range of backgrounds," said Mr. Martin, immediate past president of the NAIC's D-FW chapter. "You need at least two or three people who have had some investment experience."

Social, business aspects

Charles "Chick" Martin (no relation to Hall Martin) is secretary of the North Texas Model Investment Club.

"You'd want to start with your friends," he said.

"It's got a social aspect, as well as a business aspect. It needs to be run in a businesslike manner, with minutes and proper agreements."

JOIN THE CLUB

Here are some reasons to join or start an investment club:

•You learn more about

investing by talking strategy with other members.

•By pooling resources, you can save money on trading costs.

•Group decisions can cut down on individual recklessness.

•You can make friends and have a good time.

Most clubs are organized as general partnerships, he said. The club's income or losses are "passed through" to its partners and are reported on their individual federal income tax returns. Each member receives a tax form called a Schedule K-1 to report his share of the partnership's income, deductions, credits, etc.

More technical information is available at www.betterinvesting .org, the NAIC's Web site.

It sounds complicated, but don't be intimidated. Regular folks belong to investment clubs.

The average investment contribution for each member is "just over $80 a month," said Bob O'Hara, vice president of development at BetterInvesting, the NAIC's trade name.

When you select your club's members, make sure they're fully committed to their roles.

You should ponder these key questions, according to Lynn Ostrem, president of the Crow River Investment Club in Minneapolis:

•Will they be reliable and commit to the long term? Membership "churn" costs time and can create bad feelings.

•Will they show up, contribute and pay their dues on time? Most clubs require every member to do research and make recommendations on stocks.

•Do they have time in their schedules to devote to the club?

•Would you trust them with your money and your future?

Philosophy

It's crucial to set an investing philosophy that everyone agrees on. You don't want to be looking for regular dividend income and find yourself in with a bunch of gunslingers.

"What you want to stress is investment education," Hall Martin said. "It's not a hot-tip factory. A lot of them try to make it that, and that's why some of them drop out."

The most successful clubs operate with a long-term buy-and-hold strategy and consistent investing.

"It's a dedication to keep doing it over time, a willingness to learn and a consistent discipline in what they're trying to do," said Brian Bruce, director of the Finance Institute at Southern Methodist University's Cox School of Business.

If clubs don't have that foundation, they can be vulnerable to members voting on whether to buy a stock "based on the persuasiveness of the argument or the personality of the person presenting it, instead of the quality of the investment-decision logic," he said.

"They can easily fall prey to those things, and the most successful clubs are the ones who want to see some sort of consistent information–that you can't present a stock unless you talk about these four or five things."

For NAIC clubs, that means putting a prospective stock purchase through an analysis using the organization's Stock Selection Guide, or SSG.

Research

Each club member is expected to study and present a company for possible investment using the guide, which uses fundamental investment analysis. That entails looking at areas such as growing sales and earnings, solid profit margins, and future business prospects.

"Investments are personal opinions when you come right down to it," said Chick Martin, vice president of investments at Gurun Investment Advisors in Dallas.

"This creates a platform for discussion with historical facts and what you think those historical facts may produce in the future."

The factors that NAIC clubs look at are:

•A consistent five- to 10-year history of revenue growth and earnings per share. "That is based on the premise in fundamental analysis that sales drive earnings, and earnings drive the stock price," said Mr. O'Hara of BetterInvesting.

•Strong pretax profit margin. "If they're able to maintain or increase their pretax profit margins, that's what's giving them the money to grow their business," Mr. O'Hara said.

•Consistent or rising return on equity: "Return on equity is the money that the management is using to invest in the business to make it grow," he said. "They're doing it year after year after year."

If those factors are positive, then the next question is, "Can I buy it at a price today that is reasonable, where there's a good chance that it will double in five years?" Mr. O'Hara said. "You could be looking at a good quality growth company but it's priced too high."

For many investors, the toughest decision is when to sell.

"If you decide that you can double your money in five years, see if your projections are still holding," Mr. O'Hara said. "If it looks like it's still holding, you stay with that stock. As long as the fundamentals we look at stay the same, there's no great reason to sell the stock."

NAIC investors say the methodology of the Stock Selection Guide has proven its value in the half-century it's been in use.

"Our members have shown over 40 to 50 years that they tend to do better than the market averages," Mr. O'Hara said.

Good Stewards

The Good Stewards caught everyone's attention in 2003 when they reported a whopping 85 percent gain in the stock market, beating out the S&P 500's very healthy 26.4 percent.

The club won the Value Line Investment Club Performance Award from the NAIC, and it repeated in 2004 with a return of 38.6 percent, compared with 9 percent for the S&P 500.

Before buying a stock, the club will look at a five-year history of a company, favoring:

•At least a 15 percent historical growth in sales.

•At least a 15 percent historical growth in earnings per share.

•A price-earnings ratio of not much higher than 20 and debt not exceeding 30 percent of capital.

•A predicted annual return of at least 15 percent.

Although the club's investment portfolio is heavily concentrated in retail companies, members also ensure that it's diversified. Key holdings include energy company Apache Corp., Bed Bath & Beyond, Best Buy, Chico's, Coach Inc., Garmin Ltd., Starbucks and Home Depot.

Good Stewards members are committed to a buy-and-hold strategy, but sometimes they have to cut their losses and let a stock go, the club's president says.

"Two out of 20 or 30 is a pretty good average," Mr. Bailey said.

"We don't sell a stock until we find something that's better to replace it," he said. "We can use that money someplace else."

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