The Investor's Crash Course: How To Get Started In The Stock Market©

By Peter Bielagus

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Hey Everyone!

Peter Bielagus here. Welcome to my Investor's Crash Course. I have to admit, this is a long one. But this should take all the guesswork out of stock market investing. Good luck!

Cheers,

Peter

Who Should Take This Course: Anyone who wants a simple and inexpensive way to enter the stock market for the LONG term.

Who Should NOT Take This Course:

- Anyone with outstanding credit card debt. (Paying off your credit card debt is your best investment. Remember not losing 18% is the same as earning 18%.)
- Also anyone who cannot tie his or her money up for five years. DO NOT ever invest any money in the stock market, unless you can tie up your money for at least five years. (I'll explain why later.)

What You Will Need:

- About 1 hour of free time to read this over and get started. This is 17 pages; as simple as I can make it without robbing you of content.
- About $500-$2000 of your own money, which you will NOT need access to for FIVE years. STOCKS ARE A LONG TERM INVESTMENT. (Don't have that? Don't worry. I'll offer some suggestions at the end. Keep reading.)

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So what is the stock market, how does it work, and how can it make me money?

Let's start with how it works:

The stock market is a market just like any other market, the super market or the flea market; it's a place where things are bought and sold. But with the stock market we are not buying tomatoes or old comic books, we're buying and selling shares of companies. These shares of companies are often referred to as "stocks."

The entire impetus of the stock market is based on one simple fact: **New companies always need to raise money.** Imagine you owned a small company that specialized in drive thru psychotherapy called Drivin' Me Crazy. Your business is chugging along but you really could make some SERIOUS money if you opened 20 drive thru psychotherapy centers all over the country.

Trouble is, each drive thru center costs $1 million to build. Where are you going to get $20 million? To get that money, you could do one of two things. One, you could try to borrow it from a bank. Good luck.

Banks won't loan money to companies that have not established themselves. The old adage is true: A bank is a place that will loan you money as soon as you can prove you don't need it.

Your other option would be to appeal to investors by offering them a piece of your company. If you were to sell 1 million shares of your company for $20 each, then you would have your $20 million. Investors would buy those shares at $20 a piece in hopes that once you build the factory, your business would grow and those shares would be worth a lot more.

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But…

Chances are you don't know enough people to sell the shares to. So you would go to someone who does, namely an **investment bank**. Investment banks help companies raise money. The investment bank would sell the shares for you in what is known as an **Initial Public Offering** or **IPO**. They charge a small fee per share to do this. After the IPO, investors own part of your company, the investment bank has a made a profit by selling the shares for you, and you now have your $20 million to build the factory.

So where does the stock market fit in?

Those investors who bought those shares during the IPO need someplace to sell them. Once the IPO is done, a company will choose to be listed on a stock exchange such as the New York Stock Exchange or the American Stock Exchange. **All these exchanges together are referred to as the stock market.** After an IPO your company is now "public" which means anyone can buy the shares. The stock market simply provides an easy arena for investors to unload, or load up on, shares. So during the IPO investors are buying shares *directly* from the company. After that they are buying shares from other investors thru a stock exchange.

Up and down, down and up.

The prices of shares in the stock market are set solely by investor demand. If everyone wants to buy shares in your company your stock price will rise. If everyone is trying to sell the stock price will go down. People buy and sell based on only two emotions, fear and greed. These emotions typically spawn from their research of the

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company. For instance, if Wal-Mart finds itself in a major lawsuit, investors might cram to sell shares in Wal-Mart because they worry the lawsuit will make the stock go down.

Likewise, investors may scurry to get shares of Coca-Cola after Coke announces it now has a carb free soda. And of course sometimes, too often actually, investors don't do ANY research. They buy and sell on a whim, and usually lose money doing so.

On any given day, some companies rise in value and some fall in value. But remember one basic investing concept, **with stocks you can only lose what you put in, but there is no limit on what you can make.** So if you buy 3 different stocks for $100 each, and two of them go to zero but one quadruples in value, you've made money.

Currently there are thousands of companies traded in the stock market. So which ones do you buy?

How small investors can play big time:

It is quite difficult to pick the handful of companies that will outperform all the others. Both amateurs and professionals alike share in successes and failures. Fortunately there is a solution. You can buy them all.

Imagine you had $500 to invest in the stock market. Now imagine shares of Apple Computer are currently selling for $625. Well $500 doesn't even get you in the game with Apple. With small amounts of money, investors can't really get you much **diversification**, which is a crucial part of investing. Betting all your money on a handful of stocks is very risky; because if you are wrong about those 3 or 4 stocks, you could lose everything. Remember stocks can only go to zero, but there is no limit to how much they can make. It's better to spread your money out over many companies to mitigate risk.

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The financial industry has created a way for modest investors to diversify with little money. They created mutual funds.

A **mutual fund** is a money pool formed by a group of investors and headed by one manager. Thousands of investors throw their money into the fund and the manager decides which stocks to buy. The investors don't own the stocks themselves, rather they own shares in the fund. With thousands of investors pooling together thousands of dollars, these funds get quite large. It's not at all uncommon to see a fund of $1 billion.

Since the fund's manager has access to such huge sums of money, she can buy hundreds of different companies. This means great diversification. By the way, the manager does charge a fee to manage this money. This fee is an annual fee based on the amount of money in the fund. A manager may take a fee of say 1% of the money in the fund every year. So if the fund has $100 million in it, the manager's annual fee is $1 million, which pays for her salary, her research team, office expenses and such.

An interesting type of mutual fund:

There is one specific type of mutual fund that does not have a manager. It is called an **index mutual fund**. Instead of a living breathing human being picking the stocks, stocks are selected based on a computer program. Since there is no manager, index mutual funds charge a much lower expense fee (like less than 0.6%.) Fees cut into your profits, so the lower the fees, the more you get to keep.

What's more, the selection process pretty much goes away with index mutual funds. The computer just buys EVERY stock in a particular **sector** of the market. (I.e. a group of stocks that share the same characteristics: every US Company, every foreign company,

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and every health care company.) Index mutual funds take all the guesswork out of investing in the stock market. When you buy an index mutual fund, you buy *everything*. Super diversification.

So consider starting with an index mutual fund. It's easy, you can start with very little money, and you are super diversified.

I'm not here to say this is the greatest investment of all time, but it is a great investment for all. People always ask me whether they should invest in real estate, or biotech companies or whatever. The truth is it depends on you. I know nothing about biotech, so I stay away from it. But I do feel I have some advantages in real estate, so that is something I do invest in. Do what works for you and if you're not sure, you can buy everything using an index mutual fund.

How to buy low: The magic of Dollar Cost Averaging

One way to diversify is to buy many different investments (e.g. several different stocks in an index mutual fund.) But another way to reach diversification is to buy at different *times* as opposed to all at once. Remember we said the prices of stocks fluctuate based on the demand of buyers and sellers. Just as there is a challenge to picking individual stocks, so too is there a challenge picking the perfect *time* to buy. Fortunately the solution to both is the same. Just like we are going to buy every stock using an index mutual fund, so too are we going to buy *all the time* using **dollar cost averaging**.

The mechanics of dollar cost averaging are easy. You simply pick a set amount to invest and then construct a time interval to invest that amount. You could, for example, invest $50 or $100 a month, $100 a quarter or $250 twice a year. **The amount and the interval don't aren't what's important. What's important is that the AMOUNT and the**

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INTERVAL are ALWAYS the SAME, regardless of how well the stock market is doing. (Of course you can, and should, increase your amounts and shorten your intervals as you earn more money.)

An example can help show how profitable dollar cost averaging can be:

Let's imagine that in January shares of Sahara Heating are trading at $20. Imagine you're going to invest $1000 this year. If you invested the entire $1000 in January, you would have bought 50 shares of Sahara ($20 per share multiplied by 50 shares, equals $1000.)

But suppose you decided to invest $83 a month for 12 months. Mind you $83 times 12 months equals only $996, but you'll see that with dollar cost averaging, even by investing $4 less, you still come out ahead. Let's take a look at the calendar year.

Let's assume that in March, April, May, June, July, the price per share is $25. In each of these months you buy only 3 shares ($83 divided by $25 is 3 with $8 leftover.)

Let's also assume that for January, February, August and September, the price is $20 per share. During these months, you pick up 4 shares ($83 divided by $20 is 4 with $3 leftover.)

Then in October, November and December the share price falls to $12 per share. In these three months you would buy 6 shares. ($83 divided by $12 is 6 with $11 leftover.)

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I hear ya saying, Hey Pete; this dollar cost averaging doesn't make any sense. If I invested all the money in January I could have gotten all the shares for just $20 a share. Using dollar cost averaging, I overpaid for five months! What kind of a system is this?

Let's take a closer look. If you invested all your money in January we already know you would have 50 shares at $20 per share.

With dollar cost averaging you have 49 shares. You bought a total of 15 shares in March, April, May, June, and July (3 shares per month times 5 months.) In January, February, August and September you picked up 16 shares (4 shares per month over four months.) In the remaining months of October, November and December, you bought a total of 18 shares (6 shares per month times 3 months.)

But how much money is leftover? If you add up all the leftover money you'd discover that you have $85. That's enough to buy a few more shares (depending, of course, on the current price.)

Using dollar cost averaging, you bought more shares when the price was low and fewer shares when the price was high. You only bought 49 shares, but you paid an average of $18.60 per share as opposed to the $20 per share you would have paid in January. And there's no guesswork. As long as you keep the amount the same each month (or each paycheck or each quarter–whatever) you'll come out ahead.

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Okay but how do I know when to sell?

You've probably heard the old adage, "Buy low and sell high." Dollar cost averaging takes the guesswork out of buying low. By setting a specific amount every month or every quarter, you'll always buy more shares when the price is low and fewer when the price is high. But people often don't know when to sell. That's where rebalancing comes in.

Rebalancing: How to know when it's time to sell.

Rebalancing is the act of adjusting your investments to safeguard against risk. All investments can be categorized into two groups: **risky** and **safe. Risky** investments are just that; there is a chance you will lose your money. We invest in risky investments because they offer more reward**. Reward** is what you get back; **risk** is the likelihood that you will lose your money. **The more the risk, the more the reward should be.** Examples of risky investments are: stocks, gold, silver, real estate, and your own business.

Safe investments offer very little reward, but it is unlikely you will lose your money. Examples of safe investments are government bonds, bank savings accounts, and bank certificates of deposit.

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All of your investments together are called your **portfolio.** The question is, what percentage of your money should be in safe investments and what percentage in risky? The answer is based almost entirely on your age.

Why age? Because one simple way to mitigate risk is to hold on just a little bit longer. The stock market goes up and down and one simple way to protect against losses is to take a long-term view. (Remember at the beginning of this eBook, I asked that you not invest any money in the stock market unless you could part with it for 5 years? Now you know why.)

Rebalancing has 3 simple steps:

1. Take your age and subtract it from 100.
2. The answer is the percentage of your money that should be invested in **risky** investments. The remainder, or your age, should be invested in **safe** investments.
3. Once, twice or perhaps three times a year, rebalance, based on the performance of your investments.

Rebalancing in action:

Suppose you are twenty years old. Using the above formula, 80% of your money should be in risky investments and 20% should be in safe investments. Let's say you invested $1200 this year, or, using Dollar Cost Averaging, $100 a month.

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Every month, you would buy $80 worth of risky investments and $20 worth of safe investments. Suppose after 6 months, the stock market just explodes. Your total portfolio is now worth $10,000 but $9000 of that consists of risky investments. Your percentages are off; they are now 90/10 instead of 80/20. You would sell $1000 of your risky investments and invest that money in safe investments to rebalance to 80/20.

Suppose in another two months the stock market crashes. You still have $2000 in your safe account, but your risky account is now worth, $7000. You're off your percentages again. So you sell $200 worth of the safe and move it into the risky, you so you now have $1800 and $7200.

Rebalancing helped save investors like me in 2008 when the stock market crashed. When the market hit bottom, many people panicked sold everything and put all their money into safe investments. This however was the exact *opposite* of what they should have done. A crash is a GREAT time to buy. Sadly many people let emotion make all their investment decisions.

Remember it's not just what you own but *how* you own it.

Now you know how the stock market works. You know all about mutual funds, dollar cost averaging and rebalancing. The final thing to learn is *how* you are going to own the investment.

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Suppose that tomorrow, you purchase shares in a mutual fund. If you did that, then 100% of all profits you made off that investment would be taxable. **Remember, fees cut directly into your profits.** Taxes are a type of fee. Wouldn't it be nice if you could keep those extra dollars instead of giving them to Uncle Sam? You can, if you buy your mutual fund shares inside a **Roth IRA.**

An IRA is an **Individual Retirement Arrangement.** The word "Roth" comes from the Senator who proposed the idea, William Roth. The purpose of the Roth IRA is to encourage people to save for their retirement. The enticement is that any investments inside a Roth IRA are exempt from taxes. In short the government WANTS you to save.

Picture the Roth IRA like a suitcase. In it you can put investments like index mutual funds. Whatever is inside that suitcase is protected from taxes. So in order to protect our index mutual fund from taxes, we're going to buy the shares of that fund inside the Roth.

Doing this is easy. You open up a Roth IRA account at any major investment firm, like Charles Schwab, Fidelity, Scott Trade or E*TRADE. When you open the Roth IRA you have to deposit cash into it. Once the cash is inside the Roth, it is protected from taxes. You now use that cash to buy investments, which are also exempt from taxes. Easy.

Be patient…

There is only one catch to the Roth. Any profits you make, must remain in the account until you reach age 59 ½. (Don't worry; it isn't as bad as it sounds.) Imagine you invest $500 in a Roth IRA and within a year your investment swells to $550, a 10% return.

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Now let's say the gang's having a road trip and you want in. If you wanted to take the cash from your Roth IRA you could, but only $500, because your profits (the $50) must remain in there until you turn age 59 ½. So you can get out whatever you put in, **but you have to leave the profits in there**, otherwise the government takes a HUGE chunk of it as a penalty. Remember if you didn't have it in the Roth, you'd lose a bit of it every year to taxes.

So you're buying stocks, via an index mutual fund, inside a Roth IRA using dollar cost averaging. And once, twice, maaaaaaybe even three times a year you are rebalancing. Not so hard right?

The Last Question: (Well…two questions actually.)

There are two questions left. First, which company do you open an account with? And second, if there are different index mutual funds that cover different sectors, which sectors do you buy? Let's start with question one.

Some companies will let you open a Roth with as little as $500. Some firms require a lot more. If you have more money (like $1000) you probably can find more firms. And nearly all firms will let you get started with $2000.

Unfortunately regulations start to get in the way when I steer you towards specific companies. So I'm sorry I can't help there. But ask your family whom they use and shop around online. Your local bank may even help you get started. The point is not so much

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which company (since **you can always switch at any time**) but *a* company. Getting started is half the battle.

What types of index funds?

There are index funds that invest in domestic stocks, foreign stocks, small company stocks, big company stocks, real estate, gold silver and timber. Again regulations prevent me from naming specific funds, but most financial experts suggest investors stick to the old one word strategy: **diversify.**

A sample portfolio for a 20 year old:

- **Risky Investments: 80%**
  - **25% US stock index fund.**
  - **25% Foreign stock index fund.**
  - **20% Real estate index fund.** (Mutual funds that invest in real estate are often called "REITs" or Real Estate Investment Trusts. REITs buy huge properties like hotels and shopping malls. A REIT Index funds buys a whole bunch of REITs.
  - **10% Natural resource index fund.** (These funds invest in stocks and other investments that own natural resources such as gold, silver, oil, timber, vacant land, and iron.)
- **Safe Investments: 20%**
  - **10% Guaranteed fund.** (These are index funds that guarantee a very small return. Super safe.)
  - **5% Money market funds.** (These are index funds that invest in the something called the **Money Market.** Without getting too

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complicated, the money market is just that, it's a market where people buy and sell money. Specifically they buy and sell short-term debts. You can Google the money market to learn more but for now just know it's super safe.)

- **5% Income fund.** (Income funds are a bit riskier than money market funds or guaranteed funds. They invest in corporate and government bonds. Google them to learn more.)

Pretty much any investment company will offer these funds and their customer service center is there to help you get started.

Ummm yeah hello…I don't have $1000. I'm not even close.

No problem. I am a big fan of just getting *started.* Its not about how much or even where you start. **It's the habit that's important.**

To get into the stock market with very little money: Try the website www.giveashare.com is a way for you to buy just one share of a stock (over 100 companies to chose from.) Admittedly, this is an expensive way to buy shares, but it can help you get started with very little money.

For a fun little investment that costs the price of two movie tickets: Consider buying a 1 oz. silver American Eagle Coin. These coins are .999% pure silver and cost, at the moment, around $20. Silver is a rather risky investment, but these coins allow you to start small. Plus, silver has NEVER gone to zero. You can buy these coins at www.apmex.com or www.goldsilver.com. (By the way, these coins make great gifts!)

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You're done!

Congratulations! You've completed the "Investor's Crash Course." I wish you the best of luck in your endeavors, and I am here if you need me.

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