## Stock Market Investing And Trading Foundation

### Useful Links

1. [www.finance.yahoo.com](http://www.finance.yahoo.com)
2. [www.investing.com](http://www.investing.com)
3. [www.investopedia.com](http://www.investopedia.com)

### Can you make money in stocks?

The good news for investors; long term market makes returns. Usually stock investor survive or make money only for long term investment, even through the great depression or covid-19 pandemic for instance. Buy why? Because stock rises over time, even with big pull back, such as covid-19 or even with high inflation.

### How to evaluate a Stock?

There are 3 ways to evaluate stock.

1. Competitive advantage.
2. Ratios.
3. Technical Analysis (Charting).

### Competitive Advantages

What is competitive advantage? Competitive advantage defines how good is the stock good at. What advantages are the stock you buy. What advantages of this stock compare to its competitors or to their peer companies. There are usually 2 areas to define the advantages of a given stock.

1. Low-Cost Leader or high/quality services.
2. Strong brand name.

You can take an example of “Apple Inc.”. Although Apple products is expensive, but it has a high in terms of quality and services, also Apple is well known and has a good reputation.

### Ratios

Ratios means the price you are paying for a stock good in relation to something. There are 3 type of measures in ratios.

1. Price/Earnings (PE)
2. Price/Sales (PS)
3. Price/Book (PB)

### Price/Earnings (PE)

P/E are used by investor or analyst to determine the relative value for a company’s shares, it helps to determine whether the stock is overvalued or undervalued. It can be compared to the company’s historical record or even to its competitors or the similar aggregation market. Some would even compared against a broader market such as S&P Index. P/E can be estimate by trailing (backward looking) or a forward looking (future projected estimate or even call “estimate price to earnings”). P/E less than 25 is good. But the rule of thumb, the **lower** the number the better the stock to buy assuming if you are not applying forward looking P/E ratio.

Some of the financial web site, such as yahoo finance already calculated the P/E ratios. You can check it up on the website (please refer to the useful links above). From the yahoo finance web site you can click on the **statistic** link, from their you can find all sort of calculated data including P/E (trailing or forward) , P/S or even P/B ratios. To calculate P/E, you can use the formula to calculate yourself:

From the formula, market value per share means the stock price, earning per share (EPS) is the value provide by the company (you can find this data from the yahoo finance website from the statistic section). As mentioned P/E ratio can be backward looking or forward looking. Usually many companies can provide backward looking EPS (cause this data computed from historical records), however, not many companies can provide forward looking EPS, this is subject to whether the companies provide the it’s earnings for near future, you can find this data from the company’s earning release (if provided). Sometimes P/E ratios can be zero or N/A, this means there are no revenue or even posting a losses.

### Earnings Per Share

Earnings per share is calculated as the company’s profit divided by the number of outstanding shares of it’s common stock. The resulting number serves as an indicator of the company’s profitability. The **higher** a company’s EPS, the more profitable it considered to be. To calculate the EPS, you can use the formula below:

### Absolute P/E

The term absolute P/E represent the P/E of the current time period. For instance if stock today is $100 and the EPS is $2, then the P/E ratio is ($100/$2) that P/E is 50.

### Relative P/E

The relative P/E compares the absolute P/E to the benchmark or a range of past previous P/E over a relevant time period, such as past 10 years. The relative P/E shows what portions or percentage of the past P/Es. The relative P/E usually compares the current P/E to the highest P/E of a given time period. Sometimes investor could even compares the current P/E to the lowest P/E range, which indicates how close the current P/E is to the historic low. P/E below 100% if the current P/E is lower than the historical P/E range, P/E above 100% tells the investor the current P/E pass or surpass the past value.

### Limitations Of P/E

One primary limitations of P/E is when comparing P/E with P/E ratios of different companies. Valuation growth rates of companies often vary between sectors due to different way companies earn money and different timeline. As such, one should use P/E as a comparative tool when comparing companies with the same sector.

### Pros of P/E

Investor can valuate short to long term valuation trends such as P/E 10 to P/E 30, which the average of 10 to 30 years. The benefit of long term measures can compensate the changes or fruition of the business cycle. Can be used as a tool for the company’s future estimate, which provides a clear picture of what earnings will look like, without changes or accounting adjustment.

### Cons of P/E

Companies sometimes inherit problems with the forward P/E metrics, namely, to underestimate the earnings in order to beat the estimate P/E ratio, for the next quarter earning announcement.

Others companies could even overestimate the P/E ratio and made adjustment later in next quarter announcement. External analyst also provides P/E ratio estimate which may diverge from the company’s estimate which create confusion. Companies sometimes could also provide inaccurate estimate P/E ratio, that’s why most investor prefer to choose the trailing P/E ratios. Further more past performance doesn’t signal future behaviour.

### Price/Sales (PS)

The Price to Sales (P/S) is calculated by taking a company’s market capitalization (the number of outstanding shares multiplied by the share price) and divide it by the company’s total sales or **revenue** for over the past 12 months. The **lower** the P/S ratio, the more attractive the investment. Price-to-sales provides a useful measure for sizing up stocks.

To understand P/S, we first need to know what is market capitalization. Market capitalization or market cap, is the total number of shares of a company multiply by the share price of the stock. For instance, if a company issued 10 million shares, and it’s share price is $100, that means its market cap is $1 billion. There is also another way to calculate the size of the company, that is by “shares outstanding”, what are the differences compare to the total number of shares of a company? Shares outstanding simply means the number of share of a public company that are currently held by shareholders.

To calculate P/S, you can use the formula below:

**OR**

One thing to mentioned P/S Ratio is target to total sales or revenue **not** net income. Revenue consists of all expense and income; whereas net income consists of only differences between revenue and the expenses.

Most of the statistic display the P/S ratio in terms of (TTM), that is trailing twelve months of the past four quarters. Some display the ratio in terms of current fiscal year or the most recent.