***Warren Buffet's 4 Stock Rules:***

“I buy on the assumption that they could close the market tomorrow and not re-open it for another five years”

-Warren Buffet

1. The stock must be stable and understandable.
   1. Invest only in stocks that are NOT volatile
   2. Look for companies with similar earnings and a consistant growth of equity over the years
   3. A stable and understandable stock is a calculable, predictable stock. We can much more easily figure out the value of something that is consistent.
2. The stock (its company and product) must have long term prospects. Think 30-40 years.
   1. This is for tax purposes. The growth of the stock happens at the market rate and therefore we don't pay taxes on it.
3. The stock must be managed by vigilant leaders.
   1. These leaders need to be able to manage debt well. STAY AWAY FROM DEBT!
4. The stock must be undervalued.
   1. Determine the intrinsic value of the stock, and then only buy it at lower than that price.

Determining the Value of a Company:

1. Use the Market Price, Earnings (Potential Returns), and Book Value (Margin of Safety).
   1. Market Value Per Share: the price a share would fetch on the marketplace.
      1. **Calculated by**: (# Outstanding Shares) \* (Current Share Price)
   2. Earnings per Share: the portion of a company's profit allocated to each outstanding share of of common stock.
      1. **Calculated by**: ((Net Income) - (Dividends on Preferred Stock)) / (Average Outstanding Shares)
         1. Average outstanding shares is just the average shares out in the year period
         2. Net Income: A company's total earnings/profit.
            1. Calculated by: (Total Revenue) - (Cost of Doing Business)
            2. Cost of doing business includes depreciation, taxes, etc.
         3. Preferred Dividends: a dividend that is accrued and paid on a company's preferred shares
            1. **Calculated by**: (Equity's Dividend Rate) \* (Par Value of the Preferred Stock)
            2. Dividend: a distribution of a portion of the company's earnings to a class of its shareholders (in $ per share or % of market price)
            3. Preferred Shares: Give holders extra benefits over "common shares".
            4. Holders have claim on company assets before common shares. If the company goes bankrupt, preferred holders get paid out first.
            5. Preferred stocks pay set dividends on regular intervals. If the company cannot pay that dividend, it must pay it as soon as possible, and must do so before paying to common stocks.
            6. Unlike common stocks, preferred ones offer no voting stake in the company.
            7. Unlike common stocks, preferred stocks typically trade at a very stable price due to their set dividends.
   3. Book Value: the value of all tangible assets a company owns subtracted by their liabilities.
      1. **Calculated by**: (Tangible Assets) – (Liabilities)
      2. Indicates the total value of the company’s assets shareholders would receive if the company ceased operating immediately.
      3. When compared to the company’s market value, it can indicate whether a stock is over/under priced
      4. Mark to Market Valuation: a measure of the fair value of accounts that can change over time (e.g. assets and/or liabilities).
         1. MTM intends to try to more accurately calculate the “book” value of a company when the value of their tangible assets may be in flux. In a financial crisis, company’s valuations drop dramatically, but using MTM we can figure our what they’re really worth.
      5. Book value shows you your “Margin of Safety”, i.e. how safe are you if the company ceases business immediately, what would you get out of the stocks you hold.
   4. *Combine Market Value and Earnings Per Share* to determine the Price To Earnings Ratio
      1. **Calculated by:** (Market Value per Share) / (Earnings Per Share)
      2. This metric values a company that measures its current share price relative to its per share earnings
      3. If X/Y is the P/E Ratio, we say “For every X Dollars I invest in this business, I can expect to make Y dollars 1 year later”. To calculate the % return, simply do Y/X.
      4. THE LOWER THE P/E THE BETTER THE POTENTIAL RETURNS.
      5. P/E is the best possible scenario, if the company perfectly allocates and manages their money to return the absolute maximum amount to the shareholders. Odds are this will not happen.
      6. Investigate P/E over a large period of time, and consider it alongside the company’s projected earnings estimate and the economy as a whole.
      7. Study similar companies and their P/E’s to see how this company’s compares to others in the industry
   5. *Combine Market Value and Book Value*to determine the Price to Book Ratio
      1. **Calculated by**: (Market Value per Share) / (Book Value)
      2. If X/Y is the P/BV Ratio, we say “Every X dollars paid for this company has Y dollars in equity in this business”.
      3. The higher this number is, the more security we have with this stock because we actually “own” more of the company. If we have a P/BV ratio of 100, for every $100 we put in, we only own $1 of the company. But if we have a P/BV ratio of 1, for every $1 we put in , we own $1 of the company.
      4. Of the money we put in, only Y/X percent of it is “safe”.
      5. A P/BV RATIO THAT IS <1 IS PHENOMENAL
      6. Typically a low P/BV indicates bad earnings (high P/E).
   6. *We want both a low P/E ratio (higher potential returns) and low P/BV (highs security in our investment).*
      1. Warren Buffet looked for a P/E of 15 or lower (indicating 6.6% or higher returns per year)
      2. He also looked for a P/BV of 1.5 or lower (indicating 67% safety or higher).
      3. To make this easier, combine those two metrics into (P/E) \* (P/BV), or 15 \* 1.5 = 22.5.
         1. \*\*\*Companies’ (P/E) \* (P/BV) that comes out to 22.5 or less are ones we really want to look at.\*\*\*
         2. Look at companies’ historical (P/E) \* (P/BV) and see if its consistently lower than 22.5
         3. If a company’s indicator is > 22.5, look at why.
            1. If the P/E is too high, then it doesn’t return enough earnings in a year to make it worthwhile
            2. If the P/BV is too high, then it doesn’t provide enough security to make it worthwhile
   7. *The day-to-day value of the company does not matter. What matters is that the company performs as per our expectations in the long term.*
      1. We invest in these companies to make huge amounts of money 20-30 years from now.
      2. Buffet is OLD. He started investing when he was young with the intention of being incredibly wealthy when he was old. He didn’t do it to “get rich quick”.
      3. Some days we’ll get offered great buys, and other days we’ll get offered horrible deals. Its our job to know which is a great buy, and which is a horrible deal.
   8. *Patience is a virtue that all successful, long-term traders have.*
      1. Have patience, and stick to the fundamentals.
      2. “Pigs get fat, but hogs get slaughtered”. The person who tries to “get rich quick” isn’t going to find much success with that approach.
      3. Instead of making 200% return for 3 months, and then losing it all, we aim to make 10-15% returns for 40 years.
         1. A $1 investment held for 40 years with 12.5% returns (reinvested) per year gives us $93.05 at the end of that 40 years. $1000 gives us $93,050.97. If we can maintain that we will make boatloads of money IN THE LONG TERM.
         2. The calculation (Compounding Interest) for this is A = P \* (1 + r/n) (nt)
            1. **A** = the future value of the investment/loan, including interest
            2. **P** = the principal investment amount (the initial deposit or loan amount)
            3. **r** = the annual interest rate (decimal)
            4. **n** = the number of times that interest is compounded per year
            5. **t** = the number of years the money is invested or borrowed for
   9. *Think for yourself; Don’t ever base your decisions to buy/sell on other people’s opinions*
      1. Do the research yourself, ALWAYS. Utilize other people’s opinions and analyses, but never take just one person’s word.
      2. If you’re doing exactly what everyone else is doing, you’re doing it wrong. If everyone is buying or talking about what they’re planning to buy, odds are you don’t want to be buying. Likewise, if everyone is panicking about how bad the market is, you probably want to be buying great companies as they’ll likely be trading at great values (do the above calculation!!)