Advanced Stocks

Advanced Stock Valuation Methods

- Discounted Cash Flow (DCF):
  - This method estimates how much a company's future cash flows are worth in today's dollars.
  - Investors use DCF to find a company's intrinsic value — if that value is higher than the current stock price, it may be a good buy.
  - Example: If you expect a company to generate $1M in annual cash flow growing 5% per year, DCF helps estimate what that stream of money is worth today.
- Comparable Company Analysis:
  - Compares a company's ratios (P/E, EV/EBITDA, P/B) to similar businesses in the same industry.
  - It's useful when you want to see if a company is overvalued or undervalued relative to peers.
- Free Cash Flow (FCF):
  - FCF shows how much money a company has left after paying for operations and capital expenses.
  - High or growing FCF means the company can reinvest in growth, pay dividends, or reduce debt.

Understanding Market Cycles and Behavior

- Economic Phases:
  - During expansion, growth stocks usually perform best.
  - During peaks, defensive sectors like utilities or consumer staples become safer bets.
  - In recovery, cyclical sectors (like tech and finance) rebound fastest.
- Sector Rotation:
  - Investors can shift focus to industries that historically outperform during certain phases.
  - Example: Energy and industrial stocks often do well early in a recovery, while healthcare holds up better in a downturn.
- Behavioral Finance:
  - Investor psychology drives short-term market moves. Fear, greed, and herd behavior often cause people to buy high and sell low.
  - Recognizing your own biases — and staying disciplined — helps you stay rational when others aren't.

Portfolio Optimization and Risk Management

- Modern Portfolio Theory (MPT):
  - Suggests combining assets with different risk levels can improve returns without increasing overall risk.
  - For example, pairing tech stocks (high growth, high risk) with bonds or dividend stocks (steady income) can create a smoother performance curve.
- Beta and Volatility:
  - Beta measures how much a stock moves compared to the market.
  - A beta over 1 means it’s more volatile than average; under 1 means more stable.
- Sharpe Ratio:
  - This tells you how much return you’re earning for each unit of risk taken.
  - A higher ratio = better risk-adjusted performance.
- Hedging:
  - Advanced investors may use tools like options or ETFs that move opposite the market to protect against downturns.

Advanced Technical and Fundamental Analysis

- Technical Analysis:
  - Involves studying price charts and indicators to identify patterns and trends.
  - Moving Averages: Smooth out price data to spot long-term direction.
  - RSI (Relative Strength Index): Shows if a stock is overbought or oversold.
  - MACD: Highlights momentum changes — useful for timing entries and exits.
- Fundamental Analysis:
  - Looks at company data — earnings, cash flow, debt, management — to assess true value.
  - Advanced investors dig into free cash flow trends, capital structure, and profit margins over time.
- Combining Both:
  - Example: Use fundamentals to pick a strong company and technicals to decide when to buy.

Building a Long-Term Strategy

- Thematic Investing:
  - Focus on long-term trends like AI, renewable energy, or biotech.
  - These themes can outperform over decades but require patience.
- Rebalancing and Taxes:
  - Over time, some holdings grow faster than others — rebalancing restores balance.
  - Tax-efficient investors also use strategies like tax-loss harvesting to offset gains.
- Active vs Passive:
  - Even advanced investors often mix both:
  - Passive for stable market exposure.
  - Active for high-conviction, researched opportunities.
- Performance Review:
  - Regularly compare your portfolio's returns to a benchmark like the S&P 500. If you consistently lag, re-evaluate your strategy.

Learning Assessment Question 1

What is the main goal of a Discounted Cash Flow (DCF) analysis?

- To estimate what future cash flows are worth in today's terms
- To track daily price changes
- To compare company revenue
- To project short-term profits

Question 2

What is one reason to study market cycles?

- To predict exact stock prices
- To identify which sectors tend to perform better during each phase
- To decide which days to trade
- To avoid fundamental analysis

Question 3

Why is a high Sharpe Ratio desirable?

- It shows high volatility
- It means you're earning more return for each unit of risk
- It means the stock is undervalued
- It measures company debt levels

Question 4

Why do advanced investors combine technical and fundamental analysis?

- To time purchases of fundamentally strong companies
- To make short-term guesses
- To avoid doing in-depth research
- To replace valuation methods

Question 5

What is the main purpose of rebalancing a portfolio?

- To maximize tax write-offs
- To maintain your target mix of investments as markets change
- To increase overall volatility
- To invest only in new sectors