Portfolio Managers: The Challenge Is Making More than One Winning Stock Pick

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When Scott Bupb started dabbling in the stock market earlier this year, he had a cool $100,000 to play with. Now, he and his fellow stock pickers are a few dollars shy of his initial investment, thanks to a couple of underperforming members of his portfolio. “We invested in some things that were at their 52-week lows, but they kept going down,” he says. “They’re starting to come back up now, so we might start making money soon.”

Alas, the money’s not real — it is part of a stock market simulation game that Bupb, a senior at Mayfield High School in Las Cruces, New Mexico, and his classmates are playing for a class project. But the lessons he is learning are the same as those that professional stock portfolio managers use on a daily basis to manage millions – sometimes billions – of dollars of other people’s money.

Managing the Mix

Portfolio managers make investment decisions for individuals and institutions – including organizations, like pension funds, that pool large sums of money and invest in stocks and other assets. They are charged with matching investments to objectives and balancing risk against performance. The investment portfolio they manage can be a mutual fund or a hedge fund, but the basic theory is the same: They decide what mix of investments is most likely to make money for their clients.

With thousands of stocks available to buy, the first decisions about how to invest have less to do with data and more with strategy, notes James Early, a former hedge fund manager who is now an advisor to the investor newsletter service run by the Motley Fool, a financial services company.

Funds that promise a modest, but steady return on an investment over time will likely invest heavily in stocks with a long history of good performance, Early says. Funds that aim to take on a little bit more risk with the potential for making more money will look for stocks with a lot of room to grow in the market. “Investing is about screening,” he says. “There are 8,000 or 9,000 stocks out there. You can’t buy every one, you can’t analyze every one, so you’ve got to whittle it down to a manageable list and know what you're looking for."

Ty Stovall, another senior at Mayfield High who is participating in the stock market game, says his small group of investors has mostly been buying up stocks of familiar companies. "One of our stocks, Apple, we bought because we knew the iPad 3 was coming out," he says. "We figured [the stock price] was going to go up, and it has, significantly."

Although the Mayfield students are picking high profile, well-known stocks, Early notes that investment managers usually spread their investments across dozens or hundreds of companies – sometimes even picking companies that don't have great reputations. "You may want some beaten-down companies that are not very good companies but are priced as terrible companies, he says. "If you know this company has seen declining sales and doesn't have a very good product, but the stock price has been devalued [the stock price is cheaper than it should be given the company's bigger picture], you may see a bounce" in the stock price.

'A Statistical Process over Time'

While portfolio managers have years of schooling and experience to draw on when picking stocks, choosing investments is easier now due to the wealth of information available on the Internet. Jeannette Showalter, a financial columnist and investment analyst from Naples, Fla., says her favorite website is ValueForum, where stock experts offer advice to subscribers about where to invest. "If someone makes a commitment to read the website, they can learn a tremendous amount," she says. Showalter adds that despite fund managers' claims to knowing the secret to stock-picking success, about 60% of them don't make money in the long haul.

The key to successful portfolio management, suggests Early, is less about finding one hot company and more about finding a lot of stocks in which to invest with the goal of having more of them do a bit better than expected over time. "It's a common misunderstanding that it's about picking one or two big winners," he says. "It's a statistical process over time. Gradually you get better, and hopefully you'll win at it maybe 60% of the time."

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Explain James Early's comment that "Investing is about screening."

Why would you choose to invest in a company with a declining stock price?

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