Research Strategies for New Investors

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When it comes to picking stocks and building investment portfolios, research is one of your most powerful tools. “Doing your homework allows you to have conviction on your ideas and to analyze and internalize,” says Virgilio Aquino, an assistant investment manager on the U.S. equities team at Aberdeen Asset Management in Philadelphia, Pa. “When choosing stocks, logic and common sense should drive your decision process. Sometimes emotions can trump common sense. Don’t let your emotions drive your decisions, but rather your own research. You have to have your own assumptions, and in order to have good assumptions, you must do your research.

Here are Aquino’s top five best research practices for new investors:

Start with the basics: What do they do? How do they make money? The natural research starting point is a company’s financials. Every year, public companies file a 10-k, which is an annual report detailing how the company has been performing and how it has grown its earnings (or not). In addition to the numbers, the annual report also gives you context for what those numbers mean. For example, the Management Discussion and Analysis (MD&A) is a qualitative review by the CEO and others of how the business has been doing. Caution: “We like to look at what management is saying, but keep in mind that nobody really knows what the future holds,” notes Aquino. “What they say about the future will allow you to make reasonable assumptions about if the company will grow or the path it plans to take. But things can happen in the market that may not be incorporated in a management assessment.” Other good research sources include newspapers and journals, company websites and data collection companies like Capital IQ.

Who are the competitors? As you research, you will discover insights that help inform your stock decisions. Competitive dynamics that affect a company are particularly important. Did a direct competitor of the company you are considering for your portfolio buy another company and become more aggressive in the marketplace? Are competitors trying to undercut pricing to gain market share? You should also consider competitive changes within the broader industry. “Retail is a good example right now,” says Aquino. “The off-price segment of retail – companies like TJ Maxx – is booming. It’s a treasure-hunt-type model where you can search for high-end brands sold at a discount. Department stores like Macy’s, Banana Republic and Gap don’t know where they belong in a shifting retail environment, which is also increasingly disrupted by the rise of e-commerce. The monitoring of what’s happening in industries like this will help you make a decision to add to a position or buy something new.”

Watch for yellow flags. Changes in company strategy or management are big yellow flags that require further work. After you make an initial investment, you should monitor and follow up on how that company continues to perform. A change in strategy might signal a big change in the movement of the stock price. “Ask yourself, ‘What is the effect on the dynamic and the complexion of the company based on new information? Would it be a better company as a result of the change?” suggests Aquino. “We don’t look just at the CEO, but the entire management and their movement within the company or the industry. Finding a trustworthy management team is important because ultimately they make the decisions on strategy. If a CEO who was driving the old strategy leaves, for example, will the new leader enact or follow through on what the prior management set out to do, or will he change the direction of the company? Also, where does the new CEO come from and how might his or her prior experience affect the company strategy?” Set Google Alerts on the companies in your portfolio to stay up on the most current news.

Gathering information is important, but learning how to sort is even more important. You can never research too much. Where mistakes usually tend to occur is not from missing information, but rather a failure to prioritize what’s important and what’s not. In general, more research tends to lead to greater conviction about your stock decision-making. Deeper research will often help you establish a clearer stance as to what drives the value of the company.

“Don’t ever forget that a free market is built on differences of opinion,” Aquino points out. “If every investor thought the same way and came to the same conclusions, there would be no market. Doing your homework allows you to parse through noise, and to sort through whether something is relevant.”

Mistakes happen. Learn. Move on. Will you get it wrong? Yes! Investing in a company that doesn’t perform as well as you had hoped is fairly common. The key, says Aquino, is learning from your mistakes and turning a negative into a positive. Mistakes help you refine your search process. “Stocks sometimes behave in ways that you can’t explain, but you can always go back and try to uncover the information to help you explain what happened. That look back will help you choose better companies in the future,” he says. “Things might not pan out the way you expected due to the unexpected, but if you continue to do your homework, you increase your chances of being more right than wrong. Don’t be so afraid to make mistakes that you don’t invest your money. Investing is not gambling. It comes down to doing the best research you can and having conviction about your choices.”