Newsletter

Protecting your portfolio

In any market, regardless of whether a bull or bear market, it is important that you have a risk management strategy.

This means you need to think about how you will protect your investment.

Yes you want to make money, but if you don’t protect it in the first place, you may not get very far.

Your goal first and foremost is to preserve your capital – your $50,000. In doing this you want to be able to cut your losses and let your profits run.

So how can you protect your portfolio?

Firstly, **don’t put all your eggs in one basket.** Consider investing across 2 to 3 different sectors. If you put all your money into one sector and that sector falls, this is not going to help you preserve your capital.

Don't put all your eggs in one basket - ASIC’s Moneysmart have a great article on this concept.

Don’t invest everything into one company. If you were able to put all your money into one company and the shares of that company fell, again you would potentially lose a significant amount of money. This is why we have the diversification rule in the Game, which means, already you are already managing risk, by investing across a number of stocks.

How many stocks should you hold? Article on this age old question by Dale Gillham.

Use the falling sell (stop loss). Yes, you may have heard this a number of times, but you would be amazed at the number of players that don’t use this tool. Decide on how low you are prepared for your shares to go, before selling them and conversely when you will take your profits. As your shares move up, you could also adjust the falling sell, so that even if the stock falls you may still gain or your loss is much less.

Here is an excellent article on setting your stop loss & take profit points to help manage risk.

Decide whether you will invest defensively or aggressively. In the sharemarket you will find that there are companies that are known as defensive companies and those that are known as aggressive companies. Aggressive companies are also referred to as cyclical stocks. When choosing whether you will invest aggressively or defensively, you will also need to decide on what you think the market is going to do e.g. keep going up, move sideways or fall.

We have only touched briefly on this subject and if you are looking to invest in the market, it is a subject that is definitely worth educating yourself further on, so that when you do take the step to invest, you have solid risk management strategy that helps protect your portfolio.

Stock Doctor Game webinar recordings

Webinar 1 Recording
Stock Doctor Game On webinar
Webinar recording

Webinar 2 Recording
Smarter Game strategies with Stock Doctor
Webinar recording

Webinar 3 Recording
Reporting season update – the good, the bad and the ugly
Webinar Recording

Webinar 4 Recording
Six secrets of successful sharemarket investing
Webinar Recording

Understanding and managing risk

As a DIY investor, you need to be familiar with managing risk.

When most investors think about risk in the sharemarket, they gravitate to the obvious example of losing their money on any stock. However, the reality is that avoiding capital losses all together is a near-impossible task.

Therefore, you need to take a broader perspective and look at the concept of managing **portfolio** risk; the risk that the portfolio, **as a whole**, will not achieve your end objective.

To explain the concept of portfolio risk, let's use the analogy of a football match. The coach starts with an objective (win the game) and formulates a strategy to meet that objective (game strategy). To execute the strategy, the coach will then select the players, assessing all the traits and skill sets, to give the team the best chance of winning. Once the game begins some players will perform their role flawlessly, others will be a little flat, while some will not be performing and will need to be substituted.

In a similar vein, as an investor in the ASX Sharemarket Game, your objective is to win. Your strategy is likely to have been focused on picking a concentrated list of companies and cutting your losses quickly (within a very tight, three-month period) as you don't have the time to recover from a big fall in share price. That means sticking to companies that only have good news surrounding their operations, where the trend is their friend.

Such a high stakes all-in strategy, if executed correctly, will give you a great chance of winning. However, get it wrong and it could be a painful experience.

In real life there is always an ongoing trade-off between risk and potential reward that needs to be carefully managed to ensure that a portfolio remains aligned with your objective. While 'making money' makes sense, a flippant approach to portfolio construction means any positive outcome is a game of chance, rather than due to good stock selection.

At Lincoln Stock Doctor, we always recommend starting with strong financial health when selecting your companies i.e. make sure your businesses are exposed to manageable financial risk and can absorb a shock to its operations, should it occur. You will then have a platform to select from around 15 – 20 Stock Doctor Star Stocks for example, that are made up of high growth stories, some consistent income payers, some large caps and some small. All chosen to give your portfolio the best chance to achieve its long-term objective. You then need to be disciplined and proactively make changes as needed because the biggest risk a portfolio is exposed to is neglect; the failure to act when necessary.

The best way to position your portfolio to manage risk and achieve your investment objective of either growth, income or both over the long-term, is to have a defined strategy that allows you to proactively manage a naturally diversified portfolio of great businesses that aligns with your objective.

Game update