Herald Sun

The keys to robust investments can be in your hands

TERMS OF TRADE

with CARL CAPOLINGUA

IN last week's article I challenged you on your investing approach.

Are you a hobby investor, that is, a part-timer who hopes for the best, or are you a professional investor who meticulously plans every aspect of your approach?

This week I will cover very briefly the key aspects of a robust investing plan.

Objectives

YOU can't plot a course if you don't know where you're going, or what investing outcomes you are trying to achieve. Investing objectives should be defined in terms of reward and risk. What is the average annual return you are trying to achieve and how much are you prepared to risk to achieve it? I define "risk" as the maximum drawdown. This is the loss you will endure before removing yourself from the markets completely. Risk too little and you might not be in the market long enough to achieve your objective; risk too much and it might take a long time to recoup losses.

Trading style and universe

IF you have chosen a very high-return objective, you will inevitably have to be more active in the markets and most likely invest in a greater number of markets. More active means more work, but more work is required for more return. If you have chosen a low-return objective you may get away with holding a few bank shares and Telstra. My clients aim high and look to invest in a wide range of securities over a wide range of global markets.

Methodology — getting in

WHAT signals need to be in place in the broader market to allow you to apply your capital? We like to measure the overall market risk and apply more capital when it is low and less capital when it is high. This is quite separate from picking individual investments. Secondly, how will you engage individual investment opportunities? It is absolutely crucial that individual investment entry rules are clearly defined — there can be no grey area as to whether a requirement is observed or not. I use technical analysis (charting) to determine all of my entry methodology requirements.

Methodology — getting out

I BELIEVE this aspect is even more important. It is where big profits are made, or small losses are contained. The rules for exiting must be as clearly defined as those for entering.

Capital management

THIS is the most important aspect of any investing methodology. Capital management deals with how much you risk when you engage the markets. This includes how much you risk on an individual investment, and how much you risk across your entire portfolio. Finally, it also deals with limits on portfolio losses and how one disengages and re-engages markets.

Process

THIS aspect deals with what is required to implement your investing plan and when it is done. The plan should be implemented in a methodical way and each step should be documented to ensure everything is done and in the correct order.

Documentation

A GOOD plan is a well-documented plan. All the above aspects must be put in writing. Very comprehensive records of investing activities and results must be maintained. Performance analysis is crucial for assessing the viability of and improving a plan. A well-appointed trading journal is highly recommended here.

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