

*Preserving Capital Using Stops

Presentation by Colin Nicholson

AIA Conference 2017

*The most important single objective in investing:

Preservation of Capital

*Investment return derives from risking capital

*Lose too much capital and recovery is very difficult.

*What is a stop?

- *An order or alert to buy or sell a stockholding
- *Types of stop:
 - *Buy stop - to open a long or close a short
 - *Sell stop - to open a short or close a long
- *Not necessarily a market order - just an alert for action
- *I will not deal with short selling today.

*Two Ways Stops Protect Capital

*To seize opportunities (buy stop)

This is outside today's topic

*To preserve capital (sell stop)

- *If we make a mistake and the investment fails to perform (limit a loss)

- *If the investment is profitable, but starts to fail (lock in a profit).

*Conference Theme: Transitions

*Transitions will present opportunities

Time does not permit dealing with this today

*Transitions will present risks to capital

Sub-topic I have been assigned to talk about:

Preservation of capital by using stops.

*Transitions

*Schumpeter's *Creative Destruction*

*Some current and/or evolving transitions:

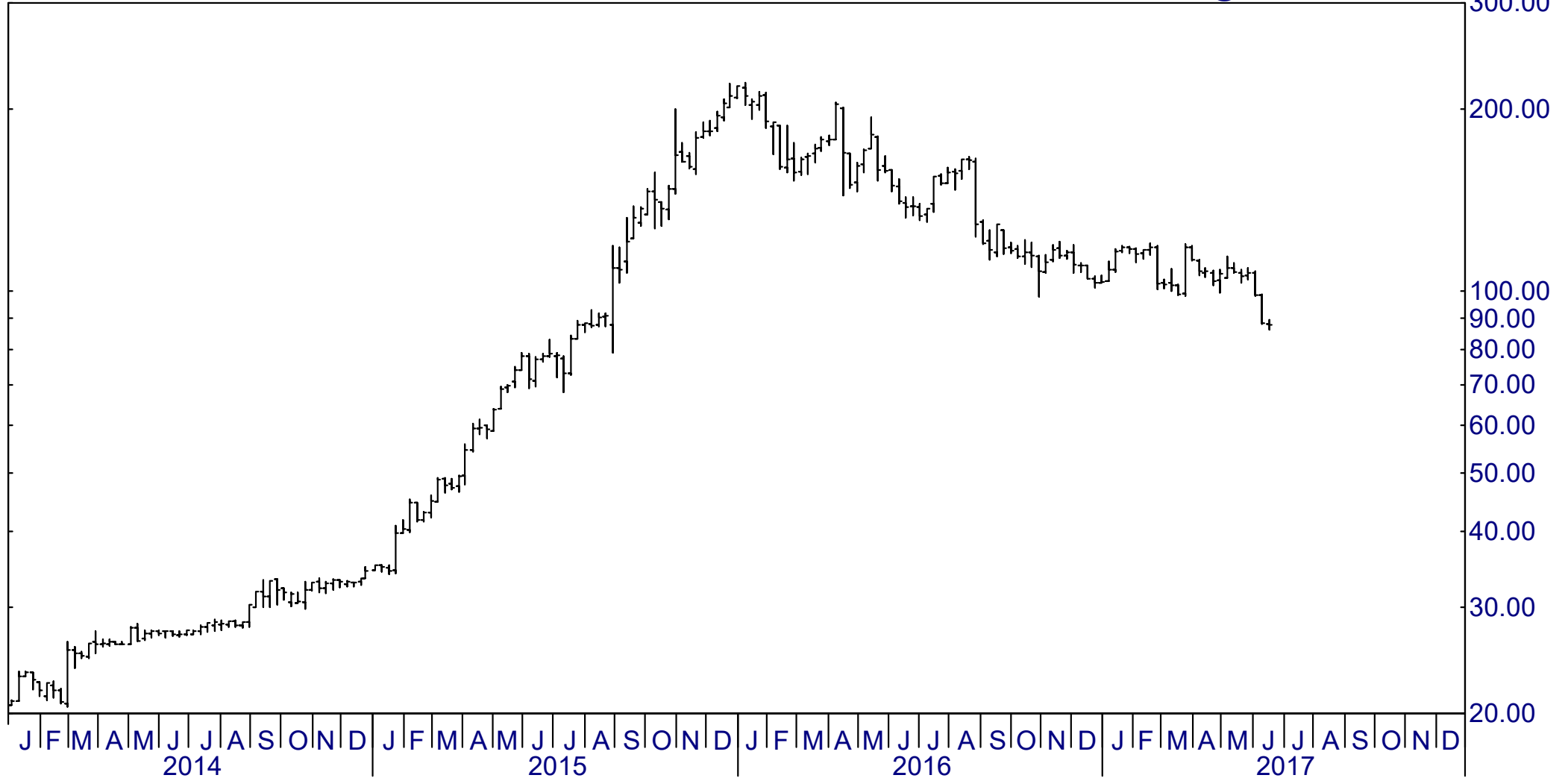
- *Automation, Artificial Intelligence, Blockchain, Additive Manufacturing
- *Online retail and threats to big shopping centres
- *China's shift from infrastructure and trade to consumption and services
- *Fintech e.g. banking and investment management
- *Coal/Oil to Renewable power
- *Copper to NBN
- *Electric and self-driving cars
- *Media - TV to streaming movies/Newspapers to internet and social media

All involve winners and LOSERS.

*Stops Protect Capital

BKL - BLACKMORES > -0.7% -0.64 to 87.90

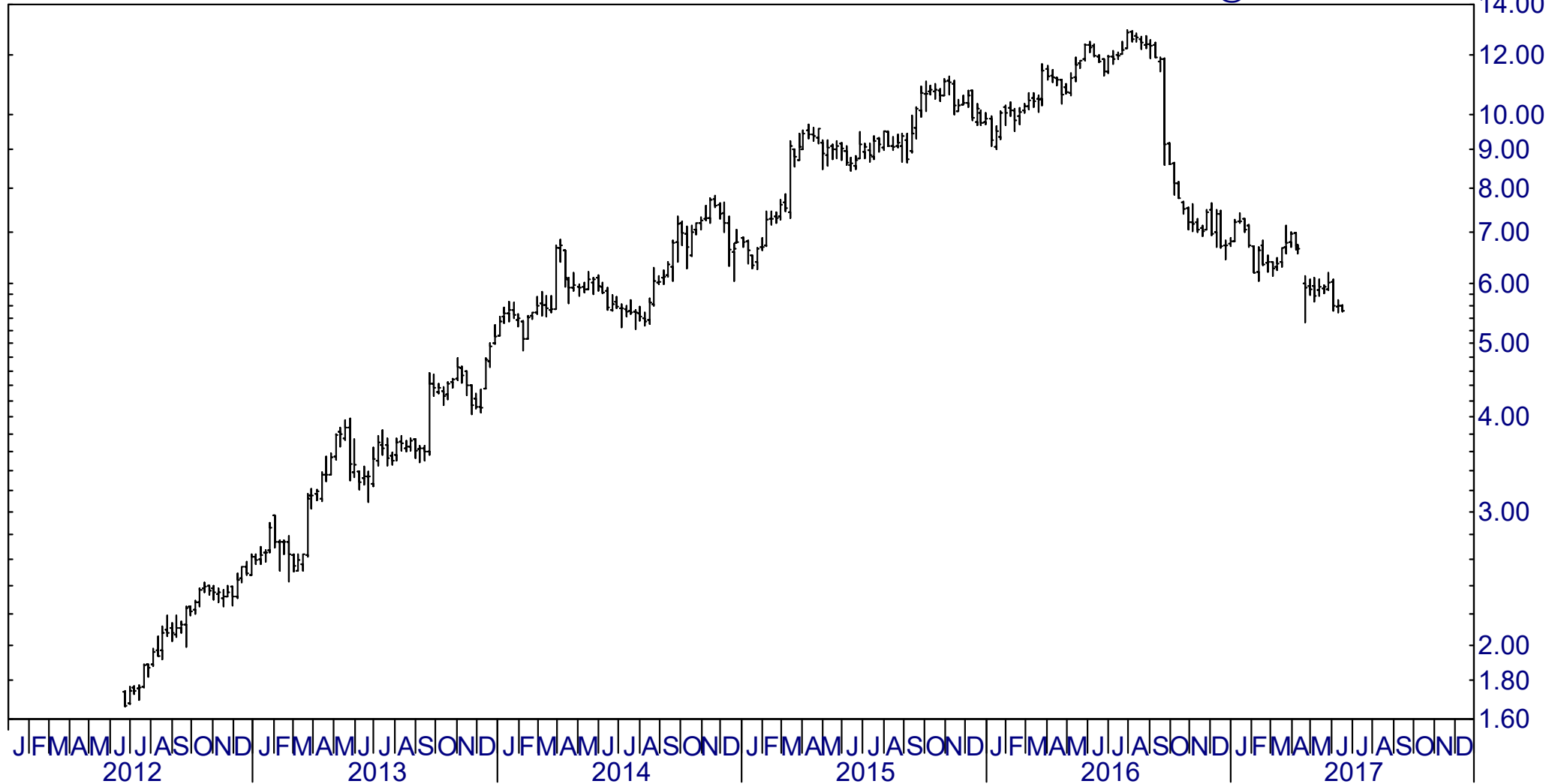
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*Stops Protect Capital

TPM - TPG TELECOM LTD > -1.3% -0.07 to 5.52

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*Stops Protect Capital

VOC - VOCUS GROUP LTD > -3% -0.11 to 3.57

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*Stops Protect Capital

TLS - TELSTRA CORPORATION LTD > +0.2% +0.01 to 4.37

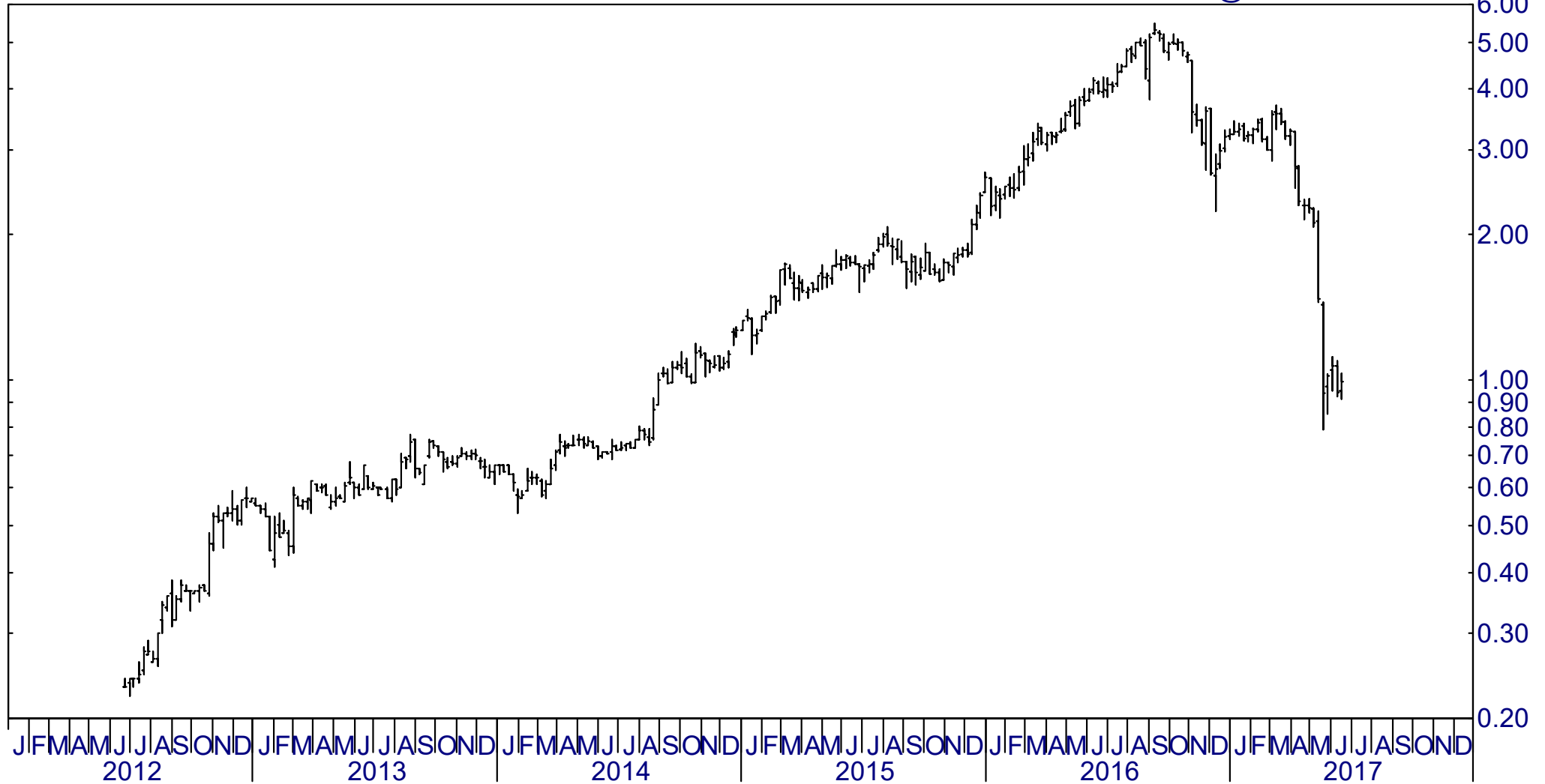
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*Stops Protect Capital

VTG - VITA GROUP LTD > -0.5% -0.005 to 0.995

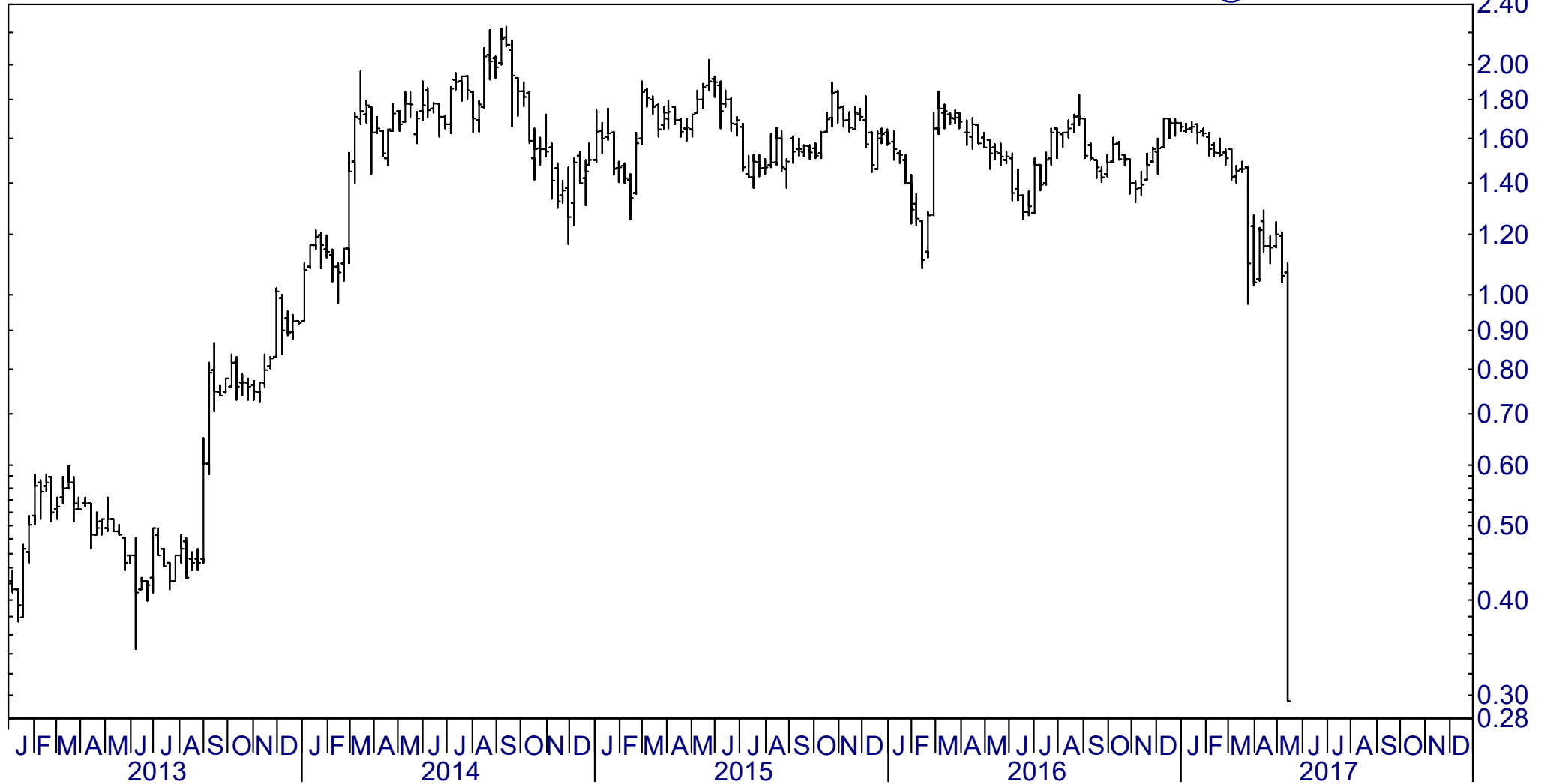
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*Stops Protect Capital

QIN - QUINTIS LTD > -35.9% -0.165 to 0.295

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*The Fourth Cure

Guard thy treasures from loss.

The Richest Man in Babylon by George S Clason

*Zurich Axioms #3

When the ship starts to sink

Don't pray...

Jump!

The Zurich Axioms by Max Gunther

*Successful Investing

Buying part ownership of a business which produces a growing stream of profits

Profits come to you in three forms:

- * Dividends
- * Franking Credits
- * Capital growth (from retained earnings profitably reinvested in the business).

* Investing Involves Risk

Risk arises in two ways:

- * We make a bad decision
 - * Some information we did not know
 - * Some new development we did not anticipate
 - * A poor judgement
- * A successful investment deteriorates
 - * New information
 - * New developments.

For both we need stops to protect capital.

* Sell Stops - General Description

- * We should have a clear idea of what we expect to happen when we buy a stock
- * We should define when it is happening
- * From that we can define when it is **not** happening
- * That is the signal to execute our sell stop to protect capital.

*Sell Stops - Two Situations

1. We have made a good gain and it starts to slip away
2. We are under water right from the start

*The second situation is the most difficult stop situation for most investors to execute -

Don't fool yourself that unless you sell you have not made a loss.

*Sell Stops - The Key

*We should know very clearly when we will sell before we buy

*That is what a sell stop is.

*Example - Fundamental Stop

- *We require that a business we invest in be conservatively financed
- *Defined as each year debt be no more than 2.5 times EBITDA
- *It is defined as not happening when debt exceeds 2.5 times EBITDA in two consecutive years
- *That is the sell stop signal.

*Some Triggers for Stops

- *Reason for buying does not eventuate
- *Company makes unwise mergers or acquisitions
- *Debt rises to dangerous levels
- *Founder/directors/large investors sell out
- *Company stops growing
- *Shares become significantly over-valued
- *Share price trend is violated
- *Disaster strikes the business.

* More than one stop

* I have two types of sell stop:

* A soft stop which my investment plan allows me discretion on whether to act

* A hard stop which my investment plan calls for me to act without hesitation

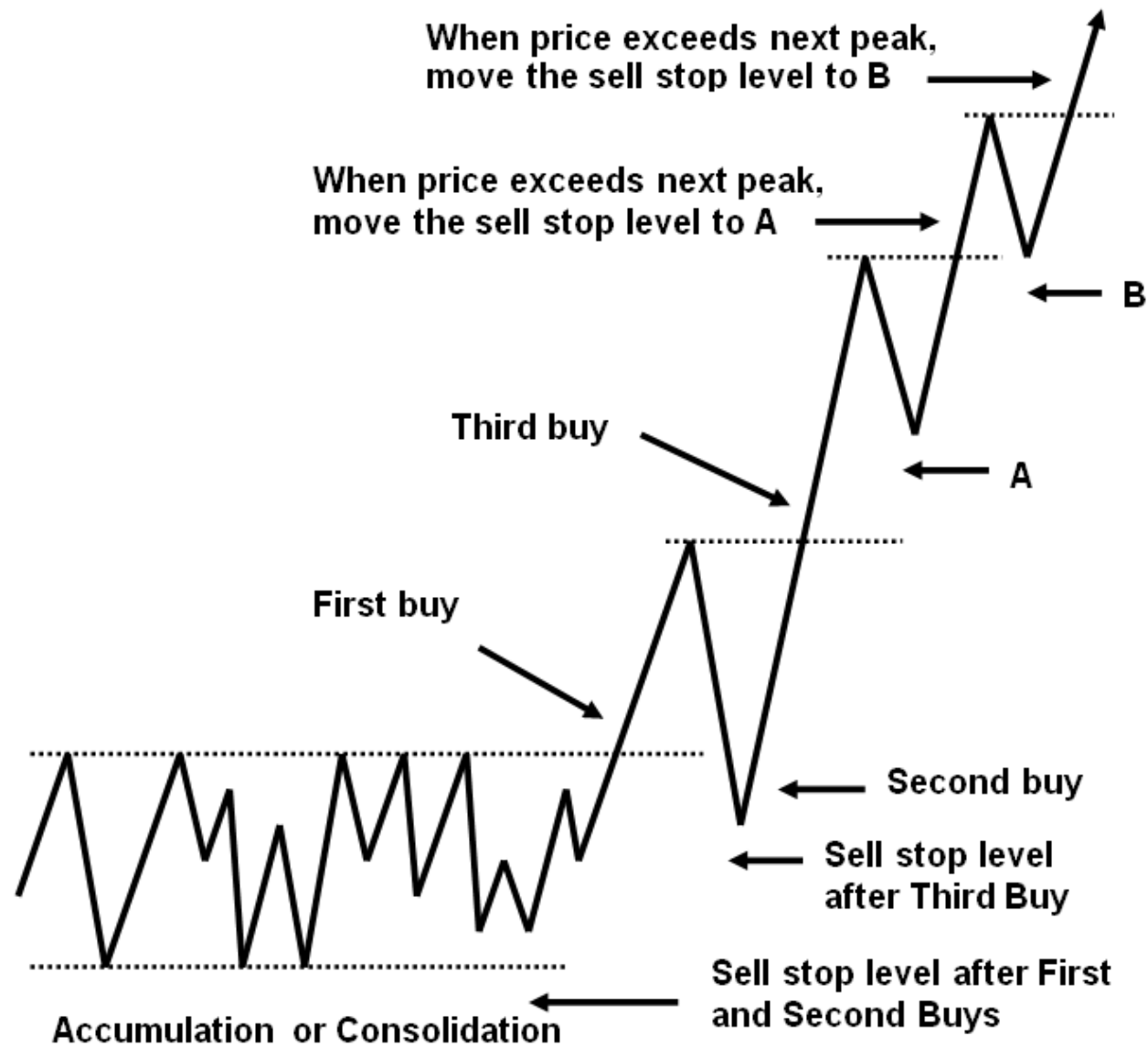
* Remember Chamberlain.

* My Stops are Based on Price

- * News travels fast and before it is announced
- * Those in the know leave footprints on the price chart:
 - * Legal insiders
 - * Smart money

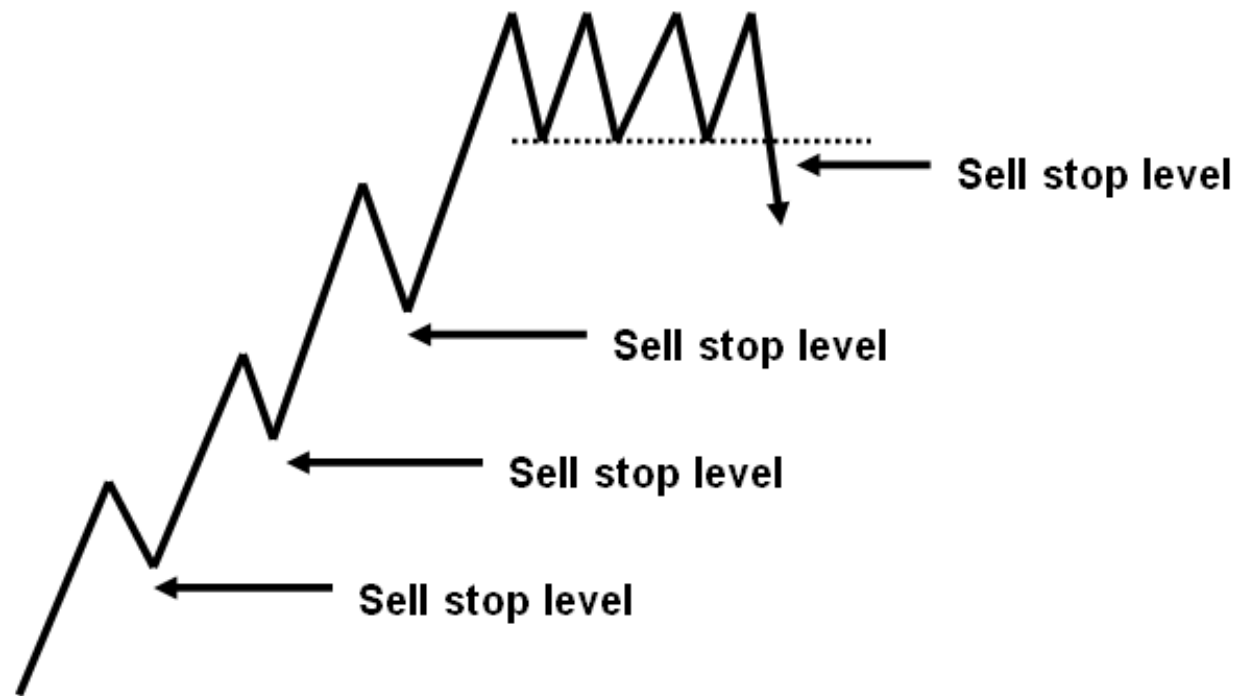
This is how I do it...

SELL STOP LEVELS WHEN BUYING AFTER A BREAKOUT

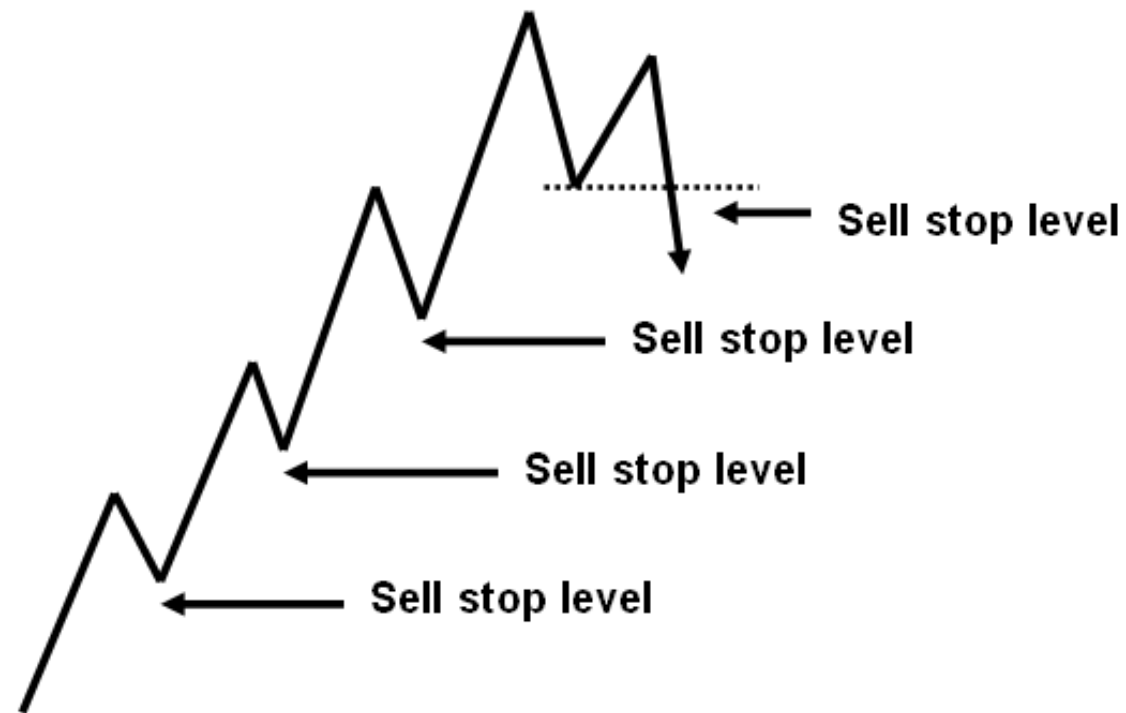




FIRST ADDITIONAL SELL STOP RULE



SECOND ADDITIONAL SELL STOP RULE



Questions?

