

Basic Principles of Stock Investing

Understanding how to invest in stocks is easier than many people realize. Successful stock investing involves the application of common-sense principles that many people erroneously believe do not apply to stock investing.

Perhaps because these principles are so simple, many people assume they cannot possibly apply to something as complex as investing in stocks. Those people would be surprised to learn the principles to successful stock investing are elementary. We can summarize them in the following way: buy quality companies; do your homework; and be patient.

Buy Quality Companies

We live in a world of modern capital markets. Investors can buy many, many stocks and sell them almost as soon as they buy them. But we believe investors make the best decisions if they forget we live in a world of modern capital markets. Investors should buy every stock as if they had to put ***all*** of their money in a ***single*** company and hold on to that company for 30 – 40 years.

If faced with these prospects, investors automatically adopt the highest standards and buy only stocks with impeccable fundamentals. We believe it is this quest for the best fundamentals that is the key to succeeding.

That is not to say that paying a low price is unimportant, but it is secondary in importance. It is much better to buy a very good company at a slight discount than to buy a lousy company at what seems like a huge discount. We consider the first approach a quality-centric approach to investing, and we feel it is the best way to beat the market.

There is a drawback to emphasizing quality and de-emphasizing price. Quality companies usually do not come cheaply. Therefore, you will pay slightly more and earn a return slightly less than you would earn if you just bought the cheapest and most speculative companies available.

But there are great benefits to emphasizing quality too. Determining quality is a straightforward endeavor. It does not require the application of some complex and risky calculus that may or may not be valid. The features of these high-quality companies are not hidden in some mysterious numbers or locked in some complex technique that is the exclusive domain of a privileged few.

The admirable features of quality companies are easily measured and understood. A quality-centric approach to investing is analytically simple (we explain exactly how to find quality companies in the **Use Simple Methods and Numbers** section of our **[How-to-Invest-in-Stocks](#)** page).

Furthermore, as a quality-centric investor, you are essentially giving up the pipe dream of becoming a millionaire overnight and instead you are sensibly zeroing in on obviously first-rate companies and aiming to beat the market in a slow but certain way.

For this reason, a strategy emphasizing quality is not only analytically easier to put into practice, but the result is more certain and it involves less risk. The only thing standing between you and these exceptional companies is the time and effort it takes to find these quality companies. And time and effort are things over which you have complete control. This aspect of quality leads us to our second principle.

Do Your Homework (Put in the Time and Effort)

Quality is a many-faceted phenomenon. It is not summed up with one or two numbers. It takes many different numbers to give an accurate description of a company's true quality.

In fact, we feel diminishing returns set in when it comes to trying to identify quality, but these returns never turn negative. In other words, it is beneficial (however slight) to study as many numbers as you can.

Finding the quality investments we speak of is like learning to play a musical instrument. The more time and effort you put in, the better will be your performance. In fact, (also like playing a musical instrument) putting in the time and effort is the only way to improve your performance. We call this aspect of quality investing "doing your homework."

Doing your homework may sound like an unpleasant task, but you must understand that it pays off. And it pays off for the same reason that doing your homework in grade school paid off. It is not easy to do, and so not everyone does it; therefore, those who do stand out from the rest.

Furthermore, you may be surprised at how gratifying doing your homework becomes once you excel on a few tests. Once you have tasted success, hard work (e.g., crunching numbers, reading footnotes, creating pro forma financial statements, and then combining all this analysis into one comprehensive rating of every company under consideration) will become enjoyable and even thrilling.

One of the most important principles to succeeding at stock investing is one of the most important principles to succeeding at anything. Put in as much effort as you can. Do your homework. If you have never liked doing your homework before, you will be delighted at how fun and enjoyable this type of homework can be.

Be Patient

The best investors in the world can underperform (and have underperformed) many years in a row. In fact, they are the best investors in the world precisely because they can underperform and not feel the need to change a fundamentally sound approach to investing. You must exhibit the same patient confidence.

In fact, if you embrace a quality-centric approach to investing as we recommend with our first principle, then the need to be patient becomes even more imperative. Quality-centric investors abandon the possibility of becoming millionaires overnight and instead sensibly aim to beat the market in a slow but certain way. The possibility that they will eventually outperform is more definite, but the degree by which they will outperform is potentially less than a more speculative strategy.

What this by-product of a quality-centric approach to investing means is that, over the short run, the degree of noise in the market is much greater than the degree by which even the best quality-centric investors could hope to beat the market. In time, the noise fades and the superiority of the quality-centric approach begins to emerge. But this emergence may take several years.

Therefore, quality-centric investors must exhibit even greater patience than the average investor. Successful stock investing requires tenacity, but the slow-but-steady nature of quality-centric investing requires an extra dose of tenacity.

Basic Principles of Stock Investing—Summary

You will learn that the single most important rule to successful stock investing is to favor quality companies. With this rule, investing becomes simple, and you tend to favor safe, low-risk companies.

And if you are embracing a *favor-quality-companies* approach to investing, then no other principles complement this approach more completely than *doing your homework* and *being patient*. These three principles go together like an axe head, axe handle, and a rock-solid chopping block.

Combine these three basic tools together and you will accomplish wonderful things. You will stack up stock market success like a champion lumberjack stacking up firewood.