Chapter 7:
The Art of
Concentrated Investing

"*If you want to get rich……you have to concentrate and focus*."

Jim Rogers

7.1 Introduction to Concentrated Investing

One of the most important investment strategies we should learn from Koon is concentrated investing, which is referred to as investing in a limited number of securities, with odds are in our favour. If you are a follower of Koon, you would have noticed that Koon is in the camp of concentrated investing, and he does not like the idea of broad diversification. According to him, the only way to make big money is by betting on either one stock or a few promising stocks, which have shown two consecutive quarters of earnings growth and have demonstrated revenue and profit growth potential. He does not only practice it religiously; he preaches the concept of concentrated investing to all his followers.

You might be wondering how many stocks you must own in order to be considered concentrated investing. According to Koon, as a rule of thumb, one should hold no more than three stocks in three different segments if the size of the portfolio is not too big, generally less than Rm 100,000. But, if the size of the portfolio is larger than Rm 100,000, the investor may put the money in more baskets in order to spread out the risk of the overall investments. That said, it is not advisable to hold more than eight stocks in the portfolio, as Koon believes that we may have difficulty to achieve satisfactory return, and may have a hard time to monitor all of them. Even though as large as a few hundred million ringgit the size of Koon's portfolio is, he has never owned more than eight stocks at a time. In fact, he always tries to limit his major investments to just three stocks.

It is worth noting that Koon is not the only one who adopts the investing concept; many shrewd and successful investors, including Jim Rogers, Mark Minervini, Kristian Siem, George Soros, and Stanley Druckenmiller, to name a few, also do the same. They pick only a few stocks that they have conviction in, and make sure that the odds are skewed in their favour before they wager their entire fund in the stocks. This is how they invest in the markets, and how they make their fortune.

7.2 Why Concentrated Investing?

"*Soros has taught me that when you have tremendous conviction on a trade, you have to go for the jugular. It takes courage to be a pig. It takes courage to ride a profit with huge leverage. As far as Soros is concerned, when you're right on something, you can't own enough.*"

Stanley Druckenmiller

For astute investors, concentrated investing is the best way to maximise gains, and to grow wealth. Successful people have a tendency to invest fully in a few of businesses they dedicate their lifetime effort to. This practice is very common in world of business, where we see most of the successful businessmen or businesswomen are very focused in their undertaking. They spend their time and

energy on what matters the most, and have their money invested only in the companies they founded. For example, in Malaysia, the wealth of Public Bank's Chairman Teh Hong Piow, Hartalega's founder Kuan Kam Hon, and Press Metal's CEO Koon Poh Keong is all tied to their stakes in their own companies, and the performance of their stocks. The reason why they do so is that they know their own businesses much better than they know about other companies, and that concentrating their bet in just a few companies is a better way to growing wealth. Similarly, in investing, concentrated investing is also an excellent approach to magnifying gains if we have good investment ideas, we know exactly how the companies make money, and we are on the right side of the game.

Do not be fooled by those financial consultants who advocate either building a diversified portfolio, or buying those actively-managed diversified global funds from them to minimise risk. The concepts simply do not hold water. Other than enriching themselves, the ideas will not help us much in achieving our goal. Instead of following their absurd ideas, you might be better off buying an index fund, such as DIA (ETF tracking DJIA), SPY (ETF tracking S&P 500), or QQQ (ETF tracking Nasdaq). Whilst Koon does not reject the notion that diversification helps reducing systematic risk and volatility, the approach, according to Koon, certainly will not make you rich. Also, in the preceding chapter, we have discussed how over-diversification can ruin even the best investment idea. Every good investment is hard to come by, and the area of our knowledge and experience is so limited. If we use our limited available fund to buy fifty stocks, instead of only a couple of truly great stocks that we know well, our overall investment return will be reduced significantly.

7.3 Is Concentrated Investing a Game for Everyone?

"*I have 2 views on diversification. If you are a professional and have confidence, then I would advocate lots of concentration. For everyone else, if it's not your game, participate in total diversification.*"

Warren Buffett

Concentrated investing is not a game for everyone. Do not get me wrong, concentrated investing is an amazing strategy to generating extraordinary returns, but it is definitely not a game for everyone.

Since stepping into the stock markets, we have seen countless of people going from rags to riches within a short period of time, and have witnessed people falling into bankruptcy in the blink of an eye. Having observed nearly all the emotions of people in the stock markets, and having seen their reactions following their losing trades, truth be told, we believe that the approach – concentrated investing – may not be suitable for everyone.

Whilst the above-mentioned prominent investors seem to be good at the concentrated investing game, it is noteworthy that not everyone has the Midas touch. In order to acquire the superpower, these master investors have sacrificed countless precious hours and tiring days to understand their targeted companies'

business operation, study the competitive advantage of the businesses, analyse the earnings growth potential of the companies, study the strengths and weaknesses of their competitors, and value the assets of the companies. It is undeniable that if they can do the work, other retail investors should be able to excel at the job as well, but how many people are willing to devote so much effort to get the job done well, and toward achieving the awe-inspiring performance?

Investors who bet blindly might get a nasty shock if they are not mentally prepared for any unforeseen circumstances. As they follow the advice of some securities analysts or market pundits blindly when these so-called financial experts pound the table on a stock, the investors may not be aware of the presence of uncertainties and risks associated with the stock. When share price tanks or a disaster breaks out, their confidence is shaken, and they will be suffering from stress, anxiety, depression or/and insomnia. Consequently, their normal everyday lives are disrupted by the mental illness. In the preceding chapter, we have studied the finding of Kahneman and Tversky that the magnitude of pain experienced by human when losing money is greater than that of joy when winning the same amount of money. If one is unable to deal with the mental stress or handle other psychological challenges, it is best to avoid this type of investing game.

In comparison, the volatility of a portfolio with limited number of stocks is far higher than that of a portfolio with a larger number of securities. Therefore, investors who are unable to control their emotions will definitely have difficulty holding onto their stocks during turbulent times or in turbulent markets. According to Koon's study, people who are unable to live through price volatility will sell their stocks in fear and in panic during price correction at the bottom when their normal brain function – logical thinking function – is shut down, and lock in the loss.

Also, people who have a poor record of financial planning definitely should not try their luck with this type of game. The stock market is a dangerous battlefield. Without having a viable investing strategy, sound investing philosophy, high emotional intelligence, and good money management skills, making the concentrated investing attempt is akin to playing Russian roulette. There would be no back-out, and your life savings would turn into dust if you fail. Can you imagine how your family members would live when the life savings, which can be used to provide comfortable life to them and to provide quality education for your children, disappear down the rathole?

7.4 The Strategy for Successful Concentrated Investing

Concentrated investing can be destructive to our wealth if we are not prepared to deal with the challenge wisely. Without having a viable strategy, taming our emotions and staying disciplined, betting blindly in the stock market will only get our financial life shot into pieces. For amateurs and beginners, it may sound like a hopeless dream, but it is not an impossible mission either. Here's some good news: even if you are not an experienced investor, but if you are willing to

put forth some effort to learn, and follow the guidelines outlined below, you are less likely to lose money in the game. Also, the strategy enables you to hit the ground running faster than you would otherwise.

7.4.1 Only Invest in Stocks with Promising Earning Growth Potential

First thing first, pick the stocks with bright earnings growth prospect that have reported two consecutive quarters of increasing profits. If the slogan for success in real estate investing is “location, location, location”; for stock investing, it must be “earnings growth, earnings growth, earnings growth”. Based on Koon’s observation, however, most investors and investment professionals overly concentrate on balance sheet, dividend yield, and technical analysis, and fail to notice the importance of profit growth. They do not think like a businessman. But the best way to mint money in the stock market is to invest like a businessman in companies with high profit growth prospect. To be really successful in investing, one must be willing to venture like an entrepreneur, and focus on the profit growth prospect of a company. Out of a thousand-plus counters in Bursa Malaysia, we must pick only a few stocks that have truly tremendous profit growth potential and get stronger sequentially each quarter.

Why company with tremendous profit growth potential?
According to Koon, amongst all the popular selection criteria, i.e. book value, cash flow, dividend yield etc, the most powerful catalyst to move share price is profit growth prospect. To do so, we need to be able to see the earnings potential of a company, and must use some business sense to estimate the earnings of the company a few years down the road. One of the techniques is finding the factor or catalyst that can move the earnings needle. The chance of picking a winning stock would be higher if we could leverage on our knowledge and experience to find a profitable company with near-term and long-term catalysts. For example, Koon has been in construction business for more than sixty years, and has involved in countless mega projects. He knows how construction companies make money, and can tell if the companies are likely to make more money next year or not.

But mind you, in the world of business and investing, any of the outcomes is possible. Our judgments may sometimes go wrong due to some unforeseen circumstances such as natural disasters, sabotage, sudden reversal of governmental policies, and etc. The stock market may crash after we have built our position, and the prices of our stocks may fall. Nonetheless, if we invest in stocks with incredible profit growth potential underpinned by the combination of near-term and long-term catalysts, based on something we know best and with high level of confidence, we are less likely to lose money. The least we will not be stuck with something that we have never wanted to hold in our portfolio. In addition, it will reduce the downside risk of our investments.

7.4.2 Invest in Truly Cheap Stocks

Concentrated investing is a double-edged sword, which does not only increase return, but also magnifies loss if we do not invest with caution and prudence. To reduce the risk, we must avoid all overpriced stocks. No matter how promising the future of a company is, we are susceptible to a loss if we buy it at an inflated price, or buy it with the fear of missing out, as the growth element may have been priced into the stock. During recession, economic stagnation, reduce access to borrowing, poor wage growth, and rising unemployment will result in companies face poor earnings growth. Additionally, negative market sentiment will cause the share price spiralling downward, as buying volume overwhelmed by selling volume. The double whammy would put a big dent in our wealth, if we overpay for a stock.

To avoid investing in an overpriced stock and to prevent any unforeseen circumstances, Koon only looks for promising stocks with projected P/E ratio lower than 10. This type of stocks is either out of favour, or still flying under the radar. Further, market confidence on the stocks is at low ebb. This is the best time to go on the prowl for them at bargain prices. They offer serious investors a great deal by maximising returns whilst minimising risks, as either the bad sentiment or risk has been discounted by the market, or the gems have not been discovered by people.

Please note, however, that not all stocks with projected P/E lower than 10 are cheap stocks. Many cyclical stocks are traded at low projected P/E multiples at the peak of their up cycles, especially when their earnings have been rising for several quarters or years. According to Peter Lynch, "*Buying a cyclical after several years of record earnings and when the P/E ratio has hit a low point is a proven method for losing half your money in a short period of time*." In order to ensure that a stock is truly cheap, we need to estimate the ballpark figures of the company's earnings for the next couple of quarters or years, using some business sense, prior to estimating its projected P/E. If the earnings growth is not sustainable, it is highly unlikely that its share price will increase. Once we have found a bargain stock, we can begin to invest in the stock if we believe that its growth is on the cards. Otherwise, we should wait patiently for the right time to swing for a home-run.

7.4.3 Stick to Your Guns

To be successful in the stock market, we have to follow our investing rules, and be decisive to buy or to sell. Of course, it is easy to lose sight of our objectives when market is in chaos especially during turbulence, but if we stick to our guns like Koon, it is unlikely that we will miss any precious opportunities. The magnitude of risk we bear is not necessarily equivalent to that of reward we can expect from our

investments. In fact, the latter could be far greater the former if we know what exactly we are doing, and when our predictions are correct.

During correction, the stock market is rife with negative news and bad sentiments. What we need is an unwavering confidence in our investing principle. Ignore those scaremongers who often spread frightening bad news, especially during market correction. Do not be afraid to buy when we have found a good one. After discovering the gem, we must monitor its progress and share price, and then buy the stock immediately once our price target is hit. Remember, to score a home run, we need to position ourselves right, and hit the ball hard when the opportunity arrives.

Do not follow anybody's recommendations or rumours blindly, including those from your relatives or your best friends. No matter how reliable it is they claim about the "wind" they got, if you buy it at an inflated price, you would be left in the lurch when the share price slips, the party ends, and the buying momentum wanes. Also, we should not follow any stock analysts or our brokers blindly. These analysts are not clairvoyants, and are also unworthy of our benefit of doubt. Brokers are paid for advising us to buy and sell stocks through the brokerage fees we pay for each transaction we make. They have no obligation to help us make money. Even if we jump all over them when we lose money, we will not be able to recoup our money.

"*More money is lost listening to brokers than any other way. Trading requires an intense personal involvement. You have to do your own homework.*"

Michael Marcus

7.4.4 Trade Around A Core Position

Trade around a core position is a strategy usually used in conjunction with concentrated investing approach. Koon capitalises on this strategy to maximise his investment returns as he has a good understanding of human emotions and a solid grasp of the market dynamics – change in supply and demand. It indirectly allows him to increase his position size at low prices, and to lower his average buy price by selling a partial of his stake in a stock at high prices, and buying more shares at low prices.

Koon always says, "*No share can continue to go down for whatever reason and no share can keep climbing up and up indefinitely for whatever reasons*." At some point, the stock will take a short rest prior to resuming its trend. When the price of a stock goes up too fast within a very short period of time and the slope is too steep, its resistance will increase, as selling pressure builds up. When it approaches the resistance zone, we can cash in a fraction of our profit by selling some of our shares into strength. Then we jump right back in near the

support zone during correction when the momentum is built up again, by using the proceeds to buy more shares at a lower price.

The illustration below is an example of how Koon maximises his investment return using the strategy of trade around a core position.

Scenario 1: buy-and-hold
Let's suppose that Koon buys 10,000 units of a promising stock, DEF, at Rm 0.50 / share with Rm 5,000 initial investment, as shown in the table below. Koon holds the stock until it is fully valued and then sells it at Rm 1.10 / share for Rm 11,000, which gives him just a gain of Rm 6,000 or 120%.

Scenario 2: trade around a core position
Now if he trades around a core position by purchasing 10,000 units of the same stock, at Rm 0.50 / share as an initial outlay to build his core position, then he sells 3,500 shares (at Point 2) around Rm 0.85 / share for Rm 2,975, subsequently buys back 4,577 units of the stock (at Point 3) around Rm 0.65 / share with the proceeds, and in the end exit his position at Rm 1.10 / share, he would earn Rm 7,185 or 144% profit, an additional profit of Rm 1,185 or 24%.

Type of investment strategy	Buy-and-hold	Trade around a core position
Initial batch's buying price (Point 1)	Rm 0.50 / share	Rm 0.50 / share
Initial batch's buying volume	10,000 units	10,000 units
Initial value	Rm 5,000	Rm 5,000
First batch's selling price (Point 2)		Rm 0.85 / share
First batch's selling volume		3,500 units
Second batch's buying price (Point 3)		Rm 0.65 / share
Second batch's buying volume		4,577 units
Final batch's selling price (Point 4)	Rm 1.10 / share	Rm 1.10 / share
Final batch's selling volume	10,000 units	11,077 units
Final value	Rm 11,000	Rm 12,185
Total gain	Rm 6,000	Rm 7,185
Percentage of gain	120%	144%

Figure 7.4.4.1: Comparison between Buy-and-Hold and Trade around A Core Position Strategy

Figure 7.4.4.2: Share price of Stock DEF

Note that our success in trading around a core position lies in our ability to interpret market participants' emotions. For example, when the pendulum has shifted too much in the direction of greed, we must get ready to sell, and then prepare to buy back the shares when the market is in fear, in order to increase gain. To do so, we can use Turning Point Investing principle or Fibonacci Extension and Retracement method to determine the best time to take further actions, such as increasing our position.

7.4.5 Turning Point Investing Principle

A turning point is a point where change in price direction takes place based on developments shaped by events, human perceptions or emotions. The change can either be a new downtrend, a temporary pullback, or the beginning of an uptrend.

As investors, we can build a position in a stock or even buy more shares of a stock at the turning point when the event occurs (i.e. the government announces a change in the regulation) which we believe is in favour of the company in term of business or profitability growth before/when the new uptrend starts. Likewise, we can take some profits off the table if we sense some pessimism out of some trading activities immediately when a downtrend starts, as the share price has probably risen too fast or market participants' confidence has started to wane. We may buy back the shares again later when the uptrend resumes, as the fear has subsided or market participants have regained confidence.

Technical analysis is one of the tools we can use to find the turning point of a stock. We can start buying it back when its resistance is broken. The resistance is typically broken when bulls prevail over bears and when their earnings have improved, as either their businesses have expanded or the recovery of their industries has started to gain traction. The breakout usually heralds a round of upward move. Taking some calculated risk by buying shares at the inflection point can be a rewarding one.

7.4.5.1 Technical Analysis (Chart Patterns and Momentum Indicators)

The increase of long position pushes the price upward, the liquidation of positions leads to price tumbling. The upward and downward movements of share price form patterns on charts. According to chartists, the patterns, like a map, could show us the direction where the stock price is likely to be heading to in the near future. By identifying a pattern early, we can get a grasp of market participants' emotions such as greed, fear and confidence levels, and can position ourselves for the next opportunity.

As discussed in the preceding chapter, to do so, we need to train our eyes to identify trends and recognise chart patterns. Finding the peaks and valleys is the first step in chart reading. Subsequently, we need connect them together to find resistance and support lines, and to form a chart pattern. This is an important step we should not forget. The lines of support and resistance act as infrared beam detectors, which give us a signal when the trend has changed. Below are some common chart patterns we have discussed in the previous chapter and should pay attention to:

Chart Patterns:

a. Bearish Trend: Head-and-Shoulders Top

A head-and-shoulders top pattern is a potential bearish reversal of an uptrend indicating that the bullish trend has come to an end. As soon as the neckline (a line drawn across the left and right armpits) is broken with a close below the line, the trend is confirmed, we may take some profits off the table by reducing our position in the stock or get out of our position completely if we do not intend to hold the shares any longer.

Figure 7.4.5.1: Head-and-Shoulders Top

b. Bearish Trend: Double Tops

A double tops pattern is also a bearish reversal of an uptrend. It gives a warning signal to people that the existing bullish trend is likely to come to an end. A close below the neckline confirms the pattern. If we plan to exit to our position in the stock, a breakout to the downside is a good selling window. If we have no plan to sell the stock too soon, we may take some of our money off the table once the breakdown occurs, as fear has overcome greed.

Figure 7.4.5.2: Double Tops

c. Bearish Trend: Bearish Symmetrical Triangle

A downtrend will begin when the support (lower ascending trendline) of a symmetrical triangle is broken down. The price movement of share is usually bounded by upper descending and lower ascending trendlines and the volume before the breakout is generally low. A close

below the lower ascending trendline confirms the pattern. We can take some profits off the table by reducing our position in the stock.

Figure 7.4.5.3: Bearish Symmetrical Triangle

d. Bearish Trend: Bearish Pennant and Flag

Bearish pennants and flags are the patterns indicating the continuation of an existing downtrend if the support line is broken down. (Note: they may sometimes indicate the reversal of the existing downtrend if the breakout is on the upside.) The price movement of share in a pennant or a flag is usually bounded by its resistance and support lines, and the volume diminishes gradually before the breakout. We may reduce our position in the stock when the breakout happens.

Figure 7.4.5.4: Bearish Pennant

Figure 7.4.5.5: Bearish Flag

e. Bullish Trend: Cup-with-Handle

Cup-with-handle is a bullish pattern signalling the continuation of the previous bullish trend after a period of share price consolidation, as selling pressure dissipates or buying pressure regains its lost ground. A close above the resistance (or the old highs) at the breakout point confirms the pattern. Volume tends to be high at the breakout point. We may add to our profitable position by buying back the shares we have sold earlier or by buying more shares when the breakout happens.

Figure 7.4.5.6: Cup-with-Handle

f. Bullish Trend: Ascending Triangle

Ascending triangle is a wedge-shaped pattern showing the continuation of the prevailing uptrend when the share price breaks out upward after a period of sideways

consolidation. Volume is usually high at the breakout point, where buying pressure is strong. We may buy back the stock we have sold earlier, or buy more shares to take advantage of the bullish momentum.

Remark: whilst the price usually breaks out upward, it may sometimes go in the opposite direction. If the share price breaks down or crosses below the rising support line, it then signals the start of a bearish trend.

Figure 7.4.5.7: Ascending Triangle

g. Bullish Trend: Inverse Head-and-Shoulders

An inverse head-and-shoulders pattern is a bullish reversal of a downtrend indicating that the bearish trend has come to an end. As soon as the neckline (a line drawn across the left and right armpits) is broken with a close above the line, the uptrend is confirmed, we can take advantage of the momentum by adding to our position in the stock. After buying more shares at the breakout point, we may set our profit-taking point based on the height from head to neckline.

Figure 7.4.5.8: Inverse Head-and-Shoulders

h. Bullish Trend: Falling Wedge

Falling wedge is a bullish reversal pattern that sloped downward, with contracting price range, signalling the beginning of a bullish trend. Trade volume usually picks up at the breakout point after a period of consolidation, as sell volume has dried up. This is a good time to add to our position by buying back the shares we have sold earlier or by buying more shares to take advantage of the upside momentum.

Figure 7.4.5.9: Falling Wedge

i. Bullish Trend: Bullish Symmetrical Triangle

An uptrend will begin when the resistance (upper descending trendline) of a symmetrical triangle is broken. The price movement of share is bounded by

upper descending and lower ascending trendlines. The volume before the breakout is usually low. A close above the upper descending trendline confirms the pattern. We may add to your profitable position by buying back the shares we have sold earlier or by buying more shares when the breakout happens.

Figure 7.4.5.10: Bullish Symmetrical Triangle

j. Bullish Trend: Bullish Pennant and Flag

Bullish pennants and flags are the patterns indicating continuation of an existing uptrend if the breakout is on the upside. (Please note, however, that they may sometimes indicate the reversal of the existing uptrend if the breakout is to the downside). Just like a symmetrical triangle, the price movement of share in a pennant or a flag is bounded by its resistance and support lines and the volume diminish gradually before the breakout. We may increase our position in the stock when the breakout happens and set our profit-taking point based on the height of the flagpole or pennant pole if we intend to take some profit when the share price is on the way up.

Figure 7.4.5.11: Bullish Pennant

Figure 7.4.5.12: Bullish Flag

k. Bullish Trend: Double Bottoms

Double bottoms pattern is a bullish reversal of a downtrend indicating that the existing bearish trend has come to an end. A close above the neckline confirms the pattern. We can ride the train by buying back what we have sold earlier or by adding more shares to our existing position once the breakout occurs, as greed has overcome fear.

Figure 7.4.5.13: Double Bottoms

Momentum Indicators

The following indicators can be used in conjunction with chart patterns to determine a change in the existing price trend.

Indicator 1: Relative Strength Index (RSI)

If the RSI level of a stock is below 30, it indicates that a stock is oversold. When RSI crosses above the level of 30, it is considered a bullish signal. We may accumulate or buy back the stock when its RSI crosses above the level of 30. On the other hand, the level above 70 represents an overbought condition. We may sell all our shares or take some profit off the table when its RSI crosses below 70. Whilst some books recommend using 20 and 80 as oversold and overbought reference levels, respectively, it is advisable that you use the reference levels of 30 and 70, as not all stocks' price movement is volatile in nature. We would miss lots of good buying and selling windows if we use a wider range as references. Also, we must not forget to pay attention to the divergence between RSI and share price movements. The possibility of having a price reversal is very high when divergence occurs.

Indicator 2: Accumulation and Distribution (A/D)

A/D is a momentum indicator used to judge if the market participants are accumulating or selling a stock. A positive gradient indicates that the stock is having high demand, as investors are accumulating it. When demand exceeds supply, buying volume is greater than selling volume, share price will naturally move up. Therefore, when the A/D line of a stock is trending upward, the price will eventually go up, even though

its share price is initially in a downtrend. We may take the advantage of the divergence (between A/D and share price movements) to build position in the stock or buy back the stock we have sold earlier when the reversal occurs, as the bulls have prevailed.

Indicator 3: Moving Average Convergence Divergence (MACD)

MACD is calculated by subtracting 26-day EMA from 12-day EMA. MACD is a momentum indicator signalling a change of trend when the signal line, 9-day EMA line, is crossed over by MACD. When the MACD line rises above the signal line, it gives a bullish signal. On the other hand, when the MACD line falls below the signal line, it gives a bearish signal. When the share price diverges from the MACD, it signals the end of the current trend. For example, when the share price is in an uptrend and the MACD line is in a downtrend, the uptrend momentum is going to end soon and we may sell some shares into strength. Conversely, if the share price is in a downtrend and the MACD line is in an uptrend, the downtrend will come to an end soon and we may build a position in the stock or buy back the shares we have sold earlier at a lower price.

7.4.5.2 Special Events

Special events generally create some intriguing possibilities, which may help us avoid some devastating losses or/and enable us to make some money out of the changes, uncertainty, or miseries if we know how to capitalise on the developments or changes to our advantage. That's how Koon and other successful investors, like Stanley Druckenmiller, Bruce Kovner, Jim Rogers and etc,. make big money in the markets. If we always pay attention to the developments in the world, and move one step ahead of the crowd, the information could tip us off to making more money and to avoiding huge losses from those events. Below is a list of some special events, which happened in the past, and worth our time discussing about them.

Example 1: Outbreaks of Diseases

Outbreaks of diseases and infections, and striking of natural disaster may sometimes lead to a sudden surge of demand for certain medical products such as medical glove, surgical mask, vaccine and medicine, and medical equipment. For example, the outbreaks of diseases such as H1N1, bird flu, MERS, SARS could benefit medical glove makers due to a surge in demand for medical gloves. In 2010, during the H1N1 fever epidemic, the Health Authorities took extra precaution to

prevent the spread of the deadly virus. As a result, the demand for rubber gloves far exceeded the supply. During the H1N1 fever epidemic, most of the glove manufacturers were making phenomenal increasing profit every quarter and their share prices were shooting through the roof. According to Koon, when he saw there was a sudden jump in demand (and profits) for Supermax's gloves in March 2009, he started buying it. When he saw X-ray detectors installed at the airport to prevent the spread of the deadly H1N1 virus, he bought even more shares aggressively. At the same time, he also recommended the stock to his relatives and friends. He accumulated so many shares that he eventually became the 2nd largest shareholder of the company in 2010. The stock went up from Rm 0.95 to above Rm 6.20 within 15 months and he made a lot of money out of the event.

Example 2: Change of Tax Policy or Regulations

Any changes to existing tax policies may lead to either a decline or a boost in consumer spending, depending on the objectives of the revisions. For example, the implementation of GST would deter consumers from spending, push up the cost of living in the country and push more people to the brink of poverty. In this case, consumer goods companies are generally expected to perform poorly once the tax is implemented. If we possess any of the related stocks, we can trim our position in the stock before the law takes effect and buy it back later at a lower price. Similarly imposing of heavy tariffs on imported steel products, though benefits local steel players and protects domestic employment, may hurt consumers, as it leads to an increase in the cost of raw materials and results in a jump in the prices of consumer goods. Immediately when the news is released, we can consider buying some good steel-related companies, which are likely to be benefited from the change, and trim our position in those affected consumer product stocks, which will be hurt by the tariff but are unable to pass on the cost to their customers or the end users.

Example 3: Invention of New Technology

Scientific and technology breakthroughs do not only change the way people lives, but they have also made many industries heading for extinction. For examples, the creation of internet has led newspaper industry to its current nadir. In addition, although the rise of automation has lowered manufacturing cost and improved system efficiency, it too has made many jobs and companies disappear. If any of the technology or automation companies we own announces a new discovery or breakthrough that will benefit the whole world, we should add

to our position immediately because the technology will soon create a new market and generate a lucrative stream of revenue to the company. Likewise, if we have any newspaper publishing stock in our portfolio, we should pay a close attention to its performance and development. If it does not evolve into a growth company, we should consider selling the stock.

7.4.6 Be Patient

Having the ability to identify good companies can only help us find the right horse, it is patience that can get us to the place where we want to be ultimately. After identifying an undervalued stock, we have to wait patiently to buy it. Our investments will be jeopardised if we act hastily in the stock market. Warren Buffett once said "*the stock market is a device for transferring money from the impatient to the patient*."

Do not expect it to double our money overnight after buying a stock. Rome was not built in a day. It took years to build a strong empire. No matter how efficient the management team is, how great the business model can be, we need to give the company time to grow its earnings before we could reap the fruit of our labour. Again, patience is the key to growing wealth here.

Do not go in and out of the stock market unnecessarily whilst waiting for the earnings to grow. Your returns would be greatly reduced if you trade unnecessarily. You will only enrich your brokers by doing so. Koon always says, "*Short term traders cannot be rich*." Therefore, we should aim to hold for long-term. When we trade sparingly, and invest for long-term, our cost will be stripped to the bare bone, and the ultimate return will be maximised.

7.4.7 Mentally Prepared for Market Volatility

According to Benello et.al., the strategy – concentrated investing – does not only magnify gains, but it also leads to higher volatility. Since the road to growth is bumpy, we need to be mentally prepared to stomach the volatility. If you visit any stock forums lately, you would see people react negatively to market volatility by groaning in pain at their (realised and unrealised) investment losses. Weak holders who cannot control their emotions properly, on the other hand, would sell their shares at a loss even if the fundamentals of the companies are still strong. They blame everything, including the changes in government policy, poor market sentiments, falling consumer price index, rising inflation, trade disputes, lockdown, spread of infection, currency depreciation, bad news, and lower projected GDP growth, except themselves, for their losses.

To be a success investor, one should stop grumbling or whining about market volatility. For better or for worse, we follow our rules or

principles, and should be happy with the outcomes of our effort. Even if it does not turn out the way we wanted it to be, we chalk it up to experience.

Bear in mind that the market hates negative news and uncertainty, and it is short-sighted. People have a tendency to sell their holdings immediately when market sentiment turns sour. As a result, they have to pay higher prices to buy back the same stocks when there are any good news later. If we invest in a promising stock with the objective to magnifying gains, but we dispose it before the share price rising due to mental stress, we are literally following the herd shooting ourselves in our foot. Remember, the market can be at times inefficient, but it cannot always be wrong. When thinking goes deeper, ignorance recedes. The true value of a stock will be reflected in its price one day when its earnings grow, and the negative sentiments wane.

7.4.8 The Rule of Thumb for Fund Allocation

"*Stock trading is not an on-off business; moving from cash into equities should be incremental. You should start off with pilot buys by initiating smaller positions than normal; if they work out, larger positions should be added to the portfolio soon thereafter. This toe-in-the-water approach helps you keep you out of trouble and building on your successes. If you're not profitable at 25% or 50% invested, why move up to 75% or 100% invested or use margin?*"

Mark Minervini

Wise deployment of fund, or position sizing is as important as finding a winning stock. Immediately investing a substantial amount of money in a stock after discovering the counter could be a dangerous move if the company fails to perform later. No intelligent investor would go to the market without having a proper risk management, position sizing, or fund allocation plan. Even professional poker players with the best hand do not normally wager their entire fund, or go all-in at the beginning of a betting round. They would place a small bet initially and raise their stake gradually whilst assessing the cards on their hands, and the response and strengths of their opponents.

Similarly, in investing, shrewd investors like Koon, George Soros, and Mark Minervini do not invest with all their funds immediately at the beginning of a round. What they usually do after discovering a winning stock is placing a decent bet on the stock, which they call a probe trade. At the same time, they will continue to monitor the performance of the company, and the supply and demand of the stock. They would only increase their stake in the company by adding more to their winning position continuously if initial investment shows them profit, and if the business continues to expand and its profits continue to grow. By doing so, they do not just reduce the risk of losing too much money; they also increase the probability of winning big in the game.

To begin with, we can use 20% - 35% of our money to buy a stock like Koon, and set aside 65% - 80% of the money as a "war chest". As the name implies, the fund allows us to buy more shares on the cheap when the price goes lower (note: do not buy until the stock turns up) after our initial purchase if the profit growth prospect of the company remains intact. Also, we can use the money to add more shares into our portfolio when the price continues to rise as the company continues to report increasing earnings until it does not grow anymore or when the fund is the exhausted. However, the amount of money allocated for each successive batch of shares should be lesser to prevent the cost rises significantly.

Example:
Let's suppose that we have Rm 100,000 in our account, and we would like to invest in a stock called ABC. We can buy the stock in seven batches as follow.

Batch	Share Price	Amount (Rm)
1	0.50	30,000
2	0.55	22,000
3	0.60	16,500
4	0.65	13,000
5	0.70	9,800
6	0.75	7,200
7	0.80	1,500

Figure 7.4.8.1: Pyramiding Table

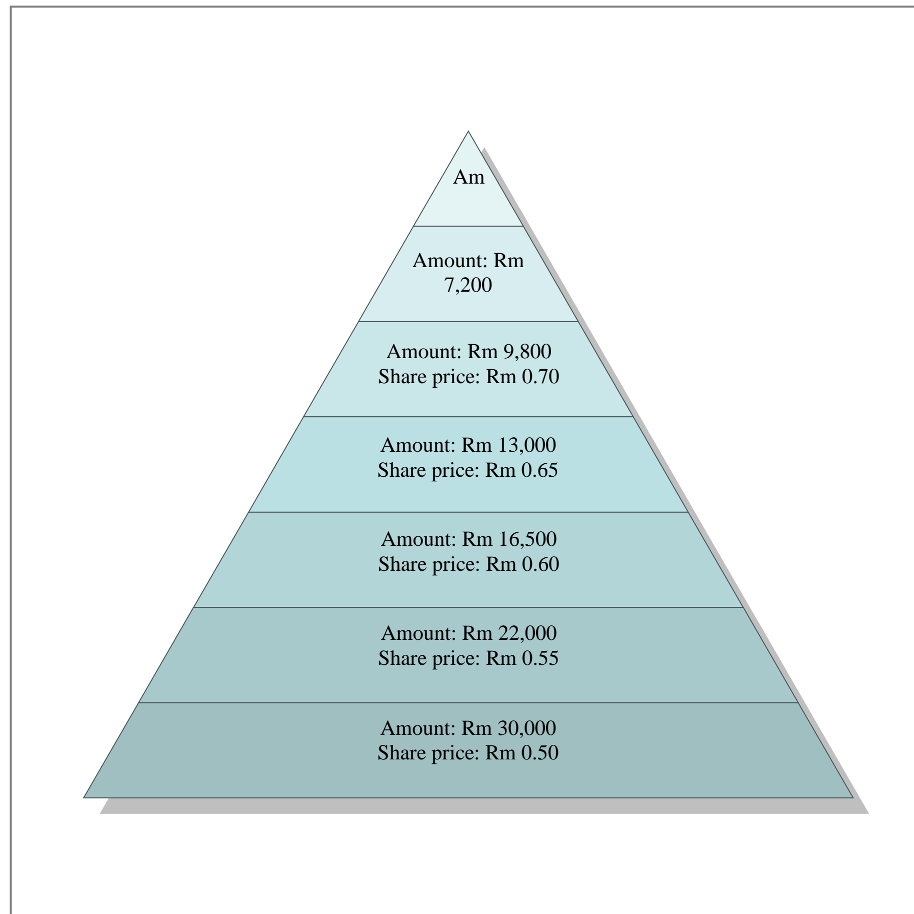

Figure 7.4.8.2: Pyramiding Chart

If we invest using margin trading account like Koon, we may use the additional margin from our unrealised profits to buy more shares as the share price goes higher. The advantage of using this system is that the amount of each successive purchase will automatically be smaller. Therefore, we do not have to worry that the cost may be rising too fast. This concept is also known as pyramiding. That said, we must not use up to the maximum allowable limit of the margin finance. Always allow some room in case the share price suddenly drops unexpectedly.

Note: if you are the breadwinner of your family, you need to set aside an emergency fund – six to twelve months of your family's monthly expenses. Prior to making any investment decisions, it is advisable that you take your family's needs into consideration when making capital allocation. No matter how great the deal you discover, you should not touch the money in the fund under any circumstances. A blow to your investment can sink your family into financial hardship. Therefore, you must make sure that your family is protected financially before pursuing your new adventurous investment journey.

7.5 Stocks You Should Avoid

Invest our hard-earned money in a wrong company can be even more painful than stashing our cash under the mattress. You certainly do not want to have

sleepless nights for investing in a losing stock. The best solution is to have those unsuitable companies removed from your watch list at the beginning of the process.

Below are the types of companies Koon usually avoids betting his money with

7.5.1 Downtrending Stocks

Koon always says "*Don't touch downtrending stocks*." Downtrending stocks will hurt our portfolios. This is especially true when the share price of a stock is still near its peak, because the price can go further down and we will lose money. We do not know when it will reverse its course. Stock price will not tank for no apparent reason. On normal days, smart traders, insiders, and investors will not dump their holdings hastily unless there is some bad news, the businesses have taken a beating, the fundamentals of the companies have changed or the tide has turned. We do not have to wait for the announcements from the management to make our own judgement. When bad things happen or the fundamentals have changed, some unscrupulous management will keep the negative news under wraps until their friends and relatives have exited their positions. To avoid being trapped between a rock and a hard place, it is better to avoid all downtrending stocks in the first place.

7.5.2 Companies in the Industry with Oversupply Problem

Oversupply problem is commonly faced by companies operating in cyclical industry (such as oil and gas industry, property industry and shipping industry, just to name a few) and companies offering commodity-like products (such as crude oil, palm fruits, steel pipes, and meat, which have no patent protection and can be obtained easily everywhere). When supply exceeds demand, business performance will deteriorate and profitability will lapse into decline. As a result, the share prices of the stocks will drop like a stone. They will be pummelled by the market continuously until the supply and demand come into balance, and we never know how low the share price can go.

For example, crude oil price dropped about 40% (from $115 to $70) within six months in the second half of 2014 due to oversupply problem, as US shale producers ramped up production, OPEC refused to scale back on production, and the demand of oil from China shrank. As a result, the earnings of many oil and gas companies sank into red between 2014 and 2018, with some going into liquidation later on. Holding on to their shares could be very painful, and the road to recovery was not smooth. The shareholders would see their stocks continued to get clobbered and their accounts continue to bleed. Sometimes, the shareholders may not have a chance to see light at the end of the tunnel. To avoid being stuck in the stocks that will go nowhere for years, it is best to shun this type of companies before recovery begins.

7.5.3 Poorly Managed Companies

Warren Buffett always advises investors to look for management with integrity, intelligence, and energy, as management can make a huge difference in a company. According to studies, "*Good management adds value beyond a company's hard assets. Bad management can destroy even the most solid financials*." Bad management are either managing the available resources inefficiently and ineffectively, or running the companies only to set themselves up for life without carrying out their fiduciary duty. However, it is very difficult to judge whether the managers are honest, intelligent, and hardworking because we do not know them personally for a long time. Therefore, Koon advises investors to look for companies with controlling shareholders managing the business. They will surely protect their own interest in the company. They focus on growing the business, thus creating long-term shareholder value. Managers who act like employees often focus on short-term earnings in order to secure a large sum of bonus and other perks. The companies would lose ground to their stronger peers if the management is incompetent and running the companies for own personal gain. Those financially weak ones with bad management may go under any time. By then the share price will continue to break all-time low records, and we will have no chance to recoup our losses. Very often the prices of these stocks are low for good reason.

7.5.4 Stocks with Complex Businesses

Do not touch any stocks that we cannot understand their businesses and structures within ten minutes. Based on Koon study, if we do not understand the businesses, estimating their earnings can be very difficult, let alone valuing their businesses. The higher the complexity of a business and ownership structure is, the lower the accuracy of our projections can be. Also, this type of companies is rarely efficient. When available resources are split over several businesses, with no relationship at all, hardly this type of companies can grow at a fast pace, as the synergistic effect is lost.

Most of the great businesses like Public Bank, Liihen, Gamuda, Yinson, IJM, Favelle Favco, Supermax, Dayang, Dialog, V.S. Industries, and etc do not have complicated structures. Their structures are quite simple. Anyone looking at them can understand the businesses and organisations fairly quickly. As they are focused and do not go beyond the areas of their core competencies. They possess some forms competitive advantage over their competitors. When they perform well, their values will grow noticeably, so are their stock prices.

7.6 When to Sell?

One is unable to turn a great investment into a big profit unless he or she can sell his or her shares at good prices. In this case, finding the right time to sell a

stock, which has appreciated substantially, is an important process. Below are the three best times we can cash in our profit.

7.6.1 Take Some Profit off the Table if the Share Price Goes Up Too Fast

Koon always says, no share can go up indefinitely for whatever reason. At some point, the stock will take a breather before it continues its journey upward. That is the point where we should sell a portion of our position, so that we have more money to buy during market correction. Remember, if we don't take the money off the table, someone else will.

There are many indicators we can use to judge if the share price of a stock has gone up too fast. Amongst the commonly used indicators, the following three indicators, which we have discussed in Chapter 3, are the most popular ones,

- Price curve. We may sell some when its share price begins to show the sign of exhaustion or retracement after it surges up, far above 10-day EMA line, as the temporary buying frenzy or euphoria has waned.
- Momentum indicator. We may sell some shares when momentum indicator (i.e. RSI or Stochastic indicator) crosses below the overbought line.
- Bearish candlestick pattern. We may sell some when a bearish candlestick pattern (i.e. bearish engulfing, tweezer top, hanging man, bearish Doji star, shooting star, etc.) appears near the peak of recent advance.

7.6.2 Take Profit Gradually if We Have Found Other Better Stocks

Unlike marriage, investing does not require us to show our faithfulness. We can cash out anytime, and use the proceeds to buy another promising stock if we believe that the latter will bring us a higher return on investment.

Once we have identified another stock to invest in, we can do so in a few stages. For example, we can sell 35 to 40 percent of the shares we hold, and use the proceeds to buy the other stock. The main reason of doing so is to minimise our initial loss in case if the price of our new investment drops below the predetermined cut loss point, or if we make some mistakes in our analysis. At the same time, we still get the opportunity to ride the uptrend of the former, despite growing at a lower rate. Once the uptrend of the newly invested stock is confirmed, we may sell another batch of the former to buy the latter, on the way up, when the new stock continues to report increasing earnings. Also, the amount of money spent on the following batch of shares should be lesser than that on the first batch of shares to prevent the overall cost rises significantly.

7.6.3 Liquidate Your (Long) Position when Any of The Stocks Reports Two Consecutive Quarters of Decreased Profits

To some long-term value investors, selling a stock we own within five years is not an investment. But, we need to understand that we are not bound to follow their rules. And, we need to be clear that we are here to make money, and our objective should be to maximise our gains. We certainly do not want to see our (unrealised) profits go up in smoke. Remember: if you do not take the money off the table, someone else will.

The best time to sell a stock is when the company reports two consecutive quarters of decreased profits. That is, usually, the time when the share price of a company would start falling down seriously. Koon usually starts selling some of his shares when the stock he owns shows a quarter of reduced profits to reduce his margin loan, and will sell them aggressively when it reports two consecutive quarters of decreased earnings until he has no more share left in his trading accounts.

Sometimes parting with our favourite stock can be very painful, especially when the value of our stock and our account are under water. But, in order to protect our capital, we need be objective and have our emotions detached from the stock whilst investing. Below are the situations in which we need to be decisive to get out immediately when our investment goes wrong.

7.6.4 If Any of the Stocks Fails to Meet Your Investment Criteria, Dispose It Immediately

When we put all of our eggs in just a couple of baskets, we need to be vigilant and be firm. We must not be afraid sell our holdings when stocks fail to meet our investment criteria one day either due to some changes in its fundamentals, or the inability of the company to make more profits next year than this year.

For instance, if we set the allowable limit of Net Debt-to-EBITDA ratio at three, we need to make sure that our stocks have their Net Debt-to-EBITDA ratios maintained below the limit. When the figure of any stock approaches the limit, we need to investigate why its Net Debt-to-EBITDA ratio keeps rising. Is it due to falling earnings? Or perhaps the company has overpaid for some acquisitions? High Net Debt-to-EBITDA ratio generally implies that the company has difficulty servicing its debt, especially during industry downturn. In that situation, when it exceeds the allowable limit, we must close our position immediately. It will ensure we are not there when the shit flies.

Bear in mind that our investment criteria is the best defence system in our investment. We are susceptible to a loss if we ignore the warning signal. According to Koon, every time when he ignores his golden rule, his fund will wind up suffering a drawdown.

7.6.5 Do Not Hesitate to Cut Loss if Their Share Prices Hit Your Stop Loss Points

Similarly, we must not hesitate to cut loss if the share prices of our stocks fall below our cut loss points, and if we realise that we have made some mistakes in our judgements earlier on. Unless we are very sure that the decline has got nothing to do with the business fundamentals, we should not let our emotions affect our judgements and decisions.

"*If a position doesn't feel right as soon as you put it on, don't be embarrassed to change your mind and get right out.*"

Michael Marcus

Keep in mind that cut loss will minimise our loss and protect our capital. In general, price decline for an undervalued stock with a bright profit growth prospect is rarely more than 10% during a normal correction, especially when it is under accumulation and when weak hands are eliminated. A pullback of more than 10% for an undervalued stock with high profit growth potential signifies that there is a problem in the company. Our loss would be widened if we refuse to get out of our position in the stock when its share price begins to take a nosedive. When a stock takes a beating, it is unlikely that its share price will rebound anytime soon. Even if the company's management expresses positively about the future of the company, do not hold your breath. It is better to cut loss and use the sale proceeds to invest in other promising stocks.

"*The elements of good trading are cutting losses, cutting losses and cutting losses. If you can follow these three rules, you may have a chance.*"

Ed Seykota

Example:

Let's suppose that we initially invest in a stock called ABC. After six months, we realise that we had made some mistakes in our estimation earlier on, and that the share price falls continuously as its business continue to deteriorate. If we adhere strictly to the cut loss rule by limiting our loss to only 10%, and we use the proceeds to buy another high-growth stock, let's call it XYZ, which will provide us a return of 30% after six months, we will be netting 17% (gain) end of the day despite losing some money in our first investments.

Calculation:

$$\begin{aligned}\text{Total return} &= \left[(100\% - 10\%) \times (100\% + 30\%)\right] - 100\% \\ &= \left[(90\%) \times (130\%)\right] - 100\% \\ &= 17\%\end{aligned}$$

Further, cut loss approach helps us avoid losing too much of money in a stock. The more we lose, the more difficult it gets to recover from the loss. Bear in mind that we need to make a 100% return for every 50% of the capital that we lose to get back to our starting point. Below is the table showing the percentage of gain needed to break-even.

Percentage of loss	Percentage of gain to break-even
- 10%	+ 11%
- 20%	+ 25%
- 30%	+ 43%
- 40%	+ 67%
- 50%	+ 100%
- 60%	+ 150%
- 70%	+ 233%
- 80%	+ 400%
- 90%	+ 900%
- 95%	+ 1,900%
- 99%	+ 9,900%

Figure 7.6.5.1: Gain Required to Break Even

"*Consistent winners raise their bet as their position strengthens, and they exit the game when the odds are against them, while consistent losers hang on until the bitter end of every expensive pot, hoping for miracles and enjoying the thrill of defeat. In stud poker and on Wall Street, miracles happen just often enough to keep the losers losing.*"

Peter Lynch.

The old adage still remains true today that "Your first loss is your best loss." Therefore, if we do not want to see a small loss snowballs into a huge loss, we must adhere to our cut loss rule strictly.

Chapter Summary

- What is concentrated investing?
  It means wagering one's entire wealth in just a few stocks.

- Why concentrated investing?
  Concentrated investing allows astute investors to maximise gains and grow wealth faster.

- Whilst concentrated investing is an amazing strategy to generating extraordinary returns, it is not a game for everyone.

- The Strategy for Successful Investing
  - ✓ Only invest in a few stocks with promising earnings growth potential.
  - ✓ Invest in a few truly cheap stocks
  - ✓ Stick to your guns
  - ✓ Trade around a core position
  - ✓ Using Turning Point Investing Concept to maximise gain
    - Technical analysis (chart patterns and momentum indicators)
    - Special event
  - ✓ Be patient
  - ✓ Mentally prepared for market volatility
  - ✓ Use the rule of thumb for fund allocation

- Stocks you should avoid to Invest
  - ✓ Down-trending stocks
  - ✓ Companies in the industry with oversupply problem
  - ✓ Poorly managed companies
  - ✓ Stocks with complex businesses

Chapter Summary (Continued)

- When to sell?
  - ✓ Take some profit off the table if the share price goes up too fast
  - ✓ Sell gradually if you have found other better stocks
  - ✓ Liquidate your (long) position in the stocks when they report two consecutive quarters of decreased profits
  - ✓ If any of the stocks fails to meet your investment criteria, dispose it immediately
  - ✓ Don't hesitate to cut loss if the share prices of your stocks hit your stop loss points