

## How to find a stock that ‘fits’ your investment goals

There are many tools that investors use to help decide if a stock "fits" their investment goals. What is a good match for you?

### **Personal experience**

Some investors insist on sampling a company's products before they consider investing in that company's stock. They check with their friends and co-workers to find out whether people in the "real world" like a company's products well enough to buy them.

Why do this "grass-roots" research? Because it can weed out companies that are likely to be poor investments and find companies that might be very good investments.

People invest in a stock because they think the price of the stock will increase, allowing them to sell the stock for more money than they paid to buy it. And stock prices generally rise for companies that report increasing profits over time. What makes a company's profits go up? Usually, it sells more products to its customers.

A company whose products are selling because they're very popular with consumers might very well report higher profits from year to year—in which case its stock price is likely to increase over time. On the other hand, a company that makes products no one wants to buy is not likely to report higher sales and profits. It's unlikely that the price of such a company's stock will go up--and stay up—over the long run.

### **Beyond personal experience**

The "personal experience" approach only works with companies with products the average person can buy or use—like toothpaste, shoes, cars, food, and clothes.

Since the average consumer can't buy "big-ticket" items like jets or supercomputers (and may not be able to use these items either), personal experience with such items will probably be limited. So, if you want to invest in a company that makes this kind of product, you will have to use other methods to decide if the stock might be a good investment.

Finding a company that sells products that many people like isn't an automatic signal to invest in the company's stock. An investor has to consider whether the company's stock is selling at a reasonable price—if its stock price is already very high, it might not go up enough in the future to allow a new investor to profit.

An investor also must consider whether consumers will keep buying the company's products, and if the company can keep charging the same prices for the products.

### **Looking for special stocks**

Some people classify stocks in a number of ways—for example, as a "growth stock," a "value stock," a "defensive stock," or a "cyclical" stock. Why try to decide whether a stock fits into one of these categories? The categories have characteristics that make them appeal to investors with different goals.

***To make a profitable investment, find a good company and think about whether the price of the stock will go up.***

**Growth** investors look for stocks whose profits will grow faster than average. Because of the link between increasing profits and higher stock prices, some people feel that investing in "growth" stocks is the best way to make money in the stock market.

An example of a "growth" company is a biotechnology firm working on a new medicine that researchers think will cure cancer. If the medicine works the way the researchers think it will, the company should sell a lot of the medicine, its profits will grow faster than the average stock, and the price of its stock should go up.

Why don't all investors prefer "growth" stocks? Because the success of "growth" companies is generally less certain than the average company. Take our example of the biotechnology company with a potential cure for cancer. All medicines have to go through a series of tests over many years to make sure that they are safe. It's possible that company's new medicine will fail the tests. If so, an investor who expected that medicine to produce high sales and earnings, and bought the stock for that reason, will be very disappointed.

**Value** investors look for stocks whose price they think will turn around. A value stock's price is low and is cheap by measures like the price-to-earnings ratio (see Part 3). Perhaps the company makes a very basic product, like bricks used in construction, during a time when high-technology stocks are popular with investors. Such companies are sometimes considered "boring," and this could be a reason why their stock is cheap.

For whatever reason, value investors believe that a "value" stock is worth more than its current price. They feel that the stock market will eventually see the hidden value in the stock, and as more investors start buying the stock, the price will rise.

But there is no guarantee that a turnaround will actually happen. This is one risk involved in buying a value stock—that the reason that caused its stock price to drop doesn't go away, or even gets worse.

**Defensive** stocks are relatively stable and issued by large companies. Such stocks generally do not go up as much in good times

as other companies, but they generally don't decline as much in bad times.

Examples of defensive companies are firms making basic necessities, like food. Since people need to buy food in good times as well as bad, the sales of companies selling food are likely to remain fairly stable. If a company's sales remain stable, its profits and the price of its stock are likely to remain stable as well. But, the stability of a defensive stock usually comes at a price—these safe companies don't generally make very high gains.

**Cyclical** stocks' performance are tied to what's going on in the overall economy—sometimes known as the business cycle. Companies that make automobiles are good examples of cyclical stocks.

Car companies sell more and make a lot of money when the overall economy is doing well because consumers feel comfortable spending money on cars. But when the overall economy is doing poorly, consumers put off buying new cars, and the stock prices of car companies tend to fall.

If an investor thinks the economy is doing poorly but it likely to improve, he or she might want to invest in a cyclical stock—on the theory that the company's sales, profits, and the price of its stock will increase as the overall economy gets better.

### **Dividends**

Another reason some investors buy certain stocks is because they have a good record of paying dividends--quarterly payments sent directly to stockholders. Such investors want to receive a steady stream of income from their investments, and may not care if the price of the company's stock doesn't go up too much over time.