7 Ways to Build and Protect Your Wealth
We’re veterans of the stock market, having been at it since 1970, and having studied (and re-studied) market history for decades. But most investors are newer to the game, having only invested for the past five, 10 or 15 years, so the 2000s have been a bit of a shock—we started out with the biggest bear market in a generation, enjoyed a solid-but-choppy bull market from 2003 to 2007, and had another generational decline in the summer and fall of 2008.

All told, many stocks and sectors were decimated during those two bear markets, leaving most growth investors to wonder if there is any way to protect their wealth.

The answer: Yes—if you have a proven system and have the discipline to follow it. While the market is sure to be challenging, we know we have the tools and tactics to make it through in fine fashion. In fact, these rules helped us avoid the market’s crash of 2008, and have helped us take advantage of the current bull market.

Below are seven relatively simple steps that will help you preserve (and, more importantly, build) your wealth in the months and years to come. Nothing below is necessarily new ... but that’s the whole point. Most investors look for the new, exotic system, but over time, it’s the basic, straightforward advice—and, again, the discipline to follow it—that gives you above-average returns.

1. **Pay Attention to Market Timing**

   Years ago, when we were researching market timing systems, we came up with the Cabot Tides, which determine via a series of moving averages whether most stocks are trending up or trending down. We overlaid the signals from the Tides on top of a performance chart of our *Cabot Growth Investor* Model Portfolio and made a stunning discovery—nearly every large decline in our portfolio came when the Tides were negative, while nearly every major upmove came when the Tides were positive.

   Of course, we immediately began implementing the Cabot Tides into our system, and we’re glad we did. Following the Tides guarantees that we’ll never miss out on a major bull move, and also guarantees that we’ll never stay bullish during a major drop. But most investors ignore market timing, buying into the “I must be a long-term investor” gibberish from Wall Street.

   We consider ourselves longer-term investors... but if the market turns down, most stocks are heading down with it, and thus selling your weakest holdings and raising cash protects your portfolio from the possibility of a devastating decline. We did just this in early 2008!
2. It’s OK to Be Wrong – But Not to Stay Wrong

Being an investor is not like being a doctor or a lawyer. In those professions, you must be nearly perfect in order to excel. But investors can be highly imperfect and still make a fortune in stocks. The very best investors are wrong 30%, 40% and even 50% of the time, as a matter of fact.

But the difference is that the best investors recognize when they’re wrong (because they have a loss), and they correct that mistake—by cutting the loss short! By consistently cutting all losses short, the smart investor is basically like a baseball team with great pitching; since the other team can’t score many runs, all it takes is a few base hits to win. Similarly, all it takes is a few mild winners to more than make up for the small losses ... and a few homeruns can really goose your overall performance. So remember that it’s OK to be wrong, but not to stay wrong—cut all losses short.

3. Inverse ETFs Can Help You Hedge

Just in the past few years, some new, exciting vehicles (dubbed inverse ETFs) have been launched by ProShares. These are exchange traded funds (they trade just like stocks) that track a given index. But here’s what’s special: Some of the funds are leveraged long funds, so if the S&P 500 rises (or falls) 1%, the fund will rise (or fall) 2%. In terms of protecting capital, there are also funds that do the opposite; if the S&P 500 falls 1%, the fund will rise 2% (and vice versa).

The benefit to you is that you can easily hedge part of your portfolio with these inverse funds. Just be aware that you only need to invest half as much, since the funds will be twice as volatile as the index. When our market timing indicators turn negative, it might pay to buy a small position of the leveraged inverse S&P 500 fund (symbol SDS), Nasdaq 100 fund (QID) or Dow Industrials fund (DXD), to hedge your exposure.

4. Take Partial Profits

All the books tell us that investors like to sell their winners quickly ... but we’re not so sure. Our experience is that when a stock has been good to them, investors hate to sell. Selling effectively means the investor has given up hope that the stock will move even higher, which is against human nature.

Thus our advice is to take partial profits on the way up. If you buy a stock and it rises 15% or 20%, consider selling a small piece, maybe 10% or 15% of your shares. If the stock continues to rise, you can cash out some more. There’s no magic percentage gain at which you should sell, and you want to hold onto most of your shares if the stock is acting well, but taking a few chips off the table on the way up—called offensive selling—is a great way to book a few profits and lessen your position, making the eventual final sell decision that much easier.
5. Follow a Plan during Earnings Season

It used to be that earnings season brought about some minor changes to stock prices—maybe a small jump here, or a little decline there, but nothing too serious. But ever since Regulation FD (fair disclosure) became law a few years ago, many stocks will move 10%, 15% or more depending on how their earnings are received. If you’re running a concentrated portfolio, it can literally make or break your performance for the quarter.

There’s no perfect way to handle earnings season, but we think you should avoid buying many shares just before a firm reports its quarterly earnings (it’s just too risky). And, if you find yourself owning an uncomfortably big position just before earnings are about to be announced, there’s nothing wrong with selling some of your shares (maybe 1/4 or 1/3 of your holding) to lighten the load. Lessening your risk a little during earnings season can help smooth out your returns.

6. Strong Fundamentals are Key...

Too many investors buy a stock because they’re familiar with the company, or because the company is talked about regularly in the financial press. But the big surprise is that many well-known firms often have deteriorating fundamentals, such as decelerating sales and earnings growth, shrinking margins and increased competition. The result can be generally lackluster performance, as institutional investors slowly move out of their position in these favorites and into new, younger, faster-growing companies.

Thus, you could have protected yourself against most of the horror stories seen during the 2007-2008 bear market by focusing on companies with solidly growing sales and earnings. (All those brokerage, bank, homebuilder and airline stocks that plunged had horrible sales and earnings, so you would have avoided such sectors.) Remember that institutional investors, who control billions of dollars, are always interested in what’s new, what’s revolutionary, and what’s showing exceptional growth. If you focus on those types of names, you’ll be fishing in the same oceans as they are.

7. ...And So are Strong Technicals.

Last, but certainly not least, one of the best ways to hold onto and build wealth is to focus on stocks that are acting well—those that are outperforming the market during the past few months. We know that’s counterintuitive, but the market is a contrary beast, meaning its action is very often the opposite of what you expect. Bottom fishing is always tempting; after all, our whole economic lives have generally revolved around getting a bargain. Yet studies have shown that buying beaten-down growth stocks rarely works out.
Thus, you should only buy issues that are trending higher. Historically, all our biggest winners were initially bought after they had already had a solid upmove in the prior few months. It’s true! But we don’t just buy something that’s soaring to the heavens. You should strive to buy these strong performers during normal (5% to 15%) pullbacks that generally last one to three weeks (assuming you’re in a bull market). That way, you’ll be getting into a stock that’s under strong accumulation, but is suffering from some temporary profit taking.

None of these seven tactics are secrets, or super-complex methods. They’re relatively easy to understand, but the key is following them. Too many investors buy a few stocks and then put everything on cruise control. Sometimes that can work, but you’re better off spending time reviewing your stocks, cutting all losses short, and making sure they’re all strong, fundamentally-sound names. If you do that, you’ll be ahead of 90% of investors, and you’ll be in position to not just hold onto your hard-earned money, but to earn terrific returns during bull markets.
About the Expert

A growth stock and market timing expert, Michael Cintolo is chief analyst of Cabot Growth Investor and Cabot Top Ten Trader. Since joining Cabot in 1999, Mike has uncovered exceptional growth stocks and helped to create new tools and rules for buying and selling stocks.

Perhaps most notable was his development of the proprietary trend-following market timing system, Cabot Tides, which has helped Cabot place among the top handful of market-timing newsletters numerous times.