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3 Steps To Profitable Stock Picking

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Suppose you decide to be a long term investor, you would want to find stocks that have sustainable competitive advantages along with stable growth. The key for finding these stocks is by looking at the historical performance of each stock over the past decades and do a simple business S.W.O.T. (Strength-weakness-opportunity-threat) analysis on the company.

If you decide to be a short term investor, you would like to adhere to one of the following strategies:

a. Momentum Trading. This strategy is to look for stocks that increase in both price and volume over the recent past. Most technical analyses support this trading strategy. My advice on this strategy is to look for stocks that have demonstrated stable and smooth rises in their prices. The idea is that when the stocks are not volatile, you can simply ride the up-trend until the trend breaks.

b. Contrarian Strategy. This strategy is to look for over-reactions in the stock market. Researches show that stock market is not always efficient, which means prices do not always accurately represent the values of the stocks. When a company announces a bad news, people panic and price often drops below the stock's fair value. To decide whether a stock over-reacted to a news, you should look at the possibility of recovery from the impact of the bad news. For example, if the stock drops 20% after the company loses a legal case that has no permanent damage to the business's brand and product, you can be confident that the market over-reacted. My advice on this strategy is to find a list of stocks that have recent drops in prices, analyze the potential for a reversal (through candlestick analysis). If the stocks demonstrate candlestick reversal patterns, I will go through the recent news to analyze the causes of the recent price drops to determine the existence of over-sold opportunities.

Step 2. Conduct researches that give you a selection of stocks that is consistent to your investment time frame and strategy. There are numerous stock screeners on the web that can help you find stocks according to your needs.

Step 3. Once you have a list of stocks to buy, you would need to diversify them in a way that gives the greatest reward/risk ratio. One way to do this is conduct a Markowitz analysis for your portfolio. The analysis will give you the proportions of money you should allocate to each stock. This step is crucial because diversification is one of the free-lunches in the investment world.

These three steps should get you started in your quest to consistently make money in the stock market. They will deepen your knowledge about the financial markets, and would provide a sense of confidence that helps you to make better trading decisions.

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