Are you a potential investor?

(Continued from last week)

Are you ready to make money in the stock market? Investing is an important step towards building your personal wealth, and there are many things to consider before you begin.

Know why you want to invest

Having a firm understanding of the specific reasons why you want to invest your cash today is essential in determining the kinds of investments you can allow yourself to get into. Are you saving for your child's school fee for the next term? Or are your cash supposed to be your/your family's emergency fund? Then investing in the stock market is not for you.

Do you want to save for retirement? Or do you have extra cash that you are willing to invest today and a commitment to put in additional investments every month for as long as you can? Then maybe investing in a stock market (or Unit Trusts) can help you achieve your goals.

Your present financial situation

You need to begin by evaluating your current financial situation. Consider your assets, your liabilities, your total household income and the amount of discretionary income that you have available to invest on a monthly basis. Your discretionary income is the income that you have left over each month after you pay all of your household expenses. Next, you need to evaluate your current level of cash reserves. Cash reserves can be defined as the assets set aside in the case of an emergency or for an opportunity.

Define your Investment Risk Tolerance

You need to determine your personal risk tolerance before you start to invest. Your risk tolerance refers to the amount of variance you are comfortable with in your portfolio, and is often defined by how far away the goals that you are savings towards are. Investors are typically categorized as Aggressive, Moderately Aggressive, Moderately Conservative and Conservative. Each investor type is characterized by their investment portfolio, their time frame to save, their expected portfolio returns and their overall tolerance to withstand portfolio value changes on an annual basis.

Do you already have an emergency fund?

An emergency fund is just a fancy term for the old-fashioned (but time-tested) "secret stash" the elders used to have. Although in our modern age, you don't have to keep it in the darkest part of your closet anymore. It helps to have something you can dip into when the need arises. It gives us the peace of mind.

It does not have to be big, but it has to be there. Never let your emergency fund get into Investments like in the stock market. Keep it in a safe time deposit. Never mind if it is earning almost nothing.

Have a solid comprehension of basic economic principals.

Before you get started, you should understand basic principles and laws of economics. The stock market closely follows the law of supply and demand. For example, when there is a large demand for the stock of a certain company, the cost of its stock will increase along with the demand. However, if there are more stock available for sale than there are buyers, the unit price of that company stock will decrease.

Learn about prospective companies you want to invest in.

Do your homework before you invest in prospective companies. Read the company annual report and find out about their products, operations, services and basic business track record. This information gives you an idea of how stable the company is and whether they can deliver on their promise to offer profits to investors.

Select companies with staying power.

There are so many companies that exist in today's stock market, selecting becomes a major decision for beginning investors. Select relatively stable companies to buy shares. You can go through stock broker research reports for this purpose. But remember you are taking the final decision to invest.

Keep an eye on the news.

Guesswork is completely ineffective when it comes to investing in the stock market. Good intuition and solid decision-making come from learning about global and local news both politically and economically. When you watch the news, make sure to keep track of the industry your company is in. Even stable companies may go bankrupt or have a major blow that will bring them down.

Stockbrokers aren't the final word.

A stock broker is there to assist you and to guide. You need to do your own homework.

Nothing lasts forever.

While everyone is eager to make profits in the stock market, an investor loses their sense of reason when they are fueled by greed. A money hungry investor may forget to check on economic rumors and spontaneously decide to sell or buy with the thought of making major profits and then lose it all.

Extreme optimism or pessimism doesn't last forever. Prices will always return to more realistic valuations. You need only two emotions to keep in check while invested in the stock market: fear and greed. Be fearful when others are greedy, greedy when others are fearful. Be wary of "gurus" preaching new phase of unprecedented growth. Be reminded of the technology and real estate bubbles. Be watchful for opportunities when everyone expects all the world's companies to go bankrupt. Back up your emotions with rational reason.

Remember, greed is your enemy

It is better to sell ahead than selling at the bottom.

There will come a time when you are no longer comfortable with an investment. It may become overvalued by the market or the broad market may just be in a bubble ready to burst. Either way, you will want to sell, but your greed will be telling you to hold on until the right moment before prices go down. Your mind will rationalize this by thinking of the "long-term". Expect your ego to give in to cutting your losses at the point of extreme selling which usually happens before the market turns back up again.

These are the most important things to consider before you invest into the stock market. Having a financial plan that you implement will increase your chances for financial success and the above tips should help point you in the right direction.