4 Investing rules from John Templeton

John Templeton is one of history's most famous and down-to-earth investors. The Templeton Growth Fund, which he launched in 1954, was made public in 1959. At that time, it had 5 funds and $66 million under management. In 1992, he sold it to Franklin Resources for $913 million.

Mary Mazzio, who directed a documentary on his life, told Forbes that he avoided the usual trappings of wealth. "His grandchildren remember his sea-green jacket that he wore constantly for many, many years. He never flew first class – always by coach. He remarked to a close friend that 'I get there at the same time as the first-class travellers.'"

Here are some guidelines investors would do well to follow.

Rule 1: Invest, don't gamble.

The stock market is NOT a casino. But you can surely make it one if you constantly move in and out of stocks each time they move a point or two. Or, if you continually sell short or deal only in Options or Futures. And, like most gamblers, you may lose eventually—or frequently.

Detractors of the stock market often liken it to a casino. Many stock traders, like gamblers, develop addictive personalities, are on the lookout for easy and quick riches, and often overestimate their chances of success.

The Cameron School of Business put forth an important perspective.

In casinos, the odds of winning, while quite small, are clearly defined. If one plays at the roulette table, one knows that there is a likelihood of 1/38 that one can beat the spinning wheel. Or in the game of poker, one can calculate quite accurately the probability of being given any particular winning hand. The players are facing the so-called "known unknowns." The gamblers are facing Risk, where the odds are given, as opposed to Uncertainty, where they are not.

However, the odds of beating the stock market are rarely clearly defined. As a result, many investors face Uncertainty as opposed to Risk. That is to say, the investors are faced with the "unknown unknowns." This is simply because Wall Street rarely tells us what the future has in store for us. For example, the stock market may be reaching new highs, while at the same time the economy is tanking. Under these conditions, it is quite difficult to decide on the right time to quit the market.

Templeton also noted that no matter how careful you are, you can neither predict nor control the future. A hurricane or earthquake, a strike at a supplier, an unexpected technological advance by a competitor, or a government-ordered product recall—any one of these can cost a company millions of dollars. Then, too, what looked like such a well-managed company may turn out to have serious internal problems that weren't apparent when you bought the stock.

Templeton's advice: Buy value and quality; and diversify—by industry, by risk, and by country.

Rule 2: Invest, in value and quality.

Quality is a company strongly entrenched as the sales leader in a growing market.

Quality is a company that's the technological leader in a field that depends on technical innovation.

Quality is a strong management team with a proven track record.

Quality is a well-capitalized company that is among the first into a new market.

Quality is a well-known trusted brand for a high profit-margin consumer product.

Naturally, you cannot consider these attributes of quality in isolation. A company may be the low-cost producer, for example, but it is not a quality stock if its product line is falling out of favour with customers. Likewise, being the technological leader in a technological field means little without adequate capitalization for expansion and marketing.

While individual stocks may be pulled along momentarily by a strong bull market, ultimately it is the individual stocks that determine the market, not vice versa. All too many investors focus on the market trend or economic outlook. But individual stocks can rise in a bear market and fall in a bull market. The stock market and the economy do not always march in lock step. Bear markets do not always coincide with recessions, and an overall decline in corporate earnings does not always cause a simultaneous decline in stock prices. So buy individual stocks, not the market trend or economic outlook.

Rule 3: Invest, when the going is tough.

When prices are high, a lot of investors are buying a lot of stocks. Prices are low when demand is low. Investors have pulled back, people are discouraged and pessimistic. When almost everyone is pessimistic at the same time, the entire market collapses.

It is extremely difficult to go against the crowd—to buy when everyone else is selling or has sold, to buy when things look darkest, to buy when so many experts are telling you that stocks in general, or in this particular industry, or even in this particular company, are risky right now. But, if you buy the same securities everyone else is buying, you will have the same results as everyone else. By definition, you can't outperform the market if you buy the market. And chances are if you buy what everyone is buying you will do so only after it is already overpriced.

In 1939, Templeton made a $10,000 bet on stocks trading on the New York Stock Exchange. He bought 104 stocks, each trading under $1. This was during the Great Depression (1929-1939). Near the end of WW2, he sold the stocks for around $40,000.

Stock Investor reported that in the 1950s, he invested in Japan when "Made in Japan" was synonymous with free toy trinkets found in cereal boxes. He exited when he believed the stocks were overvalued, well before the Japanese stock market collapsed in 1989. Not following the crowd is a simple concept, very difficult to execute.

Rule 4: Invest, for maximum total real return.

If you constantly trade your investments, you may find your profits consumed by commissions/brokerage, not to mention taxes. You should look at the total return that takes into account commissions, taxes and inflation. This is the only rational objective for most long-term investors. Any investment strategy that fails to recognize the insidious effect of taxes and inflation fails to recognize the true nature of the investment environment and thus is severely handicapped.

It is vital that you protect purchasing power. If inflation averages 4%, it will reduce the buying power of Rs 1,00,000 to Rs 68,000 in just 10 years. In other words, to maintain the same buying power, Rs 1,00,000 would have to grow to Rs 1,47,000—a 47% gain simply to remain even over a decade. And this doesn't even count taxes.

This is why the entire portfolio should not only be in fixed income securities but a substantial allocation must be made to equity.

It is frequently said that history repeats itself and, as savvy investors, it is always advisable to understand the history of the investment world. Understanding major investing rules and heeding the advice of legendary investors like John Templeton can go a long way towards bolstering your journey, given that you follow these investment rules born out of experience. As you have seen, John Templeton is among the world's greatest investors and his investing rules come with a huge amount of wisdom. These investment rules have also been time-tested, making it great advice to listen to. John Templeton's investment rules take into account all types of investors and have the power to turn your portfolio from a loss-making investment to one poised for success.

Let us summarise these investing rules – first and foremost, always treat your investment as a well-considered step, rather than a gamble. The second investing rule prompts you to focus on quality and value, over market trends. Finally, Templeton also advises you to invest in tough markets to optimise returns while focusing on maximum total real return for the best outcome. Now that you have these four rules handy, you can go ahead and chart a winsome investing journey for your portfolio.