

Warren Buffett's Six Principles of Investing

Warren Buffett consistently explains, to anybody that's willing to listen, how you can make excellent returns from the stock market by following just a few simple rules and his key message of patient, rational and independent investing.

Principle 1: keep it simple

There seems to be some perverse human characteristic that likes to make easy things difficult. I don't look to jump over seven foot bars. I look around for one foot bars that I can step over.

'Intelligent investing is not complex, though that is far from saying it is easy. What an investor needs is the ability to correctly evaluate selected business. Note that word 'selected', you don't have to be an expert on every company, or even many.

Principle 2: be an investor, not a trader

Buy a business, don't rent stocks. If you aren't willing to own a stock for 10 years, don't even think about owning it for 10 minutes. I never attempt to make money on the stock market. I buy on the assumption that they could close the market the next day and not reopen it for five years.

Our favourite holding period is forever.

Principle 3: find outstanding businesses

Our method is very simple. We just try to buy businesses with good to superb underlying economics run by honest and able people and buy them at sensible prices.

It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price. If the business does well, the stock eventually follows.

Never invest in a business you cannot understand. Focus on return on equity, not earnings per share.

Principle 4: make your own decisions

With enough inside information and a million dollars, you can go broke in a year. You don't need to be a rocket scientist ... once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble.

The fact that people will be full of greed, fear or folly is predictable. The sequence is not predictable.

You are neither right nor wrong because the crowd disagrees with you. You are right because your data and reasoning are right. Look at the market fluctuations as your friend, rather than your enemy – profit from folly rather than participate in it.

Be fearful when others are greedy and greedy when others are fearful.

Principle 5: leave a margin of safety

Rule No 1: Never lose money. Rule No 2: Never forget rule No 1.

We insist on a margin of safety in our purchase price. If we calculate the value of a common stock to be only slight higher than the price, we're not interested in buying. When you build a bridge, you insist it can carry 30,000 pounds, but you only drive 10,000 pound trucks across it. And that same principle works in investing.

It's not risky to buy securities at a fraction of what they're worth.

Principle 6: focus on your strengths

Risk comes from not knowing what you are doing. Why not invest your assets in the companies you really like? As Mae West said 'Too much of a good thing can be wonderful'.

I can't be involved in 50 or 75 things. That's a Noah's ark way of investing – you end up with a zoo that way. The less you know the more stocks you have to own – because diversification is a protection against ignorance.