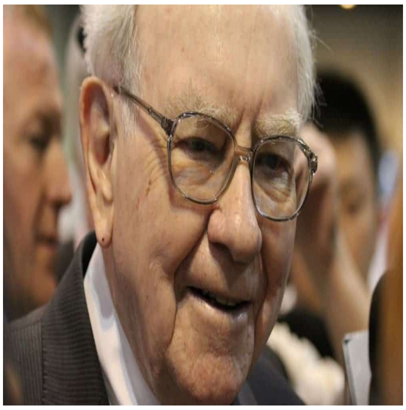

Warren Buffett’s #1 Rule and How to Apply it to Stock Investing

Description

Warren Buffett is one of the best investors ever. Through **Berkshire Hathaway**, the brilliant investor compounded returns at 20% annually from 1965 to 2020, which almost doubled the **S&P 500’s** compounded annual growth rate of 10.2% in the period.

Persistently investing in either would have led to a nice retirement. However, for a monthly investment of $500 compounded annually, the Berkshire investment would have turned into $815 million compared with the S&P 500 investment of almost $13.5 million. That’s a humongous difference of more than $801 million!

Every percentage of return you can juice translates to more money in your pocket. Isn’t high return high risk, though? Warren Buffett’s number one rule to investing should shed some light.

Warren Buffett’s number one rule to investing: Never lose money

Even the best investors like Warren Buffett lost money sometimes. So, what does Mr. Buffett mean to never lose money? Here are two ways to interpret it.

First, preserve your capital. When an investment is turning south and obviously not working out, it may be the best move to cut losses. Then redeploy the capital in other promising investments.

When analyzing stocks, analysts or investors are in one way or another forecasting what could happen to the businesses. We buy stocks for the businesses that we anticipate will have a bright future. However, of course, no one has a crystal ball. So, we can only make the best estimate based on the information that we have at present.

Second, focus on your overall returns. We cannot be sure that every investment decision we make will be correct. However, we can aim to improve our odds. In essence, you never lose money when your overall returns are positive, even if you'll have losses here and there.

How to do way better than never losing money

You need to have a goal in mind to achieve it. Otherwise, you wouldn't know what to aim for. What is a long-term rate of return that satisfies you? Berkshire is a much bigger company now. Additionally, when it was small, it would invest in small-cap companies that would make a big impact on returns. Going forward, it's unlikely for it to generate an annual return of 20%.

The long-term market returns are about 10%. If you're aiming for market returns, you could just buy a market-wide index like the S&P 500. Alternatively, you could target a higher rate of return. Whatever the percentage may be, write it down where you can see it. Make sure it's reasonable and attainable.

Additionally, the S&P 500 only yields 1.3% right now. Income investors are probably dissatisfied with such a small yield. That's why some income investors invest in the S&P 500 for the purpose of diversification but also invest in a group of dividend stocks for more income.

Don't put all your eggs in one basket

No matter how attractive an investment may be, don't put all your eggs in one basket. Diversify! Especially during market corrections, you should have a list of best stock ideas. Buy quality businesses from different industries and sectors. In many cases, stocks from different industries go on sale at different times anyway. So, it's a great idea to put a diversified group of wonderful stocks on your watch list. Remember to update your buy price target ranges annually.

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kayng