

JIM CRAMER'S

25

Rules

for Investing

Rule 1: Bulls, Bears Make Money, Pigs Get Slaughtered

What would you do if I told you the Nasdaq were to go up 1,000 points between now and November? What would you do if I told you the Nasdaq was going to double by December? How about if I told you that after it doubled, you would then catch another 1,000 points up by March?

First, I think you would tell me that I was nuts, and not worth listening to. But what if I were so persuasive that you believed me. Wouldn't you want every penny you had in the Nasdaq right now?

Or would you say, "Nope, not for me, this one's not worth catching. I don't want the 1,000 points, I don't want the double and I certainly don't want that last 1,000 points. Way too dangerous for me."

From the way people talk these days, with sober intonations about the market, total sobriety, you would believe the latter. You would think that people would avoid that 3,000-point move like the plague. Because we know how that 3,000-point up move turned out, we know that we simply climbed the stairs to jump off the tower.

Yet, that's what happened six years ago, that exact same sequence. Knowing what we know now about how hard it is to make money in the market, I think we would regard ourselves as utter fools if we avoided that incredible move simply because we didn't have to jump off the tower of Nasdaq 5000. It wasn't inevitable.

It wasn't inevitable unless we are pigs.

Which leads to one of my absolute favorite adages:

Bulls make money, bears make money, pigs get slaughtered.

Rules like that one — simple, nonquant and yes, nonfinancial rules — saved me in 2000.

These days there's plenty of revisionist history on the part of financial commentators, editors and occasionally even brokerage house personnel — if they let themselves wax philosophical — about what happened when the Nasdaq bubble burst. Those who tried to capitalize on it are now ridiculed. Those who avoided it are now held up as some sort of paragon worthy of Diogenes.

Hardly.

The truth is that for one year of our lives, the Nasdaq gave away money to those who were bulls, but after 3,000 points, the bulls morphed into pigs and everyone who was piggish got annihilated.

So often, when I bring this adage up, people ask me "How do you know when you are being a pig?" I know there's not supposed to be any stupid questions out there, but the answer is, frankly, you don't need me to tell you. If you weren't feeling piggish after we hit an all-time high on the Nasdaq in 2000, you needed a shrink, pronto.

Remember, my goal is to stay in the game. The people who got wiped out by the Nasdaq crash tended to be people who never took anything off the table, who never felt greedy, who got slaughtered by their own piggishness.

Unlike so many others I see and hear on television or read in articles, I have no regrets about liking the market during that period. To have avoided those 3,000 points would have been sinful. It would have been suicidal for a professional manager.

But it was my desire not to be a pig that kept me in the game in March and April of that year. That's why I remind people every day: Have you taken your profit? Have you booked anything? Or are you being a pig? Because you never know when things you own are going to crash. You never know when the market could be wiped out. You can't have certainty. At those times, you have only human nature to guide you.

Whenever I struggle with a stock in my Charitable Trust portfolio because I have booked so many profits that I feel I don't have enough on my sheets, I console myself with the simple lesson of Nasdaq 5000. For example, I caught the oil move in a prudent way that made me a lot when it first started but couldn't make me as much later, simply because I had taken stock off because I didn't want to be a pig. That meant I would make less money than others who were in the patch. I accepted that, as I do every time I make the decision not to be a pig.

It's the price I have to pay for following my adage. It always seems a high price when things are going well, as it did in March 2000 when I sold so much stock.

Until I look back and realize that my desire not to be too greedy saved me so I could live to play again.

Rule 2: It's OK to Pay the Taxes

No one has ever liked to pay taxes. As long as there have been taxes, people have hated paying them. But the aversion to paying taxes on stock gains borders on the pathological. That's why my second bedrock tenet for my 25 rules of investing is:

It's OK to pay the taxes.

When I went bearish in March 2000, I received a huge amount of angry email from people who felt aggrieved. They had bought, I don't know, Redback Networks or InfoSpace because of me, because of something I wrote, and now they were being told to sell it.

Had I no regard for them? Had I no regard for how much in taxes they would have to pay because the gains were short-term? What was the point of making money in a compressed period of time when it meant you would have much less to show for it than if the stock were held long-term?

I had zero sympathy for these people. I had long ago made my peace with the tax man. I knew that some gains were and are simply unsustainable. Given, though, that so many people thought that if you bought and held, you always ended up with more than if you bought and sold, my discussion fell on deaf ears, an audience like the character in *The Lord of the Rings*, Gollum, who says, "I'm not listening, I'm not listening."

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In 1996, Jim founded TheStreet, one the leading financial media websites for individual to institutional investors. Jim also writes daily market commentary for *TheStreet's Real Money* premium service, and participates in video segments on **TheStreet TV**. He also serves as host of CNBC's "Mad Money" and co-host of CNBC's "Squawk on the Street".

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Anyone who held on to get the long-term gain then ended up with no gain at all. You obviated the need to pay taxes the hard way; no taxes are due when you sell at a loss.

It's important to remember that gains, any gains, can be ephemeral. It is better to stop worrying about the tax man and take the gains when those gains appear unsustainable than to ride things back to a loss. Stop fearing the tax man; start fearing the loss man. You won't regret it.

Rule 3: Don't Buy All at Once

No broker likes to fool around with partial orders. No financial adviser has the time to buy stocks methodically over time. The game is to get the trade on, at one level, in a big way. Make the statement buy. Get the position on the sheets or in the portfolio.

And from where I sit, that's all wrong. 100% wrong. Never buy all at once. Never sell all at once. Stage your buys. Work your orders. Try to get the best price over time.

When I first started out as a professional trader, I wanted to prove to everyone how big I was and how right I would be. If I wanted to buy Caterpillar, by golly, I wanted to buy it now, big, at one price, because I was so sure of how right I was. "Put me up on 50,000 CAT!" I would scream, as if I were the smartest guy in the universe.

What an arrogant son of a gun I was. Arrogant and wrong.

What should I have been doing? Following my rule that you don't buy all at once. If I wanted to get 50,000 CAT in, I would buy it in units of 5,000 over time, trying to get the best price. I would put some on to start and then hope to work my way down to get a better basis.

I no longer trade institutionally. I no longer trade "in size." But I still invest for my *Action Alerts PLUS* portfolio, and when I have a new name, I buy in 500-share increments over a day to get my several thousand share position on. I did it in a way that gave me a terrific price.

Why don't more people do it my way? Why don't people, if they want 500 shares of ExxonMobil, buy it in 100-share increments? I think it is because they want to be big, too. They don't want to waste their broker's time. The broker wants to get the trade done. I know my brokers hated it when my wife, who came in to run my trading desk, took orders like mine for CAT and then broke it into small increments and worked in over a day's time.

You must resist feeling like you are making a statement. I have bought and sold billions of shares of stock. Do you know how often I got it in at the right price? Do you know how often the last price I paid was the lowest and it was off to the races? Probably one in one hundred. And I'm pretty good at this game.

Resist the arrogance, buy slowly, even buy over a couple of days as I do for my *Action Alerts PLUS* portfolio. It's humbling and it's right.

Rule 4: Buy Damaged Stocks, Not Damaged Companies

Let's say Wall Street is holding a sale of solid merchandise that it has to move. And let's say you take that merchandise home only to find it doesn't work, has a hole in it or is missing a key part. If we were on Main Street, of course, it wouldn't matter. There are guarantees and warranties galore on Main Street. You can take anything back.

You can't return merchandise on Wall Street and get your money back. Nope, no way.

Which is why I always say:

You have to buy damaged stocks, not damaged companies.

Sometimes these buys are easy to discern. In 1998, when Cendant was defrauded by the management of CUC International through a series of bogus financials, the stock went from \$36 to \$12 in pretty much a straight line. Was that a one-day sale that should be bought? No, that was a damaged company. It took years for Cendant to work its way back into the hearts of investors. Some say it has never recovered.

But when Eastman Chemical announced a shortfall in early 2005 because of a problem — a fixable problem — at one of its facilities, that 4-point dip was a classic panic sale, one that you had to buy. The stock subsequently moved up a quick 8 points when the division recovered in the next quarter.

Sometimes, the sales on Wall Street aren't as obvious. I got snookered in 2004 thinking that Nortel's accounting problems were a simple sale of a damaged stock, with the company quite whole. In fact, the company was gravely damaged by an accounting fraud, and it has looked doubtful the company would ever recover.

And sometimes the sale is so steep that it looks as if something's dreadfully wrong, when really the problem is something that over the longer term will go away.

How do we know if there is something wrong with the company instead of just the stock? I think that's too complicated a question. What I like to do is develop a list of stocks I like very much, and when Wall Street holds an en masse sale, I like to step up to the plate. I particularly like to be ready when we have multiple selloffs in the stock market because of events unrelated to the stocks I want to buy, a major shortfall of an important bellwether stock, or perhaps some macro event that doesn't affect my micro-driven story.

Of course, sometimes you just have to deduce that the company's fortunes haven't really changed, and the fundamentals that triggered the selloff (either in the market or in the company) will be something that will reverse themselves shortly. But you never know. Which is, again, why I think that rule no. 3 must be obeyed. If you don't buy all the stock at once, and if you take your time, it is more likely that you won't be left holding a huge chunk of merchandise when more bad news comes around the corner.

Rule 5: Diversify to Control Risk

If you control the downside, the upside will take care of itself. I have always believed that to be the case. But controlling the downside means managing the risk.

The biggest risk out there is sector risk. I don't care how great a tech stock was in 2000 — even eBay and Yahoo! — if you had all your eggs in that sector, you got scrambled. Same with pharma in the last several years. Or oil in 1982, when I broke into the business.

What can keep you from getting nailed by sector risk, which is about 50% of the entire risk of owning a stock?

Diversification.

It's the only investment concept that truly works for everyone. If you can mix up enough different sectors in your portfolio, you can't be hit by one of the myriad perfect storms that come our way far more often than you would think.

Why aren't more people diversified? Many amateurs don't know the stocks they buy. They end up with stocks that are frighteningly similar. When I started playing "Am I Diversified" on my radio show in 2001, I was blown away by how few people knew just how undiversified they really were.

I still field quite a few calls from people who genuinely think that owning Sun Microsystems, EMC and Microsoft is a form of diversification because they own servers and software!

They think that having Pfizer, Bristol-Myers Squibb and Procter & Gamble makes them safe!

And no matter how much I may like oil stocks at any given moment, I can't countenance a portfolio made up of ExxonMobil, Chesapeake Energy and Halliburton.

An undiversified portfolio is not just an amateur mistake, though. Many professionals don't like to be diversified because of the bizarre way money is run in this country. If you concentrate all your bets in one sector and the sector takes off, you will beat pretty much every diversified fund out there. That's the nature of the beast. You then can market yourself as a huge success and get profiled by every magazine and take in capital from unsuspecting folk who don't know how much risk you truly are taking on.

Both amateur and professional are wrong; controlling risk is the key to long-term rewards and controlling risk means being diversified at all times.

Rule 6: Do Your Stock Homework

My kids hate homework. They think it is punishment. Sometimes when I look at what they are studying, I have to admit that I find it easy to sympathize with them. What's the relevance of most of the things they study? How will it help them in later life? Why bother?

Of course, that's a terrible attitude, and, as a parent, I encourage them to study because I want them to do well, and because you never know what they eventually will be interested in.

I think many of you believe that the homework you do on stocks might be just as irrelevant to your own portfolios as schoolwork seems to my kids.

When I tell people that they have to listen to the Starbucks conference call or know what the analysts are looking for from Urban Outfitters if they are going to own those high-multiple stocks, they don't want to hear it. They can't understand what a scold I am.

When I remind people that doing the homework could take as much as an hour per week per position, they look at me as if I am some sort of old-fashioned teacher who is asking for way too much in this busy world in which we live.

That's just plain wrong.

Where does the desire to own stocks with no research into the companies come from? It comes from two different views:

- If I buy it and hold it long enough, it will come back.
- I don't have the time — no one has the time — to be that diligent.

The latter point's easy to counter: You don't have the time? Give it to someone else. You don't understand how to read a balance sheet? Give it to someone else. There are lots of good managers out there who will beat you simply because they are at it every day and you can't be.

It's the first concept, though, that I find really needs debunking. Buying and holding became the be-all and end-all for many people in the 1990s. "You know what? I am just going to hold on to that CMGI because it has to go back to \$100, where I bought it." Or, "Why sell Sun Micro now? When it gets back to \$70, I am going to sell it because all of the texts say that if you hold things for the long term, everything works out."

Huh? What text says that? I don't know of it. That's just a fictional contortion of what the texts say.

That's why I say: Before you buy any stock — before you purchase Caterpillar, before you buy Lucent — please, please, do your homework.

Listen to the conference calls. Go to the company's Web site. Read the research. Read the news stories. Everything's available on the Web. Everything.

But if you fall back on a buy-and-hold strategy for an EMC or a Microsoft, I can assure you that you will be soundly beaten by professional managers with good track records who are actively searching for good stocks all of the time.

Remember:

Buy and homework, not buy and hold.

Rule 7: No One Made a Dime by Panicking

You see it over and over again. A stock gets hammered. People flee after the hammering. The market gets crushed on a huge down day. People leave at the end of the day. A sector gets annihilated. Quickly. People can't take the pain; they bolt after the annihilation.

Panic is the operating instinct in all of these cases. There's something basic and instinctive about panic, about the desire to flee. It might work when it comes to individuals and things that might threaten us physically. But it can't make you a dime. That's why I say: No one ever made a dime panicking.

There will always be a better time to go, a better time to leave the table than the one brought on by panic.

Let's take a classic panic, a run out of Biogen Idec from March 2005. As soon as I saw the panic in that stock, I wanted to run the other direction; I wanted to buy. If you bought the heart of that panic, the \$36 price, you could have made a quick 5 points. If you flipped it then, you could have gotten back in and already would have been up a couple for the investible side of the ledger.

But by going up again, that stock made a mockery of those who fled.

We get mini-panics all the time in the market. We might have a mini-panic in Starbucks off a weak monthly comp number, or in Panera and Whole Foods off a couple of not-so-great months. Those down-5 and down-10 situations don't need to be chased or participated in. A better time to sell will come.

I want you to do something for me next time there is a panic. I want you to take the opposite side of the trade. When you see one of those high-speed routs of a sector or a stock, buy a little. Get a feel for it. See what I mean. The most rewarding trades you can make are those where the decks have been cleared out by panicky folks using market orders who just don't get that the exit doors aren't as big as they think they are.

Mind you, I am not saying that all merchandise that gets panicked out of is worth buying for the long term. I am saying that it's a rare day when a stock or market that is socked that there won't be some sort of bounce that allows you to get out at a better price than you would have if you just joined the fleeing masses.

Rule 8: Buy Best-of-Breed Companies

In cars, we buy best of breed. Not even an issue. We pay up for the brand because we know that a brand, a good brand, signifies reliability. It signifies a higher level of service, a quality of ownership that can pay dividends for years.

Why don't so many of us feel that way in the stock market? Why are so many drawn to a Safeway or a Kroger, inferior supermarket chains, when Whole Foods Market is clearly the best of breed?

Why did so many people lose money in so many different audio component stores, when Best Buy is the only company that delivers sustainable profits in that retail sector?

Why would people want to own General Motors or Ford, just because those stocks are down a lot, when they could own best-of-breed Toyota, which is taking share and making big profits? I know they are drawn by the low dollar amount of the American carmakers, but Toyota is the cheapest and the best, a rare find.

The list goes on and on. Way too many of you are unwilling to pay up for best of breed because you think that you are getting short-changed. There are very few bargains out there in the world of secondary and tertiary players. I believe that when it comes to price-to-earnings multiple, investing in the more expensive stock is invariably worth it because you get piece of mind.

That's why I say:

Own the best of breed; it's worth it.

Take Walgreen and Rite Aid. Sure, Rite Aid seems perpetually in turnaround mode and you have to love the cheaper stock. Don't you? Not me; I have to tell you that I think Walgreen is the bargain of those two, because I never mind paying a higher price for the better company.

Forget about it. Buy best of breed. Pay up. You almost never will find yourself regretting it.

Rule 9: Defend Some Stocks, Not All

When the markets are hard and unrelenting, as this one has become this year, it's important to remember an adage that's well-suited for a battlefield plan but is just as valuable for a portfolio plan:

He who defends everything defends nothing.

When the market's flying and many stocks are in a bullish mode, it really doesn't matter how much you have on, or how many positions you have. The more exposure the better.

But when things get tougher, you have to recognize that many stocks that you bought for better times may not be in good enough shape to rally. You can't own everything you would like to own.

For example, last March you may have been playing the chemical sector with Eastman Chemical, Dow Chemical and DuPont because you saw the demand from China. But when General Motors suddenly "blew up," you had way too many chemical companies.

I like to say, don't defend them all, just defend some. Pick your favorite and defend that. If you try to defend them all, you simply will run out of capital or go on margin before the bottom. You will lose your reserve and not be ready if the market doesn't turn in your direction.

That's why I rank all my stocks at all times for my *Action Alerts PLUS* portfolio. I need to know which stocks I will defend when things get tough and which I will cut and use as sources of capital.

It's extremely important, say, if you think that the techs are going to start rallying here, that you don't just keep the whole complex. Pick the best stocks, the ones you know you will want to buy if they go lower and toss out the rest.

Let me give you an example. Say storage stocks seemed to be holding up rather well under tough market conditions and that sector struck me as worth defending. But that might mean I'd toss out a software stock that I was more worried about or eliminate an Internet stock because I couldn't know when it would reverse. I would defend, only, say, QLogic or Brocade, but not both.

If you rank stocks on a scale of one (buy) to four (sell), as I do at the end of every week for *Action Alerts PLUS*, you know that when you come face-to-face with the enemy — an onslaught of selling — you are ready to buy on the way down the ones you can truly defend — the No. 1 stocks — and you will wait on the twos until they are lower.

The nonessentials — the ones that have no catalysts and that you are using just for exposure because you thought you liked the market — they get the heave-ho immediately.

My wife, the former Trading Goddess, used to call this "circling the wagons" around your best names. The few first times you do it, you will curse yourself because you will be slaughtering stocks you might have had on for some time.

But you must go through this process a multitude of times before you realize how right it is and before it can become second nature.

You will end up with great costs bases on the stocks you really like, and you will have enough capital left to make a difference.

Rule 10: Bad Buys Won't Become Takeovers

Nothing's more exciting than a takeover. Nothing's as lucrative. You can put on a lifetime's worth of moves in a day from a takeover. So people go to great extents to try to get them,

including buying a lot of bad companies in the hope of catching one takeover.

Funny thing about bad companies: They rarely get bids. In fact, the companies that get bids are great companies with cheap stocks, not crummy companies with expensive stocks. Yet that's what people buy, all the time. Here's my rule:

Never speculate on companies with bad fundamentals.

The odds are that you will end up owning something that could go down much more than you thought, but that has very limited upside. You can make much more money buying a company that is doing well and can still get a bid, than you can buying a company that is doing poorly and is unlikely to get a bid.

Any time I deviate from this rule I get burned, particularly when I approach a stock as a nontakeover story and then the fundamentals go awry and I try to shoehorn it into a takeover story. Take Nortel. After the accounting fiasco, I consoled myself that perhaps the company would be acquired because it was so cheap. That proved to be a sucker's game, because the company simply couldn't put out financials. Maybe one day Nortel will get a bid, like Lucent, but I have a feeling that it won't happen soon enough to make up for the time value of money.

Some people have stayed in painful stocks believing that lightning could strike. Meanwhile, if they had moved on, they could have bought high-quality companies that moved up over time and could have done much better.

When you're scouting for companies where the fundamentals are cheap and the takeovers are likely, remember that, unlike companies with bad fundamentals that you speculate on, if these go down you don't need to cut and run. If they don't get a bid, you still can win.

And you need multiple ways to win, at all times.

Rule 11: Don't Own Too Many Names

In my years as a hedge fund manager, I spent three hours every day analyzing the mistakes of the day before.

That was my major task, one that I completed before anyone else came into the office, generally between 4 a.m. and 7 a.m. I would analyze every losing trade — you don't need to analyze the winners, they take care of themselves — and try to figure out how I could have made more money or lost less money.

I was maniacal about it.

And after a couple of years of this, I realized that good performance could be directly linked to having fewer positions.

I never will buy a stock without first taking one off. That's a great discipline and one you should adopt, pronto. All the bad money managers I know have hundreds of positions. All the good ones have a few that they know inside out and like on the way down. That's why I say: Don't own too many stocks.

I know it can be constraining. For instance, I might like several stocks in the chemicals group, say, DuPont, Dow Chemical and Eastman Chemical. But my discipline leaves room for only one, so I would own the one that I thought was the cheapest and the best.

When I lost the most money as a hedge fund manager, by the way, my "sheets," my position sheets, were as thick as a brick. When I made the most money, my sheets were, well, one sheet of paper, double-spaced. And I ran hundreds of millions of dollars.

Please remember that whether you are a pro or an amateur, you can always have too many positions.

Rule 12: Cash Is for Winners

The aversion to cash in this business breaks my heart. Sometimes cash is such a perfect investment that it drives me crazy how

few people ever recommend it. Nah, they hate the market so they are only 95% long instead of 100%. Or, they think the market stinks, so they decide to short a few highfliers against their longs.

No, No, No!

You don't like any sectors? Sell everything and go into cash, don't short Advanced Micro Devices vs. Intel or Nortel vs. Lucent.

You don't think the market's going to do anything? Don't try paired trades, like General Motors vs. Ford, and don't buy defensive stocks like Anheuser-Busch or General Mills. Just get out.

So many people never want to get out and go to cash, which is literally short-term Treasuries of the less-than-a-year variety. People start talking about how little cash earns — although it sure earned more than a year ago. Or they say, "Can't be in cash, that's for losers." But I say:

Cash is for winners.

A lot of this cash aversion stems from something that occurred a decade ago, when Fidelity Magellan underperformed because it had too much cash. As a result of the weak performance, the manager was fired! But no one ever seems to get fired for bad stock-picking. The takeaway in this game ever since that high-profile firing was: Don't dare get caught with too much cash.

That's why you see and hear all of these fund managers who have lukewarm views walking around with massively long-biased portfolios.

I grew up in a different time. I only shorted when I had an edge — I can't short at all right now by contract, but back when I could, I didn't short just for the sake of having some shorts on against longs. I don't care about not having enough exposure; I care about losing money!

If I were you and I didn't like the market or didn't have anything that compelling to buy — as defined by a willingness to buy it down if the stock keeps going lower — I would go with cash. It's never wrong when you don't like the tape or when you can't find anything that truly makes sense for you.

Rule 13: No Woulda, Shoulda, Couldas

Your head matters in this game. You need to have it on right every day if you are going to see opportunities and act on them. Yet so many of us have heads clouded with thoughts that genuinely throw us off target and make us do the wrong thing.

The most damaging recurring thought you can have is this: "If only I ..." — you can fill in the rest. As in, "If only I had acted sooner on Electronic Arts." Or, "I should have pulled the trigger on Nvidia ahead of that quarter." Or, "I could have made a fortune if I had stayed short that Sun Microsystems."

Don't get hung up on the woulda, shoulda, couldas.

This is wasted, damaging emotion. It is destructive to the positive psychology you need when you are making investment decisions. For a long time, I took it to an extreme. I would sit and be mesmerized by a couple of big misses, by things that I got wrong. I would be obsessed, hitting up the big miss over and over again.

Not anymore. With the help of my wife, the Trading Goddess, I was able to see just how destructive such a pattern of thinking is. In fact, I have had to build in methods of tricking my mind into not playing this game.

A while ago, I absorbed a terrible loss in Charter at the \$2 level. I knew that to keep myself from thinking "I could have sold the stock at \$4 and change for a nice gain," I had to take Charter off my screen. I do that with all stocks that go up huge after I leave them or that have gone down huge and I had to take the loss for fear that they then will rally and further shatter my confidence.

If you are like me, and you need help curbing this kind of destructive thinking, go to that extreme; take the stocks off your monitor or your portfolio watch. You will be surprised how much better you perform when you stop the woulda, shoulda, couldas.

Rule 14: Expect, Don't Fear Corrections

You'd think that after the dozens of corrections we've had in the last 20 years, we would get used to the process. You would think that we would say, "Let's prepare for the correction because it has to be right around the corner." Yet most people I know act as if corrections are total shockers, the type of thing that never happens.

To me, they are like the rain. I expect it has to rain. I prepare for it. When it comes, I am ready. I have an umbrella and a coat or I stay indoors.

Expect corrections; don't be afraid of them.

Of course, corrections happen at allegedly unexpected times. The last few we had were preceded by terrific days during which we made lots of money and all systems seemed go.

That's when I worry most. I used to have a rule at my hedge fund: When I made 2% in a day on the upside, I knew I was too exposed, I knew I was too long. I knew that my portfolio would kill me if we caught a storm. So as the market lifted, or if my performance was swinging too much to the upside, I would pull back, sometimes furiously, into strength, so I would be ready for that big down day.

Sometimes it never occurred, and I had to swallow my pride days later and come back in. But when it did occur, I outperformed by so much that my partners thought I was a genius. Plus, I was ready to buy things with the cash I had taken off the table.

For example, let's take the oils and the oil drillers, companies like ChevronTexaco, ExxonMobil, Halliburton and Schlumberger. I like to pick on them because they are classic rally/correction stocks. When these stocks were ramping every single day in early 2005, I knew we were setting ourselves up for a fall. So I did my best to scale out into strength.

I felt terribly naked when, for example, Kerr-McGee spiked to \$81-plus and I had none left because I had been selling into strength. Sure enough, though, a week later, and it was already below where I had sold it. If I liked it so much, I could have bought it back.

You may not know when a storm might strike. But we do have barometric readings that help immensely. When the S&P's proprietary oscillator registers plus 5, that signals to me a level of overbought that I regard as dangerous and I pull back aggressively and wait for a correction. That might mean that if I owned a portfolio of Intel, PNC Financial, Electronic Arts and Procter & Gamble, I might be selling up to half of those positions, no matter what, in order to be ready for the storm.

If the rough weather doesn't come, I underperform on the upside. But think of this: I compounded at 24% after all fees for my hedge fund career, about twice what the market did during a long stretch in which it was pretty darned good. The only empirical conclusion: My method of avoiding the big down days more than made up for having less exposure on the big ramps up.

Rule 15: Don't Forget About Bonds

"Where are the bonds?" That's how I used to begin every phone conversation when I was on the road, away from my desk, back when I ran my hedge fund.

Yet people forget the bond market all the time. They forgot it in 2000, even though it told them the economy was softening. They forgot it in 2001, when it was clear that the cash rates were too competitive to stocks and would cause a massive selloff. That's why I say:

Don't forget bonds.

I was trained to focus on bonds because bonds are the competition to stocks, the competition I most fear. When short-term rates go sky-high, you have to expect companies that had been bought for good yields, stocks like Bank of America or BP, will sell off.

When long-term rates fall to 4%, you have to believe that the economy may be too soft to own deep cyclicals or that stocks that have high yields, like utilities — I like to watch Duke Energy — will be on the move.

You need to watch more than the stocks. If this were basketball, I would be saying that if you just watch the man with the ball,

let's call him Citigroup, and you don't watch what the others are doing on defense — the bonds — there's no way you are getting to the basket. The men without the ball — the bond market — can determine the action.

Many people who got in this game in the last decade still don't even know what bonds are. They are troubled when you say bonds went up today. They think that means interest rates are going up rather than what it really means, which is that interest rates are going down. If you don't understand how bonds work, I think you will not be able to make nearly as much money as if you do.

By the way, a lot of younger managers think they only need to think about bonds if they own Washington Mutual, American International Group or Fannie Mae.

They don't think bonds matter with a portfolio of Research In Motion, eBay or Qualcomm.

Wrong! When interest rates move significantly higher, no one's going to pay a lot for the future earnings growth stocks provide.

So keep your eye on the ball, and on the men without it.

Rule 16: Never Subsidize Losers With Winners

Professionals and amateurs alike hate selling their dogs. They keep hoping, keep assuming, that a sinking stock is wrong in its direction. They rationalize that the weakness or lack of interest they see is and will be fleeting, and that people soon will recognize the value that the holder sees in the stock.

That's all well and good, until you need money.

Most fund managers have fabulous marketing teams that are able to hype their funds regardless of performance. Despite that and despite the shameless way this industry supports just about anyone who runs money if the money-runner is willing to kick back to the sources of funds, managers do get cash calls. They periodically have to redeem shares they own for cash to send

back to unlucky investors.

When they do, that tendency to keep the dogs develops a sinister side: Good stocks get sold to subsidize the losers. You then get a self-fulfilling spiral as the bad stocks stay bad. They usually keep going down. And the fund, without the good stocks, keeps sinking. They never learn my rule:

Never subsidize losers with winners.

Individuals do the same thing. They have only a finite amount of capital to invest. Rather than take the medicine — the loss — they hold on to the losers and sell their winners.

My advice to anyone who is stuck in this position is quite simple: Sell the losers and wait a day. If you really want them, go buy them back the next day. I also am certain that you never will.

Rule 17: Check Hope at the Door

When I hear the word “hope,” as in, “I hope that doomed stock du jour will come back to where I bought it so I can sell it,” I get furious. Always remember:

Hope is not part of the equation.

Don't “hope” for anything. Hope is emotion, pure and simple. And this is not a game of emotion, other than to take the other side of the desperate. Yet, I hear “hope” more than any other word, particularly with troubled tech stocks. Those stocks are filled with hopeful people betting that something good eventually will happen that will drive the stocks higher.

Hoping and praying are excellent things in religion. They are integral to sports. You know that the coaches of some of these come-from-behind NCAA men's basketball teams keep players motivated through hope.

But hope is a mistaken emotion in our business. It supplants reason, it supplants rigor — especially when it comes to low-dollar-amount stocks.

No company ever set out to have a low-dollar-amount stock. The companies fight like heck not to have them. When they have them, it is a judgment rendered by the market that is harsh, difficult to accept and ultimately, far more right than wrong. When you suffuse your thinking with hope, you end up holding on for something that most likely will never occur. Cut your losses and move on.

Remember, we don't care where a stock has been, we care where it is going, and it is most likely headed down if you are hoping.

Rule 18: Be Flexible

The most important rule of all is: Be flexible.

You have to be flexible because business, by nature, is dynamic, not static. Things change. Markets change. Competitors start new price wars to win share. Companies execute poorly. Customers cancel orders. Events happen that make buying decisions more difficult or postpone them.

Of course, our buy-and-hold brainwashing totally precludes many of us from ever thinking like this. We have made up our minds

that things are great for Coca-Cola, say, and we don't want the facts to get in the way of the story. Or we decided in 2000 that Cisco was a winning stock and we are not going to be dissuaded by the change in the fundamentals to sell it. Our "love" for stocks is so misplaced in this rough-and-tumble world of business.

Let me tell you a story of what happened to me a couple of years ago by way of illustration. I thought that Charter Communications would be a terrific stock if the largest shareholder would simply pony up more money with the rest of us to improve the balance sheet.

Instead, the largest shareholder took a powder and the company went to hedge funds and offered them the right to short as much common as they wanted to in return for lending them money. The hedge funds obliged. If the company had adopted my funding method, or if the company simply had done a huge equity offering, we would be looking at a win, not a loss. But the company made the wrong move and the stock went from being a good stock to a bad one.

Many people thought that I had gone from being a good stock picker to a bad stock picker because of Charter. Frankly, I think that management and the largest shareholder made moves that weren't rational. It's hard to invest with someone who exhibits irrational behavior after that person had not exhibited such behavior before. So I had to cut my losses and run. I mention all of this because the unwillingness to recognize this turn for the worse, as bad as it was, would have led to much larger losses than I already had accrued in the stock. This is what happens if you are inflexible (see Rule No. 18), too, if you believe too much and don't shift when it's clear that management doesn't care.

Stay flexible and recognize the vicissitudes of the market and of individual businesses. Or, own bonds.

Your call, as always.

Rule 19: When the Chiefs Retreat, So Should You

Lots of guys had lots of reasons to sell Enron. I only needed one of them: The CEO quit for personal reasons.

CEOs don't quit for personal reasons. CFOs don't quit for personal reasons. These are fabulous jobs. You get them after giving up much of what people enjoy about life, such as family, friends and nights out. Competition is so fierce for these positions that when you finally land one, you don't up and leave. You leave because something's wrong at the company. Hence, my rule: When high-level people quit a company, something is wrong.

"Aha!" you say, "I know a CEO who quit because he had an epiphany about climbing K2." Or, "I know a CFO who left because she wanted to spend more time with her family."

Fine. There are exceptions.

This is a game about the rule, not the exception. There will always be some situation in which it is a mistake to sell when a high-level person leaves. I don't care.

As you can tell, if you have read the rules to date, I am giving you the stuff that has kept me in the game all these years, that literally has kept me from losing more money than I have made.

In the midst of its scandal, AIG felt like Enron to me. We have no idea what kind of reserves AIG really has at all, and the high-level departures are unnerving. This one seems like Fannie Mae at best, Enron at worst.

This is why on some sleepy August night with Enron at \$47 a share, I told everyone and anyone that I would sell it nine ways

to Sunday because Jeffrey Skilling, the man who would have given his eye teeth to get his CEO job, suddenly quit. Of course, there were those who said, "Cramer, if you had done more homework, you could have gotten out at \$90." Yeah, maybe. I didn't.

I didn't keep you in till zero, though, either.

Rule 20: Giving Up on Value Is a Sin

Patience is a virtue — giving up on value is a sin.

I see so many people throwing in the towel on companies that have real assets and real worth just because they aren't working now, and it angers me. I recall an interview I did a year or so ago with the CEO of Superior Industries, a wheelmaker for auto companies. At the time, its stock was at a 52-week low.

It had a big short position. It was getting lumped in with ne'er-do-well companies.

And I asked myself, "Why sell that one? It's already down so much, it has a clean balance sheet, it can make acquisitions, buy back shares, do so many things." But people didn't want to wait until the cycle turned to get the profit that most certainly would come to those who waited for Superior. That's because it was cheap and good. It was cheap because it sold at book value; it was good because it had plenty of business.

Or take the situation I see developing in banks like J.P. Morgan and PNC. If the Fed doesn't tighten forever — which it won't — at a certain point, the value in these banks will be realized. Great brands, great branches.

But no one cares.

At any given moment, I like to have a portfolio of what's working now and what will work in the future. I think that after 16 tightenings, you have to start thinking that the Fed will have an impact and when it does, the Fed will be through. When the Fed is through, you are going to want to own the financials. I think they are a lot easier to own now than Phelps Dodge or U.S. Steel are.

It takes patience. Most don't have it. If you don't, frankly, I think you should let someone who has patience run your money. You don't deserve to.

And by the way, stocks like EMC and Cisco and Sun Micro don't qualify. They are expensive, not cheap. They don't represent value ... at these prices.

Rule 21: Be a TV Critic

Do you know how financial television really works?

I'll tell you. At times, it can just be a gigantic booking machine. That's right, people are scrambling to get money managers on who can talk, almost regardless of how good they are. And lots of times, executives say whatever they want on air, knowing that they can get away with it.

I accept this as a given. I accept that what I hear on television is probably right, but no more than that. That's the world in which we live. That's the reason I follow this tenet:

Just because someone says it on TV doesn't make it so.

Back in early 2005, a money manager came on television and knocked down Sirius by saying some negative things about it, some of which were true. I accepted the fact that he was short it and that he probably shorted the stock right before he went on and that probably what he said wasn't right. Did you think he was right?

I think you are naive if you simply believe what you hear. The vetting process to get on television simply isn't all that rigorous. When a manager says he likes EMC or Sun Microsystems, do you ask yourself where he bought it? Do you think he might be selling it?

When someone comes on and says that Elan is a buy, do you think, "He's really stuck in that pig"?

If you answered yes to these inquiries, then you are armed for the daily chatter.

Rule 22: Wait 30 Days After Warnings

Few rules have saved me more than the 30-day preannouncement rule.

When Tibco Software preannounces a bad quarter, do you rush to buy it? Are you someone who put money to work in Waters right after its vicious preannouncement in spring 2005?

If you are, this rule is for you:

Always wait 30 days after an earnings preannouncement before you buy.

I designed it because I recognize how compelling some of these price adjustments are, but they often are not deep enough to make the stocks ultimately attractive.

Here's why. When a company preannounces a bad quarter, it isn't just looking at the past. It is looking at its order book, its future. Believe me, if there were any hope that the company wouldn't have to preannounce — hope in the form that maybe something could get better, not worse in the next 30 days — the company would wait.

Preannouncements signal ongoing weakness. That's why I like to wait 30 days to see if anything has gotten better before I pull the trigger to buy.

Sure, I will miss some great opportunities. Most of the time, though, after 30 days, I find that there is more woe and another leg down! If there isn't, then I might miss a point or even 2, but I will be on terra firma. That's the only thing you want to be stepping on in any market, including this one.

Rule 23: Beware the Wall Street Hype

Amateurs and professionals alike simply don't have enough respect for the Wall Street promotion machine.

They don't realize that balls can stay in the air much longer than they should. They don't understand that analysts and firms get behind stocks — sometimes irrationally, sometimes greedily — and they can keep the stocks propelled in an up direction well beyond reason. That's why I say,

Never underestimate the Wall Street promotion machine.

Consider American International Group and Fannie Mae. Here are two companies with extensive banking opportunities

dangling from one side and good track records hanging from the other. These had been two lovey blankets for the sell side for so long that they wouldn't give them up. Both stocks stayed up far too long, even in the post-Spitzer era, because the analysts viewed it as their job to keep the stocks up.

Now, I don't mind admitting that things are better now than they used to be. When I owned Cabela's right after it came public, the analysts who brought it public bent over backward

not to recommend the stock, to the point that I missed the promotion machine.

Analysts now have some degree of conscience and are able to separate themselves from being flunkies for banking. But that doesn't mean they won't fall in love with some stocks and do everything they can to praise them long after they shouldn't. It tends to happen particularly to winners, stocks like the online education companies or the biotechs or some of the doggie software companies. The hope never ends. The hype never ends. Not until the cracks are so obvious that it is too late to get out.

In particular, when you short a stock remember that an analyst will twist any data point into a positive to get a stock juiced. Again, that's his job. Don't think badly of him; just be ready to reload when he does it.

Rule 24: Explain Your Picks

One of the worst things that ever happened to stock picking was the Internet, because it took away one of the most

important brakes on the process, one of the most important warning systems, which is talking to someone about a buy. Now you can, with a stroke of a key, buy the stock of Sirius or Avaya without ever having to explain to another human being why you are doing so. This is why you should always:

Be able to explain your stock picks to someone else.

Buying stocks is a solitary event — too solitary. As I love to say, we all are prone to making mistakes, sometimes big ones. One way to cut down on these mistakes is to force yourself to articulate to someone else why you like Elan or why you think Biogen Idec is a winner.

When I was at my hedge fund, I always made every portfolio manager sell me the stock, literally sell it to me like a salesperson, before I would buy it. If you are in a position where you are picking stocks yourself, get someone to listen to you and let you articulate your reasoning.

Recently, one of my email correspondents said that her daughter bought the stock of Sony because of the Xbox. Ouch! That would be Microsoft that makes the Xbox. A mistake like that would have been picked up by most people who articulated their reasoning to others. The simple selling of the idea first, to someone else, can help you spot flaws.

I also like to ask people, "What's going to make this EMC go up, what's the catalyst?" Or, "Have we missed the move in this EnCana already?" And, "What's your edge?" These are among the questions I ask. If you can't answer, you shouldn't be buying.

Rule 25: There's Always a Bull Market

I like to end every television and radio show I have with this signoff: "There is always a bull market somewhere, and I will try to find it for you." I say that because it's true.

Something is always working! Maybe it's gold, so you buy best-of-breed Newmont Mining. Maybe it's oil, so you buy some Halliburton. Maybe it's the chemical complex, so you pick up some Dow Chemical. I've seen moments where the only stocks in bull mode were in your supermarket or your medicine chest, stocks like Anheuser-Busch and PepsiCo.

Now, I know that might mean you have to do some trading. It might mean that you may have to look further and harder than your time and your inclination allow. That's OK, too. What matters is that you don't simply default to what's in bear mode because you are time-constrained or intellectually lazy.

This is not just a criticism of do-it-yourselfers. Many professionals stuck with the leg irons of the wrong tech stocks long after they should have. If they looked around, they might have spotted the bull market in oil, and bought something as simple as Exxon Mobil or as complex but rewarding as Ultra Pete.

Just remember:

There is always a bull market somewhere.

I will always end my shows with this tag line because it is vital for me to get you to think more opportunistically than the average investor does.

Oh, and by the way, it has the added advantage of being true. For 25 years there has always been a sector that works. You just have to find it. I know it, and I am honored if you will let me help you.

I CANNOT WIN, UNLESS YOU WIN

Every single trade that I recommend in **Action Alerts PLUS**, I am also investing my own personal funds.

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