31 Simple Investment Rules – With Supporting Data

Table Of Content

Having investment rules is critical as it is what keeps you from following the flock and making questionable investing decisions.

It's also important to keep them simple to make sure your rules are actionable.

Why Use Investment Rules

How often do you resist buying hot stocks in the news? With some investing rules, you can avoid falling for hot tips or becoming emotional.

The rules you put together keep you grounded and make you follow a process.

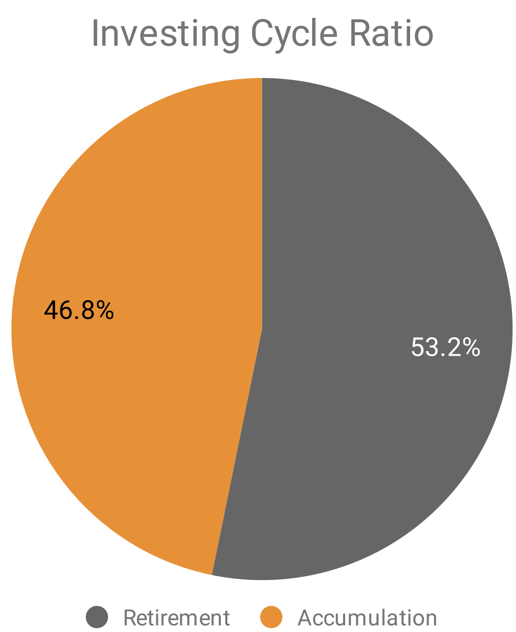
I will be the first to admit that it has taken me many years to really sort out my rules. While I initially started with 7 rules, I realized that I actually have many unwritten rules and I decided to put them all down on paper.

Rules lead to building a process and a process keeps you honest with your goals. After all, investing is critical to build wealth, you want to avoid mistakes when you can and learn from those you make.

While working on listing my investment rules, I was curious how they were compared to other investors. Am I going against the flow? Am I alone with the rule? or do I have more in common with others.

To get an idea of where my rules stand, I ran a survey with my readers. I have now compiled a lot of **data from hundreds of real DIY investors** like yourself to show my rules aren't that odd even it if goes against the financial industry saying … And many of the data points come from successful retirees.

Here is the survey breakdown by investing cycle: accumulation or retirement phase. The colors are the same throughout all the graphs for comparison.



Type of Investment Rules

My rules are broken down into 4 categories to simplify the usage and application of your investing strategy.

Portfolio Rules
These rules help manage your portfolio.

Business Rules
These rules deal with the companies you are looking to invest in. Filtering by metrics is important but I believe the business is more important than the metrics.

Metrics Rules
These rules help find the needle in the haystack. For a dividend growth investor during the accumulation years or a dividend income investor in retirement, there are key criteria to be met to find the right dividend stocks.

Miscellaneous Rules
These are rules that can help get an edge and don't really fall into the other categories.

As a final note before you go through the rules, they are outlined to build a dividend growth portfolio during the accumulation years. If you have a different strategy or are in retirement, you don't have to use these rules but you should still have rules to help you stay accountable.

11 Portfolio Rules

Portfolio Rule 1 – Investing Is Not A Get Rich Quick Scheme

Don't expect to get rich overnight. I know it and I accept it.

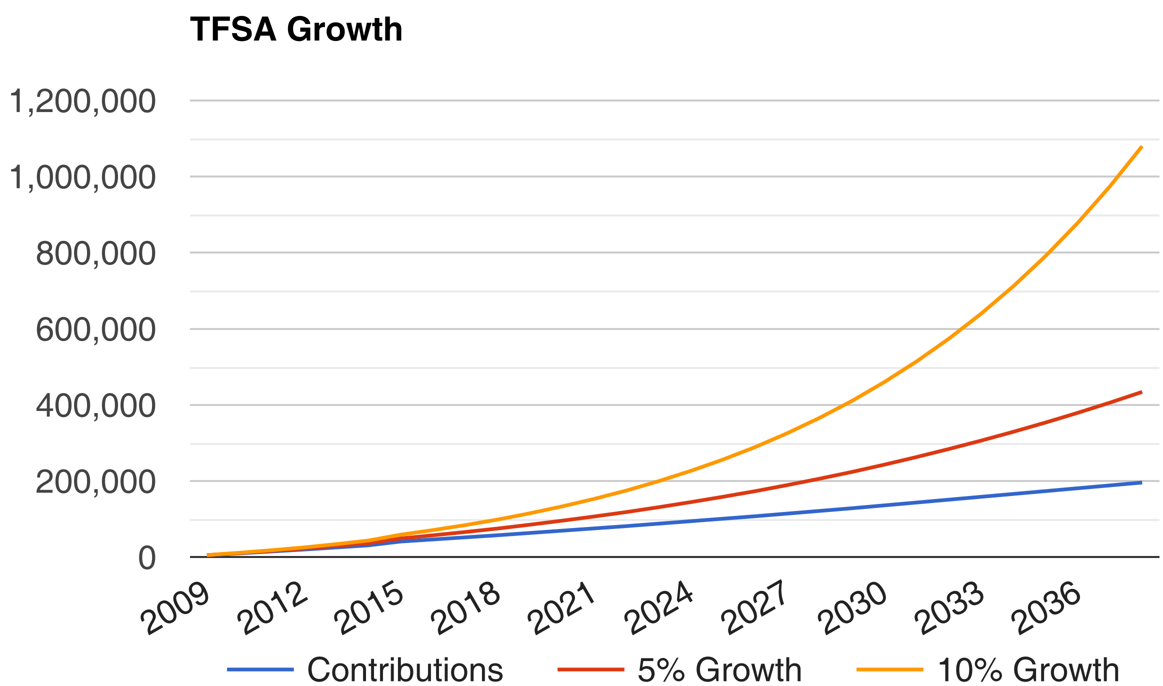
Investing is a proven method of building wealth, or more specifically, a proven way to put your hard earned money at work. Greed on the other hand can lead to bad decisions.

Keeping your money in the bank in a so-called high interest savings account doesn't do anything. Instead, put it to work for you by investing.

Accept your rate of return based on your investment strategy. Index investing leads to average market returns whereas other investing strategies can beat index investing and others might not.

Beating the index is my benchmark during the accumulation years. So I am set up to track my portfolio performance and choose to buy stocks or an index ETF.

Homework: Write down the rate of return that would make you happy. Use the rule of 72 which tells you how many years it would take to double your money.



Portfolio Rule 2 – I Question All Financial Sayings

The financial industry likes to simplify investing and make it into a process they can apply to everyone but every situation is different.

In fact, their solution is often a mutual fund and that's not good advice. One that many learn the hard way once they ditch their mutual funds.

Take one saying that says *"you should have a fixed income, or bonds, ratio matching your age"* but in this low interest rate environment, it doesn't work. It damages your portfolio.

As long as interest rates are going to stay low, I will not have bonds or buy bond ETFs.

Same goes for gold, when markets go down, the fear kicks in and investors flock to gold but why? What do you expect with a gold ETF in your portfolio? Many papers have shown *gold doesn't protect against inflation or economic downturn*. In fact, the Canadian government sold nearly all of its gold reserves.

Investing in gold is not a scientific portfolio strategy. It's an emotional decision driven by the feeling you need to do something. A great YouTube video going over gold to make you reflect.

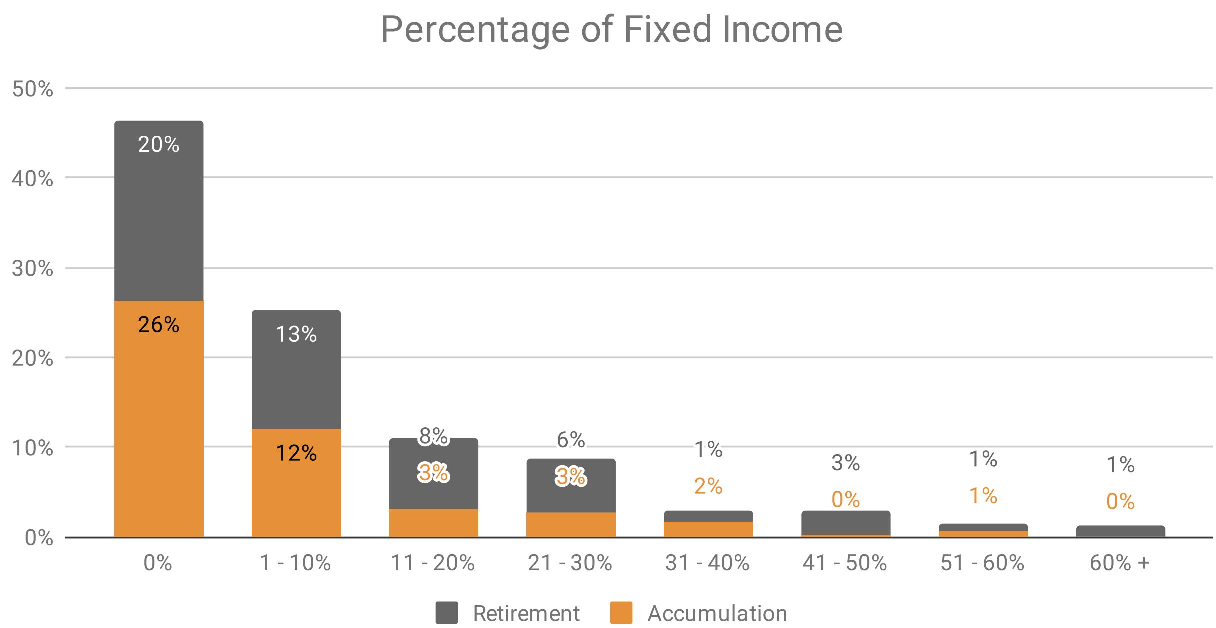
Another one is the *"4% withdrawal rule"*. Does it still work? Most financial plans are put together with the assumptions of a 4% withdrawal rate.

If you are told to have bonds and fixed income with near 0% return, then you rely on your equity for growth and the theory says to increase fixed income as you get older … I don't see how the equity portion can keep up.

It's not surprising to see that many retirees from the survey have 0% fixed income. In fact, the saying by the financial industry is not followed at all. Is that just by the DIY investors?

This is why I am a dividend investor. I want to avoid unknowns and be in control of my retirement income with the dividends I receive. I follow dividend growth investing during the accumulation years and dividend income in retirement.

Homework: Identify if you have fixed income and why you have them. Are you convinced of the reasons why you have them? What's the percentage and what do you want it to be. Ignore whatever you find out there, it's all based on fear management. Decide what your number is.



Portfolio Rule 3 – Managing A Portfolio Is Like Managing A Sports Team

Just like a team manager wants the best player at each position, and each player to play a specific role, managing your portfolio is the same.

For example, some stocks like Alimentation Couche-Tard or Intact Financials are for growth but others like BELL or Royal Bank are for stability and some growth.

You are an investor and a portfolio manager when you go DIY. Like a team manager, you need a plan and a strategy. You need to cultivate your holdings but you also need to scout for the next best stock.

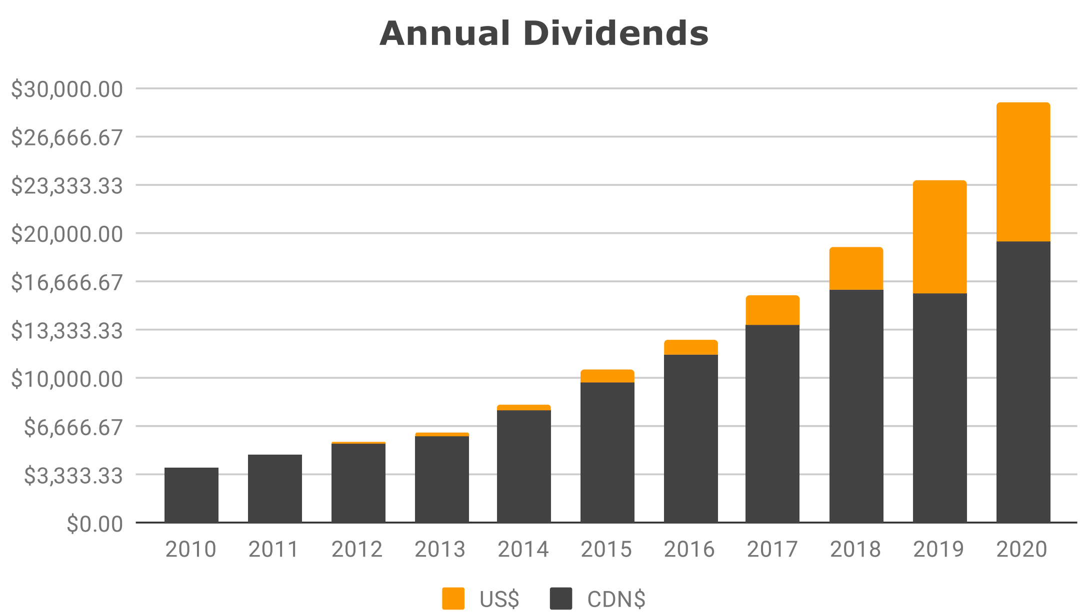
- The players are like your investments
- The positions are like your sector and industry
- The plays are how you fit your stocks on a performance scale (think of bond-like stocks for defense, millionaire makes for powerplay)

The portfolio tracker I use provides me with an excellent breakdown of my holdings by sector and industry along with a holistic view of my portfolio across all accounts.

As a portfolio manager, data is critical to make decisions. **I have not seen a discount broker aggregate all accounts together to give you 1 view**. In many cases, when they can do it, the reports are not very useful. Do yourself a favor and think about what you need to see.

For some details look at my monthly dividend income reports as a starting point. I can see the ratio of my portfolio against high yield stocks vs low yield stocks.

Homework: Get setup to have a clear view of your entire portfolio. Holdings by equity or fixed income, equity by sector and industry and a total exposure to your investments (when you hold the same stock across many accounts).



Portfolio Rule 4 – I Hold Between 20 And 25 Stocks

How many players on a team do you need? It's not an infinite amount…

The same goes for your portfolio. You need to identify a limit to work within since you can't keep track of too many businesses so you need a limit.

I find 10 stocks to be too little as it puts more risk on your portfolio into an equal amount of stocks.

With 20, you have more room for focus on your winners and work on your upcoming recruits. You don’t need an equal weight distributed across your holdings either.

If you have too many, you end up building an index; the ***You Index***. If you hold all the banks and all the telecoms, it doesn’t take long you have a lot more stocks. Question is, do you need them all or should you consolidate?

See the graph below on the number of stocks many DIY investors have in their portfolio. Interestingly, the pattern is similar between retirees and those actively building their portfolio.

Homework: Identify the number of stocks you have. How many do you think you should have and why do you have them? Can you consolidate them?

Portfolio Rule 5 – No More Than 15% In One Stock

Wow 15%, are you nuts? I went through the 5% and 10% limit in the past 12 years but in reality, I don't want a hard rule here as it needs to be in context of the economic situation.

I have a couple of winners in my portfolio where I took profits in the past as they were growing and taking profits was a mistake, so what's the largest exposure you want? I say 15% but I watch at 10%.

The idea here is not to buy 15% worth of one stock but to allow for your winners to run away if it happens. At 10% I watch but at 15%, I will consider trimming if it continues.

Index ETFs are excluded as they intrinsically invest in many stocks across sectors and industries.

After getting data from real DIY investors, you can see below what the majority think about letting their winners run. I had not expected this many investors with more than 10% in one holding, let alone this many retirees.

Homework: Get setup to track the ratio of your holdings. You want to know how much of a company you have across all of your accounts.

Portfolio Rule 6 – I Invest In My Winners

Since I learn from my mistakes, and one of them was taking profits from my winners, you need to know which stocks are your winners.

A winner is found after holding them for a few years where the performance has been consistent as opposed to a quick win over a few months.

A winner is different depending on your investing stage (accumulation or retirement). In the accumulation, it's a stock with a 25% (for me) annual rate of return and during retirement, I would say a yield over 4% and a dividend growth over 6% annually. (Hint, no REITs fit those criteria)

I mentally use these groupings:

- **Winners**: my consistent top performers beating the S&P500. Think of Visa, Apple and Microsoft
- **Coasters**: those are the banks for me. Yup the backboned of the Canadian economy are just coasters.
- **Losers**: stocks that are not meeting the expectations you had set and you now have reservations. Those that you say "I hope" …

Homework: Identify your winners. It's ok if you don't think you have any. Flag your stocks into Winners, Coasters and Losers.

Portfolio Rule 7 – Know When To Cut Your Losers

As a team manager, you need to cut players sometimes which is usually about fit or performance.

The same applies to your portfolio. Keeping your losers or less performing stocks can have a lasting negative impact on your portfolio.

Buy and hold is a common saying but it doesn't mean you blindly hold forever. Companies will evolve and adjust and only the best management keeps the older companies relevant. Think of IBM in this case.

The biggest warning sign in portfolio management is when you hear yourself saying the word "hope". When that happens, you need to SERIOUSLY look into why you are holding the company and what the alternatives are.

A more process oriented approach is to do a quarterly review of your holdings and make sure your reasons for each one of them still hold.

Homework: Make sure you write down why you invest in each of the holdings you have so you can validate any changes.

Portfolio Rule 8 – Don't Ignore The US Market

The Canadian stock market is small compared to the US and other countries. It's also indexed towards financials, energy and basic materials sectors and limiting your options to find winners and to reduce your risk.

The currency exchange is usually the first hurdle to overcome but do note that you don't need US dollars to invest in the US. You can buy a Canadian ETF that covers the US stock market. You can buy the S&P 500 index or the Nasdaq 100 index very easily.

Historical data could prove performance was good in Canada 40 years ago but that's like a lifetime in the investing world.

I don't want to ignore history but I also want to put it into context. In the 80's, Canada's oil was ruling … is it ruling today?

As a rule, it appears to be shared amongst many from the data below. There is no need to stress picking a US stock either as you can just buy the S&P 500 Index ETF in

Canadian dollars (VFV ETF).

Homework: No homework. Just think about it, it could benefit your portfolio.

Dividend Adjusted Chart by Stock Rover

Portfolio Rule 9 – Scout & Monitor

Scouting is critical so you can find the next winner. It took me 12 years to reach the point where I am very satisfied with my portfolio.

Still, I continue to scout for my next winners to this day. Once I find a company with potential, I put it on my watch list and monitor for a while.

The idea of monitoring is to identify if the company meets your business rules (more on that later).

> **Homework**: Build your watchlist. Googlesheet is great for that.

Portfolio Rule 10 – Diversify Across Industries, Not Sectors

You will hear that you should diversify across sector and that's what I focused on back in 2009 but you should diversify across industies.

There are 12 sectors as opposed to hundreds of industries. However, many companies under the same sector in different industries have little overlap.

Take credit card companies like Visa and MasterCard versus the banks like TD Bank or Royal Bank. All of the companies are in the financial sector but they have little overlap. The same apply to a property insurance company like Intact Financials.

> My Own Advisor has a similar rule – Through diversification you can improve performance with less investment risk. If you are unsure about how to obtain diversification, via individual stocks, then consider index investing.

Homework: For each of your holdings, list the industry it is classified under. To be specific, when you look at data providers, it's often referred to as the sub-industry.

Portfolio Rule 11 – Be Tax Efficient

Being tax efficient doesn't mean to avoid paying taxes and leaving money on the table. It means to be smart and aware of taxes you would have to pay.

- Understand the difference between dividend and distributions for example.
- Know the implication of US dividends withholding tax for the various accounts.
- Maximize the tax-free accounts available

I am not going to outline a blind rule where it says to invest your US dividend stocks only in a RRSP since I have US dividend stocks in my TFSA and non-registered. Those stocks have a low dividend yield (1% or under) and the tax withholding is very minimal compared with the total return.

Taxes vs total return is a balance.

GenYMoney has a similar rule – If you have high yield US dividends it is best to put them in your RRSP.

Homework: For each of your holdings in each account, identify if it's tax efficient.

7 Business Rules

Business Rule 1 – Understand the Businesses

You need to understand how the company makes money. This is a must in my opinion.

Imagine you have 2 friends asking you to invest in their business, which is what the stock market is by the way, and 1 friend says he wants to start a food truck business and the other is opening a pizza place. Both are asking for $25,000. What questions do you ask?

Whatever questions come to mind is probably about the business strategy like location, customer potential, and some financial questions.

In a way, investing in a publicly traded company is similar. You need to capture the essence of the business and revenue potential.

Homework: Write down what you know about the business of your investments and list all the revenue sources.

Business Rule 2 – Invest in Toll Booth Businesses

Companies that can easily grow their revenue consistently have their hooks in with their customers and have them pay ongoing fees that are predictable.

These businesses often provide a "business" necessity that must be leveraged by other businesses such as cloud computing or electricity to keep it simple. When it comes to electricity, it's regulated since it's considered a necessity in society.

Another word for toll booths these days is subscription business. It's a lot more predictable to pay $10 per month for music than to estimate the number of albums you can sell. It's much easier to increase your streaming service prices when your costs go up and you want to maintain your profit ratio.

Coca-cola, for example, is not a toll booth business. It has to make products, and market products over and over.

Homework: For each of your holdings, write down if the business is a toll booth or not.

Business Rule 3 – Invest In Global Companies

The ability to operate globally opens a lot of doors for higher revenue. Look at the Canadian banks, they all expanded globally with various successes.

For a Canadian company, making it in the US is a big deal, going global is another big deal.

Homework: Identify if your holdings are global or local to the country.

Business rule 4 – Look For Market Leaders

Usually the companies leading the markets will have a competitive advantage. Either through negotiation power, purchase power, distribution channels, brand or some other capabilities.

Being a market leader requires strategic planning and execution as the competition is always there to take your customers. Ask yourself if someone can easily do the same thing and take market shares away.

> Bob from Tawcan has a similar rule – Invest in companies that people complain about their pricing but can't switch.

> **Homework**: For each holding, identify what makes the company a market leader

Business Rule 5 – How Pervasive To Our Daily Live Is The Business

You need to look at it from a consumer perspective but also from a business perspective.

Take the airline industry, 50% of their revenue is from business travel. As for utilities, everyone needs them which is why it's regulated but when you look at railway, it's moving products that everyone needs.

In the end, how will not having that business impact living from day-to-day.

> **Homework**: Identify if the company is in the necessity business.

Business Rule 6 – Identify the Stage of Business Life Cycle

A company growing is not the same as a company that has matured.

In fact, companies go through a business life cycle where they start small, grow and mature. At each stage, the company has to decide how to reinvest the profit.

Here are the business life cycles that resonate with me. No need to be academic here.

- **Start-up**: A new launching new products or services. Rarely do they trade on the stock market. Still proving themselves ahead of an IPO.
- **Growth**: Successful launch and growing. Usually with rapid sales growth. Looking at an IPO and turning a profit.
- **Established**: Sales are slowing down from competition or saturation.
- **Maturity**: Sales are normalizing and profit margins are getting thinner.
- **Expension/Decline**: This is an adapt or fail turning point. Larger companies will have products go through the cycle internally at faster rate.

Oftentimes, dividends are paid when the company has extra cash and doesn't see a way to re-invest it in the business.

Homework: Identify the stage of business life cycle each of your holdings are in.

Business Rule 7 – Is the Business Recession Proof?

Recessions are theoretically cyclical and happen every 7 years as a rule of thumb. This is why I like to look at 10 years of historical data.

Look at the graphs and understand the company's recovery during a recession. Let's be clear that not many stocks don't go down during a recession. The sheer panic selling brings all stocks down, the question is how long does it take for the recovery.

Make sure it follow the index at least.

Homework: Review the performance history to assess how the company did during a negative market. Did it bounce back or not?

7 Metric Rules

Metrics Rule 1 – 10 Years of Consecutive Dividend Growth

10 years of consecutive dividend increases is critical for me – some exceptions will be made.

50 years of dividend increases is irrelevant as it can lead to 1 cent or a fraction of a cent to keep the streak alive. So Dividend Kings are not important. The Dividend Achievers are the most important.

Now, banks have been told to not increase recently during the pandemic so you can make a judgement call and make an exception.

> Mike from The Dividend Guy Blog has a similar rule – Throughout the years, most of my best stock picks have been found amongst the strongest dividend growers. Those companies must earn increasing cash flows and show several growth vectors to be confident enough to offer a 5%+ dividend increase year after year.

> **Homework**: Write down the number of consecutive years of dividend growth your holdings have.

Metrics Rule 2 – A Chowder Score of 10% or more

The Chowder Score tells a great story about the company's track record. The twist I put on the Chowder Score eliminates outliers.

Take a moment to read on the Chowder Score to underestand it and then pick your number. I start with 10% but a 12% or 14% is good too.

As a side note, it's not a free metric you will find and the dividend growth is also not free. This metric, which I consider critical, is a pivotal moment where you decided to access paid data. Dividend Snapshot gives you access to my formula and Stock Rover (14-day free trial) gives you access to the default formula.

Homework: Write down the Chowder Score for each holdings.

Metrics Rule 3 – Avoid High Dividend Yield

A high dividend yield points to a challenging situation. You might be able to ride it for a while but it points to investors voting against the company.

The other concern is that high dividend yields are not sustainable for dividend growth. You can't have a win-win situation with dividend yield and dividend growth as they have an inverse relationship in normal times.

Avoid stocks with a dividend yield above 5%, it is a big warning sign.

With that said, the graph below outlines the desired yield by DIY investors who took the survey. A total of 21% seek over 5%.

Homework: Write down the yield for each of your holdings.

Metrics Rule 4 – Watch For P/E Outliers

I don't like to say look for a P/E of 12 or under 20 or any other number …

The reason is that not all industries are similar for growth and not all companies are at the same level of their business maturity. Even when the company is in the same industry or sector.

The key here is to compare the P/E with the peers within the same industry and business maturity. What's the average? Where is your holding in comparison?

Don't use sectors as it's too broad. Disney and Facebook are in the communication services sector now for example and so is Netflix.

Homework: Write down the average PE of the industry peers to compare your holdings against.

Metrics Rule 5 – Watch For Payout Ratio Outliers

The payout ratio needs to be used in relation to the business maturity and the type of cash flow the business generates.

You also need to compare companies within the same industry and within the same business cycle.

I don’t have hard rules on numbers as you can’t put all the companies in the same bucket with one simple rule.

Homework: Write down the average Payout Ratio of the industry peers to compare your holdings against.

Metrics Rule 6 – Review Yield Against Historical Yield

When a business grows their earnings, the stock price tends to grow and when it also grows their dividends, the yield tends to stay flat.

If the yield goes above historical norms, assuming all other factors are good, it can be a buy opportunity (i.e. undervalued).

If the yield is below historical norms then the stock can be considered overpriced.

I never had access to this data and the only service I know offering historical yield at a decent price is Stock Rover.

Homework: Is the yield above or below historical trend?

Metrics Rule 7 – Must Keep Up with S&P500

The S&P 500 is my benchmark. I have used it for years.

Why not the TSX 60? It's not very diversified and my core Canadian stocks are already in the TSX 60. In fact, the TSX 60 is much better than the TSX in general. The XIU ETF is used below to represent the TSX 60.

Homework: Is the company's performance on par or better than the S&P500? At the least, it should beat the TSX 60.

Dividend Adjusted Chart by Stock Rover

6 Miscellaneous Rules

Miscellaneous Rule 1 – I Can Handle Market Volatility

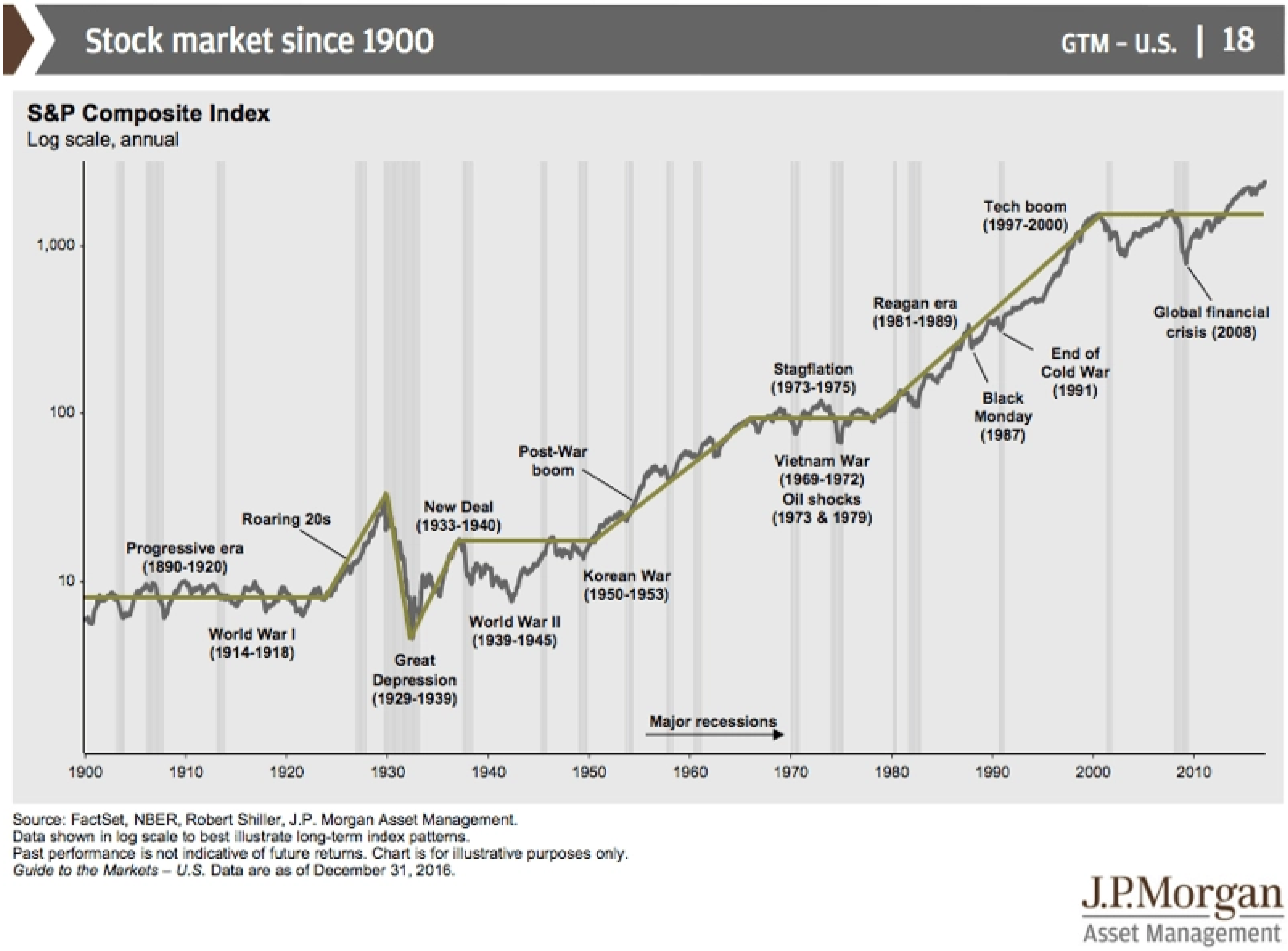
Now that we have established rules that point you towards equity investing, you need to know what you are made of.

If you can't go through an economic downturn as we had in 2020 or 2008 without panicking, you have to accept that your portfolio will not grow as fast since the solution to avoid a panic is to increase your fixed income which therefore reduces your rate of return.

Today, investing has no win-win situations where your money is safe and grows. The high interest rates of the 80's are gone.

I elected to be 100% in equity and I know many retirees that also have a portfolio exposed to 100% equity.

Robb Engen from Boomer & Echo has a similar rule – Your investment strategy shouldn't change based on current market conditions.



Source: J.P. Morgan Asset Management

Miscellaneous Rule 2 – I Don't Follow Value Investing

I don't buy the argument that your profit is made when you buy.

Value investing is challenged by companies that still have growth as you can't apply the same metrics and filters and it becomes complicated really fast.

Remember the business cycle from a previous rule, value is different at each stage. The Graham Number, for example, ignores the business cycle and can't be used the same across companies.

Waiting for a price to buy means you can miss out on the growth for years when all business rules have been met.

In short, to focus on value, it means you focus on the very mature businesses with limited growth which means your higher return is made when you buy.

Miscellaneous Rule 3 – 52-Week High Is Not a Problem

I actually prefer a stock that hits a 52-week high rather than a 52-week low. (Under normal circumstances)

Yes, it's counterintuitive but here is why. Under normal circumstances, a 52-week low means the company is struggling or pivoting. It cannot be a market leader or the business cycle is very mature and growth is therefore limited.

Miscellaneous Rule 3 – No REITs For Me

Real estate investing is easy to understand. You buy a property, you rent it, and you make money each month. It requires significant capital and you have to deal with tenants so it's not for everyone.

On the other side of the coin, REITs are companies in the real estate business and not rental properties. Just like Bond ETFs are equities holding fixed income assets.

They tend to pay a high yield which breaks one of my rules but they don't have distribution growth. In fact, the distribution growth barely keeps up with inflation.

See the breakdown below for many DIY investors on their exposure to REITs. At least 1 DIY investor focused only on REITs. No specific patterns between retirement or accumulation.

Miscellaneous Rule 4 – I Hold US Stocks in Any Accounts

Another counter-intuitive rule from what you will read.

I won't blindly hold any US stocks in all accounts but I consider the total return of the holding before I consider the tax consequence of the dividend.

My mental rule is that if the US stock has a dividend yield under 2%, I will invest it anywhere but if it's over, I will work on having it in my RRSP.

Miscellaneous Rule 5 – I Hold ETFs in my TFSA or RRSP

This rule is to simplify my accounting. I don't want to deal with all the tracking for ROC (return of capital) in my taxable account.

Miscellaneous Rule 6 – Avoid Complicated Share Structure

As some of you may know, I sold all of my Brookefield holdings in late 2020.

I just got tired of the complicated share structure. The created multiple entities out of BAM.A and then they create more entities out of BIP.UN and BEP.UN. Great management but I lost the ability to follow.

Track Your Dividends Like a PRO
Best Stock Screener to Find an Investment
Canadian Discount Brokers

Getting Better

How Many Stocks Should You Own?
How To Calculate Your Rate of Return
How To Rebalance a Stock Portfolio
How To Setup DRIP Accounts?
How To Track Your Asset Allocation
How To Transfer Shares To Your Kids

About Dividend Earner

My Story
Contact
Disclaimer
Privacy Policy
Copyright (C)