Interview with Colin Nicholson

This article was written some years ago (2010), but is very relevant to today.

Q: Colin, you've been investing in the stock market for some time now. Can you tell us a little about your trading and investing history?

A: I began seriously around the mid-1960s. We were in a great mining boom. I had read Alexander Wheelan's *Study Helps in Point and Figure Charting*, Phillip Rennie's book on the same subject (I can't recall the name, but it was pre 1966, so the charts were in pence) and Edwards & Magee's *Technical Analysis of Stock Trends*. There were not many books on charting in those days in Australia, but I later found access to many in the US.

I had been charting a number of stocks for a while, learning the craft. In the days before computers and even good calculators, point and figure charts were ideal because they were then very easy to update quickly each day from the AFR and at one point 20 years later I was charting over 250 stocks in several box sizes. Unfortunately, since the ASX has gone on line, this data is no longer available.

Then a group at my work decided to form a share trading club. It was a partnership, where we all contributed equal capital. At first all decisions were done by the group, but after a year many lost interest and I became the club fund manager, making all buy and sell decisions and advising the members. We did quite well in the boom years, but when the bull market ended in the early 1970's I wound the club up with a good increase in capital over the period.

From then I did my own trading. For quite a while I did not have much capital because of the need to pay down a mortgage on our house etc. However, I did live through the terrible mid 1970s bear market, which was just like 2007-2009. It prepared me to deal with severe bear markets, which come along every 40 to 50 years.

Initially, my time frame was all over the place, sometimes trading short term and other times a medium term active investor. By the time of the 1987 crash I evolved into an investor with a time frame of months to years. The 1970s bear market enabled me to anticipate the crash and I had taken 75% of my capital out of the market before the fatal day. On the day of the crash, I found that I was amazingly calm. I had mentally rehearsed the scenario many times and knew exactly what to do. The market on that day was totally disorderly. One stock I held had a bid of about $3 and an offer of about $9. Nobody can trade in that sort of market, so I waited for a rally. It came within a few days and, when it began to exhaust itself, I sold everything at the bid in about half an hour. My broker had the orders ready to sell at market the moment I made the phone call. There was no internet in those days.

After that it has been a total focus on investing and my capital has grown steadily. Between 2003 and 2007, I more than doubled my capital before tax and I had gradually phased my way out through 2007 into very early 2008, so that I survived the bear market on the sidelines. I had telegraphed my strategy in my book *Hot Stocks 2007*, which was written late 2006. I sat out of yet another bear market and went back in when the bull market began in 2009.

Q: You run a website today called Building Wealth Through Shares (www.bwts.com.au) , can you tell our readers more about it?

A: The website began as a vehicle to sell my videotaped seminar, later DVDs, and finally books on the internet. The main initial feature was the Ask Colin page on which I have now answered about 1,000 questions.

It moved on from there with free email newsletters, I am up to number 99 today. These were all on the website.

I also created a paid section on which I put all my copyright magazine and newspaper articles and columns. There are over 700 hundred of them now. More recently I have created a new section on the paid website which has case studies of some of my actual investments and examples of analysis of the market. This is a continual building of a resource base of case studies and examples in my book *Building Wealth in the Stock Market*.

There are samples of the paid material on the website and in newsletters.

PS This was 2010. I am now going to retire from teaching and the website will be frozen as at 31 December 2019 and open to anyone (free section and members section behind a disclaimer wall).

Q: I understand you were a speculator up till 1990; can you tell us more about what type of trading you were involved with?

A: I am not conscious of 1990 being a watershed between speculation and investment. Through the 1980s I had moved towards investing. I still did some short term trades, but they were fairly minor. Since 2000, I have been totally focussed on investing and do no short term speculation. I will not buy a speculative stock i.e. one that does not make a profit and pay a dividend. My main focus is industrial and service companies, but I (occasionally) invested in some producing resource stocks.

When I was a speculator, things were very different to today. There was no internet or mobile phones, no computers and only very elementary calculators. If we wanted to day-trade, we had to be physically in the Sydney Stock Exchange public gallery in O'Connell Street. Charts were done from the boards as the chalkies put the bids and offers up. To make a trade, we had to get out of the crush, down the steps and out onto the street to find a public telephone to call our broker.

I only did this once or twice. Mainly, I got up early as soon as the AFR was delivered and updated my point and figure charts – maybe an hour. Then made decisions and phoned (later faxed) my orders to my broker. After the market closed I had to phone to find out what had been done and at what price. Later this was faxed. I had a very good relationship with my broker in those days – he was critical to my success. I am the only client I have heard about who took his broker out to lunch, rather than the reverse. I did this to make sure that we both understood exactly how I wanted to work and what was possible. I did not want advice and he never gave it. What I wanted and paid him for was faultless execution of orders. I got it.

An interesting story from the late 1980s was the day my broker phoned wanting to borrow my shares in a company to complete a big order (precursor to a takeover, I think). I said I could do it and he asked what price? I asked for the 90-day bill rate, which I recall being well over 10% in those days.

It was a very satisfactory transaction and the shares were returned in a few weeks as soon as he could buy them on the market.

Q: How would you describe the difference between trading and investing? Where do you stand on this matter?

A: Trading, or speculating as I prefer to call it, is about profiting from short term changes in the price of shares. This can be done on the long side or on the short side. It can involve derivatives.

Investing is about buying a part ownership of a business for months to years, looking for a growing income stream in the form of franked dividends. Over time there should also be capital growth if the business is sound and growing.

As you can see from this, the time frames are quite different and often the companies are quite different, as mentioned earlier. The key is that speculation is seeking capital gains, but investing is seeking income plus capital growth, also known as the total return.

I am an investor. For a long time, I classified myself as a share trader for taxation, but I moved away from that when the tax system was changed and it became far more advantageous to be an investor and take advantage wherever possible of the capital gain tax discount for holding shares for over 12 months.

Q: Since that time you've been much more focused on combining technical and fundamental analysis to form your own unique investment style, would you be able to give our readers an insight into your investing strategy? (*Colin, this is a fairly open question – I am hoping if you have time, you could give a rather educational and detailed answer.)*

A: Actually, I am going to disappoint you a bit on this one. My complete investment plan is set out in my book *Building Wealth in the Stock Market*. You may not believe it (many don't), but EVERYTHING I do is in the book. So, to find out what I do, you need to read the book. If I tried to explain it all here, it would be a re-write of the book and take months.

However, I will comment on one very important aspect:

Fundamental analysis gives insights into relative value, but little with respect to timing. I use some key ratios to help me to buy relatively undervalued companies and therefore give me a margin of safety.

Technical analysis (charting mainly) gives insights into timing, but little with respect to value. I use charting to time my entry, position-building, sell stops and exits.

Using them properly in this way gives me the best of both worlds, because I use them for what they are good for.

I don't regard what I do as being unique. I have learned everything I know from those who have gone before me. None of it is original – there are few truly original ideas in investing. The only thing that distinguishes my methods is the way I have combined all the elements into a complete investment plan.

Q: How important is risk management to an investor/trader? How do you go about managing your risks?

A: Again this is all in my book. I have structured the book, which is my complete investment plan, in chapters that deal with each of the types of risk investors have to deal with. These are mainly market risk, specific risk, financial risk and liquidity risk.

I believe this is the key to either trading or investing. Success demands that risk should be properly priced. If we take high risk, we may have a few spectacular successes, which we will talk about. However, there will also be a bottom drawer full of CHESS statements for failed investments, which we never talk about.

Success in trading or investing is all about the return over a period – a month, a quarter, a year. The old saying of letting you profits run and cutting your losses quickly is the key mantra. Look after the losses and the profits will build for you. Big losses are what destroy portfolio performance. I stress this in my book.

Most beginners snatch small profits too quickly and let their losses run. This is fatal.

Q: Can you provide us with some examples of stocks you've picked in the past and why you invested according to your trading philosophy?

A: I will pass on this question also. I began teaching my investment plan in the last years of last century and I first wrote up my investment plan in book form in 2005. It was called *The Aggressive Investor*. That book was updated and published in 2009 as *Building Wealth in the Stock Market*. I also changed my publisher, because Wiley gave me access to New Zealand, Asia and the US markets, which my first publisher could not do. The new book has been sold on Amazon and has been the first Australian book to make the Wiley top 100 sellers on Amazon initially at No 76, but later No 42. My publisher is delighted with it and it has been re-printed several times in its first year.

In both books are case studies of investments I have made – I never give examples from theoretical investments. I am adding more case studies to the paid website as we go along and I have the time to do them (each one can take a half a day to do, at least). Each case study explains exactly how I made decisions to buy, hold, build, take profits or sell. Those decisions all relate back to my investment plan in the book. So, they are already out there and even one would take many pages to reproduce here, assuming we got past the copyright issues.

Case studies of investments do not deal with market risk. That is done through my market analysis and market exposure strategies (how much of my capital is exposed to the market). In my books *Hot Stocks 2007 and 2008*, I gave real time market analysis studies, which said what I was doing **at the time**. Any fool can invent them after the fact. These market analysis studies were re-printed in *Building Wealth in the Stock Market*.

Q: How important do you feel psychology is in investing?

A: Trading and investing involve three main skills:

0. Knowledge and analysis skills

1. Risk management
2. Decision-making skills

Interestingly, most people learn them in that order and they are not good traders or investors until they have mastered them all. It will take a minimum of ten years of hard work to get there. For most people, including me, it takes much longer, because there are other important priorities in our lives.

I wrote a book called *The Psychology of Investing* in 2006. It has been re-printed once. However, it sells slowly. I think the reasons are:

1. Most learning investors are not ready for it yet, still being in the learning phases of the first two skill sets.
2. The big mistake was the word "psychology", which turns people off because they think that admitting they need help with psychology means they have psychiatric problems. In fact, psychology is about how we think and make decisions. In other words, learning to overcome the very natural biases and errors we all make in thinking and making decisions. When/if I update and expand the book, it will have a new title that avoids psychology and focuses on decision-making. (this has since been done. Its title is *Think Like the Great Investors*)

Interestingly, *The Psychology of Investing* keeps selling steadily off my website at three to four copies a month. I get universally enthusiastic and positive feedback, even from people who only bought it because they wanted to support what I do and then got around to reading it.

Q: What do you feel is the biggest trap new and experienced investors fall into, relating to their own psychological downfalls?

A: They do not yet know what they don't know. When they are ready they will come to what I call the last frontier of learning to be a good investor or speculator – what goes on inside our heads.

It is not easy to learn to change our thinking, but the very first and most important step is to realise there is a whole area that is untouched so far. Decision-making skills bring everything together. Each of us starts the last part of our learning journey by a realisation that we have natural biases and make common errors in making decisions. The first step to improving our decision making is to be able to see ourselves making these mistakes. Interestingly, it applies to the whole of our lives, not just investing or speculating.

Q: What lies ahead for your website BWTS and will you be writing any more books?

A: I am working to constantly improve the website. Two months ago we launched a design update that represented months of work and testing for my web developer and myself. The profits from the paid website fund these improvements. I am always looking for new suggestions and have a "wish" list of ideas to implement when I have time.

One of the features of the website is that on it I disclose my stock holdings in real time. This is done to satisfy my legal disclosure obligations because I mention stocks in writing and speaking. I have gradually improved this disclosure in that there is more information there, but there is also a fine line between facts, which are legal for me to disclose, and market/stock views, which are not legal except for a licensed adviser, which I do not choose to be. I seek to teach investing skills, not advise people. I want them to learn to make their own decisions and, in effect, become their own advisers.

I have some other ideas too, but who knows. I am sixty-six this year and should be slowing down, not driving myself harder. Work is not everything, even though I love investing and writing/teaching. I should make more time to stop and smell the roses. Also to indulge my very expensive addiction to grand opera. There has to be a reason for building wealth, it is not an end in itself.

Q: Is there any final advice you would personally like to offer students who are determined to get into the world of trading?

A: Yes, these are the keys:

1. Understand compounding. To retire a multi-millionaire, it is essential to start young, as soon as you earn your first pay. Young people today marry and have children in their late thirties. By then they should be well on the road to retiring rich. It is impossible to make up for lost time. In retirement we live with the results of the choices we have made through our working lives.
2. It will take more than ten years to learn the craft. Try not to lose too much while you are learning. The worst thing is if your first trade or investment is really successful. You then have still to learn it is difficult to succeed long term. It is just the same with gamblers: If they win big on their first ever bet on the horses, they invariably give it back and more before they wake up.
3. You must have a ***written*** investment or speculation plan. It will take you many years of study, reading and THINKING, to develop it. It will be the most difficult thing you do in learning the craft. If you don't know what you are trying to do and how you are trying to do it, you have no chance of succeeding except to rely on hope and blind luck.
4. You cannot beat the professional fund managers until you learn the skills. Invest 90% of your savings with index funds or listed investment companies with low fees and a good ten-year track record. Use diversification. Take the other 10% of your savings and buy one stock at a time. Sell it before you buy another stock. Continue until you can beat the index funds for several years AND have been through at least one bull and one bear market. Then take the savings back slowly from the managed funds and manage it yourself. Don't rush it. Read points 1, 2 and 3 again.
5. Do not borrow money to invest until you have finished step 4. Then never borrow more than about 20-30% of the value of the shares you buy. Don't be beguiled by the apparent safety of blue chip shares – get the charts of 2007-2009 and take a look at what happened to them.
6. Avoid derivatives of any kind, including CFDs until you have completed step 5. Use derivatives in place of borrowing, not in addition. Do not touch them until you have fully understood how they work, how your CFD provider's trading platform works and have paper traded them extensively.

Good luck on your journey. It will be fascinating, frustrating, but greatly satisfying. I hope I can help a little bit to steer you onto the right course from time to time. It is possible to learn it all on your own from scratch, but the journey may be safer, shorter and less frustrating if someone shows you the roadmap. That is why I write books and the website and gave public presentations on investment skills.

PS This was written before I took the decision to quit teaching. I have already stopped travelling around for speaking engagements. I am currently wrapping up the website which will be frozen as at 31.12.19 and open to anyone – free and members material behind a disclosure wall.