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Plenty of Free Advice

Fred is two years out of college, living on his own and working full time. He has been frugal and has managed to save up about $6000, which he has in a savings account at the local bank. Although the money is very safe there, it earns a pitiful rate of interest. Fred has decided to leave $1000 in the bank for easy access and open an online brokerage account with the remaining $5000. This will allow him to either leave the money in the low interest savings account provided by the brokerage, or invest it in stocks using the online tools provided by the brokerage.

Fred's father Stan is dubious about this plan, but offers advice based on his experience with his retirement accounts. He praises Fred for starting to invest early, but warns him that he must diversify his holdings across sectors. He also points out that there is a fee for every trade, so it pays to buy and hold. Stan recommends that Fred invest in a few very different stocks, and simply keep them indefinitely without making any trades. When the market dips, the solution is to wait until it (almost inevitably) recovers and rises again.

Fred has also read several books about investing online. One book in particular recommended buying only stocks that you understand. Fred liked this idea, and plans to implement it when he chooses his investments. The book also pointed out that the 15-day moving average envelope provides a useful clue when to buy and sell. A stock whose value is above this envelope is likely to be overpriced and should be sold, whereas a stock running below the envelope is likely to be a bargain and should be purchased. Fred thinks this makes sense and is willing to try it. He plans on checking the value of his stocks once a month on the first. If the stock is above the envelope he will sell it. If it is below the envelope and he has money available he will buy it. Trades cost $7 per trade (no matter how many units of stock in a particular exchange) and he figures once a month will be no problem.

Fred's buddy, Ike, plays the stock market very aggressively. He checks his stocks daily and buys or sells whenever he feels prices are too low or high, respectively. He agrees with Fred's general idea about the moving average envelope, but suggests strongly that Fred should check in far more often, say on the 1st ,7th ,14th , and 21st of each month, approximately weekly.

Confused, Fred comes to you for advice. Of course, you have your own opinions, but Fred is already so confused he doesn't want them. He wants to invest in Coca Cola, Harley Davidson, and maybe a couple more stocks. He wants to know whether he should put all his money in one stock or a combination of all four. He wants to know what is better over a one year period: buy and hold, check in monthly on the 1st and buy or sell depending on the moving average envelope, or check in weekly as Ike suggests, doing the same. You, of course, have no idea. So you offer to run an experiment. Using data from the past year on Coca Cola, Harley Davidson, and two more companies of your choice, make a spreadsheet that tracks the effect of these different strategies, starting with an investment of $5000. Of course, your personal strategy is also part of the picture, because you will decide how much to invest in each of the four companies at every decision point. Then recommend a strategy to Fred based on your research.