

Jim Cramer Tips

On Monday's "Mad Money" TV show, Jim Cramer continued filling viewers in on the methods of his madness -- all the little tricks and tools he uses to pick stocks, to know when to buy and sell, and generally to be a great investor.

He started off by giving people a "rainy day" tip for when the market is having a really bad, down day. "What you need to be looking for after a down day is buying opportunities," Cramer said. "There is no better opportunity to buy than when you find a stock that's been upgraded by some analyst on a down day."

Usually when a stock gets upgraded, it jumps higher immediately, he said. But not when that upgrade comes out on a bad day for the market. "On those days, a stock that gets upgraded isn't going higher. In fact, there's a good chance it will go lower depending on how awful the action is," Cramer said.

"And there is your opportunity -- the day after the selloff, when things have calmed down and are less negative," he said.

Another method to his madness, Cramer said, has to do with how he determines if an individual stock is truly undervalued. "People like to throw around terms like over- or undervalued," but Cramer said he has his own rule of thumb for figuring it out.

"If a stock has a price-to-earnings multiple -- remember E (the earnings) times M (the multiple) equals P (the price) -- that's lower than its growth rate, then that stock is cheap," Cramer said.

"If a company has 10% growth but trades at eight times earnings, this rule says it's cheap. If it has 10% growth and trades at 10 times earnings, it's still dirt cheap."

However, a stock with 10% growth and a 20 multiple is a stock that market players should take profits in, he said. Any stock with a multiple that's more than twice its growth rate is too expensive.

At the same time, Cramer warned viewers that like any of his methods, this one is a rough approximation. "It's useful, but it's not always right," he said. "A lot of times a stock will get cheap, based on its earnings estimates, because those estimates need to be cut."

"Plenty of inexpensive-looking stocks are actually quite pricey if the fundamentals are declining, and the earnings are going to miss the estimates," Cramer explained.

"It's the same at the top of the price range, but less dangerous: A stock that's trading with a multiple that's twice its growth rate looks expensive, but if its earnings need to be revised higher, its multiple will come down, and it has more room to run," he said.

While the market is "too dynamic" for there to be any hard and fast rules to define how the growth affects a stock's price, there are some important points that come out of the connection, he continued. "The most important is that stocks with accelerating growth,

be it sales growth or earnings growth, are worth more than stocks with decelerating growth."

Wall Street doesn't like decelerating growth, and growth funds tend to lighten up their positions when they see growth decelerating. "When you see the growth start to slow, you should sell," Cramer said.

"Even if you think the stock goes higher after the decline brought about by the deceleration, you should still sell beforehand and buy back shares later to sidestep the pain," he said.

The next method Cramer talked about was buying with "wide scales" on the way down. This method, he explained, is what he used at his hedge fund to buy declining stocks that he thought were nearing their bottoms.

Because it's "nearly impossible" to call an actual bottom in an individual stock, "the smart move is to buy incrementally on the way down," Cramer said.

With wide scales, people buy larger and larger positions as the stock goes lower, and "when it's so low you can hardly believe how poorly the stock is trading, you double down," he said.

But, he said, "be sure to leave yourself room, because when the stock bottoms, you're going to want to pour your money in."

While it's nearly impossible to call an actual bottom in a stock, there are signs that can help people know when the time is right to really "bulk up" a position, Cramer said.

Doubling Down

First, most, if not all, of the analysts who follow the stock have to downgrade it to sell, even though it's already been through a "sickening" decline.

Also, when a company gets hit with bad news or a negative rumor and the stock doesn't actually go down, it's a great sign that the stock has bottomed and that it's time to double down, he added.

Plus, significant insider buying after a huge decline is a "sure sign" that people should buy more.

At the same time, Cramer warned viewers that these things are difficult to bet on and that they don't always happen at the bottom. "That's why my best advice is still that you shouldn't try to call bottoms in individual stocks," he said.

"Instead just use wide scales as the stock falls, buying in larger and larger increments as the stock declines," he said.

Furthermore, Cramer urged viewers to look for broken stocks, not broken companies. "When we get hit with a decline of sufficient magnitude, almost everything gets knocked down, every stock gets punished," he said. "But not every stock deserves the beating."

People tend to assume that when a stock gets knocked down, the company deserves it, but this is wrong. "Plenty of great companies are unfairly sold off by investors who simply don't get it," Cramer said.

This is why investors must do their homework, he stressed. "It's not hard to tell the difference between a damaged stock and damaged goods if you've listened to the conference calls and read all the findings."

Suppose "the market is getting hammered and Cramer's nowhere to be seen," he said. At this time, the "discipline" or method that will let people take advantage of all the stocks that the market's breaking in spite of the fact that they belong to great companies is "the shopping list."

"While the selloff is happening, you put together a shopping list of stocks you like that are going down," Cramer said. "These are the stocks you've done the homework on and know belong to strong companies."

Keep an eye on these stocks as they decline, he advised. But "don't look for the biggest decliners and assume they're the cheapest and that they should be bought," Cramer said. "Most of those companies are damaged goods, and you don't want to waste your time."

In addition, don't put alleged "blue chip" names on the shopping list under the assumption that they couldn't possibly be broken companies, he pleaded. "There's no such thing as a blue chip," Cramer said.

Once people have done their homework on the stocks, differentiating between the broken stocks and the broken companies, and feel the bottom is close, "that's when you start putting on your positions in your unbroken shopping list names," he said.

Finally, "always try to sell into strength," Cramer said, but not all at once. "Sell part of your position now, but wait for some strength before you unload the rest," he said.

However, if the wait is too long and either there's no strength or you have evidence the stock will only go lower, then you can sell.