INVEST LIKE A PRO

"Tonight's show is all about teaching you to invest like a pro," Jim Cramer told viewers of his "Mad Money" TV show Friday. "There are all of these money-losing mistakes that people, who don't invest for a living, make when they try to manage their money and I want to help you avoid them."

Individual investors, "amateurs who run their own money in their spare time," can make more money in the market than the professionals, who run money as their full-time job and have trained for years to be better investors, Cramer said. But most of these individual investors will never come close to that achievement mostly because of mistakes professional investors don't make and ordinary investors make constantly.

"Tonight I'll tell you how to avoid making five mistakes amateurs make and pros don't, because learning how to invest well is much more important than getting advice about individual stocks or even groups of stocks," he said.

First, from what Cramer's seen, amateurs are almost always fully invested, "meaning that all the money in their portfolios is invested in stocks and no cash is left on the side." Professional money managers, on the other hand, always have cash in their portfolios, he said.

Market players should always want to have cash and if they don't, they need to sell something, Cramer said. "This is one of the most alien and difficult concepts for most ordinary investors to understand," he said. "Nonprofessionals think it's right to be fully invested. I'm a champion of stocks, but that's totally, 100% wrong."

People need a reserve so that they can profit from declines in the market, Cramer explained. As the market will always have pullbacks, people will always need cash. "It's there so that you can take advantage of a selloff by purchasing your favorite stocks at much lower prices," he said.

About 10% of an investor's portfolio should be cash, Cramer said. Once it's at 5% cash, "there's only one circumstance where it's right to use that cash to buy stocks" and that's when the market has taken a big hit, "a decline of at least 10% from the peak before the decline to the trough."

People can use the decline to pull out their shopping list of stocks they want to buy and pick up their favorite pieces of stock merchandise on the cheap, he said. "That 5% cash reserve is there to prepare for these truly massive declines and if you use it for anything else you'll regret it the next time the market tanks."

Moving on, the next mistake an amateur makes is that when he looks at a stock, he thinks about what his upside could be, Cramer said. Pros don't do that. They think about what their downside is. "If you take care of the downside then the upside takes care of itself," he said. "That means you need to spend a lot more time considering what you can lose in a stock than you do thinking about what you can gain."

Market players have to expect their stocks to go lower sometimes, Cramer said. Instead of clinging to their "bullish case for owning the stock," it's important for people to consider the potential downside and what protections are in place.

"A company with a big buyback is a company with a big cushion, because you know there will always be a buyer for the stock," he continued. "That limits your downside."
Dividends are so important, too. "We don't like dividends for the income they provide," he said. "The reason to be attracted to strong, increasing dividends is that they limit your downside and your downside is what you have to be thinking about."

When people are interested in buying a stock they already know the bull case for it. They know why the stock deserves to go higher and have a thesis of how that will actually happen. "There's no reason to think about upside beyond that," Cramer said. "Plenty of stocks have great upside potential, but far fewer have great downside protection."

On "Mad Money," Cramer said he takes inspiration from anywhere he can find it, even from "not-quite-classic '70s action films." Lesson No. 3 comes from *Magnum Force*, starring Clint Eastwood, he said. "In the immortal words of Clint, 'a man's got to know his own limitations.'"

Translating this to investing, Cramer explained that pros try not to invest in things they don't know or understand, while amateurs do this all the time.

"If you can't explain what a company does and how it makes its money without quoting some jargon that only an information technology expert would understand, then you shouldn't buy it," he advised viewers. "If you listen to the conference call and come away more confused than enlightened, how on earth are you supposed to know if it was a good call or a bad one?

"There will be plenty of businesses and plenty of stocks that you do understand. Buy them," Cramer said.

Fourth, while amateurs worry that they aren't making enough money, pros worry that they're making too much money, he went on. "Any schmo can make a ton of money all at once," Cramer said. "All you have to do is take on way too much risk, and that's the heart of the problem."

People need to worry about making too much money, not too little, because making too much money "is a sign that your portfolio is out of whack, that you're taking on way too much risk and that everything could fall apart for your investments at any moment," he said.

When Cramer was running his hedge fund he was "never more afraid" than when he was making huge money, he said. Market players should look at what they own and if they're "killing the averages," if they're making more money than they ever dreamed of making, then they are doing something "very wrong."

"You need to take profits immediately, start selling like there's no tomorrow, otherwise you're setting yourself up for a huge fall," Cramer said.

Finally, "amateurs try to game quarterly earnings reports to catch a quick gain," whereas professionals "learn to start living and stop worrying about the quarterly report," he said.

People, Cramer said, should never buy a stock in anticipation of a quarter. In fact, they should "actively avoid" buying right before the quarter or during earnings season in general, he said. "It's just too hard.

"On this show we talk about investing in stocks, trading stocks, speculating on stocks, but there is one thing that we absolutely never do with stocks and that is gamble because when you gamble, the house always wins," Cramer said. "Trying to guess whether or not a stock will go higher after it reports earnings -- that's gambling."

He's seen so many examples of stocks going down off of great quarters that it's taught him that people absolutely should not "game the quarterly report," he said.

"You shouldn't be making snap decisions about stocks, you should be making well-considered decisions that take a lot longer because that's how you make the... mad money," Cramer said. "It's how you stay mad for life."