

Cramer's 'Mad Money' Recap: Play by the Rules

If there's one thing I've learned in my years and years of trying to help make people money, it's that you've got to play by the rules," Jim Cramer told viewers of his "Mad Money" TV show.

Almost every time he's broken his own rules, Cramer said, he's lost money. "That's why the rules are there: They keep you disciplined and they keep you from making mistakes," he said.

In his book, Jim Cramer's *Real Money: Sane Investing in an Insane World*, Cramer laid out all the rules he played by while running money at his hedge fund.

But in the year he's spent working on his "Mad Money" TV show, he said, he's learned more about stocks than he did during the five years he spent at his hedge fund.

Therefore, he has 20 new rules for people to use in his new book, Jim Cramer's *Mad Money: Watch TV, Get Rich*. But because Cramer wants his viewers to make money and believes these new rules will help, he said he's going to dedicate his show to explaining five of the 20 rules laid out in the book.

"The new rules aren't just about being an individual investor trying to beat the market," he said. "They're about how an individual investor can understand how the big institutions work."

"There's no such thing as 'the market,' and we shouldn't reify it," Cramer went on to say. "There are just a bunch of funds that control most of the money that goes into stocks, and the guys running the funds mostly think the same way."

Rule #1

Rule No. 1 deals with "resisting the business cycle," he said. The business cycle, or the series of highs and lows the economy goes through, is usually controlled by the Federal Reserve. When it raises interest rates, "the cycle gets weaker as the economy gets strangled." And when it cuts rates, the economy gets stronger, Cramer explained.

This means that when the economy's going strong, market players should buy "the dirty, smokestack stocks that make things like machinery, cars and minerals," he

said. And when the economy weakens, people should turn away from those cyclical stocks and move into secular growth stocks like health care companies, food, drinks and consumer staples. With this new rule, Cramer's not telling people to play the cycle, because that's "intuitive." What he's saying is that people shouldn't fight it.

"You can't own cyclical stocks when the economy stinks, and you should stay away from the consumer staples when the economy's stronger," he said. "I don't care how much you like your stock, and I don't care how good it is based on the fundamentals. If it doesn't fit into where we are in the cycle, it could turn you into roadkill."

For example, Cramer said, not long ago, he owned UnitedHealth Group (UNH), for his charitable trust, Action Alerts PLUS.

He said he loved this stock as it had a "great" secular growth story, its fundamentals were "beautiful," and he thought it would be "the single biggest beneficiary of the new-at-the-time Medicare drug benefit."

However, after riding UnitedHealth up to \$63 by late December 2005, the stock sunk to \$44 and change by May. It didn't matter that the company had great growth and earnings because the first half of 2006 was a great time to own cyclical stocks as the "economy was steaming," Cramer said.

Although UnitedHealth had "one of the worst options backdating scandals," most of the stock's decline was because "people were selling it in order to buy the cyclical stocks that kick butt in a strong economy," he said.

In the end, it doesn't matter what Cramer thought of the company. "What drives a stock is what the money managers think, and the money managers obey the cycle," he said.

Rule #2

Moving on to the next rule, the analysts that cover a given sector – a group commonly referred to as the Street – are "never bullish enough on good stocks, and . . . never bearish enough on bad stocks," Cramer said. This means that market players can actually follow the Street's lead and still make money.

The reason analysts are never bullish or bearish enough is because they don't just cover individual stocks but cover an entire sector, he explained.

If you're an analyst, and you're covering the oil patch, you always need to have some buys, some holds and some sells, Cramer said. "Even if oil is in free-fall, you're under a lot of pressure to put a buy on at least one or two oil companies. You can't say everything is a buy or everything is a sell."

Although this might be "terrible" for the analysts, it's great for investors, as it means, "the Street will almost always treat a sector that's en fuego as being a lot less en fuego than it actually is," he said.

Therefore, people can make money by using this as an indicator to help get into hot sectors that will be "underappreciated even if they look like they're already smoking."

Enthusiasm Curbed

Taking a look at oil in 2003, 2004 and 2005, Cramer offered an example of how analysts were bullish but not as enthusiastic as they should have been.

"They would say things like higher oil prices were being caused by increased demand and not just tightness of supply," he said. "They would recommend oil stocks – but not every oil stock. A lot got left behind by the analysts and went up anyway."

In fact, oil stocks didn't keep going up just because oil prices kept going up. They went up because the analysts had to keep their estimates too low and had to keep sell ratings on some oil stocks that kept blowing away the analysts' estimates, Cramer said.

However, the same holds true on the negative end, he continued. Although analysts were bearish on stocks such as eBay (EBAY), Amazon (AMZN) and Lucent (LU), before these stocks had "serious declines," they should have stayed negative longer because they could have probably saved a lot of market players from the pain of the stocks' further declines.

Rule #3

Cramer's third rule pretty much means exactly what it sounds like: "Don't be a snob." It doesn't matter if people are snobs in their personal lives, he said. But if they're a snob about investing and are too busy looking at Neiman Marcus rather than Target (TGT), they could be missing "great opportunities" to make money.

"The Street will almost always be late to picking up trends in low-end or even midgrade products, because everybody on the Street lives in an upper-class bubble," Cramer said.

Therefore, even an analyst, whose job it is to cover the restaurant industry, might not understand a casual-dining play such as Darden Restaurants (DRI) as much as a higher-end stock like Morton's (MRT) or Ruth's Chris Steakhouse (RUTH), he said.

In fact, most big institutional players on Wall Street missed about a 50% gain with the big move Darden had between March 2005 and January 2006 because they were snobs and didn't want to go to Olive Garden or Red Lobster, Cramer said.

When to Believe the Hype; Rule No. 4

"Whenever a stock is being heavily shorted and heavily hyped at the same time, it's time to sell that stock," he said.

"Hype can be many things, but what I'm talking about here are analyst recommendations, celebrity endorsements, and much-touted facts in the media that don't actually mean anything for a company's bottom line," Cramer explained. To find the percentage of shares in a company that are shorted, or bet against, people can go to Yahoo! Finance, Google, or TheStreet.com, where Cramer is a shareholder and director, and look up the stock.

Stocks that are heavily shorted and heavily hyped are "dangerous," and people should think of them as "a war with two sides," he said. While on one side there are analysts who love the stock and talk it up, on the other side there are people betting a lot of money that the stock will go down.

"You don't do something as risky as shorting a stock unless you're a well-educated investor who has done his or her homework on the thing," Cramer said.

"So when all the analysts are having their lovefest with the stock, and you have an army of shorts sitting on the sidelines, you should see a red flag."

This almost always means there's some negative piece of information concerning the stock that the company and analysts are not talking about, he said. It's not inside information, but it's information that the bulls would be more comfortable ignoring.

Cramer said what happened with NutriSystem (NTRI) provides an example of what can happen with a heavily hyped stock that's loved by analysts but also has a huge short interest.

It turns out the company had a "big problem" with its distribution model, information that was not emphasized, but which the shorts knew about.

Rule #5

Cramer's fifth and final rule states that "past performance is not indicative of future success." In other words, if people have made a lot of money playing a particular trend, or by investing in a "hot industry," then their natural instinct might be to keep finding new ways to play that trend, Cramer said.

However, as "every investment is different," he urged people not to let their success to make them "overconfident" or to "feel invincible."

"Don't let the fact that one stock has made you money influence your decision to buy a similar-looking stock," Cramer stressed. "Stocks have no memory and you could lose big."

If market players follow these five rules, along with Cramer's older ones and his 15 other new ones, they should be able to make themselves some mad money, he said.