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**How Do You Identify a Winner?**

By David Miller, Chief Investment Officer and Senior Portfolio Manager, Catalyst Mutual Funds

What if you had a crystal ball and could easily pick winners in the stock market? That’s every investors’ dream.

For example, if you bought $10,000 of Adobe Systems stock back in 1987, you’d now have a portfolio worth over $6 million. But what’s the best way to identify the next winning stock like Adobe?  If you want to identify a company that’s likely to win, I recommend determining the factors that have been consistent across many of the biggest winners like Adobe historically.

Naturally, the only way a company could generate a 600x return is if it rapidly grows earnings. To generate returns of that magnitude, you need to offer a unique and compelling product or service that’s in high demand. Since stocks don’t appreciate 600x in a very short period of time, they need to regularly hit new 52-week highs to eventually generate stellar returns. The institutional ownership of the firm must grow over time as the firm scales its business.

Back in the 1950s, William O’Neil, the founder of *Investor’s Business Daily,* developed the CANSLIM methodology, which identified Adobe as a winner. It drives the selection criteria for the IBD 50 Index, which has handily beat the S&P 500 since *Investor’s Business Daily* began tracking it in 2003. What drives the strong performance for the IBD 50 Index? It’s the method it uses to identify companies likely to be big winners.

[Guys, Wikipedia identifies it as the [“CAN SLIM](https://en.wikipedia.org/wiki/CAN_SLIM)” methodology, rather than CANSLIM. What is standard usage in your circles?]

The acronym CANSLIM recognizes multiple criteria that have been consistent across companies that have historically hit home runs. It stands for:

C: Current earnings increasing quarter over quarter

A: Annual earnings increasing year over year

N: New product/service/management providing catalyst

S: Stock price moves supported with increasing volume

L: Leading stock in a leading industry

I: Institutional ownership by mutual funds increasing

M: Market positively trending

The CANSLIM methodology has stood up to the test of time. But there’s another way to boost this investment philosophy by introducing another idea.

If you found out that Tim Cook just bought $10 million of Apple stock, you might think that investing in Apple right now is a good idea. That’s because when corporate insiders start buying large amounts of their own stock, they know something. Since no outside individual could know how a company is doing better than the top executives running the firm, it makes sense to pay attention to insider buying activity. If the top executive of a company is buying his or her own stock with their own money, it’s a great indicator that good things could be in store for investors. This is known as an insider investment strategy, which follows insiders’ buying and selling decisions.

**There’s a very sound reason why stocks with insider buying tend to outperform the market.** A firm’s top executives tend to be risk-averse when it comes to buying their own company stock. They already have their pension, salary, stock options, and restricted stock tied up at their firm. So when they buy even more stock, it’s a bold statement that they believe in the future of their company. It’s an even stronger statement when you see several executives all buying in a big way at the same time. Why would an executive double down on their company stock unless they thought it had good reason to outperform the market? Also, look for purchases that are large enough to make a real impact on the executive’s personal finances.

Want an example of how heavy insider buying and a great CANSLIM rank can identify compelling investments? Let’s look at Netflix. In 2003, Barry McCarthy, the CFO of Netflix, bought $98,900 worth of stock at $1.64 per share. That investment is today worth $23 million!

Back then, if you’d employed these criteria, you could have seen that Barry was buying Netflix stock, the company was growing rapidly, and Netflix had built a superior service to Blockbuster, the incumbent at the time.

Another example: Monster Beverage, the maker of Monster Energy Drinks, created a compelling product that changed the beverage market by introducing a totally new category. Early in 2001, Kevin Douglas, an insider at the firm, recognized the significance of this trend when he purchased a stake of 20 million shares for only $.16 per share on a pre-split adjusted basis.

Today Monster Energy dominates the energy drink market, and those 20 million shares that Kevin Douglas bought back in 2001 are worth over one billion dollars. Investors could have spotted all those trades he placed if they only took the time to examine the free EDGAR SEC.gov website.

It’s public knowledge. If you check out filings made available on the Securities and Exchange Commission website, every top executive at every publicly listed U.S. company is required legally to file all their transactions of their company stock with the SEC in a maximum of 48 hours following their transactions. Studies have shown that companies subject to extreme insider buying have historically done the best.

But what about insider *selling*? It’s not that significant for an insider to sell when a company is doing well. But when insiders sell into lows, that can be a sign that there’s trouble ahead. When the CEO of a major department store sold over $7 million of his company’s shares, many interpreted that as a “Danger Ahead” sign.

So until reliable crystal balls become available on the retail market (Elon Musk, are you listening?), I suggest capturing strength fundamentals through the CANSLIM methodology—and investigating whether significant insider trading has recently taken place. The owners know best.