Secrets to Early-Stage Stock Profits
By Tyler Laundon, Chief Analyst, Cabot Early Opportunities

Secrets to Early-Stage Stock Profits

Everybody has their own system for finding great stocks to build wealth. Some are more successful than others. Many systems could work better, if only the people pushing the buttons could stick with them!

Over the years I’ve developed a system that helps me identify early-stage growth stocks that can help investors achieve their long-term investing goals.

This Special Report includes a brief overview of the system I use for both Cabot Early Opportunities and Cabot Small-Cap Confidential.

It isn’t a trading system, but it’s also not for conservative, dividend investors that want to buy and hold stocks forever. It’s for relatively aggressive and engaged growth investors that like finding that young diamond in the rough before the crowd, and are willing to do at least a little digging now, and in the future, to make sure it’s legit.

Here are 10 of the most important parts of the system I’ve come up with.

Phase 1: Idea Generating Process

The first phase of the system is the Idea Generating process. This is where I go out and look for ideas that fit my investment criteria. This is fun, exploratory work that involves a lot of software screening tools, quick chart analysis and random-walk research (tracking down creative ideas, following up on thoughts from subscribers like you, etc.).

The end goal of Phase 1 is to narrow down the investable universe of early-stage companies into bite-size chunks that I can do more research on. This phase is also the primary focus of Cabot Early Opportunities. I go out and find high potential early-stage growth stocks, and share them with you.

Find Big Ideas That are Part of Big Trends

There are a zillion trends out there that seem good. But it’s the really big and durable trends that you need exposure to for building long-term wealth. Current examples include cloud computing and personalized health care. Really big trends are so big there’s many ways to play them. That translates into lots of stocks, M&A potential and flexibility for investors to be right on the trend, but wrong on the occasional stock, and still make money.
Look for Revenue Growth Above 20%

Growth is a must-have for a young company and the more the better. Beyond the obvious that revenue growth shows demand for products and solutions, these types of companies are sure to raise capital through equity raises and convertible debt offerings to fuel their growth. The pace of that growth needs to be great enough to overcome the dilutive impact of such capital raises and keep investor confidence high. If a company is pre-revenue, there should be other metrics available that show concrete progress to a value-creating goal (i.e. favorable trial data for biotech companies, rising recoverable oil estimates for oil exploration companies, etc.).

Look for Earnings Growth Above 20%

It should also go without saying that EPS growth is necessary. Attractive early-stage growth stocks don't need to be profitable. But they do need to be trending in the right direction, even if there is the occasional quarter or year where EPS ticks down due to investments, acquisitions or other short-term reasons. Earnings growth that’s faster than revenue growth is a plus as it shows the business has leverage to increase profitability as it gets bigger.

A Strong Chart

It seems like an obvious statement to buy and own stocks that have good charts that are going up. But I still get tons of emails from subscribers wondering if an ailing stock is a “deal.” No! Sure, there are always examples of a banged-up stock that pops on an earnings report or takeover. But what are the chances you can identify these opportunities with any regularity? Life doesn't need to be that difficult. Buying on a pullback or a dip when the longer-term trendlines are still up is fine, and often a very good idea. But don’t try to be a hero and buy the proverbial falling knife. You’re just too likely to get hurt.

Phase 2: Deep Dive Analysis

Phase 2 involves much deeper and time-consuming analysis than Phase 1. This part of the system involves analysis of SEC filings, financial statements, investor presentations, conference call transcripts and things like that. The idea here is to gain a deeper understanding of each company’s market potential, business model, growth initiatives, risks, management style, etc.

In Cabot Early Opportunities, I do a first pass of Phase 2-type research to qualify the ideas. But this is an idea-generating investment advisory, not a finely-tuned portfolio of exhaustively-researched companies. The stocks that I’ve done a full deep-dive analysis on and written 10-page institutional-quality research reports for are included in Cabot Small-Cap Confidential.
Look For Companies with Good Business Models

Big Trends and Big Ideas are great. But a company is only going to start gushing cash if management has developed and implemented a rational business model to seize the opportunity. The hard part for investors is that understanding a company’s business model takes time, and not all are willing to roll up their sleeves and get a little dirty. I’ll do a lot of that work for you, but you should still tune in to what I say to make sure you “get it.”

Invest in Durable Business Models

This is part two of the above. A rational business model is essential. But it also has to provide the flexibility to allow for innovation as time and markets change. Otherwise, investors will be in for, at best, a few tough years as management retools the business, or, at worst, left holding a beat-up stock with no hopes of recovering. Thus, we want to own companies with rational business models that can evolve. These are the ones that will truly stand the test of time.

Look for Repeatable Positive Events and Catalysts

Pick any stock and you can figure out at least one potential reason for it to go up. But early-stage growth stocks that deliver long-term gains tackle value-creating initiatives over and over. Examples include new products that resonate with the market and help drive deeper, more profitable relationships with customers. Also important are acquisitions that make sense, are aligned with the business model, are integrated relatively smoothly and are a more efficient way to acquire technology and talent than building from within.

Look for the Scarcity Premium

Value investors are scared of expensive stocks. True growth investors love them. P/E of 3,000? Bring it on! When a company is young typical valuation metrics are not the right ways to evaluate it. It’s more important to look at trends in revenue and earnings growth, valuation relative to peers, valuation relative to the stock’s history and valuation measures that look far enough into the future, when the Big Idea will be more understood by the crowd (who you can sell to if and when you wish).

Phase 3: Accept Accountability, Now And In The Future

The final phase of research is easy. Just realize that it's your money, your future, and you who is punching the buy and sell buttons. The final phase closes the loop so that every investor feels accountable for the winners and losers they generate over time.
Have Your Own Opinion AND Seek Help

Investors are responsible for their own actions. You can read research reports from the best numbers guy or strategic thinker out there. But it's your cash and your future. Be a skeptic, understand that even the best companies in the world are less than perfect. Your opinion of the stock's potential is what brings the entire stock selection process full circle.

At the same time, most of us need help identifying early-stage growth opportunities, vetting them, and following along as a company matures. That's why you're subscribing to Cabot Early Opportunities. If and when you're ready to go the extra step and get my deep-dive analysis, Cabot Small-Cap Confidential will be ready for you.

Try Not to Sell Too Early

It's incredibly hard to hold on to stocks for a long-term. That's especially true when talking about early-stage growth stocks because a lot of them go through meaningful corrections, then take off again. That's why it's so important to focus on everything I've just said, from big trends to business model, to durability and scarcity premium.

No single thing defines a great early-stage growth stock; it's the sum total of many smaller things that matters, and that will give you the confidence to stick with it.
About the Expert

Tyler Laundon is chief analyst of the limited-subscription advisory, Cabot Small-Cap Confidential and grand slam advisory Cabot Early Opportunities. He has spent his entire career managing, consulting and analyzing start-up and small-cap companies. His hands-on experience has taught Tyler that the development of a superior business model is the biggest factor in determining a company’s long-term success. Accordingly, his research focuses on assessing the viability of management’s growth strategies, trends in addressable markets and achievement of major developmental milestones.

Tyler’s small-cap portfolios favor a high allocation to stable, high growth companies, upon which he layers strategic purchases of higher risk, event-driven investments. He first began publishing his analysis of small-cap opportunities in 2009. Since 2012, he has led his subscribers into 10 doubles. Between 2012 and September, 2015 his small-cap recommendations generated cumulative returns of over 2,300%, including both winners and losers, and outperformed the Russell 2000 Index by an average of 28% per year.

Prior to joining Cabot, Tyler founded and operated a small business for 15 years. He then worked as a consultant for start-up technology companies, as well as Vermont’s largest health care institution. From 2009 to 2015, he was the chief analyst of growth stocks at Wyatt Investment Research, where his research spanned the full spectrum of the growth stock universe, from micro-cap start-ups to multi-national mega-caps.

Tyler holds a B.S. and MBA from The University of Vermont, where he graduated Valedictorian. He has been a long-time contributor to the Wall Street’s Best Investments, has been quoted by U.S. News & World Report, and has presented investing ideas and strategies for The Money Show and Bloomberg Markets LiveINSIGHTS.

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