Guide to Cabot Micro-Cap Insider

By Rich Howe,
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Cabot MICRO-CAP INSIDER
Micro stocks. Maximum profits.
Dear Investor,

Thank you for joining *Cabot Micro-Cap Insider*, and welcome. I hope your membership helps you achieve your investing goals.

This guide will help you get the most out of your *Cabot Micro-Cap Insider* subscription and make your investing decisions easier and more profitable. It will also explain much of the shorthand we use in *Cabot Micro-Cap Insider* and explain our ratings.

I recommend you read it in full before you begin following our advice. If you still have any questions at the end, feel free to email me at rich@cabotwealth.com. I’m always happy to help.

*Cabot Micro-Cap Insider* is designed to help any investor who wants to maximize capital gains and is comfortable buying illiquid stocks.

Sincerely,
Rich Howe, Chief Analyst of *Cabot Micro-Cap Insider*

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The Goal of Micro Cap Investing

Simply put, the goal of micro cap investing is to earn better returns than you could elsewhere. Over the long term, investing in stocks has been a good decision. Historically, stocks have returned about 10% per year. That is an excellent result and is good enough for most people.

However, some people want to make more than 10% per year.

In order to make more than 10% a year, you have to do something different. You could concentrate on a few high conviction ideas, use leverage, or try something completely different.

My personal favorite way to achieve superior results is by investing in micro caps.

Micro caps have far and away outperformed larger stocks. From 1927 to 2016, micro caps have generated average annual returns of 25.6%.

That is an astounding number, and in an efficient market, this opportunity shouldn’t exist. If the returns for micro caps are so good, more investors should be attracted to the space which should push down the returns.

But the beauty of micro caps is that large, sophisticated investors cannot invest in them. There is not enough liquidity and the companies aren’t large enough to support the massive amounts of capital that these investors manage.

Consider Warren Buffet, the undisputed greatest investor of all time. Before he controlled Berkshire Hathaway, he ran a hedge fund for high net worth individuals. During the 13 years that Buffet managed his hedge fund he generated annual returns of 31.6% mainly because he started with a relatively small capital base ($105,100) which allowed him to invest in micro caps. When Buffett first invested in Berkshire Hathaway, it had a market cap of $18 million. When he purchased See’s Candies for $25 million, the company was effectively a micro cap.

After shutting down his hedge fund in 1969, he switched his focus to Berkshire Hathaway. From 1965 (when Buffett made his first investment in Berkshire Hathaway) to 2019, Berkshire has generated a compound annual return of 20.2% Pretty amazing, but still significantly lower than his hedge fund track record.

In recent years, Buffett’s track record has further declined. Over the past 20 years Berkshire Hathaway’s compound annual rate of growth has only been 9.1%.

Why has Buffett’s track record deteriorated?

It turns out, it’s hard to generate superior returns investing in large stocks even for the greatest investor of all.
Buffett is the first to admit it.

“The universe I can’t play in has become more attractive than the universe I can play in. I have to look for elephants. It may be that the elephants are not as attractive as the mosquitoes. But that is the universe I must live in.”

- Warren Buffett

Another Warren Buffett quote helps illustrate the opportunity in micro caps.

**Question:** According to a business week report published in 1999, you were quoted as saying: “It’s a huge structural advantage not to have a lot of money. I think I could make you 50% a year on $1 million. No, I know I could. I guarantee that.”…would you say the same thing today?

**Buffett Answer:** “Yes, I would still say the same thing today. In fact, we are still earning those types of returns on some of our smaller investments. The best decade was the 1950s; I was earning 50% plus returns with small amounts of capital. I could do the same thing today with smaller amounts. It would perhaps even be easier to make that much money in today’s environment because information is easier to access. You have to turn over a lot of rocks to find those little anomalies. You have to find the companies that are off the map – way off the map.”

Ok we’ve established that micro caps are a way to generate market crushing returns.

What are the caveats?

First, you need to be comfortable buying and holding illiquid stocks. Some stocks that we will recommend will have very limited trading volume. Don’t despair. Just use limits and slowly build your position over time.

The same advice goes for when you are selling a micro cap. If there is limited liquidity, don’t try to sell your entire position in one order. Sell your shares gradually using limits.

Second, be patient. Sometimes micro cap stocks can stay flat or drift lower for months or even years only to shoot 200% high after the company issues a press release announcing major positive news.

Third, be diversified. We recommend investing an equal amount in each recommendation. This can help smooth out the volatility that micro caps can experience.
Cabot Micro-Cap Insider Basics

How Many Recommendations

While we initially will recommend 5 micro cap names to buy, we will add a new recommendation every month and expect to ultimately recommend 20 or more micro caps for inclusion in your portfolio.

Our recommendations will generally fall into one of three buckets:

Bucket #1: Rockets

These companies have the following characteristics:
1) Cheap valuation
2) Strong earnings growth prospects
3) No or manageable debt.

The idea behind “Rockets” is that, if things go well, investors can benefit from strong earnings growth as well as valuation expansion. This can result in 100% to 1000% upside.

Expect ~65% of Cabot Micro-Cap Insider recommendations to be “Rockets”

Bucket #2: Quick Trades

While it doesn’t happen every day, corporate restructurings or spinoffs can create opportunities in which a newly created public company is undervalued for a variety of reasons. Sometimes cash on hand per share alone is worth more than the price of the stock. These opportunities tend to come and go rather fast as the market will figure out the valuation problem quickly, causing prices to snap back up to a higher valuation.

Expect ~10% of Cabot Micro-Cap Insider recommendations to be “Quick Trades”

Bucket #3: Slow and Steady

These companies don’t have the massive growth potential of the Rockets. The low liquidity tends to hold these companies back a bit, making them undervalued. They’re profitable and have net cash on their balance sheets. These can often be bought dirt cheap. Oftentimes these are stocks you can buy for less than you could liquidate the company for. The right Slow & Steady companies will grow their way up to full value over a year or two, delivering you profits of 100-200%

Expect ~25% of Cabot Micro-Cap Insider recommendations to be “Slow and Steady”

Rating System
Recommendations will be rated “buy”, “hold”, or “sell”.

For every “buy” or “sell” recommendation, I will recommend a limit to be used. For instance, “Buy XYZ up to $2.10.” Or “sell YYY at $1.90 or higher.”

The buy ranges are important because micro cap stocks are illiquid. If an investor enters a “market order” for a micro cap stock, the price could spike 100% or more to fill the order. In contrast, with a large cap stock, an investor can enter a market order without moving the price of the stock by a single penny. As a result, it’s important that subscribers use limits when buying micro cap stocks.
Getting the Most out of Cabot Microcap Insider

Your Cabot Micro-Cap Insider subscription includes monthly issues, weekly email updates, special bulletins when appropriate, and direct access to me with any questions. I recommend that you reach out to me directly at rich@cabotwealth.com with any questions.

In a typically Cabot Micro-Cap Insider issue, you can expect to see:

1) New Idea
   A new micro cap investment idea with a detailed investment case

2) Recommendation Updates
   Updates on all current recommendations. These updates will be brief, but if there is news that requires a more substantial analysis, we will publish a separate bulletin.

3) Watch List
   We will include a few names that are on our watch list and may be included as recommendations in future months.

4) Stocks Ratings
   We will provide updated ratings on all open recommendations.

You'll also receive weekly email updates from us every Wednesday (except the Wednesday the issue is published), with updates on any portfolio stocks that have news since the last update.

We may also send out special bulletins when appropriate.

Current issues, past issues, special bulletins, updates and educational resources are always available on cabotwealth.com, and if you still have questions, you can email me any time at rich@cabotwealth.com and I'll get back to you as soon as possible.

That's everything to get you well on your way in the micro cap world. So good luck, and have fun!