The Kitchen Sink

Over two decades ago, I began my journey in forensic accounting and analyzing public companies.

It's financial detective work.

I like uncovering where management teams pull the wool over investors' eyes and expose their shenanigans.

Like a criminal detective, you sometimes have to put yourself in the perps shoes.

In this case, that means playing the Chief Financial Officer (CFO) role. There's plenty of leeway within accounting rules for a CFO to take advantage of Generally Accepted Accounting Principles (GAAP).

You could drive a bus through GAAP. The rules are so broad.

When bad news for a company's prospects is inevitable, the CFO can be very aggressive by making the current period look as bad as possible while also building benefits for future periods.

This is called "throwing everything in the kitchen sink."

For example, the company could write off inventory and then sell it in a later period. The expense is in the current period, but the benefit of selling that inventory is in a later period. So, future income benefits even though nothing changed.

If you charged $250 on your credit card for an item and paid your bill but two months later decided to return the item, the credit card company reimburses your $250.

You spent $250 in June (cost) but got back $250 in August (benefit). Nothing changed, just the timing.

Same with "cookie jar reserves," which allows management to boost income by reversing those reserves later, much like reversing a credit card charge.

Why do I bring all of this up?

If prospects for companies are bleak over the next few quarters, then ***now*** is the time to throw everything into the kitchen sink. If inflation remains heated and the consumer is stretched while inventory turnover is slowing, it's time to act decisively.

Now is the time to make the June 2022 quarter look like the worst in years.

Then set the company up nicely for the future.

The worst thing a company could do is act in denial and allow a slow drip of bad news over the coming quarters.

It's much better to take a big hit now and use accounting to your advantage to benefit future quarters.

If I were a CFO staring at the abyss, I would do that. Then if my stock got hit hard, I'd have all the C-level executives buy tons of stock. I'd up all the option compensation for employees. I'd buy back stock with any excess cash flow.

And, if I hit another bump in the road, I have cookie jar reserves I can reach my hand into without having to drop another bomb on the markets in the form of bad news.

I have been thinking about the kitchen sink because Target Corp. dropped a big turd on the markets last month and came out with more bad news this week.

Now they are acting aggressively to get the excess inventory off the shelves. While I do not follow Target closely, I would not be surprised if management takes more action to set themselves up to beat expectations over the next six or eight quarters.

Target's stock is down massively from its highs. Management's recent action of blowing out the inventory and taking the hit to profit margins now may restore confidence in the stock because the bleeding is likely to stop.

Other companies may follow suit—*lots* of other companies.

We may see some big moves in stocks to the downside. But that could ultimately lead to a low.

I think this is the best situation in a long time to throw everything into the kitchen sink and ride a wave higher from here.

If I were the CFO of a major company, I would be very aggressive in here kitchen sinking the whole business.

You have to hold your nose and have the guts to do it, though.

We will see who has the guts.

“Hope” is a four-letter word.

Hoping things get better is not a strategy.

Things may get worse, so now is the time to take action.

The other day I went to Costco, and about a mile from the warehouse, I looked at my gas gauge, and it was half full, so I decided to fill up. The line was the longest I have ever seen.

While I am too young to remember the lines of the 1970s, it reminded me of pictures I have seen.

Costco is efficient, so the line moved but extended *way* beyond the gas station.

Then I entered the warehouse, and the check-out line extended to the back.

The line was by far the worst I have seen.

Previously the worst line I had been in was when I got the stupid idea of going to Costco on Christmas Eve. That was tense as fights were about the breakout, and tempers were flaring.

It was calm this week, but I started thinking while I was in line that people are hurting and loading up *before* prices go up even more.

While standing in line, I thought about something I had not seen reported or analyzed anywhere else.

On the day I went to Costco, the LIV Golf Series was playing its first-ever round of golf.

Saudi Arabia backs LIV.

President Biden is about to go to Saudi Arabia and beg for oil. The Saudis have been shunning Biden since Day One.

I think they will blow off his request and inflict more pain.

Why?

LIV Golf is playing eight events this year. Two of those events are at courses owned by Donald Trump.

I could see the Saudis, who already do not like Biden, making his life more difficult given that they already have a huge business partnership with Trump. Trump’s son-in-law raised $2 billion from Saudi Arabia to start a private equity fund.

Why would the Saudis throw Biden a bone? I could be wrong, and there could be other factors at play behind the scenes, but the Saudis are Trump supporters.

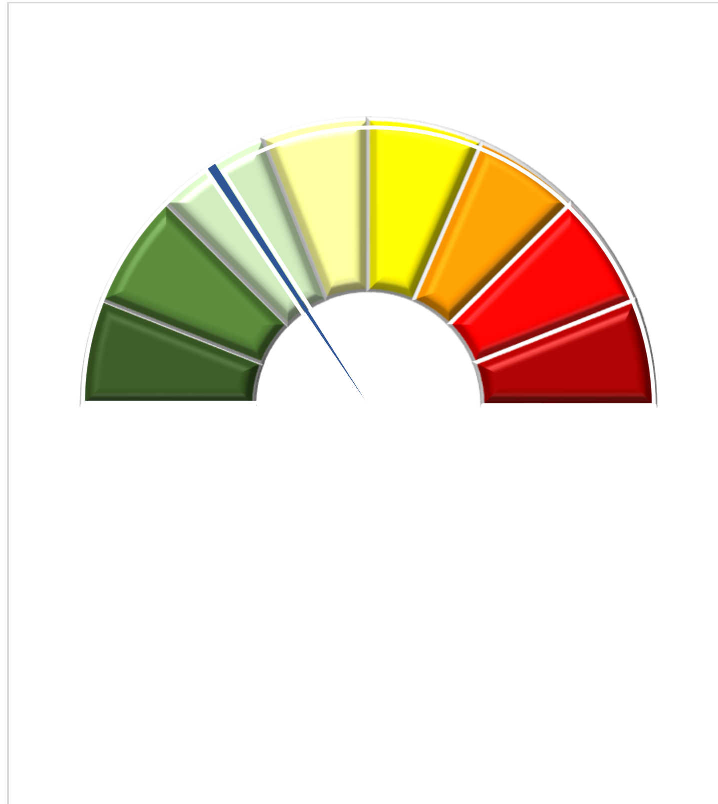
That could mean more pain at the pump for all of us.

The *Risk-O-Meter* is back in the green zone.

Despite some pressure late last week, the market is not deeply oversold and is still in no-mans-land.

I do not see an edge in any particular direction, so I continue to sit tight.

If the *Risk-O-Meter* status in the green zone and the market gets deeply oversold, I'll be more aggressive in buying stock than I was a couple of weeks ago. Of course, I'll report on what I am doing in future issues of this newsletter.



New Research and Model

As I noted in a few past issues, I have been working on a model that trades leveraged exchange-traded funds. Today, I wanted to share that model with you.

First, a little background…

My first job in the investment arena was with James P. O'Shaughnessy. He wrote a book called *What Works on Wall Street* (WWWS). WWWS is often on the top 20 lists of the most important investment books of the 20th century.

It's a fascinating book because, at the time of the first edition, O'Shaughnessy had data no one else had. He had S&P data back to 1950. As a result, he was able to conduct groundbreaking research.

Today, he manages billions of dollars for institutions.

I was his first intern. I was not the type of intern that made coffee or Xerox copies. Rather, I wrote computer code and created models. I remember I had access to a 1-gigabyte computer. This was the Cadillac of computers. It cost $10,000.

Today, your coffee machine probably has more computing power than that 1-gigabyte computer!

Then I started my career on Wall Street with a massive mutual fund company. I was in the quantitative research department, and I built a model for emerging market stocks that was implemented into what became a 5-star Morningstar fund.

I was not the fund manager, so I didn't get any credit. But I don't care. I was underappreciated and quit on my birthday (my birthday present to myself). My abrupt departure sent the CEO of the division to the hospital for a few days due to stress-related issues.

I didn’t mean to send him to the hospital. I wasn’t trying to kill him. But, what can you do?

Many years later, I developed the Forensic Accounting Stock Tracker, which was well on its way to becoming a global research product for one of the largest European banks until the firm fired its entire U.S. staff.

That's the exact product you get as part of your subscription to this newsletter.

That’s a brief history of my background in quantitative investing. It’s important to test strategies properly, and I am concerned there’s too many newsletters out there where the publisher throws a bunch of stuff at the wall and then tries to market whatever sticks.

That’s not the professional way of doing things.

I have been trading a levered ETF model I created for a while now. While trends were favorable, I did very well. However, 2022 has been challenging due to volatility and downward pressure on stocks (I do not short stock indexes in this model).

I made a couple of simple tweaks and now plan to invest more aggressively using the strategy. As a result, I wanted to share it with you.

Before I share the details, I wanted to share my thoughts on general research.

First, this strategy I am releasing today would never see the light of day at a major newsletter publisher. The main reason is that marketing people, not investors, lead major newsletter publishers.

The first problem that the marketing folks would have is that my strategy has historically generated a profitable month about 67% of the time and beat both major benchmarks 55% of the time.

They want 90% winners.

Of course, 90% winners are for losers. When you have a 90% winning strategy based on historical data, the researcher fits the system to the historical data. History is history. The future will not play out the same. Therefore, models developed and "fit" to historical data have practically no chance of winning in the future.

It’s unrealistic and scammy marketing. If you see a 90% winning strategy promotion, run for the hills!

Conversely, a 55% edge is enormous. If you played blackjack for a living, did not count cards, but somehow had a 55% edge on the house, you would be the wealthiest blackjack player in history.

I’m not a scam marketer. I’m focused on helping people reach their financial goals. Most importantly, I will be allocating money to this strategy.

To put my investment in perspective, I anticipate that I will have 10x the amount invested in the *Investable Risk-O-Meter* that I would for a levered ETF strategy.

In my life, I tend to avoid leverage. My Dad was old-school Italian American. He paid cash for *everything*. He was OK with a mortgage but advised you never to get over your skis. Hanging around my Dad and his buddies taught me a lot. I have never paid a dime of interest for anything other than my first mortgage.

Also, leverage works until it doesn't. Leverage can be a tool, but if you get greedy, you will come out with the short end of the stick.

That said, I have traded currencies profitably. I cannot think of a market with more leverage. You can lever your dough up to 400-1.

The problem is that you may have a heart attack monitoring your positions with massive trades on.

Another reason this strategy would not see the light of day at another newsletter because you will not make 1,000% returns overnight.

No day trading in your underpants with this strategy.

My strategy trades once a month. There's not enough action to make it sexy for newsletter marketing.

I don't care about being sexy or having 90%-win rates. I care about profitable investing.

Trading once a month allows me to do other things in life that I enjoy doing, such as skiing, playing golf, doing home projects, or taking my doggy for hikes.

I mentioned a few weeks ago that the strategy I was trading had a historical return of 1,008% over the past ten years.

After reading a lot to come up with news ideas and letting things marinate in my brain for a bit, I made minor tweaks that jumped the return to 1,868%.

Because I added a few markets and was able to extend the timeframe back a bit, the total return since 2003 is 2,962%.

I did not fit the model to historical data. Instead, I leaned on my experiences in quantitative investing in creating something better than what I had, which has a fighting chance of being a viable strategy in the future.

The changes I made are simple ones that you will find will be extremely helpful if you create your investing strategies.

First, the strategy is built around trend following. Trends persist all over life. Trend following works. It does not work every day, week, month, or year. But it works.

Rather than analyze the markets directly, like measuring the performance of the S&P, I look at trends in other markets and infer how those trends may impact stock prices.

For example, I measure trends in the credit market, such as junk bonds and U.S. bonds, and depending on how those markets are trading, I either own stocks or are out of the stock market.

The first change I made was to apply this strategy across six different trend relationships (up from one market initially). I look at credit markets, volatility, and sentiment.

I then measure the trends over more than one timeframe. The most common moving average is the 200-day moving average. Having one moving average longer and one shorter, helped *a lot*.

The last change I made is adding a few more potential ETFs into the mix rather than just one ETF to own in uptrends and one to hold in downtrends.

To sum it up:

Trade in the direction of the trend over multiple strategies, with a portfolio of different markets to own, and do it across multiple time frames.

Also, do not focus on the win percentage rate and pay close attention to risk.

Risk is the most crucial factor because if you cannot handle the volatility and losses, you will not stick with the strategy over time.

OK, enough blabbering!

Here's the results!

Total Return	
Strategy	2962%
Global 60/40 Benchmark	268%
S&P 500	560%
Strategy	
Percent Winning Months	67.1%
Percent Losing Months	32.9%
Average Winning Month	4.3%
Average Losing Month	-3.4%
Median Winning Month	2.6%
Median Losing Month	-2.4%
Largest Drawdown	17.53%
Time to a New High	20 Months
Benchmark Drawdown	35.40%
S&P 500 Drawdown	55.20%
Strategy vs. S&P 500	
Percent Winning Months	55.34%
Percent Losing Months	44.66%
Average Outperformance	4.88%
Average Underperformance	-3.78%
Strategy vs. Global 60/40 Benchmark	
Percent Winning Months	54.70%
Percent Losing Months	45.30%

The strategy handily outpaces the standard 60 / 40 stock / bond benchmark by about 10x and the S&P 500 by about 5x.

The most important factor is that the draw down (the percent loss before a new high is made) is 17.5%. That compares with 55% for stocks and 35% for the stock / bond mix.

Lower draw downs are easier to recover from. They are also easier to deal with psychologically.

The strategy took 20 months to recover that loss. It often takes many years for stocks to recover from a bear market.

I will be talk more about the strategy in future issues of this newsletter as I review the markets.

Year to date the strategy is down 13.9%.

That compares with -15.1% for the global 60/40 benchmark and -17.7% for the S&P 500.

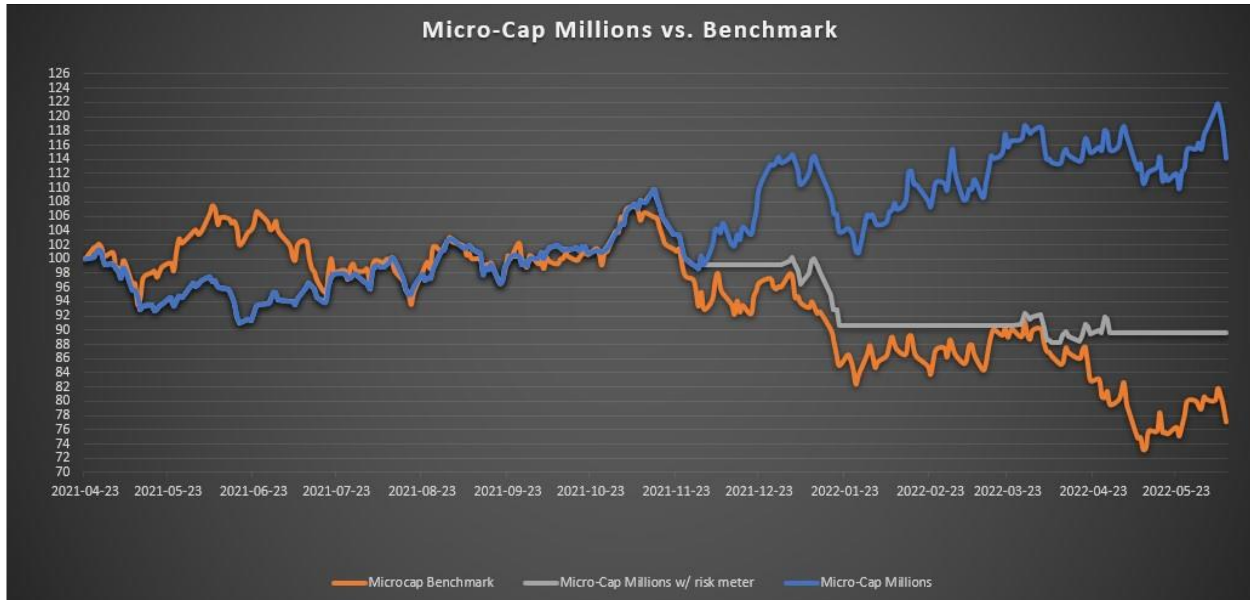
For a strategy that uses 200% leverage, I'll take that. 2022 has been a very challenging year so far.

Currently, the portfolio is 100% in cash. That makes it a good time talk about it in the newsletter without having to rush into a bunch of trades.

Wherever the low ends up in the market, the rebound is likely to be tremendous. Once trends reassert themselves to the upside, the potential exists for epic performance.

Right now, the strategy is sitting and waiting for that opportunity to capitalize.

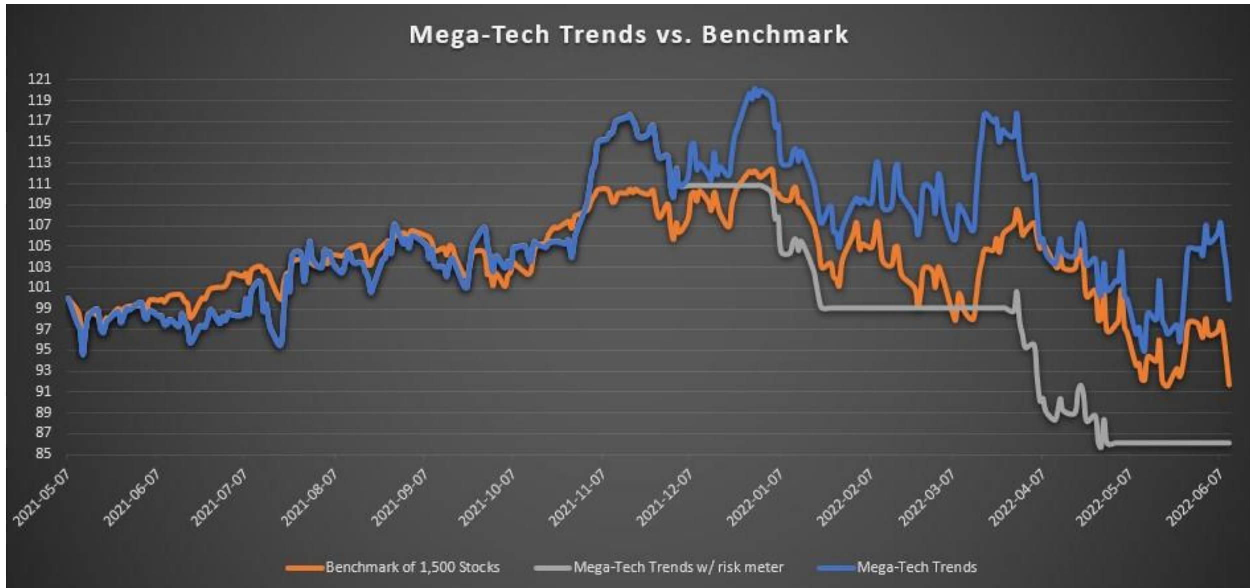
Micro-Cap Millions



No trades this week. Here is the current portfolio:

Ticker	Name	Return	Days Held	Sector
CPHC	Canterbury Park Holding Corp	-0.17%	60	Consumer Services
CTG	Computer Task Group Inc	2.56%	4	Technology
HCKT	Hackett Group Inc (The)	-7.53%	81	Technology
HSON	Hudson Global Inc	19.23%	108	Business Services
NL	NL Industries Inc.	16.71%	18	Non-Energy Materials
QIPT	Quipt Home Medical Corp	2.28%	4	Healthcare
RGP	Resources Connection Inc	10.86%	32	Business Services
SCSC	ScanSource Inc	-5.61%	11	Technology
WSTG	Wayside Technology Group	-12.99%	18	Technology
ZDGE	Zedge Inc	-9.66%	11	Technology

Mega-Tech Trends



There are two trades this week.

Buy Concentrix Corp. (Nasdaq: CNXC) and Cirrus Logic, Inc. (Nasdaq: CRUS)

Sell Axcelis Technologies, Inc. (Nasdaq: ACLS) and Jabil, Inc. (NYSE: JBL)

Here is the current portfolio:

Ticker	Name	Return	Days Held	Sector
CDW	CDW Corp	4.46%	18	Technology
CNXC	Concentrix Corp	0.00%	new	Technology
CRUS	Cirrus Logic Inc.	0.00%	new	Technology
CTS	CTS Corp	2.37%	18	Consumer Cyclicals
DIOD	Diodes Inc	-5.40%	4	Technology
HOLX	Hologic Inc	-2.46%	207	Healthcare
KFY	Korn Ferry	-23.28%	172	Business Services
LFUS	Littelfuse Inc	-1.34%	25	Technology
PLAB	Photronics Inc	24.49%	88	Technology
SCSC	ScanSource Inc	-5.17%	4	Technology

Large-Cap Leaders

There is one trade this week.

Buy Merck & Co, Inc. (NYSE: MRK)

Sell Microchip Technology (Nasdaq: MCHP)

Here is the current portfolio:

Ticker	Name	Return	Days Held	Sector
ADI	Analog Devices Inc	-6.34%	11	Technology
AMD	Advanced Micro Devices Inc	-0.55%	32	Technology
APH	Amphenol Corp	-14.23%	123	Technology
CDNS	Cadence Design Systems Inc	-3.61%	95	Technology
CDW	CDW Corp	-1.92%	32	Technology
HOLX	Hologic Inc	-3.21%	32	Healthcare
HUM	Humana Inc.	-0.08%	39	Healthcare
IT	Gartner Inc	-3.08%	25	Technology
MRK	Merck & Co Inc	0.00%	new	Healthcare
SNPS	Synopsys Inc	-6.80%	4	Technology

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