



Micro-cap Recap

With John Del Vecchio

September 29, 2022

Long-time readers are familiar with one of our partners, John Del Vecchio. John is a forensic accountant who has developed several ways to identify great opportunities as well as outsized risks in the markets. While John's current services are closed to new subscribers, we thought it would be beneficial for our readers to see what he has been up to and how they have worked out over the past few years. – Rodney

Making and Saving Money When the Markets Are Crazy

By John Del Vecchio

A rising tide does not lift all boats, and a hurricane will not sink every ship. Recently, the stock market has been a hurricane, and the selling pressure has been *unrelenting*. All major asset classes have taken it on the chin.

However, one strategy has outshone all of the others. This strategy has several advantages, and I am confident that when stocks bounce back and a new bull market emerges, this strategy will continue to perform strongly. That strategy is investing in micro-cap stocks.

Micro-caps are by definition tiny. As a result, they fly under the radar of major traders and large-asset managers. Massive institutional investors often are *prohibited* from buying micro-cap stocks. They can own only so much of a company's share count and cannot exert control over the business. This provides a significant advantage to nimble individual investors, folks like you and me.

The return potential is substantial. After all, many of today's most prominent companies were once relatively tiny. Think Amazon, Apple, or Tesla. These stocks traded for years and

racked up huge gains *before* the big guys could jump on the train and push their market values into the stratosphere. However, not all micro-caps are created equal.

That's where a strategy I developed comes in. It's called *Micro-cap Millions*.

In this strategy, the first rule is that "Quality is the thing"—specifically, earnings quality. I have been performing forensic analysis of financial statements for nearly 23 years. Think of it as stock detective work. I seek out the spots where management is pulling the wool over investors' eyes and sticking lipstick on a pig, as far as the numbers are concerned.

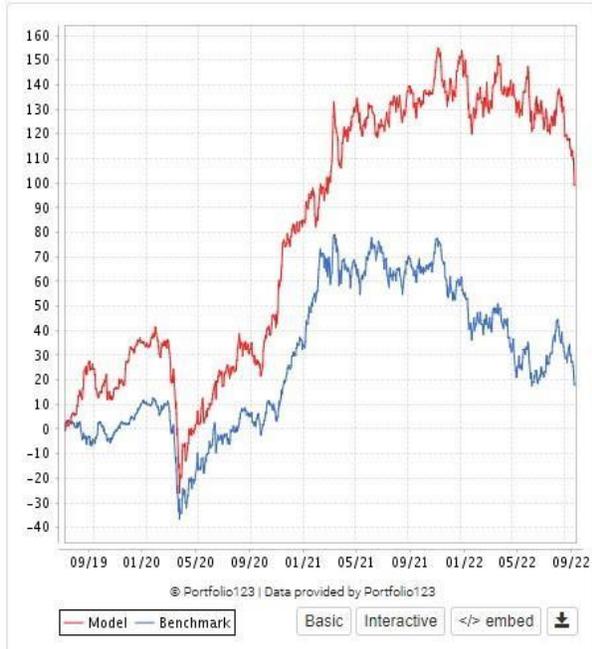
I've developed many metrics and techniques that allow me to identify companies generating quality revenue and delivering honest and repeatable earnings, not manipulating margins through accounting shenanigans. I want to separate the wheat from the chaff. This will be even more important when the next bull market emerges, because investors will have been badly burned by [story](#) and [meme](#) stocks that were all hot air and no substance.

The second rule is that "The trend is your friend"—momentum matters. There are plenty of studies going back decades that show following trends results in higher returns *over time*, which is why I've created some unique momentum indicators to identify trends.

The third rule is "Respect risk." Don't hang on to loser stocks for too long, hoping that the tide will turn. Hope is a four-letter word. Admit you're wrong. Get out. This is trading; there's no room for emotions. Success requires ruthlessness.

Even while the market has been imploding, these techniques have held up.

I created the strategy in June 2019. Below are the results since then... but they don't tell the whole story.



General Info

Total Market Value (inc. Cash)	1,992,129.48
Cash	1,297.67
Number of Positions	10
Last Trades	NA
Period	06/24/19 - 09/26/22
Sizing Method	% Portfolio Weight
Last Rebalanced (Every Week)	09/26/22
Benchmark	Russell Micro (IWC:USA)
Universe	United States (Incl. Foreign Primary)
Ranking System	Strategic Profits

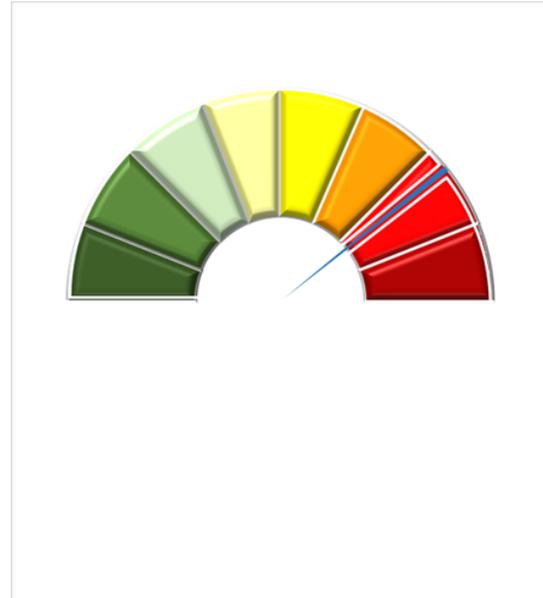
Quick Stats as of 9/26/2022

Total Return	99.21%
Benchmark Return	18.07%
Active Return	81.14%
Annualized Return	23.56%
Annual Turnover	320.54%
Max Drawdown	-47.71%
Benchmark Max Drawdown	-43.57%
Overall Winners	(74/127) 58.00%
Sharpe Ratio	1.07
Correlation with Russell Micro (IWC:USA)	0.67

The return on the strategy has been 99.2%, compared with 18.1% for the benchmark. Meanwhile, drawdowns, the peak-to-trough losses, are 47.7% for the strategy and 43.6% for the benchmark.

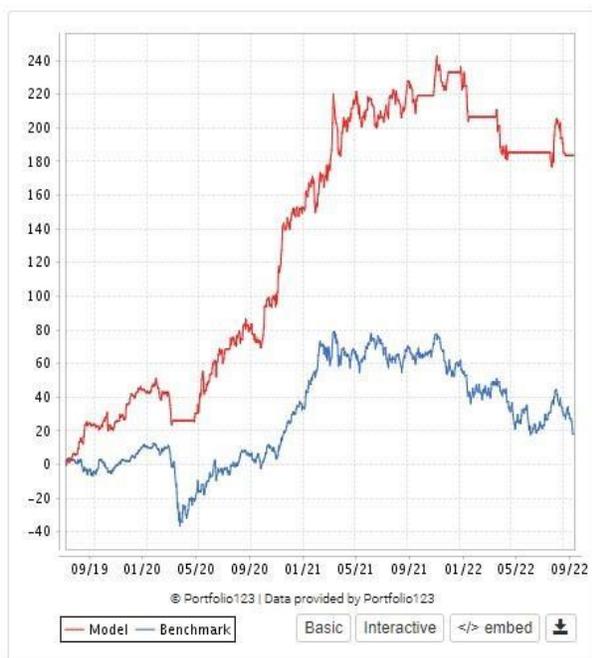
In other words, the strategy provides much-higher returns for about the same amount of risk. That's great! But with my indicators, I take it a step further. I use my proprietary *Risk-O-Meter* to measure the risks in the market, including stock and bond market trends, investor sentiment, and market breadth. The *Risk-O-Meter* basically gives me a green light or a red light on the markets.

It's like the temperature gauge in your car: It's best not to go heavy on the gas pedal if the temperature already is hot.



The *Risk-O-Meter* is a powerful guide. Adding it to the micro-cap strategy almost doubles the returns, which go to 183.7%, compared with 18.1% for the benchmark. What's more, the drawdown for the strategy falls to 19.2%. We should all be looking to double the returns while cutting the risk in half, because earning high returns with low risk is basically the Holy Grail of the markets.

I accomplish this by getting out of the markets when the risk is too high. As you can see in the chart below, the *Risk-O-Meter* has kept the *Micro-Millions* strategy on the sidelines for most of this year, and it is still in cash today. This brings up a fourth rule: “Stick with the strategy.” This can be hard when the markets are having a great day, but it will seem like a good idea when they fall in a hole—which they always do, eventually—and yet you keep your shirt.



General Info

Total Market Value (inc. Cash)	2,836,464.37
Cash	2,836,464.37
Number of Positions	0
Last Trades	NA
Period	06/24/19 - 09/26/22
Sizing Method	% Portfolio Weight
Last Rebalanced (Every Week)	09/26/22
Benchmark	Russell Micro (IWC:USA)
Universe	United States (Incl. Foreign Primary)
Ranking System	Strategic Profits

Quick Stats as of 9/26/2022

Total Return	183.65%
Benchmark Return	18.07%
Active Return	165.58%
Annualized Return	37.71%
Annual Turnover	369.45%
Max Drawdown	-19.18%
Benchmark Max Drawdown	-43.57%
Overall Winners	(89/146) 60.00%
Sharpe Ratio	1.63
Correlation with Russell Micro (IWC:USA)	0.49

If you want to have a fighting chance of beating the big boys on Wall Street, you will have to focus on stocks under the radar. Remember to follow these rules:

- Demand quality earnings and clean accounting.
- Follow the trend until the end when it bends.
- Respect risk.
- Stick with the strategy through thick and thin and through hell and high water.

That is a receipt for success!