

Searching for Quality in Small-Cap Stocks

11 September 2021

by Doug Gerlach, gerlach@iclub.com

Searching for Quality in Small-Cap Stocks

SEPTEMBER 2021



Douglas Gerlach

President, ICLUBcentral Inc.

Editor-in-Chief,
SmallCap Informer &
Investor Advisory Service



USE CHAT BOX TO ASK QUESTIONS.

OR EMAIL ME AT GERLACH@ICLUB.COM

About Our Newsletters



3

About the *Investor Advisory Service*



- Newsletter started in 1973 to address needs of BetterInvesting members for quality, growth stock ideas.
- Published monthly w/3 stock recommendations each month w/completed SSGs.
- Covers large, mid, small companies.
- Named to **Hulbert Investment Newsletter Honor Roll** for 11th Consecutive Year in 2020.
- For more: www.InvestorAdvisoryService.com

4

Searching for Quality in Small-Cap Stocks

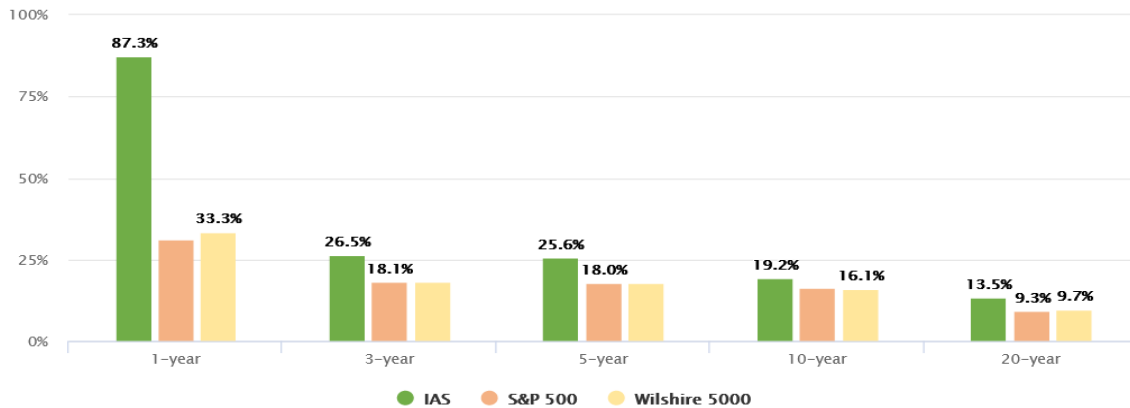
11 September 2021

by Doug Gerlach, gerlach@iclub.com

IAS Performance vs. Market



As of 8/31/2021



About the *SmallCap Informer*



- Started in 2012 to address need of investors to find smaller companies that fit long-term portfolios.
- Published monthly with 2 small/mid-sized stock picks w/Stock Studies.
- Tracks previous picks until sale is recommended.
- For more: www.SmallCapInformer.com

Searching for Quality in Small-Cap Stocks

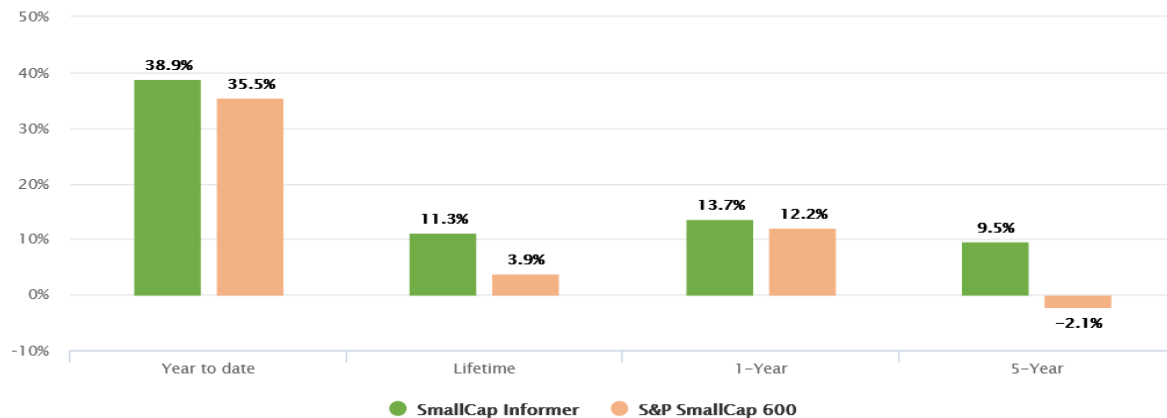
11 September 2021

by Doug Gerlach, gerlach@iclub.com

CAR of *SmallCap Informer* vs. Market



As of 9/1/2021



Our Investing Methodology



- **Concentrated on Stocks:** Cover equities exclusively.
- **Focused on Long-term:** Aim for minimum 5-year holding period.
 - Holding through market & economic cycles eliminates risk of selling low & buying high.
- **Grounded in Fundamentals:** Review key of metrics using Quality & Growth At a Reasonable Price (Q-GARP) techniques.
- **Diversified by Industry:** Hold stocks from many sectors & industries.

Searching for Quality in Small-Cap Stocks

11 September 2021

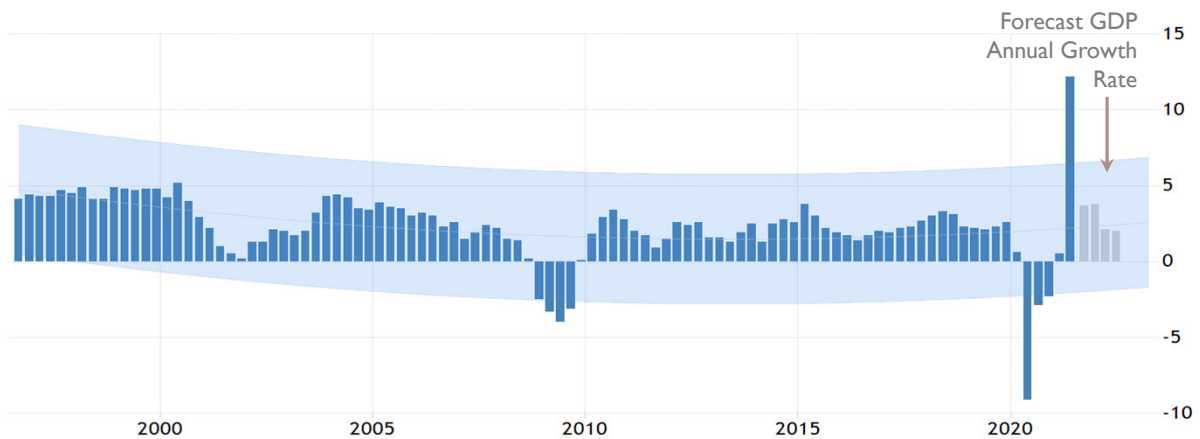
by Doug Gerlach, gerlach@iclub.com

Where We Are Now IN THE ECONOMY



9

Economy Has & Will Continue to Improve



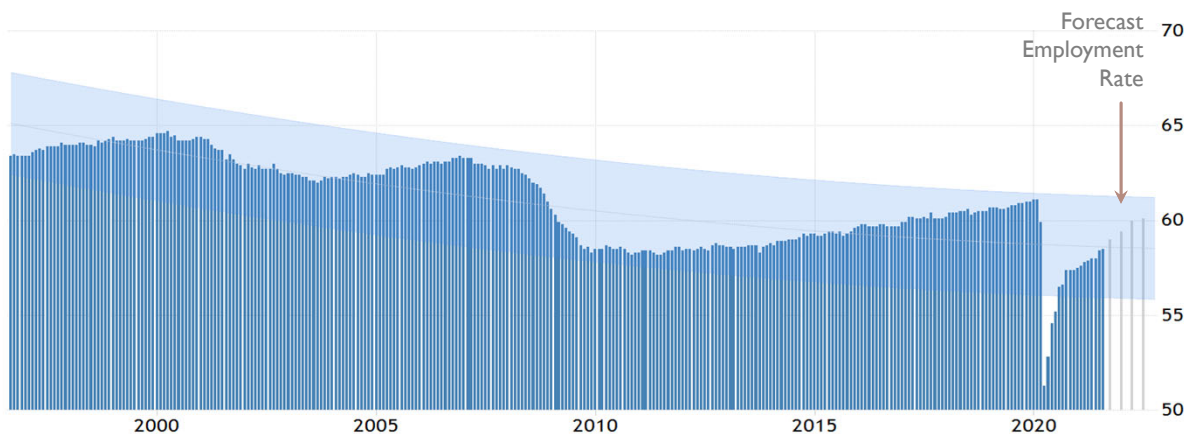
SOURCE: TRADEGEOMICS.COM | U.S. BUREAU OF ECONOMIC ANALYSIS

Searching for Quality in Small-Cap Stocks

11 September 2021

by Doug Gerlach, gerlach@iclub.com

Employment Rate Is Rising...Slowly



SOURCE: TRADINGECONOMICS.COM | U.S. BUREAU OF LABOR STATISTICS

My Economic Outlook for 2021 & 2022



- Vaccine hesitancy has allowed pandemic to enter new phase.
 - Delta & further variants are new wildcards.
- Recovery remains bifurcated with some segments at pre-pandemic levels & some segments to take much longer to rebound.
- “New normal” economy may inhibit full recovery of spending, travel, & employment (despite early eagerness of some consumers).
- Labor shortages will improve through year-end, but pressures will remain.
- Overall market volatility will increase as # of economic unknowns continue.

12

Searching for Quality in Small-Cap Stocks

11 September 2021

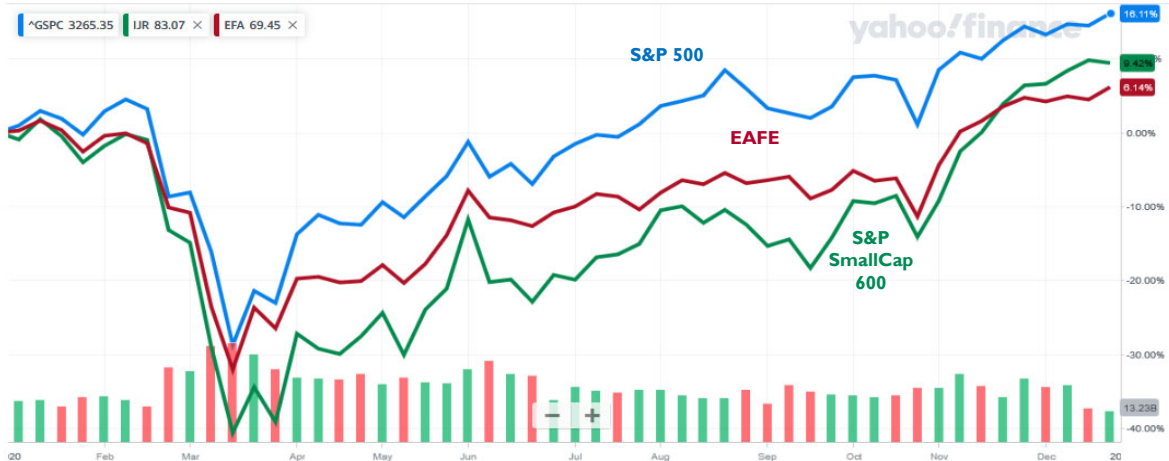
by Doug Gerlach, gerlach@iclub.com

Where We Are Now IN THE MARKETS



13

Recap: 2020 Market Performance

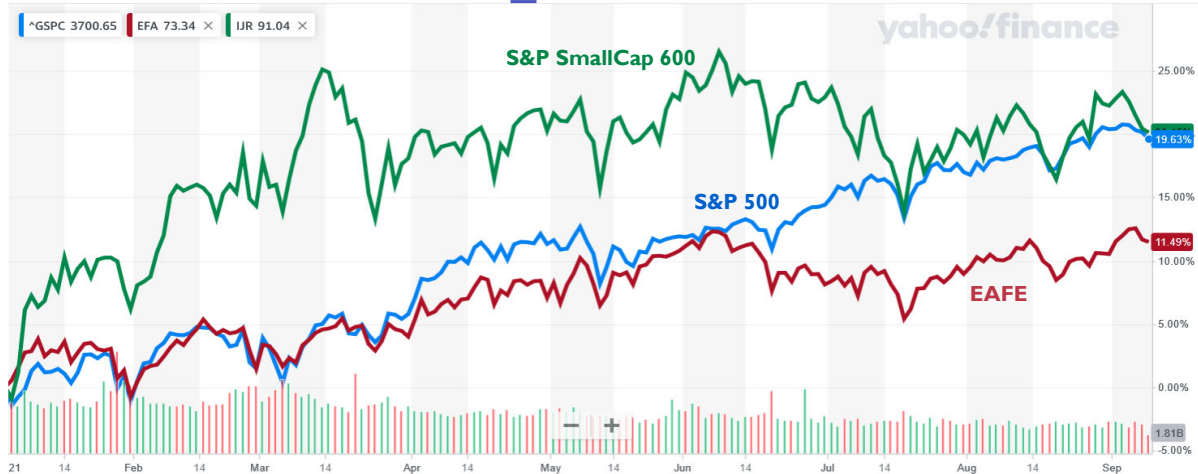


Searching for Quality in Small-Cap Stocks

11 September 2021

by Doug Gerlach, gerlach@iclub.com

2021 Market Performance YTD



6 Takeaways on 2020 & 2021



1. Companies in many sectors held steady or benefited from pandemic-induced trends (work-from-home, social lockdowns, e-commerce, low interest rates).
2. Bifurcated impact of pandemic & stimulus payments left many service & white-collar workers able to save & invest greater amounts.
3. Low interest rates & demographic trends supported housing growth.
4. Low interest rates & bond returns continue to support demand for stocks.
5. Large-caps outperformed in 2020 (as they did every year since 2015) as investors perceive they didn't need to "trade down" for performance.
6. Small-caps led first half of 2021 as they often do following bear markets.

16

Where We Are Headed



17

My Market Outlook for 2021 & 2022



- Chance of significant broad-market correction is moderately high.
- Large-caps are significantly overvalued.
 - Downside risk is considerable.
 - Consider using TSLO to protect gains in current holdings.
- COVID-affected industries still have long roads to recovery:
 - Airlines, cruise, travel, entertainment, oil & gas, hotels, sit-down restaurants, movie theaters, large financials, commercial & retail real estate, automotive.

18

Searching for Quality in Small-Cap Stocks

11 September 2021

by Doug Gerlach, gerlach@iclub.com

Large-Caps Currently Have Large Downside



Market Cap to GDP Ratio (aka "Buffet Indicator")
1970-2021 using Wilshire 5000



As of 7/30/2021

Source: LongTermTrends.net

19

Beneficiaries of Pandemic Recovery



- Some companies are delivering results or have good potential in "new normal" economy:
 - Homebuilders, mortgage finance, RVs, robotics, IT solutions (especially remote work products & services), infrastructure.
- Some companies could benefit from recession/pandemic-related/inflation concerns:
 - Gold mining, discount stores, healthcare.

20

Consider Your Timeframe



- Despite expectation of several years until economy fully recovers, some companies may take longer & others will recover sooner.
- Be careful buying companies in distressed industries as payback may be too long in coming.
 - Being “right” may not be profitable if you are too soon.

21

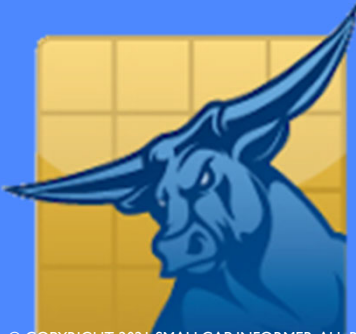
Long-Term Economic & Market Outlook



- Our focus when making investment decisions largely focuses on where markets & U.S. economy will be by 2026.
- We don't try to time market's near-term direction.
 - We look for best opportunities in every market & always remain fully invested in stocks.
- What happens in near-term is for others to worry about.
 - Control what you can, don't sweat what you cannot.

22

Questions?



© COPYRIGHT 2021 SMALLCAP INFORMER. ALL RIGHTS RESERVED.

23

Why Invest in Small & Midsized Companies?



24

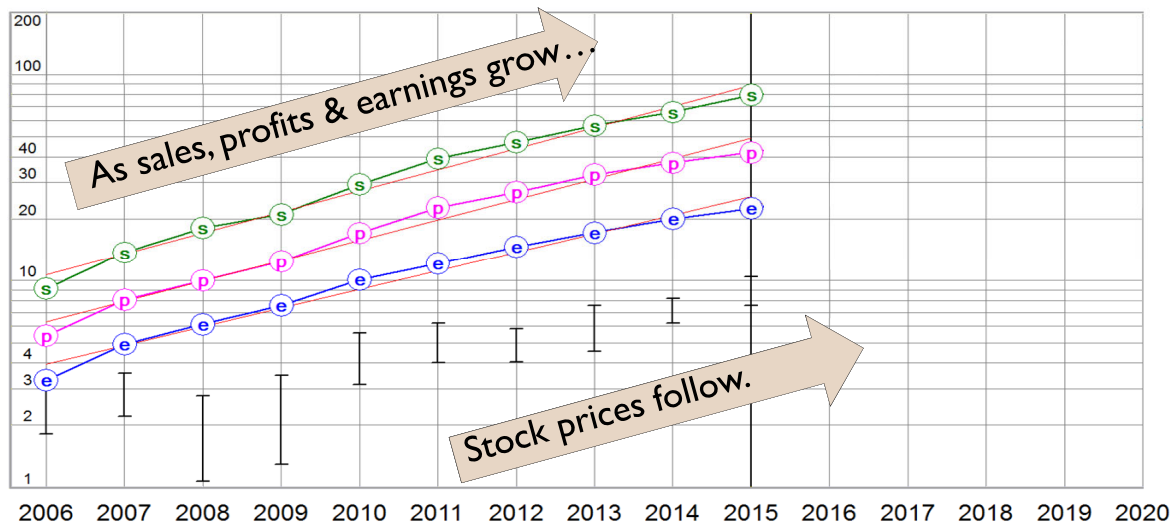
Company Growth is Key to Growth Stock Approach



**Companies that grow
revenues & earnings will see
share prices increase over
time.**

25

Growth of Company Drives Stock Prices



Searching for Quality in Small-Cap Stocks

11 September 2021

by Doug Gerlach, gerlach@iclub.com

Smaller Companies Can Deliver Higher Growth



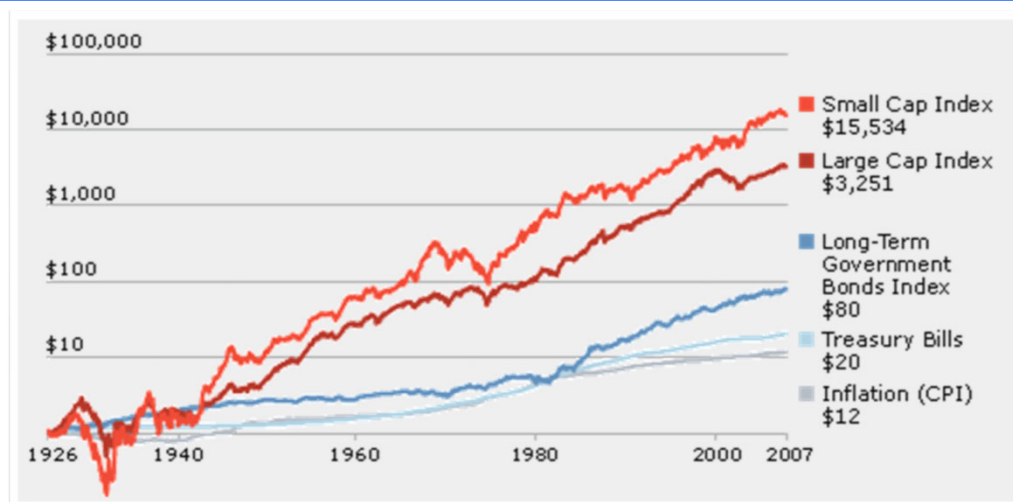
Life Cycle of a Successful Company



Growth slows as companies mature.

27

Small-Caps Outperform Over Time

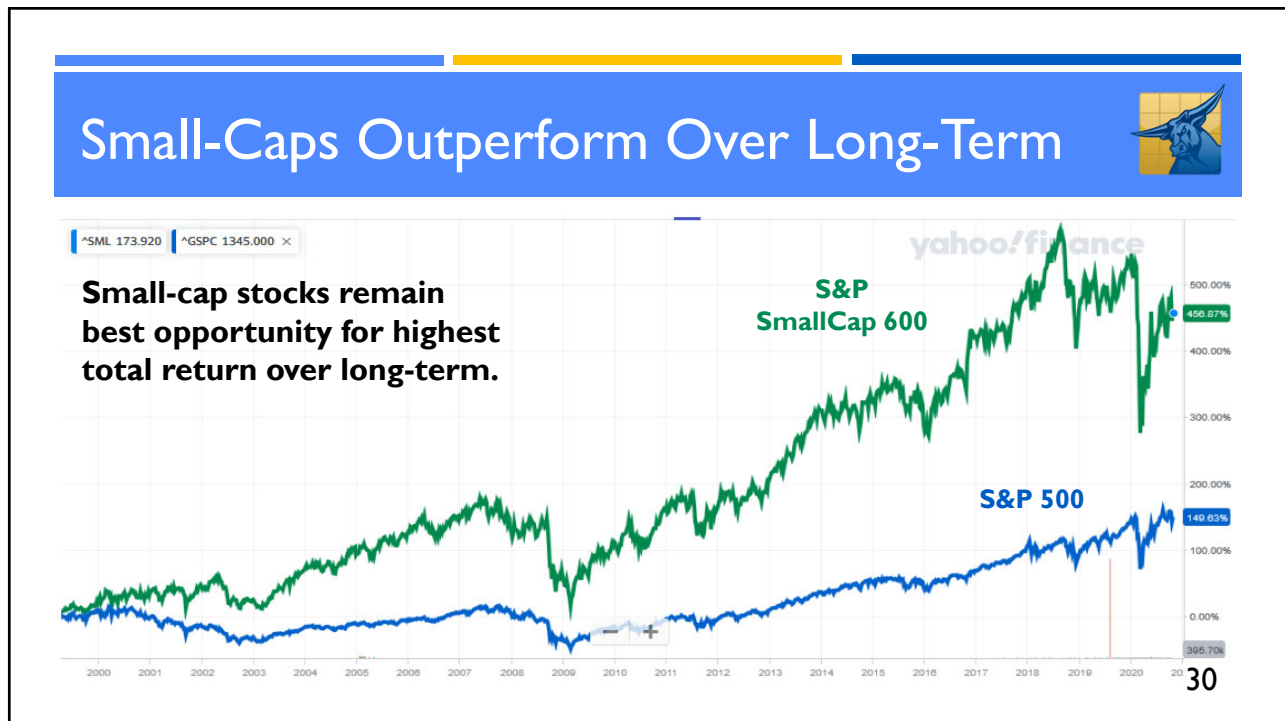
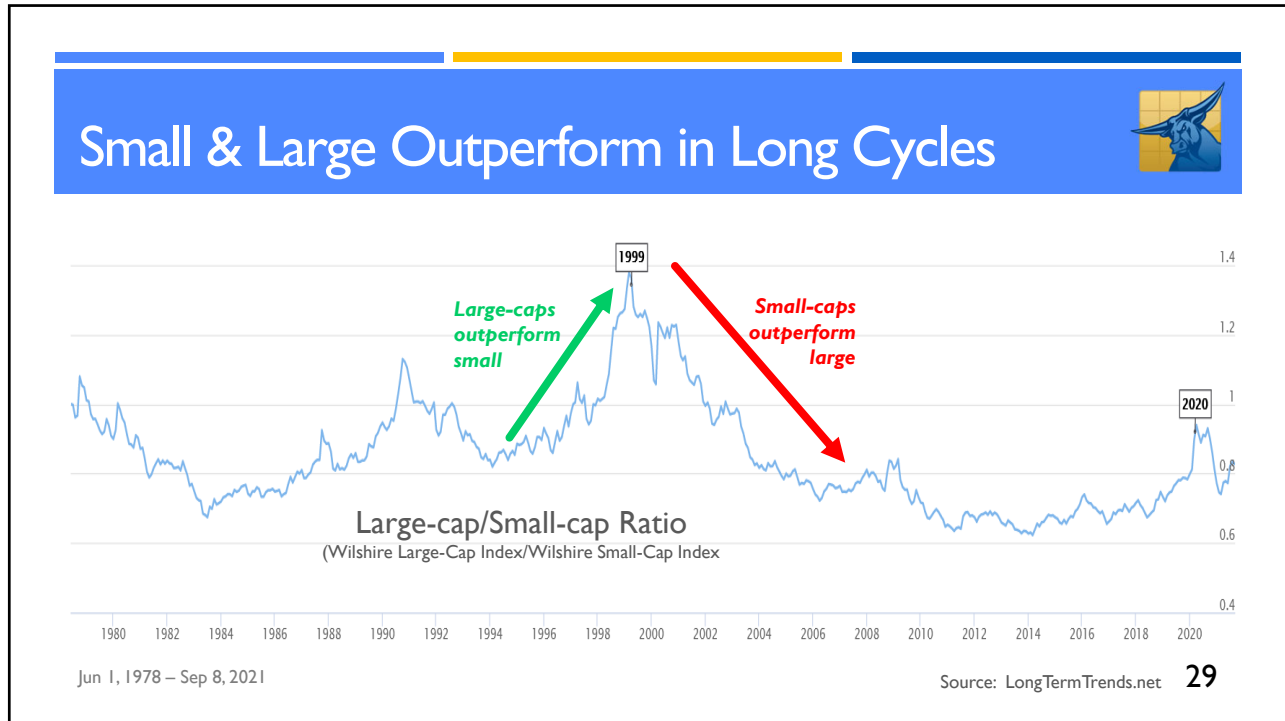


28

Searching for Quality in Small-Cap Stocks

11 September 2021

by Doug Gerlach, gerlach@iclub.com



Investing in Small Company Stocks



31

What Is a “Small” Company?



- Small:
 - By revenues: Under \$1 billion OR
 - By market cap: Under \$2 billion
- Midsized:
 - By revenues: Between \$1 billion & \$10 billion OR
 - By market cap: Between \$2 and \$10 billion
- For most investors, answer is “smaller than most of your current holdings!”

32

Small Company Stock Strategy



1. Don't swing for fences.
2. Buy well-managed small companies.
3. Keep eye out for "fallen angels."
4. Watch for opportunities to exploit market mis-pricing.
5. Be patient & hold for long-term.
6. Don't chase themes.
7. Sell if fundamentals deteriorate.

33

Doug's Rules for Small Company Stock Selection



34

Understand Drivers of Growth



- Company **must** be profitable, with 3-5 years of history of growth.
- Identify headwinds & tailwinds that have inhibited & supported company growth in past & in future.
- Minimum expected future growth of revenues & EPS is 7% a year through next economic cycle.

35

Seek Proof of Company Quality



- Management must show signs of excellence.
- Best & easiest way to understand is through pre-tax profit (PTP) margin analysis.
 - Shows core growth of profits without impact of taxes or share purchases.
- PTP margins should compare well to competitors, peers, industry group.
- PTP margins should be stable or expanding in recent years & quarters

36

Searching for Quality in Small-Cap Stocks

11 September 2021

by Doug Gerlach, gerlach@iclub.com

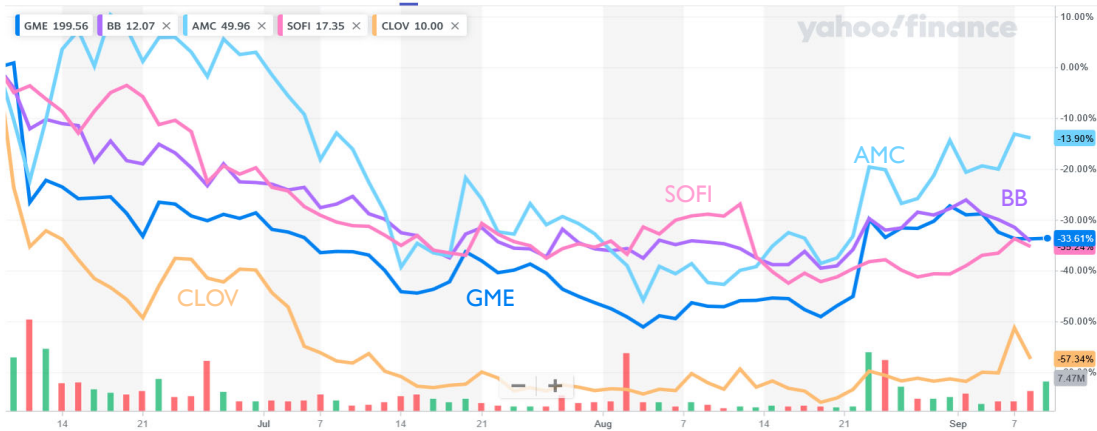
Beware Meme & FOMO Stocks



- Much of short-term stock market activity is Keynesian Beauty Contest:
 - John Maynard Keynes wrote in *The General Theory of Employment, Interest and Money* about beauty contest where judges don't pick most attractive candidates, but which candidates they think most other judges will find most attractive.
- Long-term, stock market is **marathon**, not beauty pageant.
- Don't get distracted by high P/E stocks w/poor fundamentals, by fads or hot stories.
- Look for companies that are most likely to weather test of time.

37

Meme Stock Performance – Last 3 Mos.



© COPYRIGHT 2021 SMALLCAP INFORMER. ALL RIGHTS RESERVED.

38

Buy at Right Price



- Avoid buying high P/E stocks.
- Purchase when P/E ratio is near average P/E of stock in recent years.
- Don't overestimate future P/E ratios.
 - Some P/E ratios will contract in future as company growth slows.
 - Other P/E ratios will expand as company gains attention from market.

39

Focus on the Long-Term



- Be patient with small company selections.
 - Less attention from market means their prices may only grow moderately until tipping points are reached.
- “Buy & hold” does not mean “buy & forget.”
 - Replace (not sell) stocks when real problems affect them or their future potential returns.
 - But don't be swayed into action by irrational market moves.

40

Don't Overload on Small Companies



- Portfolios have best opportunity to outperform broader market when they are concentrated & no larger than 20-30 stocks.
- Aim for 25% of portfolio in small company stocks, 50% in midsize companies, 25% in large.
- It can be prudent to spread small company exposure among more stocks to spread out risk.

41

Replenish Small Stock Allocation Regularly



- Successful small companies become large companies.
- Always be on lookout for new small company opportunities.
- Feed portfolio from bottom up, focusing on adding candidates with greater total return potential.

42

Quarantine Stocks That Don't Fit Model



- There's no need to entirely avoid more speculative stocks (such as companies with no profits or very short histories).
- Set aside pre-determined portion of portfolio (such as 5% or 10%) & keep more speculative stocks in that carve-out.
- If stocks perform, gains can be substantial.
- If stocks don't perform, losses are limited.

43

Questions?



44

Searching for Quality in Small-Cap Stocks

11 September 2021

by Doug Gerlach, gerlach@iclub.com

Small & Midsized Stock Ideas



For educational purposes only;
conduct your own research
before making any investment
decision.

45

Stocks to Consider



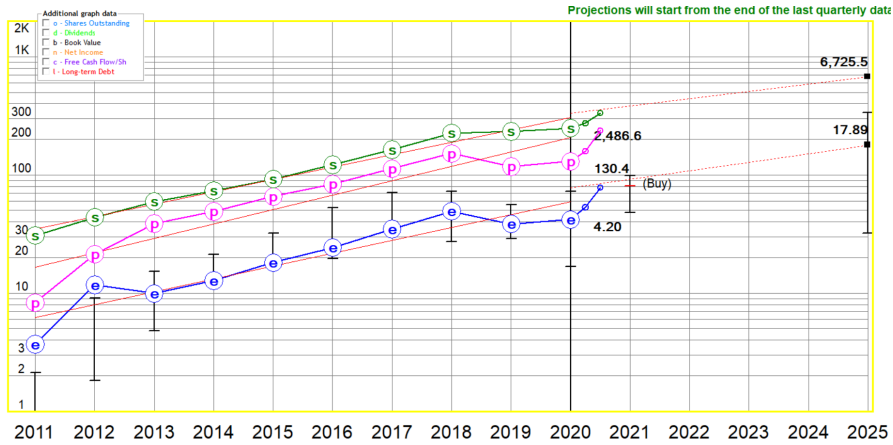
Sym	Company Name	Recent Price	Curr P/E	% Tot Ret	% EPS Grwth	% Rel Val	U/D Ratio	Buy Price	Sell Price	
PATK	Patrick Industries	\$82.30	8.7	30.4%	15.0%	65.9%	4.3	\$98	\$168	IAS
LCII	LCI Industries	\$143.73	14.1	28.0%	15.2%	75.1%	8.4	\$194	\$370	SCI
FLWS	1-800-Flowers.com	\$30.41	14.0	23.0%	14.0%	78.7%	6.1	\$37	\$53	IAS
IMXI	Intermex	\$17.75	16.6	22.0%	16.0%	85.9%	6.1	\$22	\$39	SCI
CRMT	America's Car-Mart	\$132.06	9.5	21.9%	10.0%	76.0%	4.5	\$154	\$243	IAS
SWKS	Skyworks Solutions	\$182.07	21.5	21.1%	16.0%	95.4%	3.9	\$198	\$368	SCI
CRSR	Corsair Gaming	\$27.27	17.3	20.6%	12.0%	91.2%	4.0	\$30	\$56	SCI
ACU	Acme United	\$37.72	11.2	20.6%	10.0%	81.3%	4.4	\$42	\$73	SCI
KL	Kirkland Lake Gold	\$39.15	12.7	20.4%	12.0%	82.5%	5.9	\$46	\$81	SCI
CARG	CarGurus	\$27.46	29.8	20.2%	21.0%	106.4%	3.2	\$26	\$42	IAS

Searching for Quality in Small-Cap Stocks

11 September 2021

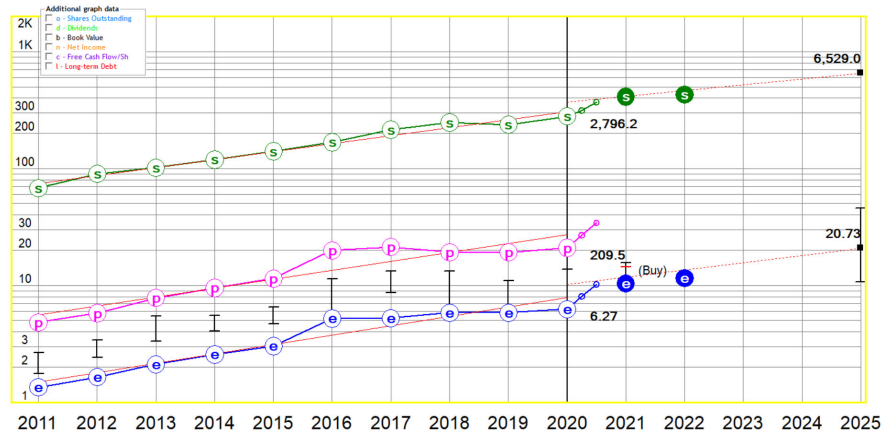
by Doug Gerlach, gerlach@iclub.com

Patrick Industries (PATK)



47

LCI Industries (LCII)



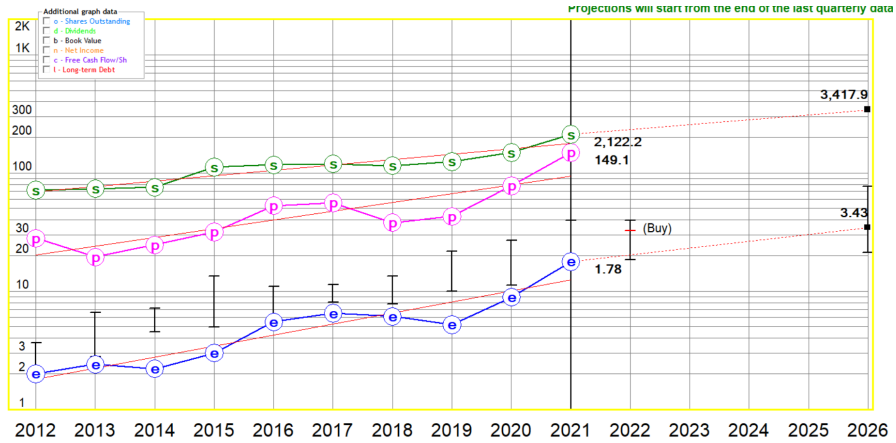
48

Searching for Quality in Small-Cap Stocks

11 September 2021

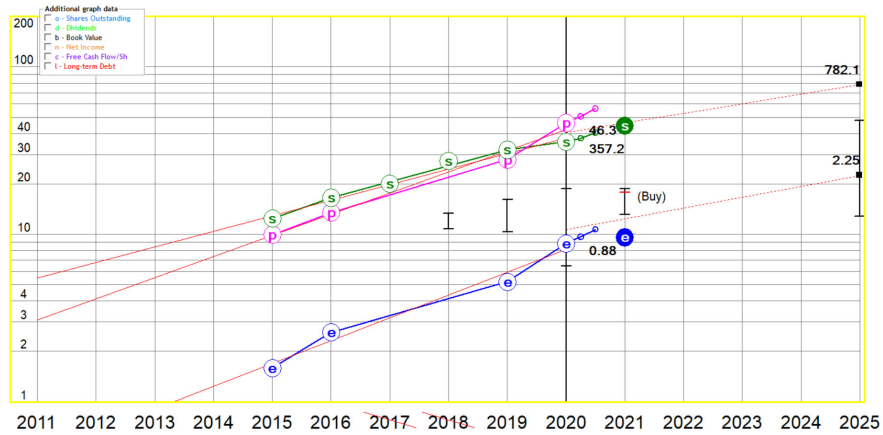
by Doug Gerlach, gerlach@iclub.com

I-800-FLOWERS (FLWS)



49

Intermex (IMXI)



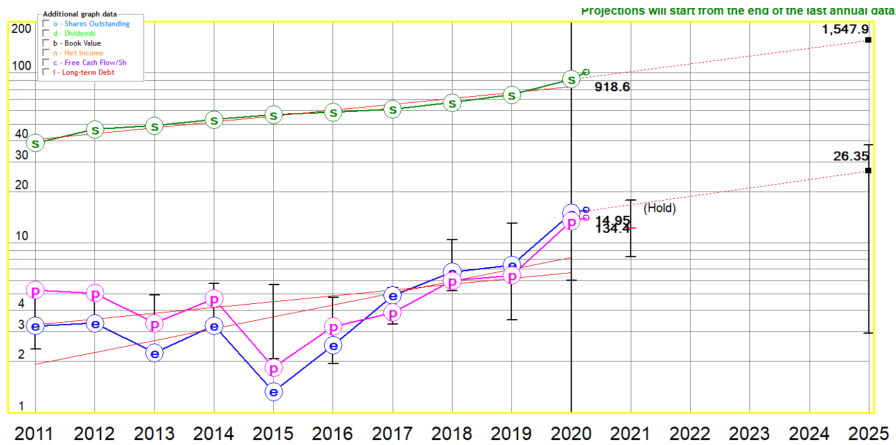
50

Searching for Quality in Small-Cap Stocks

11 September 2021

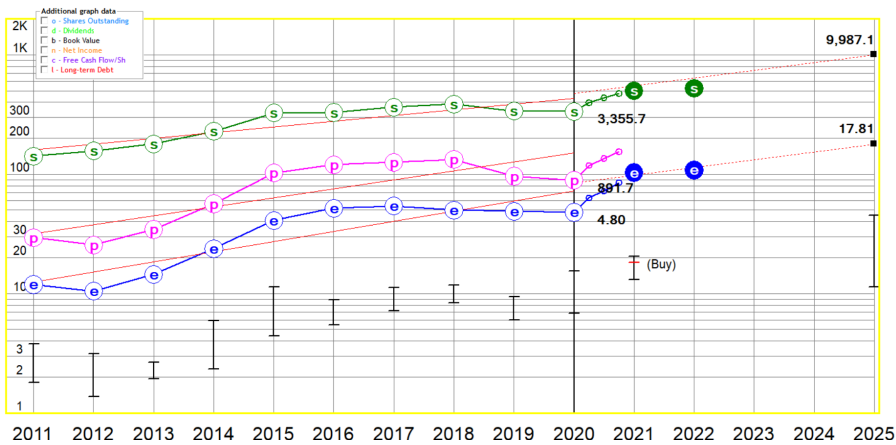
by Doug Gerlach, gerlach@iclub.com

America's CarMart (CRMT)



51

Skyworks Solutions (SWKS)



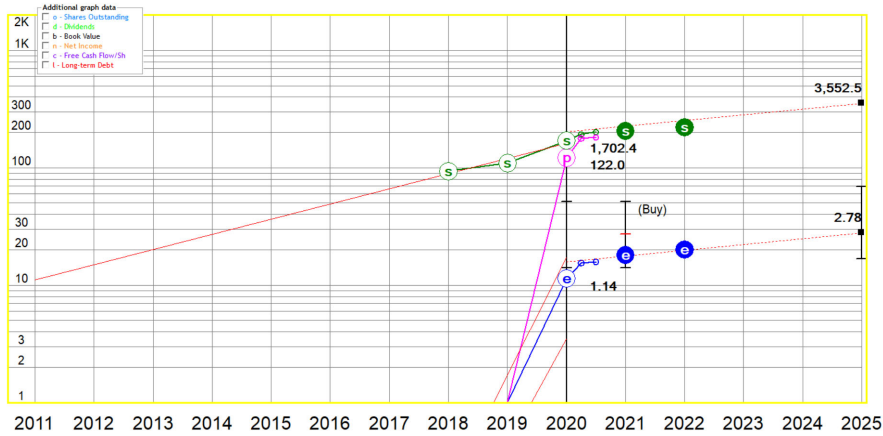
52

Searching for Quality in Small-Cap Stocks

11 September 2021

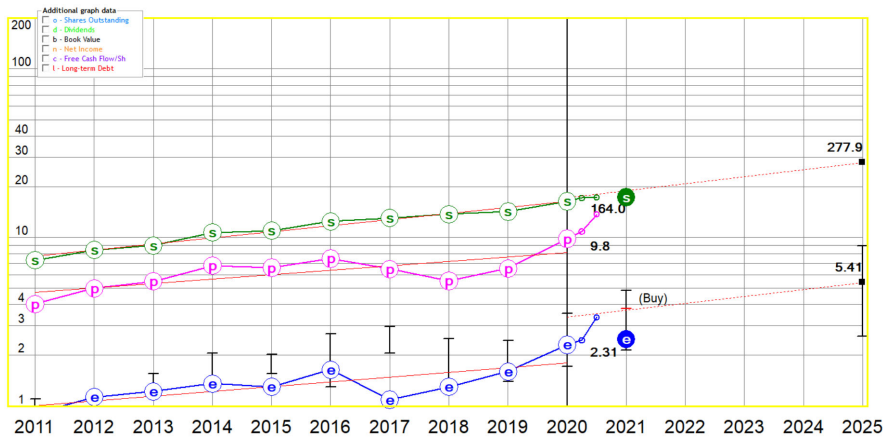
by Doug Gerlach, gerlach@iclub.com

Corsair Gaming (CRSR)



53

Acme United (ACU)



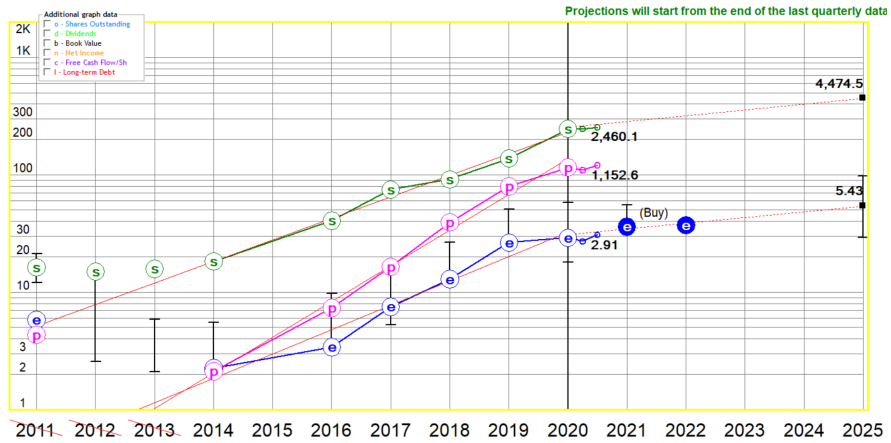
54

Searching for Quality in Small-Cap Stocks

11 September 2021

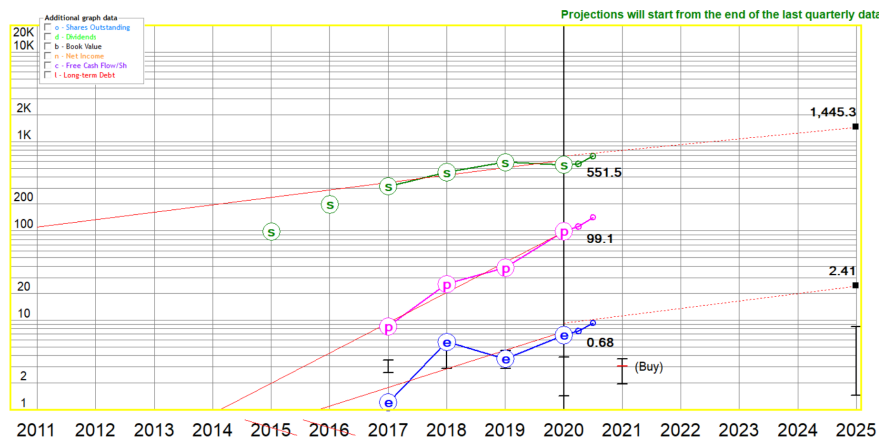
by Doug Gerlach, gerlach@iclub.com

Kirkland Lake Gold (KL)



55

CarGurus (CARG)



56

Final Thoughts



Stay the Course



- No need to make significant changes to your strategy in face of uncertain times.
 - However, some micro-adjustments in may be prudent.
- Resolve to never to take action in portfolio out of panic.
- Avoid trying to capitalize on fads & trends unless you have clear exit strategy (such as stops).
- Maintain watch list & be on lookout for opportunities whenever they present.

Questions?



59

Thank You!

EMAIL ME: GERLACH@ICLUB.COM



60

Searching for Quality in Small-Cap Stocks

11 September 2021

by Doug Gerlach, gerlach@iclub.com

Need More Stock Advice?



Visit

www.smallcapinformer.com

& use promo code **AAII**.



Visit

www.investoradvisoryservice.com

& use promo code **AAII**.