Four More Wall St Hacks

As I showed in a recent article, the original Hack Wall St portfolio has seen half of its positions sold and has beaten the S&P by a barely material 1.4% over ——the 20 months of its existence.

Here is the portfolio as it stands:

Position	Strategy	Buy Price	Shares	Investment	Current Price	Current Value	% Return	Allocation
Biglari Holdings	Activist	358.89	42	$15,073.38	452.71	$19,013.82	26.1%	17.3%
Third Point Re	Activist	15.04	1330	$20,003.20	12.63	$16,797.90	-16.0%	15.3%
Silver Wheaton	Miners	17.96	560	$10,057.60	29.26	$16,385.60	62.9%	14.9%
Sprott Gold Miners	Miners	16.68	600	$10,008.00	27.86	$16,716.00	67.0%	15.2%
CASH						$41,175.36		37.4%

In this report we will go over some new potential positions I found since the book came out, buying some and adding some to the watchlist. Stay tuned to the weekly newsletter for updates on the portfolio.

Taking Deep Value to the Macro Level

The two deep value stocks I recommended in the book were the two worst performing. I thought about digging back into the scum of NCAV stocks or returning to the Russian oil fields to try to find some more prospects, but then I heard a recent Meb Faber podcast where he talked about his book, "Global Value."

Faber's book explains how to use the Cyclically Adjusted Price to Earnings ratio to value markets. The ratio is a form of the old fashioned PE which shows what multiple of earnings the current price fetches. It adjusts the ratio by averaging out earnings over ten years in order to smooth out any volatility.

Over longer terms, the vast majority of nations see their stock markets revert to the mean following a huge downturn. Faber developed a trading system to purchase the top 33% best countries based on CAPE with a filter that the CAPE must be below 18. He created an ETF (GVAL) that follows the system and sits in cash when the entire global stock market is massively inflated.

I considered taking the lazy way out[1] and adding this ETF to the portfolio. I do happen to own it in several of the portfolios I manage. However, for our purposes, 18x is just not deep enough. We want to target the countries where the market expects them to default on their debt or the IOC bans them from the Olympics or they voted in a politician a few years ago who Bernie Sanders admires. Countries like Brazil.

The Brazil ETF (EWZ) was floundering earlier this year, hitting a low just over $17/share in January, down from a high over $70 in 2012.

Politicians working toward socialism, widespread unrest and a huge drop in the oil price pushed Brazilian markets to the brink. Then, the politicians started getting impeached, the Olympics took over news broadcasts and the ETF doubled to where it is today at $34.84 just eight months later.

This type of return is what we are targeting with our macro deep value strategy. In addition to focusing on value (Only markets that have a CAPE below 10) we will reduce our risk with the following methods:

1. We will hold all eligible markets as one 5% position to diversify the strategy. New markets that pass the screen will be given a 1% position. This means if we find four markets that pass the test we will invest 1.25% of the portfolio in each.
2. We will invest strictly in the ETFs without using options to avoid the high bid/ask spread.
3. We will only invest in those countries that have already started to trend upwards based on their current price, 20 day EMA and 50 day SMA[2].
4. We will utilize a 30% trailing stop loss on each ETF. If one of the ETFs hits this trailing stop loss will we reevaluate and wait for a new uptrend to be established to buy.

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[1] As I will do in just a few pages.

[2] If you're wondering what this means, you're not alone. Read my active trading article to learn more about finding trends.

Country	ETF	CAPE	Price	20 day EMA	50-day SMA
Russia	RSX	4.90x	18.96	18.18	17.74
Poland	PLND	8.60x	14.47	13.87	13.32
Turkey	TUR	9.70x	39.72	38.57	38.82
Spain	EWP	9.90x	26.57	25.93	25.63
Portugal	PGAL	10.00x	10.4	10.01	9.75
Italy	EWI	10.01x	11.33	11.04	11.03

Remarkably, five of the six countries that currently pass the screen are also up trending. This is likely due to the general increase in the global stock market over the past several months following Brexit. We will contribute 1% of the portfolio to each of the five and buy Turkey as soon as the 20 day EMA crosses over the 50 day SMA.

Casting an Even Wider Net for Activist Stocks

Piggybacking on activists is often the most exciting special situation. You can personally experience a Charlie Sheen — or Danny DeVito (that's even better) — movie while also profiting. You just have to avoid the subpar Shia Labeouf version. I don't understand these references at all

Activists are the newest names for the brand of private investors who were called Corporate Raiders in the 80's and sometimes robber barons in the 1800s. Activists target companies with strong balance sheet positions or brands that have been mismanaged or have had bad capital allocation that are working for change.

Some activists nicely meet with management and suggest a better course for the business. Others establish a website, send out mailers to shareholders and generally wreak havoc trying to get on the board of directors and fire management.

Both strategies can be profitable when and if the business targeted by the investor turns around and generates better returns for shareholders.

The two activist investors we focused on in the book had a mixed bag of returns: one was up 16% and the other was down 16%. In each case the focused nature of investing with just one activist led to the return. Biglari Holdings saw its market price mosey closer to its intrinsic value and Third Point Re was punished by the market for having merely average returns.

We want to get access to as many activist situations as possible with our newest pick. The Global X Guru Activist Index ETF (ACTX) follows the Solactive Guru Activist Index which is made up of 50 stocks based on the 13F and 13D filings of a select group of activists.

The index holdings are weighted equally and the weightings are adjusted each February, May, August and November. The activist pool is made up of the 50 funds in the SharkWatch 50. Opportunities from this pool are ranked by market cap and the top 50 are invested in.

I would prefer some sort of value filter instead of size, but the ETF has an expense ratio of just 0.75% and, as far as I know, there are no other funds that target the same opportunities. We allocated 30% to the two original ideas so we will use this ETF to come in at an even 40% of the portfolio.

The top ten holdings are shown below. If the fund turns out to be too diversified into large caps to return what we want in this portfolio, we will use the holdings to mine out better opportunities.

TOP 10 HOLDINGS

As of 8/12/16

FULL HOLDINGS (.CSV)

NET ASSETS %	NAME	MARKET PRICE ($)	SHARES HELD	MARKET VALUE ($)
2.38	**WILLIAMS COS INC**	26.21	1,248	32,710.08
2.32	**CHENIERE ENERGY INC**	42.99	740	31,812.60
2.28	**CONSOL ENERGY INC**	17.23	1,814	31,255.22
2.25	**RESTAURANT BRANDS INTERN**	47.43	653	30,971.79
2.21	**APPLE INC**	108.18	281	30,398.58
2.20	**YAHOO! INC**	42.94	705	30,272.70
2.19	**MICROSOFT CORP**	57.94	520	30,128.80
2.16	**PENTAIR PLC**	65.63	452	29,664.76
2.14	**ZOETIS INC**	51.98	565	29,368.70
2.14	**COMCAST CORP-CLASS A**	67.51	435	29,366.85

Racing to Spin-off Profits

I like to peruse the holdings of super investors on a website called GuruFocus. Recently, I was looking through hedge fund manager Mohnish Pabrai's holdings and was struck by the fact that over 55% of his portfolio was invested in auto stocks – I once visited an annual meeting of his where he talked about not investing more than 5-10% into any one stock.

There are a couple explanations available. The data on this site is taken from the SEC filings that investment managers who manage over a certain amount have to file. It's old (from 6/30/2016) and only consists of the portion of Pabrai's portfolio that is long stocks. Any cash or non-stock holding would not be included.

Regardless, my interest was piqued. I soon found out that two of the corporations, Fiat Chrysler (FCAU) and Ferrari (RACE) were related.

I started my research with Fiat. Pabrai has almost 30% of the reportable portfolio in the company and it has fallen over 25% so far this year. I started with Morningstar and was flabbergasted that they valued the stock at almost three times the current price. So after a little more scuttlebutt, I started a position in multiple portfolios.

Then I moved on to Ferrari. 80% of Ferrari was spun-off from Fiat Chrysler in January of 2016. The stock quickly dropped from $48/share to almost $33, where it bottomed out. It has since soared back to around $48.

Spin-offs are a strategy in which a corporation spins off a unit to shareholders. Oftentimes, the unit is more profitable than the whole and its true value can only be unlocked by freeing it from the bureaucratic jungle that is multi-billion dollar corporations. Due to the function in Wall Street wherein large corporations have an enormous proportion of their shares held by institutions that do not make subjective investments, the spin-off must be sold immediately.

This selling pressure drives the price down – it almost certainly contributed to the quick drop over two months from $48 to $33 for Ferrari. Ferrari has since survived the selling pressure and been reborn like a phoenix. However, spin-offs typically outperform the market for several years following the corporate event and Ferrari has even more advantages on its side.

Unlike Fiat, Ferrari seems to be a very high quality corporation with strong competitive advantages due to its immense branding power, high margins and room for improvement on its balance sheet – likely because Fiat loaded it up with debt (so much so that it had more liabilities than assets at the end of 2015) prior to the spinoff.

The problem is, according to Morningstar, the value is fairly close to the current price. So it seems like we may have missed the boat. Let's compare Ferrari to some of its competitors to see how its valuation really looks.

Company	ROE	Gross Margin	Current Ratio	Debt/ Equity	P/S	P/CF
Ferrari	**24%**	**48%**	**2.66x**	**23.39x**	**2.7x**	**13.3**
Tesla	-70%	21%	1.38x	1.04x	6.5x	na
Rolls Royce	2%	23%	1.46x	0.84x	1.1x	9.9x
BMW	16%	20%	1.03x	1.24x	0.6x	37.8x
Audi	21%	19%	1.57x	0.01x	0.5x	3.4x

I went through some auto companies and tried to pick those that produce the most on high quality, expensive cars, like what Ferrari produces.

I used ROE and gross margin to evaluate quality. ROE is the return the company is able to generate on its invested capital; it measures both capital allocation ability and efficiency. Gross margin is the percent of revenues the company has left over after paying to manufacture its products – this is widely used as a measure of pricing power. Ferrari dominates in both of these areas; I actually double took and went back to recheck Ferrari's gross margins. They have not been below 45% in the past five years. The reason behind this, Ferrari's ubiquity in Formula 1 racing, is actually seen as a weakness from some investors who are wary of the constant R&D it takes to remain on the top in that world and retain pricing power while growing.

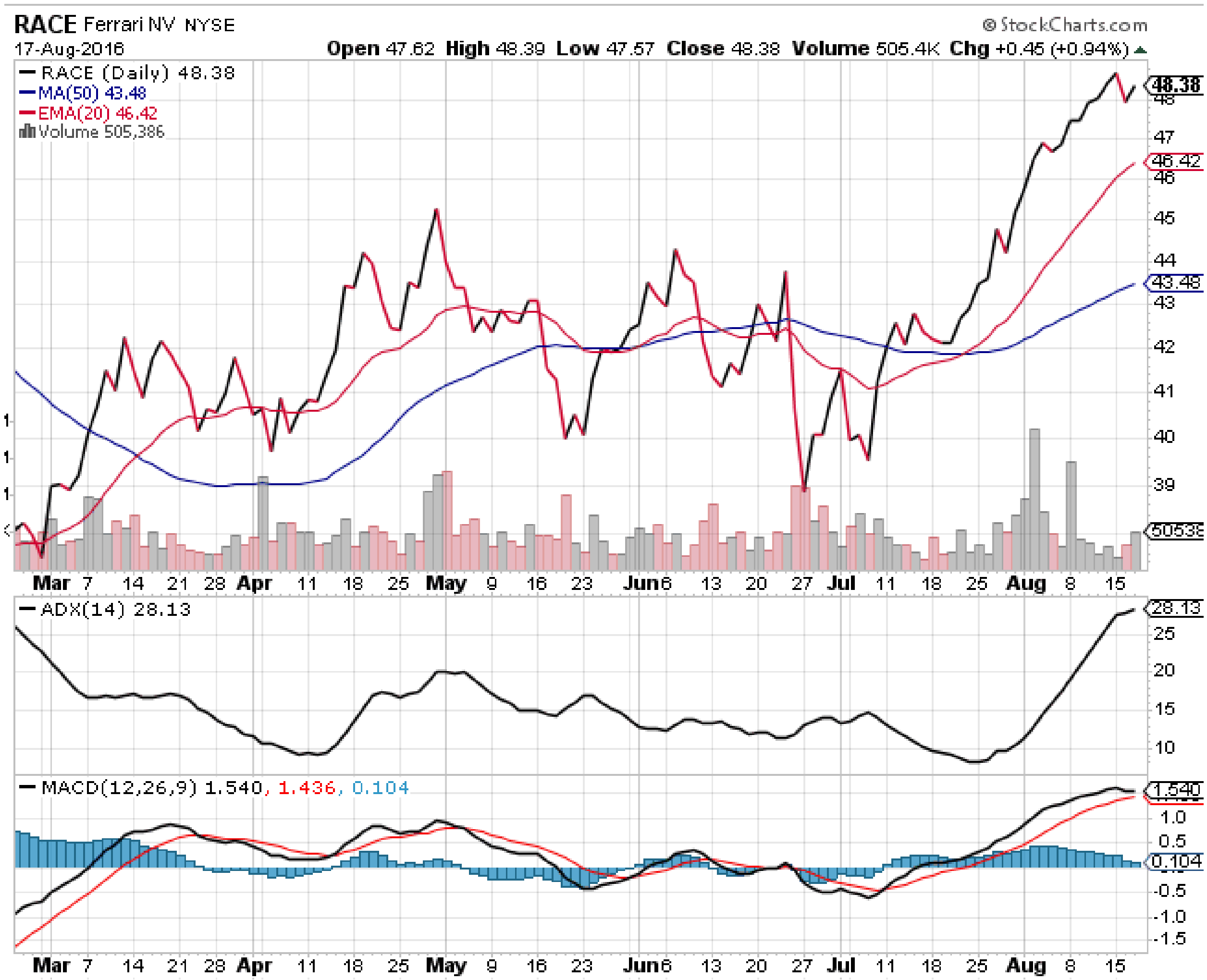
Next are the debt ratios. Current ratio is a liquidity measure evaluating the ratio between assets that can be converted to cash in less than a year and liabilities that must be paid in less than a year. Debt/Equity is the ratio of debt holders claims on assets to shareowner's claims. Ferrari has exceptional liquidity, but has a substantial debt load, as talked about before.

The valuation ratios finish it off. By either standard, Ferrari trades for a warranted higher price than its peers. While the stock is by no means expensive, the investment would not really fall into the traditional value model.

I recently wrote about an active trading strategy I've been developing. The strategy looks to locate stocks with a load of potential energy (like special situations) and pair that with kinetic energy to time the buy. You can find the article here.

As we've seen, Ferrari is technically a special situation as a spin-off, and while it may be properly valued, it is a great company with a great brand. Let's look to the trend. The following is Ferrari's price chart[3], with some of my chosen technical indicators, as I write this article.

[3] Thanks to stockcharts.com



The stock looks to be trending, the current price is above the 20 day EMA which is above the 50 day SMA and the MACD line is above 0. However, the strength of the trend is not as high as we target with an ADX of just 28 (30 signals a trend is in place). Additionally, the MACD line is moving back toward the signal line.

For now, Ferrari will be placed on the watch list. When the MACD line turns back up and/or the ADX breaches 30, we will start a half position at 5% of the portfolio. Once the ADX gains strength we will look to build a full 10% position on weakness.

If the ADX falls below 20 we will drop the stock from the watch list.

Current Portfolio

Here is the portfolio as it stands today:

Position	Strategy	Shares	Investment	Buy Price	Current Price	Current Value	% Return	Allocation
Biglari Holdings	Activist	42	$15,073.38	358.89	452.71	$19,013.82	26.1%	17.3%
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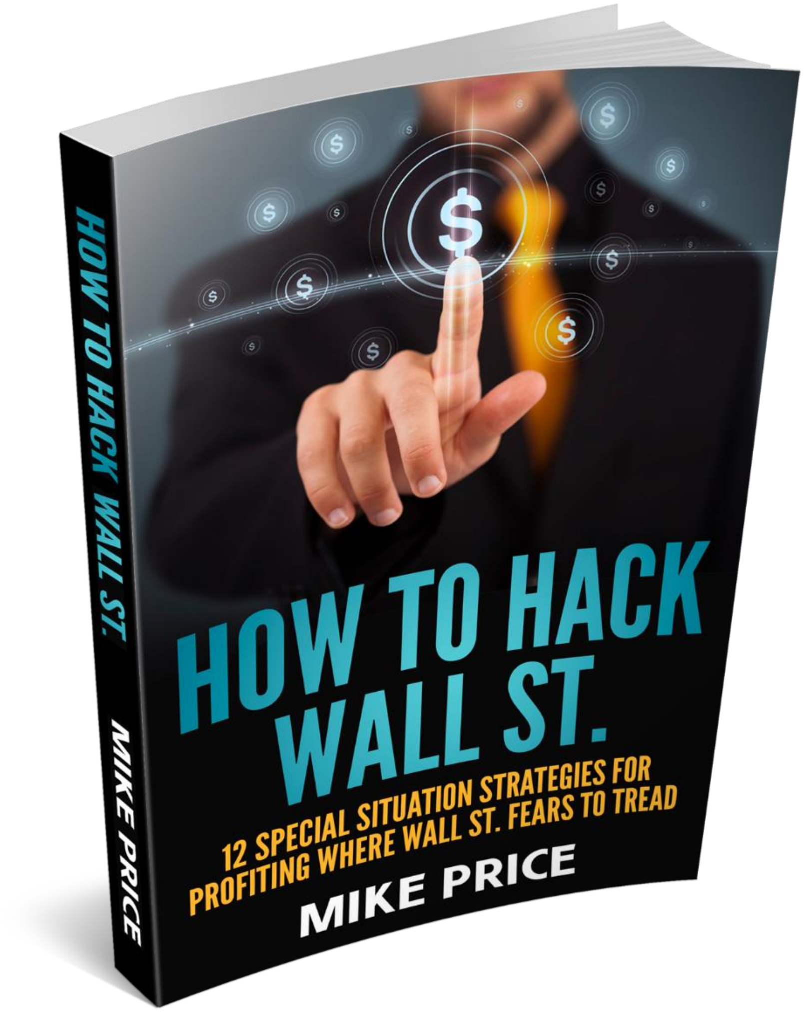
Sprott Gold Miners	Miners	600	$10,008.00	16.68	27.86	$16,716.00	67.0%	15.2%
Russia	Deep Value	59	$1,100.35	18.65	18.65	$1,100.35	0.0%	1.0%
Poland	Deep Value	79	$1,107.58	14.02	14.02	$1,107.58	0.0%	1.0%
Spain	Deep Value	43	$1,121.01	26.07	26.07	$1,121.01	0.0%	1.0%
Portugal	Deep Value	107	$1,103.17	10.31	10.31	$1,103.17	0.0%	1.0%
Italy	Deep Value	100	$1,106.00	11.06	11.06	$1,106.00	0.0%	1.0%
Activist Fund	Activist	702	$9,912.24	14.12	14.12	$9,912.24	0.0%	9.0%
Ferrari	Spinoff			Watchlist	48.40			
CASH						$25,725.01		23.4%
						$110,088.68	**10.1%**	
S&P				203.98	218.56		**7.1%**	

You can find the current portfolio at this page: http://rightpriceinvesting.com/portfolios/ and be sure to stay subscribed to the newsletter for updates on the portfolio as we go along.



Below the low hanging fruit where too-big-to-fail banks and high-fee-charging hedge funds cannot invest lie special situation investments. Mike Price details twelve special situation investment strategies for profiting in good markets and bad, delves into applicable case studies and even reveals nine current opportunities for profit.

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