
SPECIAL RESEARCH REPORT
THE
MISFITS
SYSTEM
THE MSFTs (MISFITS)
SYSTEM REVEALED

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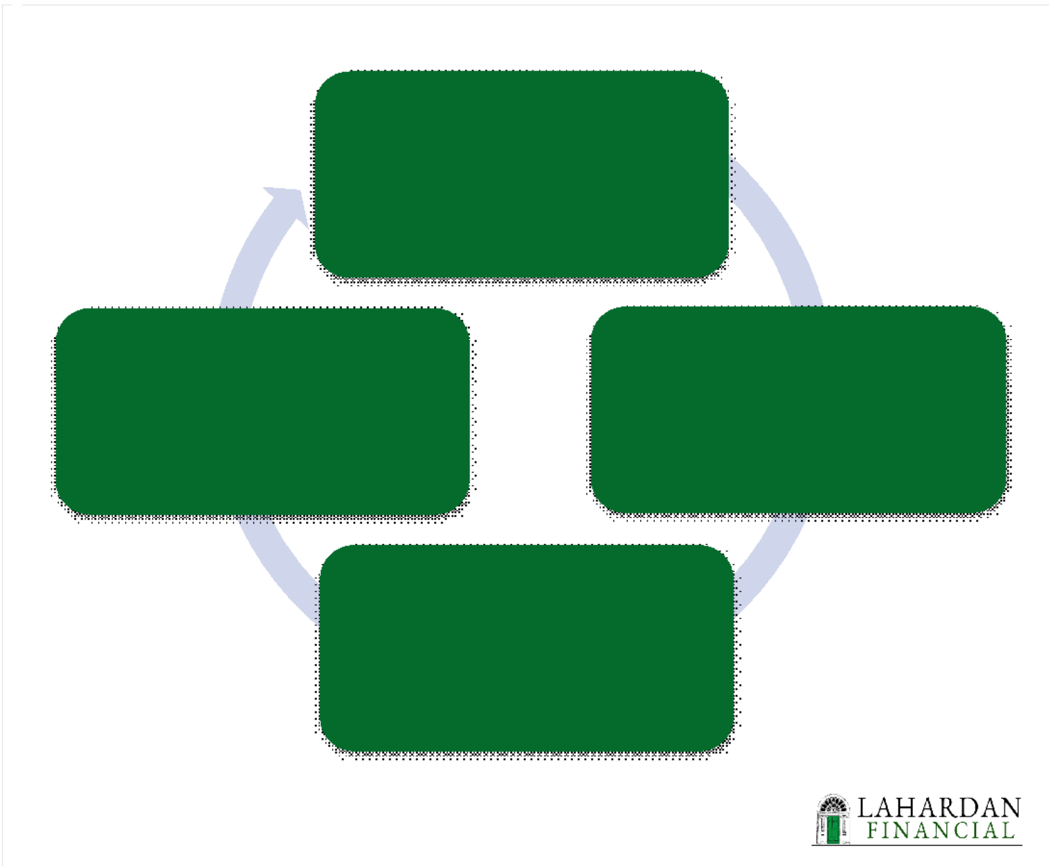
The MSFTs (Misfits) System Revealed

The roots of the MSFTs system stem from my days in the real-estate business. It's about finding good value for low prices. My father and I would spend days on end, walking from shop to shop, door to door, looking at advertisements, trying to find an undervalued property. A misfit.

I took the same approach when I started investing in stocks. The idea was to find low-risk, high-reward opportunities. Through years of experience, I've refined the system to fit the stock market, though the underlying principle stayed the same.

My approach consists of four steps, M, S, F, and T, hence the name MSFTs.



M is for macro conditions (in which direction are the macro forces moving the markets?); S for sector potential (which market sectors are best positioned to benefit from the underlying macro conditions?); F for fundamentals (because I only pick healthy stocks with high intrinsic value); T for trigger (a price action signal telling exactly when to enter a trade).

If you plan to use the system, make sure you follow the four steps. Miss one, and you will drastically increase your risk. Think of it as a chair. It needs four legs for you to sit on it. I help myself by scoring each candidate, and don't invest into anything with an MSFTs score below 8.5, but more on the scoring system later.

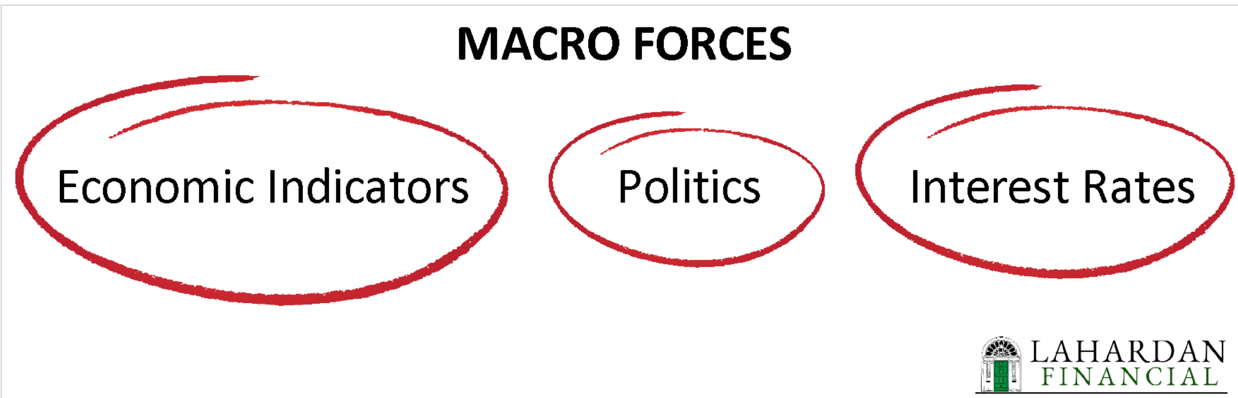
The strategy is suitable for investments ranging from six months to five years, depending on the lifecycle of the industry. Do note, that this is an investment strategy, more so than a trading system.

In short, MSFTs is a follow-the-money system. Global forces push the flow of capital to one part of the world or another (step 1), where it flows to specific industries (step 2) and to representative companies (step 3). Sooner or later, financial institutions begin to notice the money flow and invest in the same direction. This is reflected in price movements on a stock's chart (step 4).

M - Macro Conditions

In the first step of the MSFTs process, I analyze the macro conditions that are driving the global economy.

Leading world stock indices are an excellent place to start. These tell me what the sentiment is in the world's leading economies. How do investors feel about the current situation? Is there more fear or greed in the markets?



Three forces have a significant impact on the movement of the global markets. Economic indicators, politics, and interest rates.

Economic indicators tell how the economy has been performing so far. These are usually released every quarter at a preset date, so it's easy to observe their effect on the markets. The ones to look for are GDP growth, unemployment, and inflation.

Interest rates are another important indicator. Central banks adjust interest rates several times a year to keep the economy as stable as possible. Higher interest rates are usually received negatively, because they increase the cost of capital/debt, while the reverse is true for lower interest rates. However, lower interest rates and rising inflation can lead to hyperinflation, which is again unfavorable for the markets.

Politics are the third dominant force moving the markets. They are the toughest to predict, and consequently, the market reactions to political decisions or statements are the most volatile. President Trump is an ideal representation of just how unpredicting politicians can be.

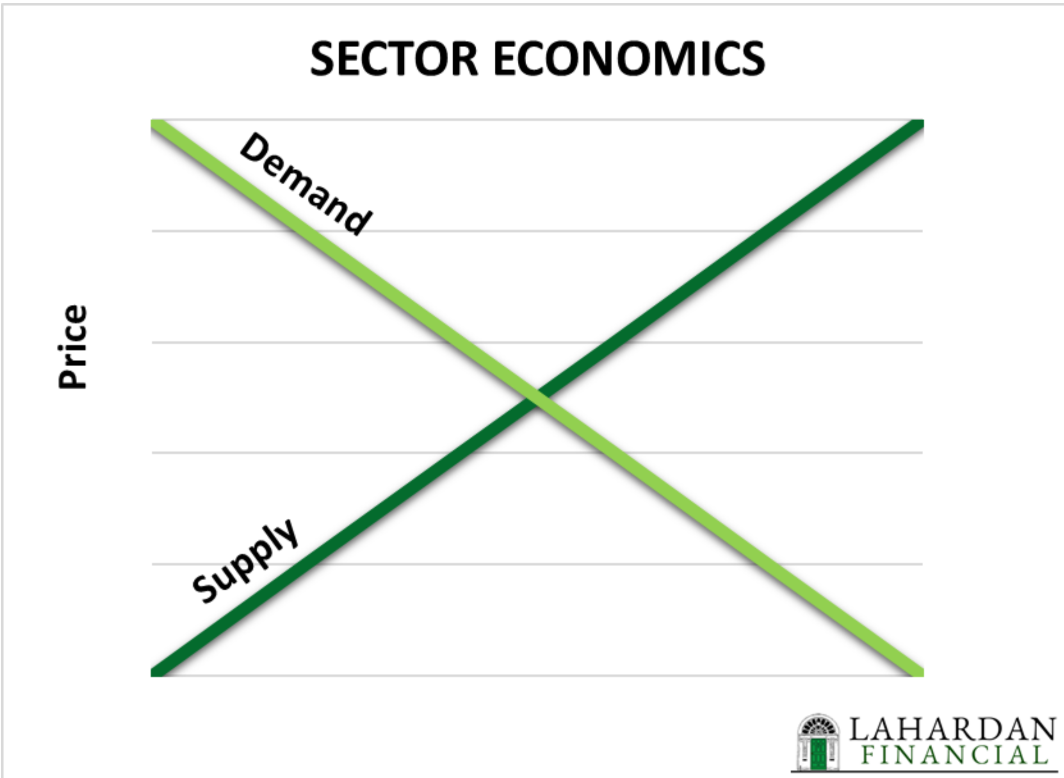
After the indices, I look at the forex and commodities markets. They are influenced by the same forces that move the indices. However, movements here tend to be smaller because these markets are not as volatile.

Then, there is the bond market. Government bonds indicate the level of short and long-term risk, as well as provide a reference point for a risk-free rate of return. For example, if the U.S. 10-Year Treasury offers a return of 3%, then I expect all my investments to have a return higher than that (a risk premium).

Following all this information may seem like a daunting task, and for someone starting anew, it can be. But if you want to become an expert in the field of investing, then the simplest thing is to make it your lifestyle. Start enjoying it, and educate yourself as much as possible. MSFTs is not a get rich quick system. You have to be up to date with what's going on in the world to implement it successfully.

S - Sector Potential

At this point, I have a clear idea about the way the global forces move money one way or the other, and I start looking at the sectors that could profit from the macroeconomic conditions.



The two fundamental forces I analyze at this point are supply and demand.

First I look at the demand. What are the emerging trends, technologies, behavioral patterns, etc.? I try to see not only how the mass behaves in the present, but how it will behave in the future.

The goal is to be slightly ahead of the curve. Not too much, because if you invest into something that could have a dramatic effect many years from now, you won't be achieving anything. You'll end up sitting on an investment that's making you 0% return, which is a loss in my book. Moreover, you could eventually get bored with the 0% return, and pull out just before the investment finally takes off.

Supply-side is equally important. Let me start by giving you an example. In the mid-2010s, we had an oil supply glut, because of overproduction, while the global demand for oil was rising. This situation crashed the oil prices, which led to a drop in share prices of oil & gas companies.

Always look for situations where future demand is going to be higher than supply. If demand is rising, supply should be falling or constant. If demand stays the same, then the supply should be falling. If the demand is falling, then the supply should be falling even faster. Any other combination and you should be staying out of the market.

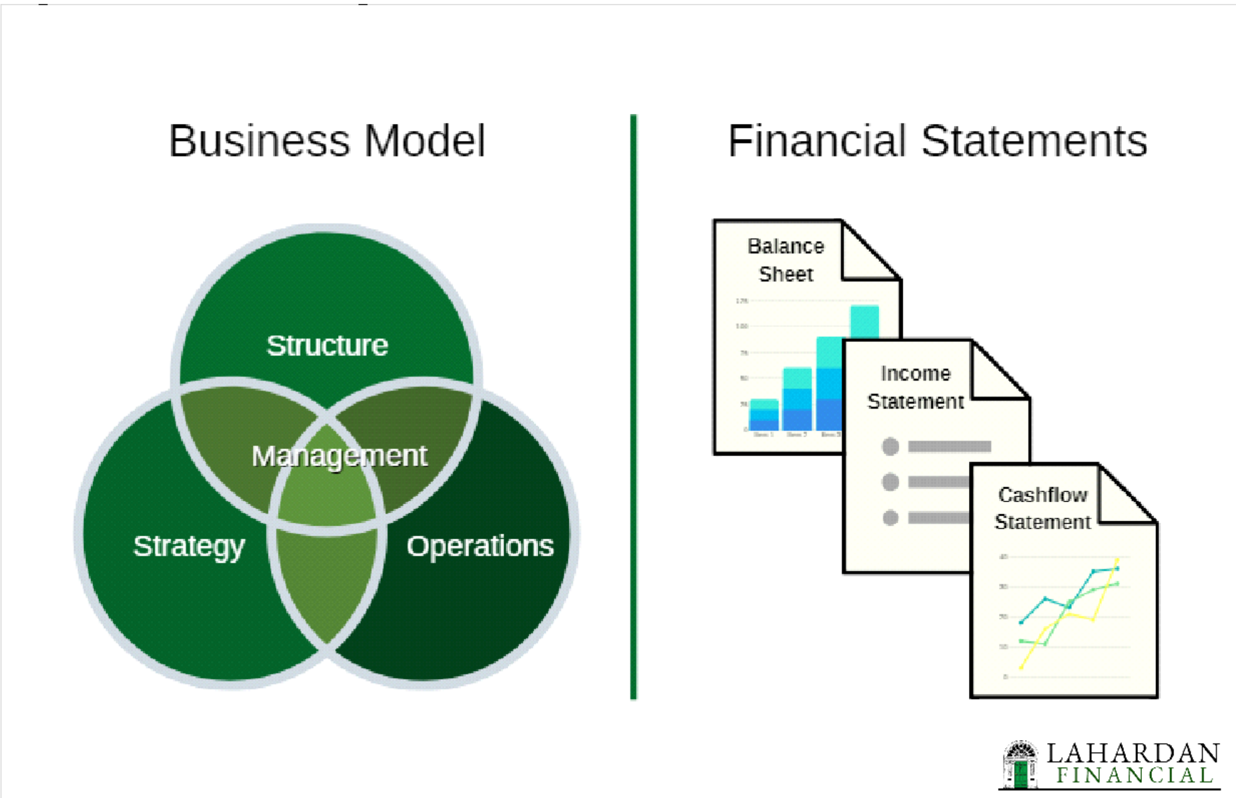
Make sure you study the possible future scenarios with enough diligence, and always keep asking yourself, what if. Try to find reasons why your sector thesis wouldn't hold up. As people, we are more prone to focusing on how much money we could make. By also trying to predict scenarios where you lose money, you will get a much clearer risk to reward picture.

To master the sector analysis, you're going to have to rely on two abilities of the mind. Imagination and logic. Imagination helps you envision how things are going to look in the future. Will the sector grow? Which direction will it take? What can go wrong? But relying on imagination isn't enough. Otherwise, everyone would be investing in lightsabers and teleport machines. You have to add logic to your thinking. The future scenarios you envision must make sense.

To get the best grasp on what could happen, study enough data (industry reports, news, etc.) even the boring ones. Try to see the picture from multiple angles. Too many times I came across industry reports promising double-digit growth numbers, just to find another promising decline. The human ego wants to justify being right, and will often reject negative information, disproving the original theory. Be careful not to fall prey to that, don't focus only on the shiny data. That's why I always prepare a bearish scenario, to see if my sector thesis holds up.

F - Fundamentals

Now that I've recognized the supply and demand picture and the market opportunities it is creating, I begin analyzing the companies in those sectors.



I look at two things when I compare the candidates with one another, the business model, and the financial statement.

One of the most important things that any investor should ask themselves is what does the company do. How do they make money? Understanding the business model is an important concept, and one often neglected by investors. When you buy a stock, you own part of the company, granted a tiny part, but a part nonetheless. Now, imagine if your neighbor would come to you and ask you to invest in his business, wouldn't you want to know what the business is about? You would probably have all kinds of questions. This is the same attitude you should have when investing in stocks.

I like to start my research by examining the company's annual report and other investment material provided on the company's website. This way I get to hear what the business is about from the company's mouth, so to speak. Because I already have a comprehensive picture of what's going on in the sector, I can tell whether the business model makes sense. Moreover, by analyzing the strategy, new products, and new operations, I can see if the company can secure its market position in the future.

But, no matter how brilliant the product, or how amazing the strategy, I never invest in a company that sleeps on financial discipline. I'm not interested.

That's where the financial statements come in handy. For an average observer they might look intimidating, but once you get used to analyzing them, they can be a goldmine of information. A suitable place to start is to look at the annual statements, though I also like to rely on quarterly reports as much as possible. If you analyze only the annual report, you might miss a recent development, which can drastically change the company's metrics. A similar situation can happen the other way around. If you're dealing with a business that generates most of its revenues during one part of the year, like a ski resort, then it's the quarterly report which distorts the metrics, and you should rely on the annual statement instead.

When I analyze the financial statement, I like to divide the numbers into four parts. Earnings & revenues, debt, dividends, and value.

Earnings and revenues section tells me how well the company is performing in the market. This should be the first part of any analysis because it tells you how successful the company is at making money.

Next comes the company's financial health. Debt is a double-edged sword. On one side it can bankrupt any business, no matter how great, and on the other, it can substantially increase business growth. The important thing is that the company shows it can manage it.

Then I look at the dividends, is the business efficient enough to reward the shareholders. While I enjoy dividends, they're not a necessity in the MSFTs system. If I'm dealing with a growth company that has a zero-dividend policy, I respect their decision, but will anticipate higher capital gains to compensate for the 0% dividend yield.

Finally, I look at a few value metrics, to see if the stock price reflects the company's performance. This is the last indicator I use, to see if I am buying an under or overvalued company, or if it is trading at par.

T - Trigger

Once I have the company pinned down, I begin monitoring its stock price. At this point, I know the stock is a buy and offers good value, but I want to get in at the right time.

The first thing I try to do when looking for the price action signal is to determine how the stock is behaving at the moment. Is it ranging between support and resistance, is it in an uptrend, or, is it in a downtrend. Depending on its behavior I apply the most suitable entry strategy.

I use three golden rules when trading stocks: (1) Manage your risk, (2) Never catch a falling knife, (3) Never chase the price.

I manage risk (rule No 1) by utilizing stop-losses. This way, I already know in the beginning how much I am willing to lose on the trade. Moreover, I diversify my portfolio, so a single bad trade doesn't affect me as much.

I only buy stocks that are either ranging or are in an uptrend. If the stock is in a downtrend, I restrain myself from buying. This can be hard to do because the stock looks undervalued, but one of my primary rules of investing is never to try to catch a falling knife (rule No 2). Moreover, this approach doesn't work well because I utilize stop-losses in my system, and it's risky to set a stop loss if the support level hasn't been tested at least twice.

If the stock is ranging, it means that support and resistance levels are well established. The way I enter that type of stock is by using either a breakout strategy or, if the stock has a high dividend yield, I enter using a range-bound strategy. Which one works best depends on the stock. If the stock doesn't pay dividends, then I enter using a breakout strategy. I also use a breakout strategy, if I am waiting for the broader market to turn bullish on the stock. I only use a range-bound strategy if the stock pays dividends and if I have a firm conviction that the price won't reach new lows.

If the stock is in an uptrend, I always wait for the correction period to enter the market. I never try to chase the price (rule No 3). If I am chasing the price, it means I am already late to the game, and that's how you lose money. Depending on what type of pattern the stock is trading in while in a correction period, I either use a breakout strategy or a range-bound strategy.

MSFTs Scoring system

Now that you know how to apply the four steps, it's time to learn how to score a candidate. Doing this is the easiest way to compare potential investments with one another.

If the company satisfies the first three steps (M, S, and F), then at the very least it deserves an 8 because it operates in a promising sector, and it has solid fundamentals.

Then, you should assess the risk. Imperfect balance sheet, risky business environment, or risky business model, can all impact the score. Depending on how much risk you see, add 0, 1, or 1.5 points to the score, with the latter representing little to no risk.

Finally, add half a point for the price action signal, the trigger. Considering you should never invest without the trigger, each of your investments should score an 8.5 at the least.

Good Investing.

Leon Wilfan

About The Author

Leon Wilfan is the Chief Investment Strategist for Lahardan Financial.

Leon is also the Senior Editor of True Retirement Wealth, a monthly advisory service leveraging Leon's time-tested stock-picking system, as well as his expert market timing to keep you in the best stocks at the right times.

Leon grew up in a family where investment education was mandatory. Even as a kid, he was encouraged to read Robert Kiyosaki, Jim Rogers, Marc Faber, Frank Partnoy, etc.

In his early 20s, Leon started a career in real estate, working alongside his father to learn the principles of value investing. After five years, he took a break from his career to pursue an MBA degree at the prestigious Vienna University of Economics and Business. Vienna University is the birthplace of the Austrian Economic Theory, a way of thinking that explains that the reality of economics cannot be captured by mathematical models, but rather by the behavior of individuals on the market.

Looking for new challenges, in 2016 Leon moved to the fastest-growing region in the world, Southeast Asia. In Singapore, he was fortunate to work for a blockchain startup. He quickly realized the potential of investing in cryptocurrencies—and managed to get in just before the mania started.

As an active Forex trader, Leon is also fluent in technical analysis and price action trading.

Leon's investment approach is geared toward low-risk, high-reward opportunities. Through years of experience, he's developed a four-step approach he uses to find undervalued stocks… or, as he likes to call them, MSFTs (misfits):

M is for macro conditions (in which direction are the macro forces moving the markets?); S for sector potential (which market sectors are best positioned to benefit from the underlying macro conditions?); F for fundamentals (because Leon only picks healthy stocks with high intrinsic value); T for trigger (a price action signal telling exactly when to enter a trade).

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