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Stock Trader

TRADER'S PROFILE

By Carol Vinzant

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# Mark Minervini: "I Don't Hold Losses"

**This self-taught pro explains how he endured "a lot of trial and error" in developing his investing strategy, which is now a proven winner**

Stocks were Mark Minervini's second career, after rock 'n' roll. In 1993, he started Quantech Research Group, which sells what's often considered the holy-grail in investing: low-risk growth ideas. His clients -- professional money managers and institutions -- put their faith in Minervini's home-grown formula, a combination of fundamental and technical analysis whose precise makeup he guards as though his livelihood depended on it.

Of course, the returns of personal investors are all but impossible to verify. So to prove his acumen (and thus attract more clients), in 1997 Minervini entered the now-defunct U.S. Investing Championship. He put up his own money to enter the so-called middleweight division, for players with stakes of $200,000 to $999,000. The heavyweights came armed with $1 million or more, and the lightweights -- well, they weren't playing. Minervini won, with a one-year return of 155%.

In fact, he says from 1995 to 1999 he had an average annual return of 220%, though nothing is average about doubling your money every year. Then he got the willies. "Feeling that a major bear market was coming, in 2000 I went into cash and stayed there," he says. "I just started trading my personal account again this year."

AN "EVASIVE" SORT. Minervini's reputation for managing money won him an accolade many traders aspire to: In 2001, he was profiled in the book series *Stock Market Wizards*, which describes the strategies of famous traders.

*Wizards* author Jack Schwager had a hard time prying much out of this trader. "His answers could be described most kindly as general, and perhaps more accurately as evasive," Schwager wrote.

Minervini did say, however, that much of his analysis was based on ideas from the book *Superperformance Stocks* by Richard Love. And he argued that investors often are too quick to decide that individual stocks are too expensive. He doesn't let a high price-earnings ratio or the fact that a stock has risen sharply dissuade him. And he uses a none-too-esoteric method of keeping risk down: He sells a stock whenever it dips 10%.

STUNNING STOCK PICK. As an aficionado of statistics, he back-tested that old Wall Street trick to make sure it still worked. It does. What he found in his testing was that even if the stocks that dipped 10% came back, they often ended up wasting his time. The real winners, by contrast, tended to blast off from the start.

For instance, last Jan. 9 Minervini bought Taser (TASR/Nasdaq), a company that makes Taser guns -- nonlethal weapons for police departments. He spotted its potential using his proprietary methodology, "Specific Entry Point Analysis" (SEPA), which he sells to high-net-worth investors. He then rode the stock up 121% in only six weeks.

Minervini says he uses a three-part process to pick his purchases. He screens 12,000 stocks daily, selecting a first cut of about 1,200 based on stats such as company size, profit-margin growth, and how much the stock has risen compared with the stocks of peer companies. He also keeps an eye peeled for growth catalysts, such as a new product. Paradoxically, he doesn't like stocks whose prices are too low, because he finds them less liquid and more volatile, and sometimes shady. He bought Taser at $87.

SAVVY ALGORITHMS. Minervini also tends to favor small companies: He figures they're more likely to be mispriced, to be lightly covered by analysts, and to have fast-growth potential. Taser, which has done well in an era of terrorism, is small, with just $400 million in annual revenue, and its margins have been rising.

Next, Minervini uses what he calls a "leadership profile." He says he has created algorithms based on stocks that have made big, fast moves in the past, and thus can pinpoint the fundamental and technical traits of such stocks. Although short interest -- the number of shares loaned out to investors who were betting the stock would go down -- was high in Taser, Minervini thought it looked like the winners he has had in the past.

Finally, Minervini prioritizes the handful of candidates that meet his criteria. At that point, he can be a little subjective. He won't say exactly what brought him to Taser, but a casual look reveals what might be considered a couple of catalysts for growth. It had just come out with Taser X26, a version of its best-selling weapon that's less likely to cause serious injury.

Taser also had just announced a three-to-one stock split -- news that usually boosts a stock. Minervini, however, says he wouldn't consider a stock split a real catalyst for company growth, but "a new product, strong earnings and sales, profit-margin expansion, or favorable regulation changes would be."

Carol Vinzant, editor of the *BusinessWeek Stock Trader Digest*, talked with Minervini recently about his investing philosophy. Here are edited excerpts of their conversation:

**Stock trader isn't one of the occupations that most kids dream of. What was your first exposure to trading?**
My first experience was investing with a stockbroker, which turned out to be a painful but valuable lesson. My broker wiped out my account in just a few months. In hindsight, he did me a favor, because it was at that point I decided to do my own research and trading.

Winning consistently in the stock market requires hard work, extensive research, and emotional discipline. If you aren't prepared to invest a good portion of your own time before you invest your money, you're gambling.

**Did you grow up in a family that traded stocks? If not, what does your family think of your adventures in the market?**
No. I grew up in a family that was always struggling to make ends meet. However, I'm very

fortunate to have had a family that gave me the confidence to be persistent.

**Compared to most Wall Street traders, you seem to have had a much more colorful, or at least mysterious, beginning in the field. What did you first set out to be, and how did you drift over to stock trading?**
I was a musician. I also loved card games, such as poker. Even at a fairly young age I was fascinated with probabilities and statistics. Initially, I started trading because I was attracted to the excitement and the "action." I later had to learn how to ignore the "action" and trade in a disciplined manner to make a living. For me, it took a number of years and a lot of trial and error to hone my skills and eventually trade for a living consistently.

**Did you trade stocks first for fun, because you were good at it, or because you were trying to make a living?**
When I first started trading I was awful. I made all types of mistakes. Luckily, I took my lumps and made my biggest mistakes when I didn't have much to lose.

My reasons for trading were simple: I did it to get rich. At the time, getting rich seemed to be the ultimate challenge, considering I came from a family that struggled financially. The reason I wanted to get rich was to have freedom. But ultimately I was excited and challenged every single day. I absolutely loved trading.

My greatest success came when I finally decided to concentrate on being the best trader I could be. Then the money followed. I was focused purely on making good decisions and working on my weaknesses until they became my strengths. After years of being focused on how and what stocks to buy, I realized that my weak point was deciding when to sell. So, I focused on strengthening that area of my trading.

**What was the first method you tried? Did it work? What did it teach you?**
The first method I tried was to buy stocks on the 52-week low list. What I learned was...this is an awful strategy. I later reversed these parameters and experienced much better results.

**When did you get the confidence to trade full-time?**
Basically, I always had the confidence but didn't always have the bankroll. After years of trading and building my account up, I got to a point where my trading could make me a comfortable living.

**Could you tell me about the 1997 U.S. Investing Championship?**
In 1997, I put up my own money in the $200,000 to $999,999 division and won with a return of 155% for the year. I applied the same methodology that I use today.

**What research do you sell to professional investors?**
Stock recommendations based on my proprietary methodology, which I call "Specific Entry Point Analysis" (SEPA). I also provide consulting and training to traders.

**How much of an advantage do the pros have over traders at home?**
With the proliferation of technology, most traders have similar tools at their disposal. Traders at home have a tremendous advantage over professionals, mainly because [they have greater] liquidity.

**Traders always say they know they can't buy at the absolute low and sell at the top high. How much of the price move are you satisfied to be in on?**
I'm satisfied when I make a profit. I'm also satisfied if I lose very little when I'm wrong. It's not about being right or wrong, it's about how much you make when you're right vs. [how much

you lose] when you're wrong. Each situation is unique. However, the one thing that remains constant for me is...I don't hold losses. My main focus is always on controlling risk and a consistent application of discipline.

**What do you have against low-priced stocks?**
Exceptionally low-priced stocks (penny stocks in particular) are off my radar for three reasons: One, they lack institutional sponsorship that could provide the fuel (volume) behind a large-scale advance. Two, they're lower in quality, and at times tend to be exceptionally volatile. Three, many lack liquidity and trade too thinly. The lower the price of a stock, the more shares you have to buy and sell. All things being equal, I want to buy fewer shares in an effort to improve my liquidity.

**What have your returns been in the bear market for the last few years?**
My account was in cash through the entire bear market.

**Why did you get back into the market this year?**
Because I see opportunity to take advantage of stocks that meet my SEPA criteria. Timing is crucial.

**Have you noticed a pattern in the way that successful traders evolve?**
They learn from their mistakes, and they learn to respect risk. And, most importantly, they learn to separate their ego from their trading decisions.

**How much attention do you pay to the economy?**
Although Fed Policy, economic conditions, and other top-down indicators are taken into consideration when I'm forming an outlook with regard to the overall market, I look company-by-company to find exciting investment opportunities. I'm interested in individual companies and in concentrating on my investing rules and discipline. Individual stocks are the best market indicators for me. I look for fast-growing companies with entrepreneurial management.

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