How To Create Wealth Investing In Turnaround Stocks

How to Find Buy and Manage a Portfolio of Out Of Favor and Depressed Stocks

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Preface.

This Short EBook is the product of 30 years devoted to investing in private and public company turnarounds. If you have the ability to read a balance sheet and are willing to learn how to interpret a stock chart you will be on your way toward profiting from out of favor and depressed stocks. Many small cap stocks are often priced for bankruptcy due to forced liquidations, especially during bear markets. Those that survive outperform substantially. Some appreciate 5-20, even 100 times. You only need a few of these stocks to build a nest egg.

There are a large number of value investing books in the marketplace. However, this book is unique in that my strategy does not promote the standard buy and hold mentality. The key to success in buying turnaround stocks is to cut losses, not double down on stocks that are declining. Many investors don't realize that value investing is not an easy game. In fact a large number of value-oriented hedge funds disappear each year from poor performance. This is due to an unwillingness to admit mistakes, which causes funds to double down on bad investments that originally looked like great value stocks. After 30 years of investing in troubled companies and working with some of the most successful investors in the country, it's clear that 20% of the stocks in a portfolio will generate 80% of the returns. Charlie Munger, Warren Buffet's partner, admits that if you took away a handful of their investments Berkshires returns would be mediocre. George Soros, perhaps an even better investor than Buffet, has made similar comments.

The principal enemy to great returns is not lack of knowledge or poor research. It's continuing to buy stocks that are falling and not selling when the market tells you the turnaround is not working. Fighting a downtrend in a stock price is like swimming against the tide.

My strategy employs using both technical and fundamental analysis. Technical analysis puts the probabilities in our favor. Fundamental analysis puts reason in our favor. Combining the fundamentals and technicals is a powerful mechanism for raising our odds of success. This EBook will provide a systemic approach to buying and managing a portfolio of turnaround stocks. The goal is to not only help you generate above average returns but maybe more importantly, preserve your psychological capital. This book is not long but its content can help to provide you with a lifelong edge for investing in turnaround stocks.

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The Five Steps To Identify, Buy, And Manage A Portfolio Of Turnaround Stocks:

1. Search for stocks that are trading at least 50% below their 3-year highs

2. Perform basic technical analysis to see if the share price is forming a base or bottom

3. If a base is formed, perform basic financial analysis to determine if the company will survive and what the future earnings potential is

4. Determine if management interests are aligned with outside shareholders

5. Manage your portfolio of turnaround stocks using the stop and reentry method

1. The Search For Turnaround Stocks

The first step in your quest for turnaround stocks is to search for stocks that have fallen 50% or more from their 1 to 5 year highs. This is accomplished by using the web site FINVIZ or any other comparable stock screener. FINVIZs website has a free screener that is ideal to accomplish this search.

During bear markets there will be a significant number of stocks showing up under this broad screen. I suggest you look through the list to see if any names come up that you recognize, such as bruised blue chips or busted growth stocks. After this review you will want to narrow the list further by searching for stocks based on particular fundamental and technical criteria. The most important criteria for turnaround stocks are:

1. Stocks trading at 70% of book value or less
2. Stocks Trading with a price to sales ratio of 70% or less.
3. Stocks with Insider buying
4. Stocks with A Technical Chart indicating a double bottom or base

In all cases, I suggest you choose stocks that are above $1/sh and below $15/sh with minimum market caps of 50 million dollars

I suggest that you search on FINVIZ once a week. As you aggregate stocks, you want to put the stocks on a watch list. FINVIZ and Yahoo Finance have excellent watch lists. It’s also a good idea to segregate your stocks into watch lists by the industry they operate in. This way you can keep track of all the news developing within the industry

2. Technical Analysis

The second step in our search for turnaround stocks is to perform some very basic technical analysis on the stocks in your watch list

If your stocks are on the FINVIZ or yahoo finance watch list, it's easy to examine the stock charts.

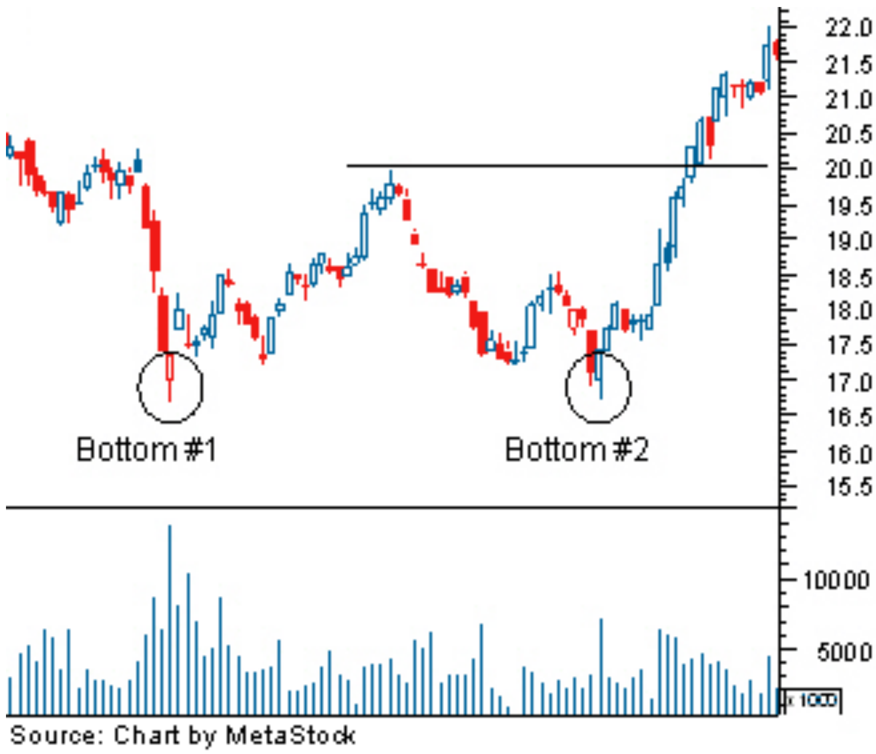
Many value investors tend to steer clear of technical analysis. They view technical analysis to be too subjective with little predictive value. I could not disagree more. Technical analysis is an effort to determine if a stock is being accumulated or distributed, important indicators in looking at potential turnarounds. Technical analysis also allows us to gauge the psychology and emotions behind a stock's price action. However, like psychology, it is not an exact tool.

Over the past 30 years I have found that successful turnaround stocks repeat virtually identical patterns. I have also found that failed turnaround stocks exhibited similar patterns that proved to be reliable signals to sell a stock. It is important to remember that every turnaround stock investment is an educated guess within a whirl of uncertainty.

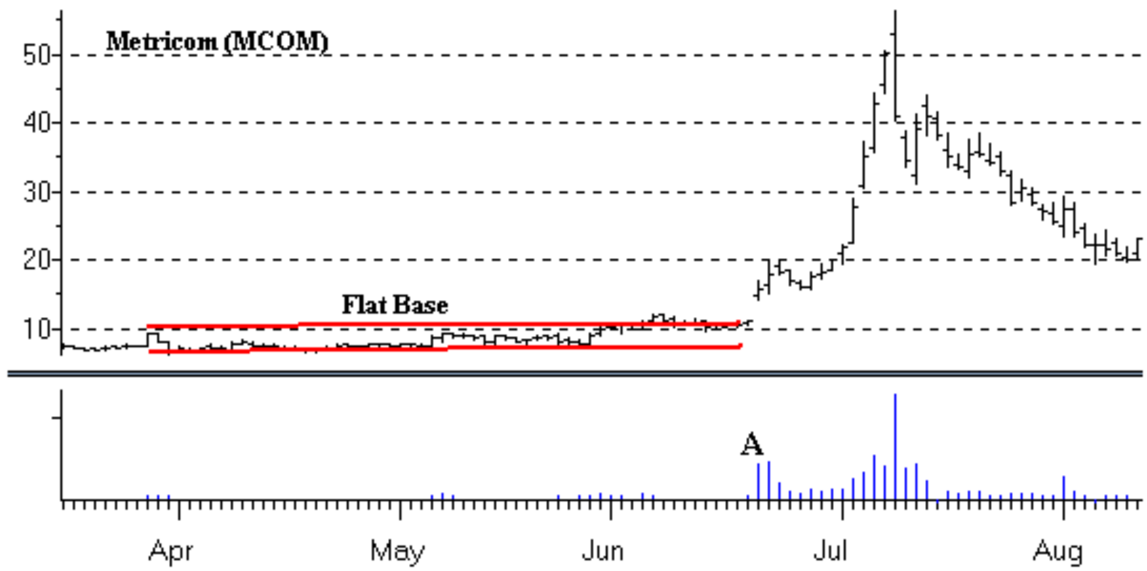
The stocks that appear in our searches will primarily be in severe downtrends. Our mission is to find turnaround stocks that have been in a downtrend for 1 to 5 years and are now establishing a base. This means that the stocks are staying in a tight price range after a long decline despite recurring bad news or a weak stock market.

While performing weekly reviews of your charts, you are looking for specific price patterns that indicate change from their long downtrends. These patterns include:

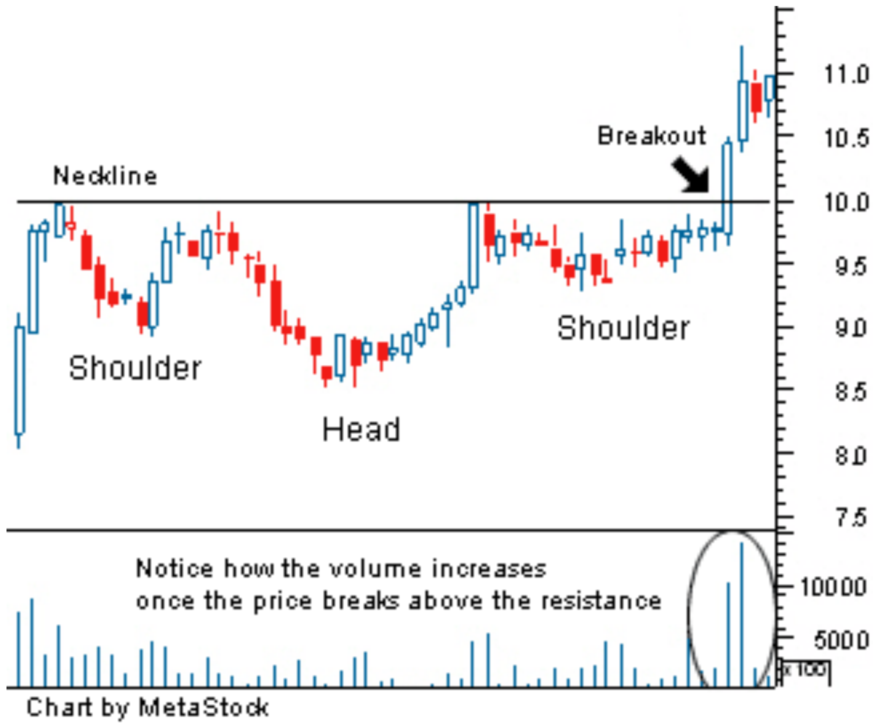
1. The Double Bottom



2. A long base



3. Reverse Head and Shoulders



4. A Stock Price That Moves To The Right Of A Downtrend Line

We want to examine the stock price over a time horizon that covers anywhere from 6 months to 10 or 20 years. This is important because many stocks have a strong tendency to decline to lows that were made many years prior. Any of the four patterns above is a powerful signal that the stock may be done with its price decline.

Besides price patterns, we are also looking for a stock's volume to begin falling as the price trades along a base, or as it tests a double or triple bottom.

The price action and trading volume of a turnaround stock often sends important signals. Turnaround stocks that don't fall further on bad news, or stay in a specific range with volume drying up are sending an important signal that a fundamental turnaround may be occurring. This indicates that despite the bad news, investors are buying and able to absorb the shares from sellers. In my experience, this is how bottoms are formed.

You do not want stocks that continue to break significant technical price support on no news or with earnings reports. This is sending a signal that more bad news is likely coming.

Most value investors continue to buy more shares as the price declines. My turnaround stock strategy plans to buy shares at a lower price only if the price is within our bottoming range.

Buying turnaround stocks in a downtrend is a riskier approach than waiting for signs of a bottom. As many seasoned investors can attest to: share prices can decline to unimaginably low prices. I liken buying a falling stock to stepping in front of train. My worst mistakes have come when I ignored this advice and bought a stock in a downtrend before it based. Turnaround stocks are not healthy companies and even though our fundamental analysis may suggest it's a good value, we want the technicals to confirm that the stock is not DOA.

I want to emphasize the point above. One of the most crucial lessons I want you to take from this book is for you **to not let your ego get in the way**. Nobody knows more than the market. There is a reason there are so few value investors who consistently beat the market. Even after decades of experience working specifically with turnarounds, it's impossible for me to know with even 50% certainty that a turnaround will be successful. As we will discuss in the money management section, it's wise to not let your ego control your investments.

There is another important reason not to rush into stocks that are in a downtrend, especially stocks that have fallen significantly with recently announced bad earnings or news. Bad news typically arrives in three stages. Stocks often start downtrends with their first announced earnings hiccup. The initial reaction is a steep fall, which finds a price bottom as value investors step in to buy shares, believing the price is cheap in relation to cash flow and earnings. However, what these value investors often fail to appreciate is how prolonged and severe a downturn can be.

When the next earnings disappointment arrives, the stage is set for more selling action. These new sellers consist both of those who did not sell out during the first downturn as well as some recent value investors deciding not to wait out a recovery. Once again, the price decline is halted when new value investors step in and old value investors double down and buy more shares.

The third earnings disappointment signals to value investors and old shareholder's alike that the problems are worse than thought. Resultantly, the stock falls again as investors give up hope and sell, regardless of price. At this stage, apathy sets in and hopefully a base begins to form as a majority of the sellers are done exiting the stock. The price has fallen so low that now buyers are willing to step in regardless of the news, as they believe the stock has reached a low price compared to its intrinsic value.

As mentioned before, turnaround stocks are inherently risky. An investor has to assume that even if a wonderful base has formed and the fundamentals look like they are turning up we may still be early or ultimately wrong.

You will never know for sure if you are buying at a bottom. That knowledge will only come after the fact. All we can ask for is an edge that the probabilities have risen in our favor and that a potential bottom is at hand. This is why examining the technicals is part of our turnaround stock buying process.

3. Financial Analysis

Now that you have found a stock that appears to be bottoming out, you need to perform a financial analysis to determine if the company can both survive and appreciate greatly in value in the future.

I believe that Murphy's Law is very applicable to turnaround investing. Nine times out of ten, a turnaround will take longer and be harder than anticipated, despite any assurances given by a management team. As a result, my first financial analysis procedure is to see if the company has the ability to sustain losses or poor cash flow over an extended period of time. Does the company have what is known as a clean balance sheet? (Low debt in relation to stockholder's equity). The number one enemy for a troubled company is debt. Debt is a monster that consumes cash for interest and principal payments at a time when cash flows are declining.

I suggest that if you are new to turnaround stock investing, stick with companies that have no more than 50% debt to equity ratio. You may also want to look at the balance sheet and examine how much goodwill accounts for total assets. If you see a goodwill balance greater than 30% of total assets, make sure your debt to equity ratio is lower than 30%. The reason being goodwill is likely be written off if a company is experiencing poor earnings, reducing total assets.

Our next step is to make sure that the company has enough cash to survive a long downturn. Depending on your level of financial acumen, it's ideal to examine possible future cash losses against the existing cash balance. Look at the future commitments for capital expenditures and examine all operating leases. As a company shrinks, operating leases will need to be terminated. This forces a company to possibly use large amounts of cash to pay of lessors.

Next, look at the company credit lines: do they have sufficient access to cash in the case of a cash flow emergency? If it looks like the company has an adequate amount of cash and credit availability, you are ready to move onto the next section of financial analysis, addressing why the company is in trouble.

Turnarounds fall into two categories. A company may be suffering due to the change of conditions in the industry it operates in or the company may be suffering from a company-specific issue, such as the loss of key customer, management incompetence, or anything related specifically to the company.

If the company is suffering due to the industry, it is important to understand that industry downturns typically last for 2 to 6 years. If the industry has just begun its downturn, it may be best to put the stock on your watch list and perform financial analysis later even if it looks looks like the stock is bottoming.

If the company is suffering due to its own problems, it's critical to determine if the management team is focusing on the right strategies. In a broad sense, you must ensure that the management team is making sure the company's service or product will be better, faster, or cheaper for its customer. It often takes at least one year for a management's team to have a positive impact on a company experiencing problems.

Now that we have a clean or solid balance sheet, adequate cash and a focused management strategy we want to conduct an analysis of future profit margins. Analyzing margins allows us to predict with some accuracy how profitable a business may be in a few years even if the company is currently earning little or losing money.

Margin analysis requires that we crunch some numbers that are contained in the company's historical financial statements. There are different ways of going about this. One way is to go to the company's website and print out all the 10k and 10q reports over the past 3 to 7 years. An alternative, to save allot of time, is to pay for the data. I use the website Guru Focus. They have a financial analysis tool that will show every financial statement along with important financial ratios and margin percentages including (gross margin, operating margins, EBITDA margins) over a 15-year period. This data saves countless hours of having to go and print out the financial statements.

The next step in our margin analysis requires a leap of courage. I suggest every investor, even the novices, pick up the phone and call the investor relations department or management of the company. Our mission is to find out what management's goals are for the long-term gross and operating margins of the business.

Get into the weeds of this topic. Try to determine what sales may be in the future. The company's sales or revenue line in the income statement is price of product or service times the quantity of goods sold or services performed (p*q). Ask the management what's going on with pricing. You need to get a sense for the direction of pricing over the next few years. Ask how a recovery in demand would increase gross margins. Inquire about the potential for increased volume for units sold or services performed. The best scenario is for increased volume with rising margins. Does the company have the ability to introduce new products and services with higher margins?

Ask how they plan to implement their turnaround and look for big changes. Raising margins requires doing something radically different than in the past. Be skeptical if management plans on getting better margins with the same old approach. Remember to forget about this year's earnings and focus on the future

Don't worry about being precise in this estimate. The most important thing is to gain some confidence that there is a reasonable plan for margin improvement.

Then ask about the company's best and worst competitors. Ask why their margins are where they are. If the competitors are public, look at their margins before your call. What were their peak and trough margins? Examine the best and worst companies in the industry

Next, ask about the company's SGA expenses. A good turnaround executive will quickly slash SGA costs. However, there is usually a floor as to what this cost can fall to. If a management has been operating for a year, you can assume SGA will stay at this level. Ask if the company plans to introduce new products and services that may require an investment in SGA.

The answers to these questions are critical for a turnaround investor. I realize that this may be intimidating for new investors, but trust me; it has the potential to confirm why the stock is forming a nice bottom or breaking bases.

With this data you are now able to calculate a rough sketch of what future cash flows could look like. Take the possible future revenue and multiply by future gross margin percentage to get gross margin dollars. Then subtract your estimate for SGA dollars from gross margin and you have a rough projection for EBITDA dollars.

After this, calculate the company enterprise value (EV). This is the equity capitalization (shares outstanding*stock price) plus the long-term debt on the balance sheet.

Then divide projected EBITDA into enterprise value. Then compare this multiple to what similar companies have traded at over the past 2 to 7 years. If the projected EBITDA/enterprise value multiple is significantly below the historical or current multiple that similar companies are trading at, you have a potential winner.

I also suggest that you examine the company's historical cash conversion cycle. This stat measures the number of days it takes a company to covert its working capital into cash. While it's easy to manipulate earnings you can't fudge the cash conversion cycle as it measures the turnover of receivables, inventory and payables. A good turnaround team should be able to meaningfully decrease the days required to turn working capital into cash.

4. Analyzing Management's Interests

A cardinal rule for turnaround stock investing is to not invest in a troubled company until the management team has been changed. Existing management rarely fixes the problems that were initially created under their watch. However, a caveat is if existing management owns a significant amount of stock and are considered good businessman, and that the initial downfall was a result of factors outside of their control.

When a company has a change in management, another layer of due diligence is required. First, determine what their backgrounds are. See if they have a history of success or if they simply go from one failing company to another. Inquire if management has any experience in fixing companies.

I have found that in many industries, bad managers flow from one company to another. Boards don't realize that the best thing to do is to find someone outside of the industry who has a history of success and can bring a fresh perspective to their problems.

The next step is to examine the executive compensation package. New management teams that arrive with insignificant option grants at inception of employment will often look after their own interests and not existing shareholders. With this, there is a higher potential for future equity offerings and dilution. Managements with little stock upside also have their minds on salary and bonus instead of stock appreciation.

We want to see management with compensation packages that are more closely linked to company performance, like equity options, as opposed to fixed payments like salary. Simply put, the more they have at stake, the harder they will work. Determining if the executives view their job as a paycheck or a way to generate significant wealth is a very important question. Experience has shown me that when a management team has skin in the game, they are incentivized to work harder and look after shareholders.

Another interesting factor I have noticed is that when new management is appointed, stock prices typically rise. In an instance like this, I would not rush in as the stock typically comes right back down. This occurs because it often takes around a year for new management to determine what truly ails a company and to "find the skeletons". Also, in most instances, expect write-offs and big bath accounting for the 1st and 2nd quarter after management takes over.

Another positive hint is if management and directors buy stock with their own cash. Additionally, a sign to exit your position might be these same insiders selling their stock interests.

5. Managing your Portfolio of Turnaround Stocks

I have invested in hundreds of public companies attempting corporate turnarounds. I have seen as many unpredictable turnouts as you can imagine. I have seen companies with clean balance sheets and reliable cash flows turned to dust as cash losses piled up from unrelenting declines in price and demand for its products. I have seen companies with mediocre balance sheets and horrible operating losses experience a turnaround so wonderful that they could pay off all their debt in 5 years. In any case, these outcomes were unpredictable at the beginning of my research process. Turnaround stock investing is similar to venture capital investing. We are betting that a management team can redeploy the assets of a company to generate a significant return.

It's critical to not become attached to an investment just because you have committed hours of research and/or believe you are right. Even the greatest businessmen can often not save a company. Forget studying Warren Buffet, and adopt the mindset of George Soros and Peter Thiel. Leave your Ego at the door. Cut your losers and let your winners run.

My method of turnaround stock investing is very dependent of stop losses. In the classic world of value investing, stop losses based on technical analysis is akin to heresy. Rarely will a professional security analyst armed with a CFA, MBA, or CPA admit a mistake or place a stop loss based on the price movement of a stock.

You also don't find many articles on stop losses and technical analysis posted on the Graham and Dodd Columbia Business School Newsletter or value investing web sites. The brilliant analysts and hedge fund managers believe they are, without fail, always buying a dollar for 50 cents, so who needs a stop loss based on a stock price chart. Value investors do not believe in the wisdom of crowds. My system believes that the crowds do have wisdom, at critical points. All one needs to do to reinforce this point is to examine the stocks of natural resource companies in 2015. In early to mid 2015 value investors thought they were getting great bargains. Many of those 50 cent on the dollar bargains were wiped out by December 2015.

Similar to a venture capital portfolio, 10 or 20 carefully selected turnaround stocks will typically yield 2 to 4 stocks that will turn into 200% to 500% winners. We want to sell stocks that are falling and breaking key technical levels of price support after our purchase. Large returns are possible over a two to three-year period if we do this. Winners will more than offset our losing positions. You will see that Pareto's 20/80 principal is alive and well in the money management world.

For those stocks we sell because the stock price fell below a key technical support level, it's important to employ a stop and re-enter strategy. The reason for this is that we may simply be early and not wrong. The end of downtrends can be very messy affairs. Since our fundamental work suggested the possibility of a turnaround, you must be prepared for a whipsaw after being stopped out. This occurs when the stock goes back up above the critical support line in the chart whose previous violation forced us to sell.

Stop and re-enter is important because the last thing we want is to watch from the sidelines while the stock we just sold potentially zooms to new heights, confirming our original fundamental analysis. Therefore, as mentally difficult as it may be, the only logical strategy is to rebuy stocks if they move back above the price we sold. Eventually this aggravation will come to an end as the price will move away from this key zone of support, whether it will be up or down. Being able to reinstate a position is the hallmark of a true professional. Amateurs will whine about the cluelessness of the markets, professionals take it in stride and treat it objectively. Just like the real world of business, investors must shift their degrees of conviction as our indicators and fundamentals shift and change. Turnaround stock investing requires a bit of forethought and a dynamic plan for contingencies.

You will find that engaging in the stop and re-enter strategy for each of your stock positions will not only save you money if a turnaround fails, but it will preserve your psychological capital from avoiding the emotional havoc of losing a substantial amount of capital. If 20 to 30% of your turnaround stocks generate 80% of the returns, taking losses is something one needs to get accustomed to. As investors are predisposed to avoid losses, this takes training. Innately, you will feel much worse about a loss of a given size than feel good about gains of the same size. You must shed this habitual instinct in order to realize your fullest investing potential.

Members of **www.turnaroundstockinvesting.com** have access to resources that will help you develop the skills necessary to become a successful turnaround stock investor.

The key is to develop a strong procedural memory for the foundations of turnaround stock investing.

1. Gain competence recognizing stocks in a bottoming process
2. Learn how to become proficient studying financial statements in a simple and straightforward way. Through numerous case studies
3. Learn how great CEOs fix companies so you can raise your odds of investing in a successful turnaround
4. Practice employing the stop and reenter strategy on every one of your stocks.

Case Studies

Cloud Peak CLD

CLD is an example of a failed base. I started acquiring shares in the $6 region. CLD has one of the few clean balance sheets among coal producers. After a 5 year bear market I believed that coal prices were bottoming and that a slight rise in coal prices would dramatically increase Clouds future cash flows and share price.

The stock subsequently broke its base and I was stopped out just below $6/sh according to my rules. The stock is currently $2.50/sh and I am waiting for another base to form to reenter. It is not unusual to be early investing in a turnaround stock. It’s best to sell and rebuy at the next base rather than average down, as it’s impossible to know if even a strong balance sheet can survive an industry depression.

Overseas Shipholding OSG

OSG had been on my watch list for a year as the share price moved between \$8/Sh and \$10/Sh after falling from \$85/Sh in 2008. However, the balance sheet had a lot of debt so I stayed away. Many value investors owned OSG. What was unknown to all was that OSG had a large undisclosed tax liability. The break in the base between March and July was a warning signal. The next base was broken between July and Oct. before the stock went to zero. Stocks that break bases are sending you a strong signal.

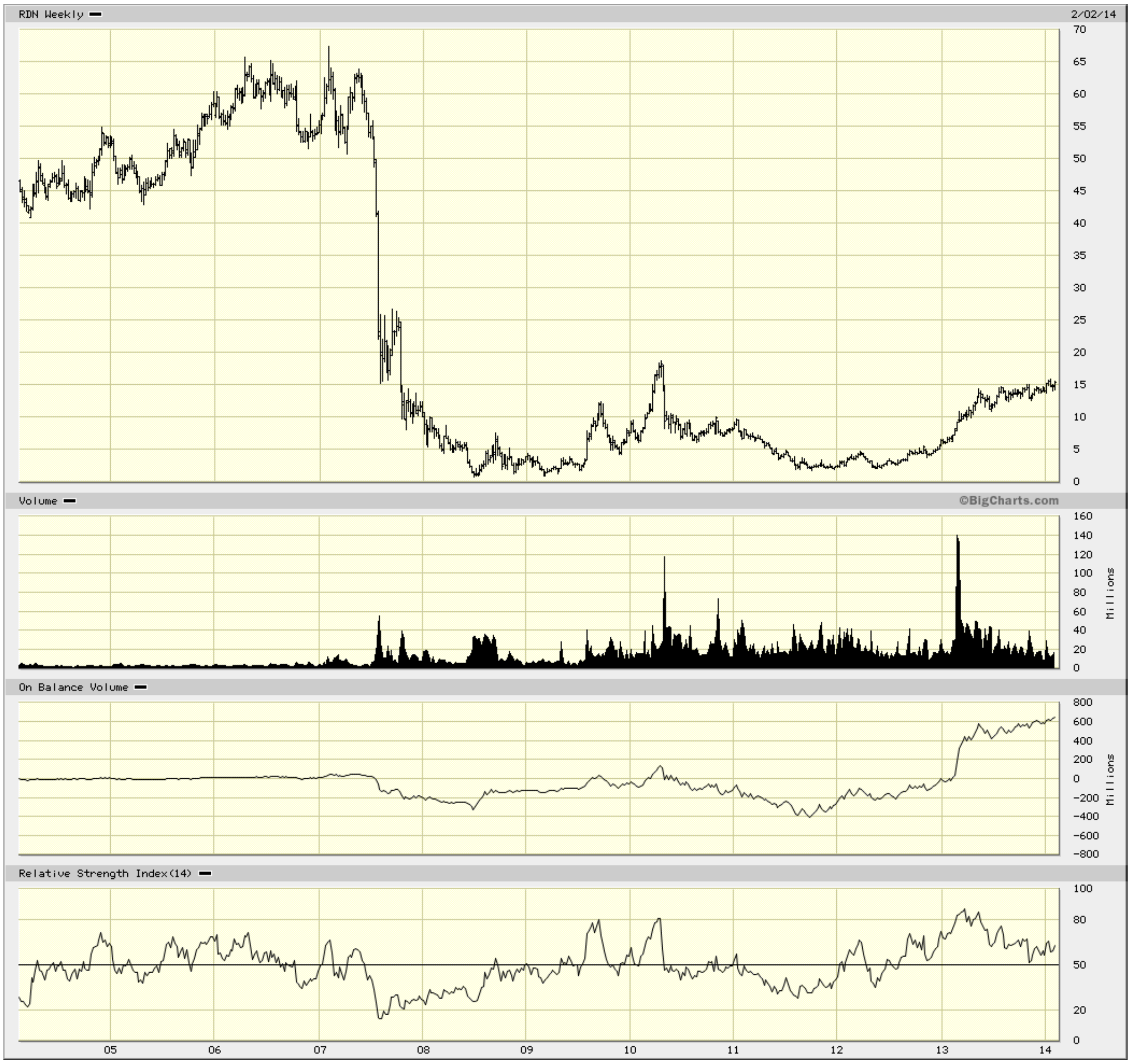
Cott

Cott was a favorite of value investors all the way down from $12/sh to $1/sh. The stock broke through three bases before it finally bottomed. An important signal was inside buying when the stock was in its 4th base. The stock went on to move 1000% off its lows: a 10 bagger.

AES Stock Chart

AES is another example of a stop and reenter. The stock appeared to be basing from July to October in 2002 but then broke its base forcing a stop out. The stock then moved to 97 cents. The ideal time to reenter was when the stock price moved back above the previous stop price known as the resistance level. At the time, AES was a high-risk investment as its balance sheet was leveraged. However, it always maintained its strong cash flows. The stock subsequently went to over $20/sh. In hindsight it looks silly to go through this stop and reenter aggravation. However, had AES gone to zero the stop and reenter strategy would have been a brilliant move. The stop and reenter method protects but also allows an investor to be present if and when the stock finally begins its turnaround.

Radian Stock Chart



Radian is an example of how oversold a stock can become in the depths of a downturn. Radian went from $60/Sh to under $1/Sh in two years during the financial crises. It was a favorite of many value investors who doubled and tripled down on the stock as it was falling. They refused to believe that the market knew more about the company then they did. Once again at critical moments in a company's life, the markets can send very strong signals that you should listen to.

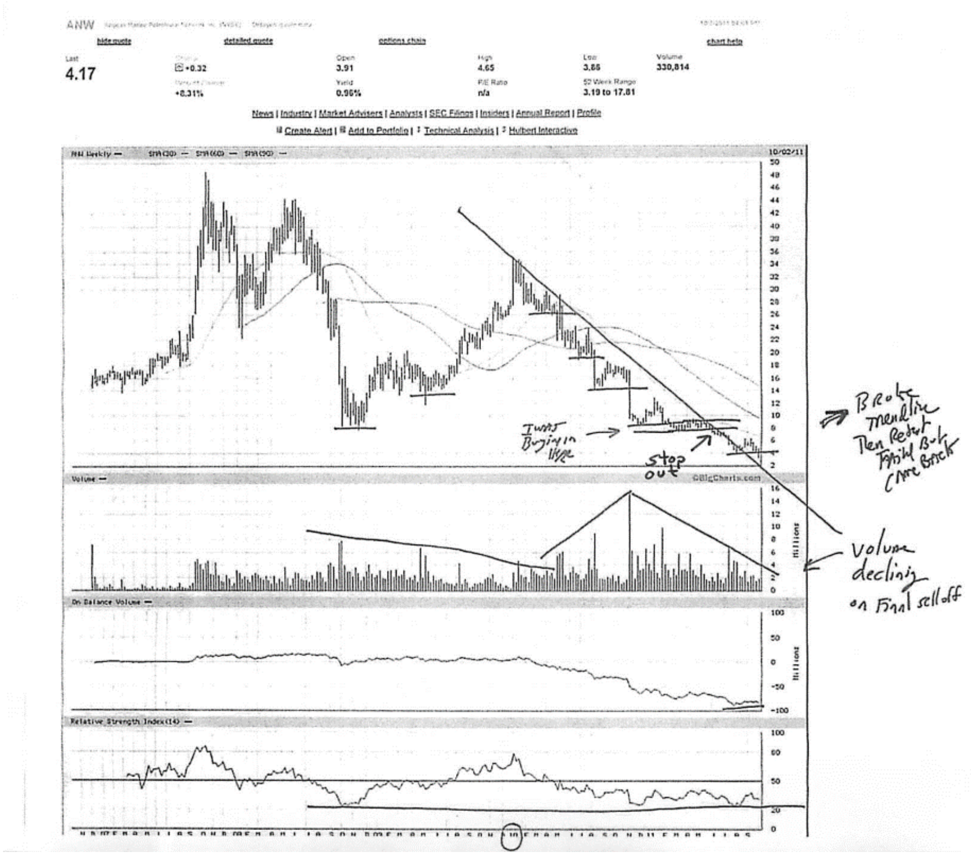
Terra Industries TRA

Terra is a perfect example of how long it takes an industry to go from boom to bust to recovery. Terra is a large fertilizer producer that peaked in 1997 and did not turn till 2003, 7 years. As you look at the long-term chart you can see the 3-year base. I started investing in late 2000 on the double bottom at around $1/sh. The fundamental analysis suggested that Terra could earn $1/sh if fertilizer prices returned to past levels. At a 10 multiple that would equate to a $10 future share price. After purchase the stock rose to $5/Sh then back to $1/Sh. The price pattern for TRA is characteristic of companies that are operating in an industry depression. TRA eventually rose to $30/sh.

Stolt Offshore SOSA

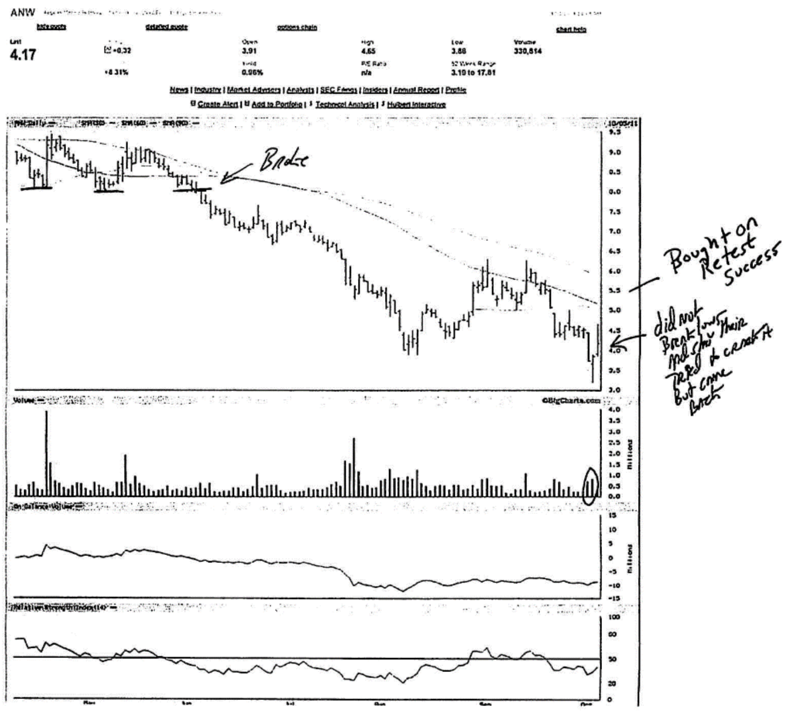
Stolt Offshore was an offshore construction company that had declined due to large cost overruns on various projects resulting in large cash losses. I became interested when a new CEO came on board. Over the next year the company announced continued write-offs and had to raise equity. Despite the bad news, the stock held the lows and a base was formed with higher lows. The stock eventually went over $20 /sh.

Aegean Marine ANW

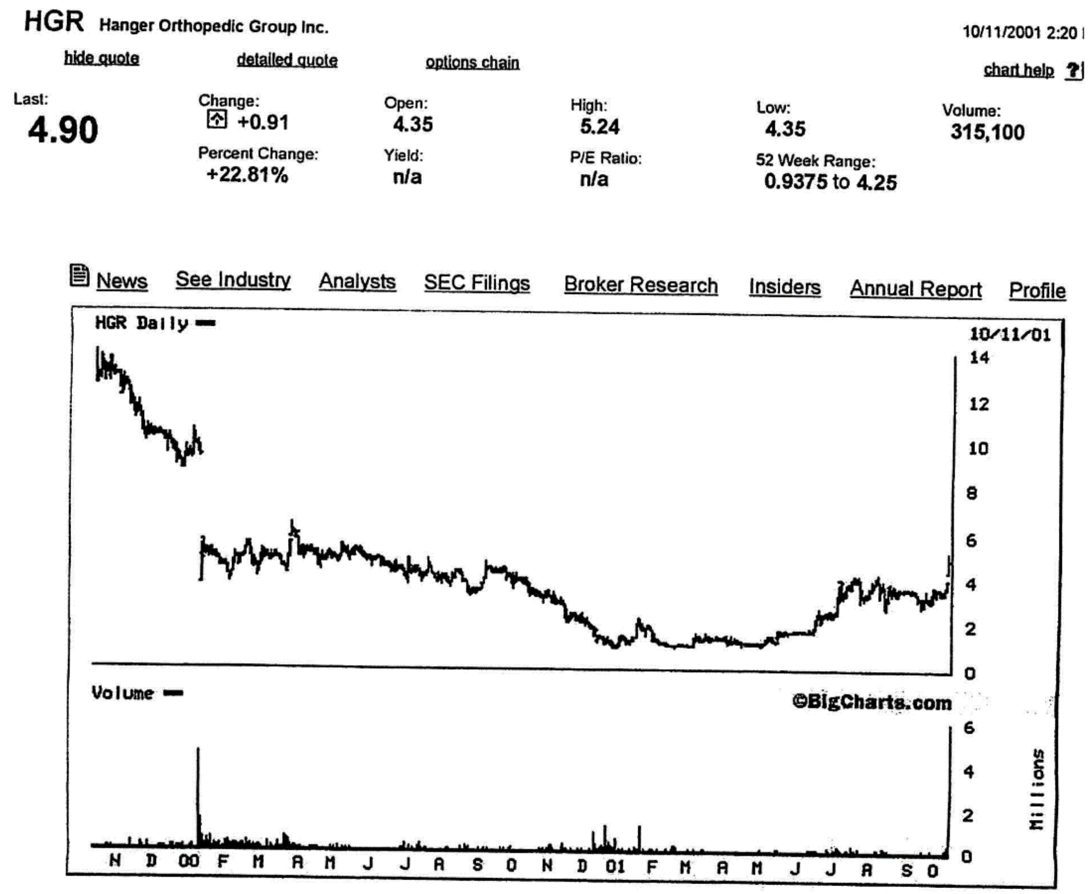


Aegean Marine is a good example of how far a stock can fall. I started buying a small amount of shares at 8/sh after the shares had fallen from $40/sh. At $8/sh the stock was forming a nice base and reached the previous lows in 2008. However, this low did not hold and the base was broken. It eventually fell to $3.75/Sh where it made a classic reversal double bottom. The stock eventually went to $14/Sh where I sold it. Aegean is a classic case of how stocks can fall to unbelievably low levels. You must have a plan of how you will deal with these situations.

Here is a chart illustrating the reversal double bottom of Aegean with my comments on the day of the key reversal. I believed the company was financially strong and a tremendous bargain. The fact that the stock tried to break to new lows and made a reversal with no news told me that strong support existed. This was the exact bottom.



Hanger Inc HGR



HGR is a supplier of prosthetics. The company ran into trouble as its roll up acquisition strategy faltered, leading to declining earnings causing concern given the company's high leverage. My fundamental analysis told me that cash flows would remain strong and the share price was very cheap. As can be seen on the chart a wonderful base was formed, with a gap up off the lows. The stock subsequently went over $30/Sh.

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Here is a close-up for the bottom in HGR. You can see the triple bottom and the gap off the lows

Teekay Tankers TNK

TNK Teekay Tankers is an example of a nice tight bottom where the price also moved to the right of the downtrend line. As the bottom was forming, the fundamental outlook for oil tankers was bleak. It was impossible for even the most experienced tanker owners to know when day rates and vessel values would bottom. However, Teekay had a sound balance sheet with financial support from its parent company. Fundamental analysis indicated the future peak earnings could rise to $1/sh if rates ever rose to just 50% of prior peak rates. The stock rose to $8/sh in 2015 from the lows of $2.15/Sh in 2013.

Ford Motor F

F Ford Motor Company (NYSE) 3/16/2004 12:55 PM

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Last:	Change:	Open:	High:	Low:	Volume:
13.00	-0.02	13.16	13.24	13.00	2,969,100
	Percent Change:	Yield:	P/E Ratio:	52 Week Range:	
	-0.15%	3.08%	26.00	6.60 to 17.34	

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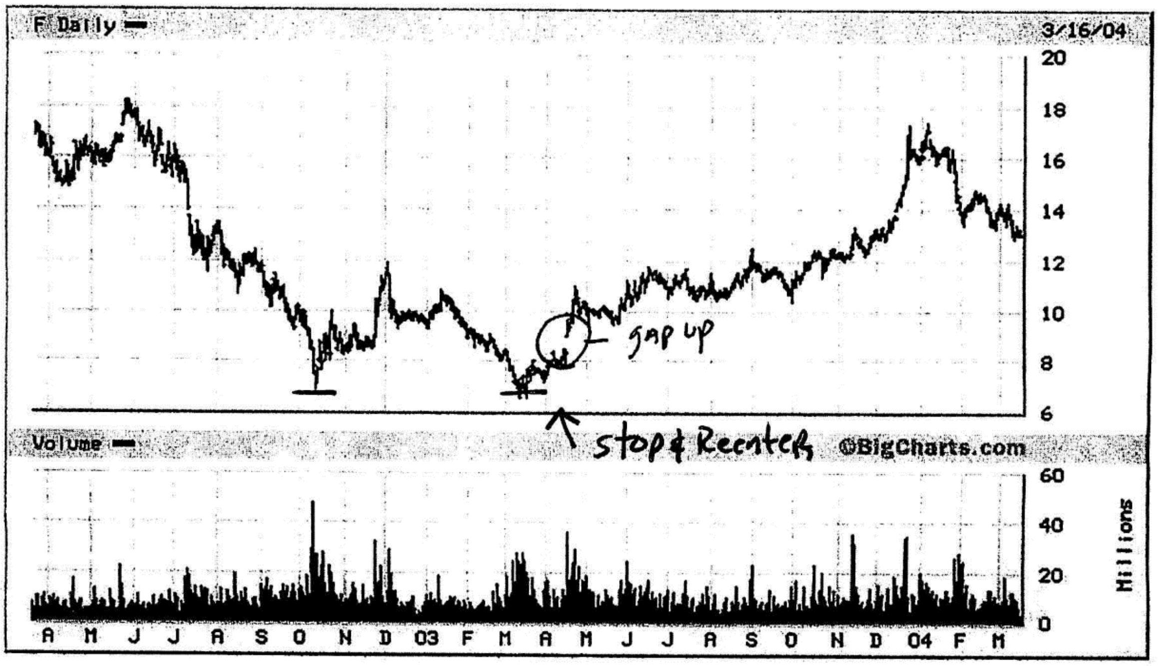
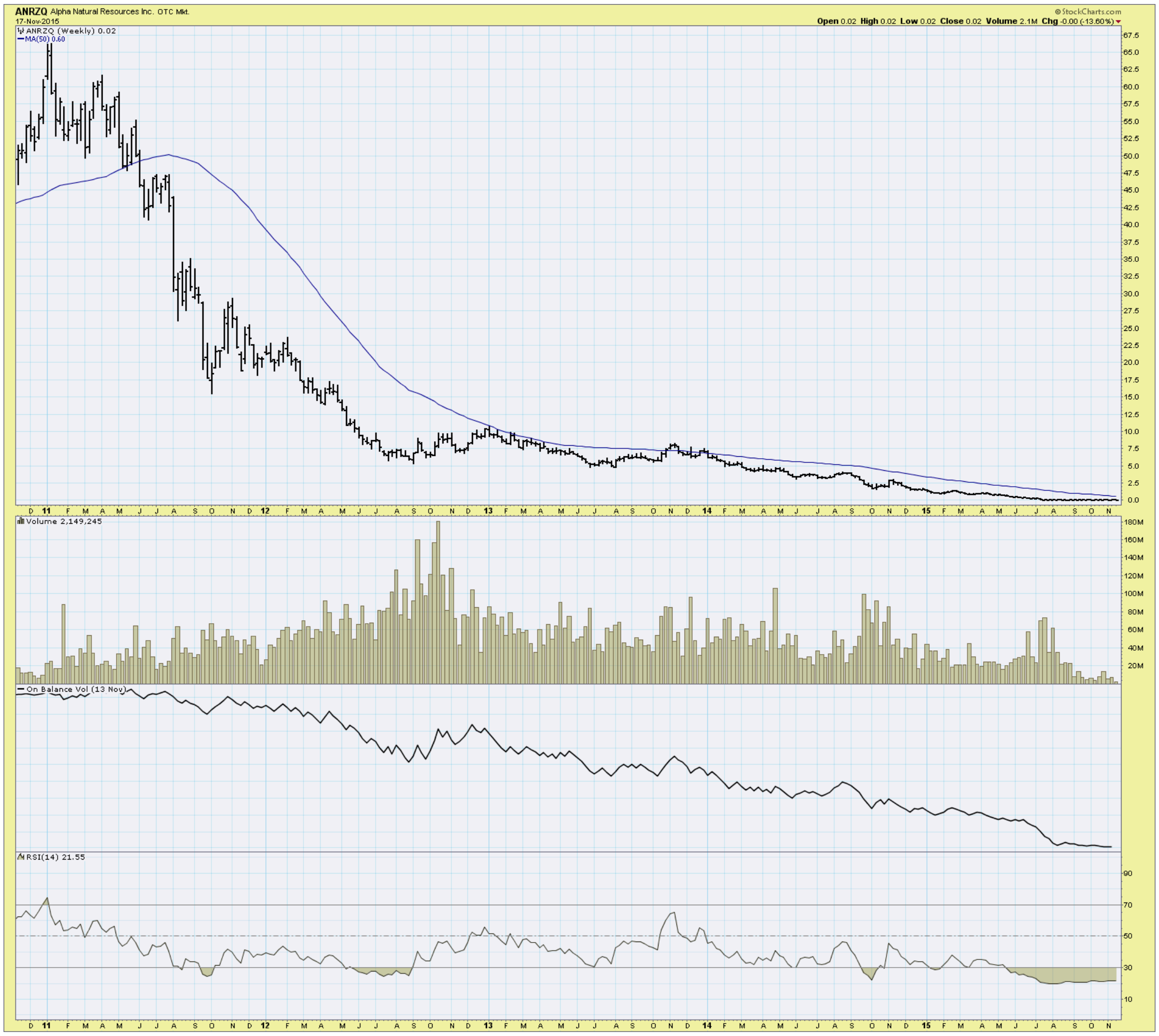


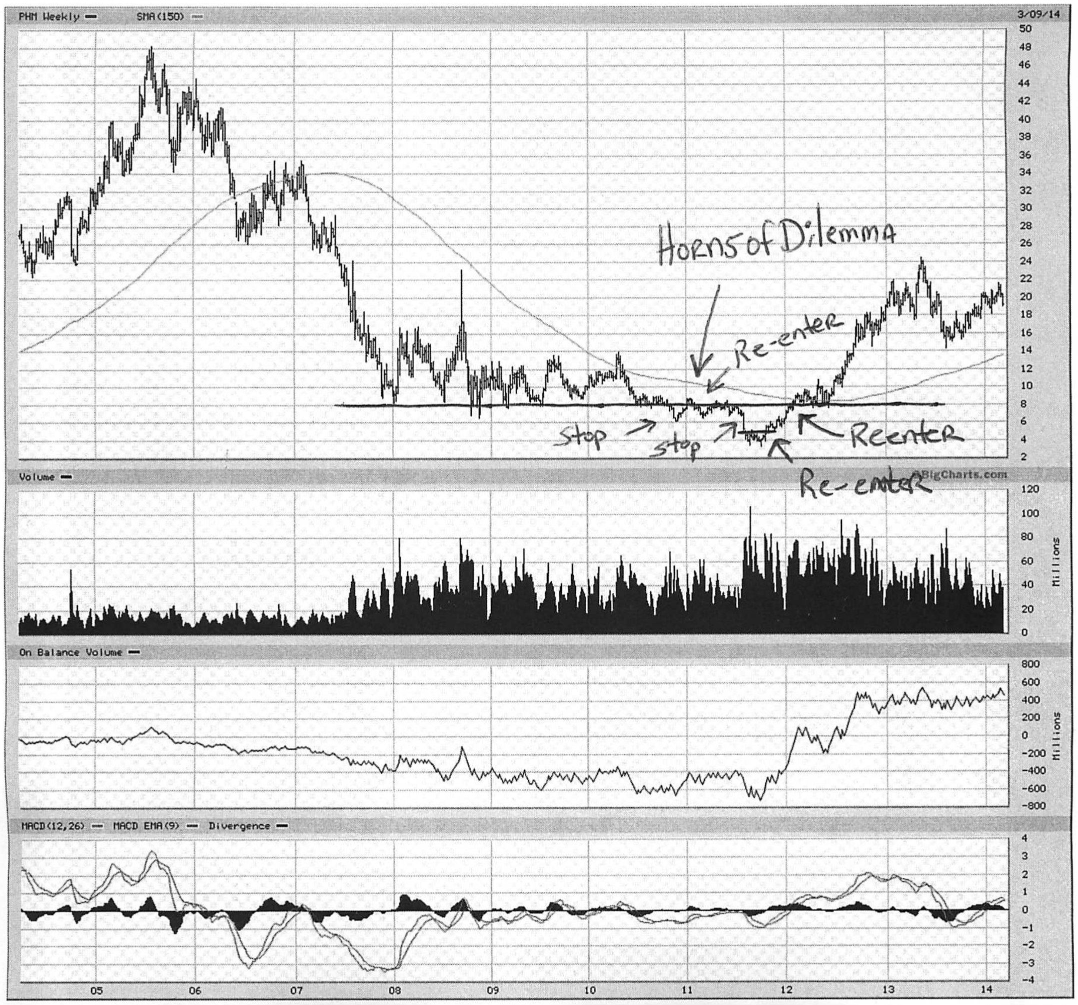
Ford is a classic example of a stop and reenter double bottom. Upon Ford's test of the second double bottom it broke the lows of the first test. This forced a stop out. However, the stock quickly reversed and the position was reentered. I point this out to show how a stop and reentry investing strategy requires a bit of planning and a willingness to be ok with whipsaws.

Alpha Natural Resources ANR



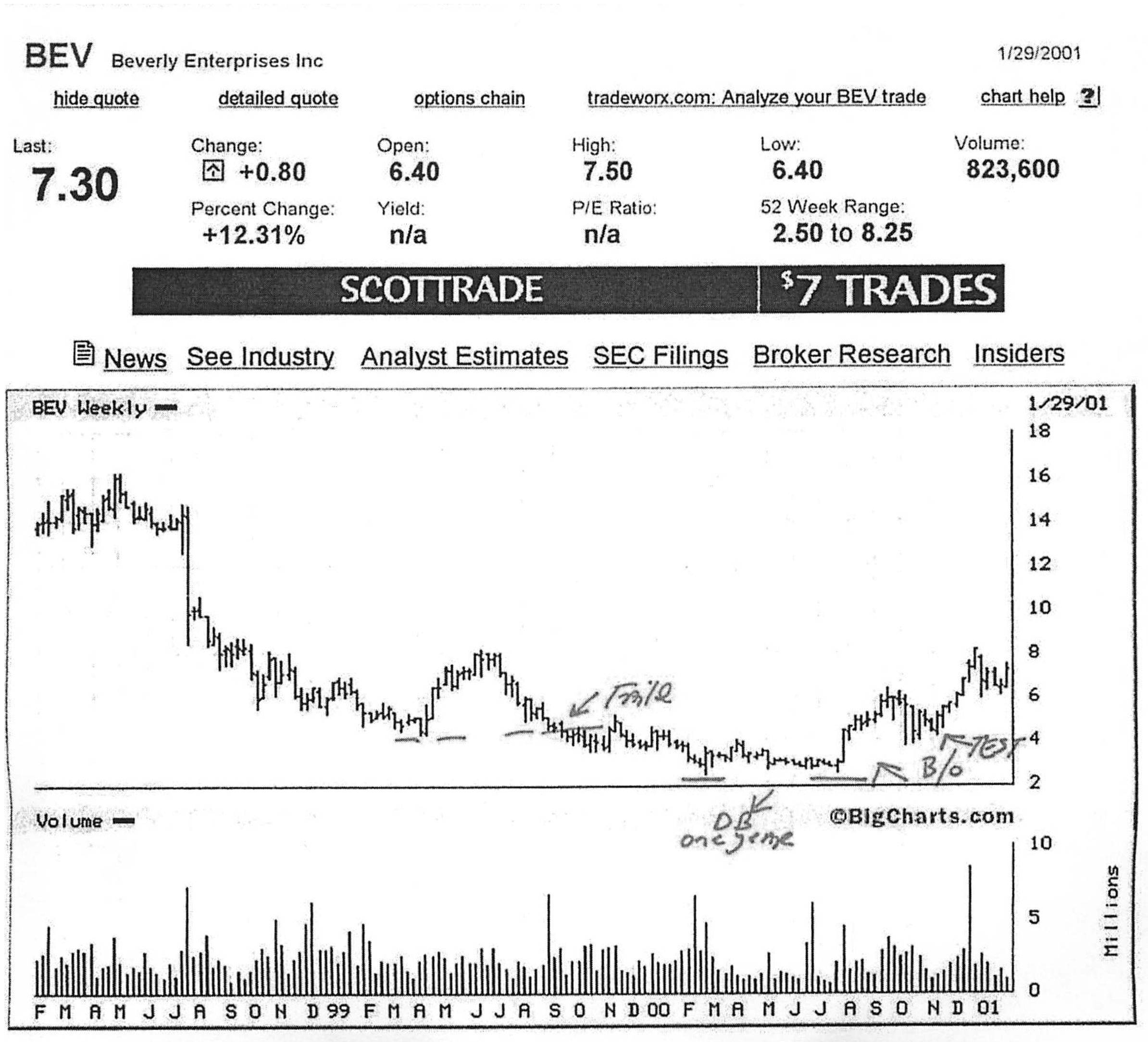
ANR is an example where I stopped and reentered in the stock four times before the stock ultimately went to zero. Fundamentally, ANR's balance sheet was leveraged but it had a large amount of cash and salable assets in relation to the debt. However, the decline in coal prices became so severe that ANR began to generate negative EBITDA losses that I did not expect. The stock never stayed within a base. Unfortunately, we will only know if we are correct in hindsight. The lesson from ANR is to never let your convictions in the fundamentals override the technicals and rush into a stock until it has formed a solid base or broke a downtrend line. I thought I was getting a fabulous value so I violated my rules. The stock price action was telling those willing to listen to stay away. Losses like ANR will show up again and again despite all the research you perform. It's the nature of turnaround stocks. Our system allows for losses like this though.

Pulte Home PHM



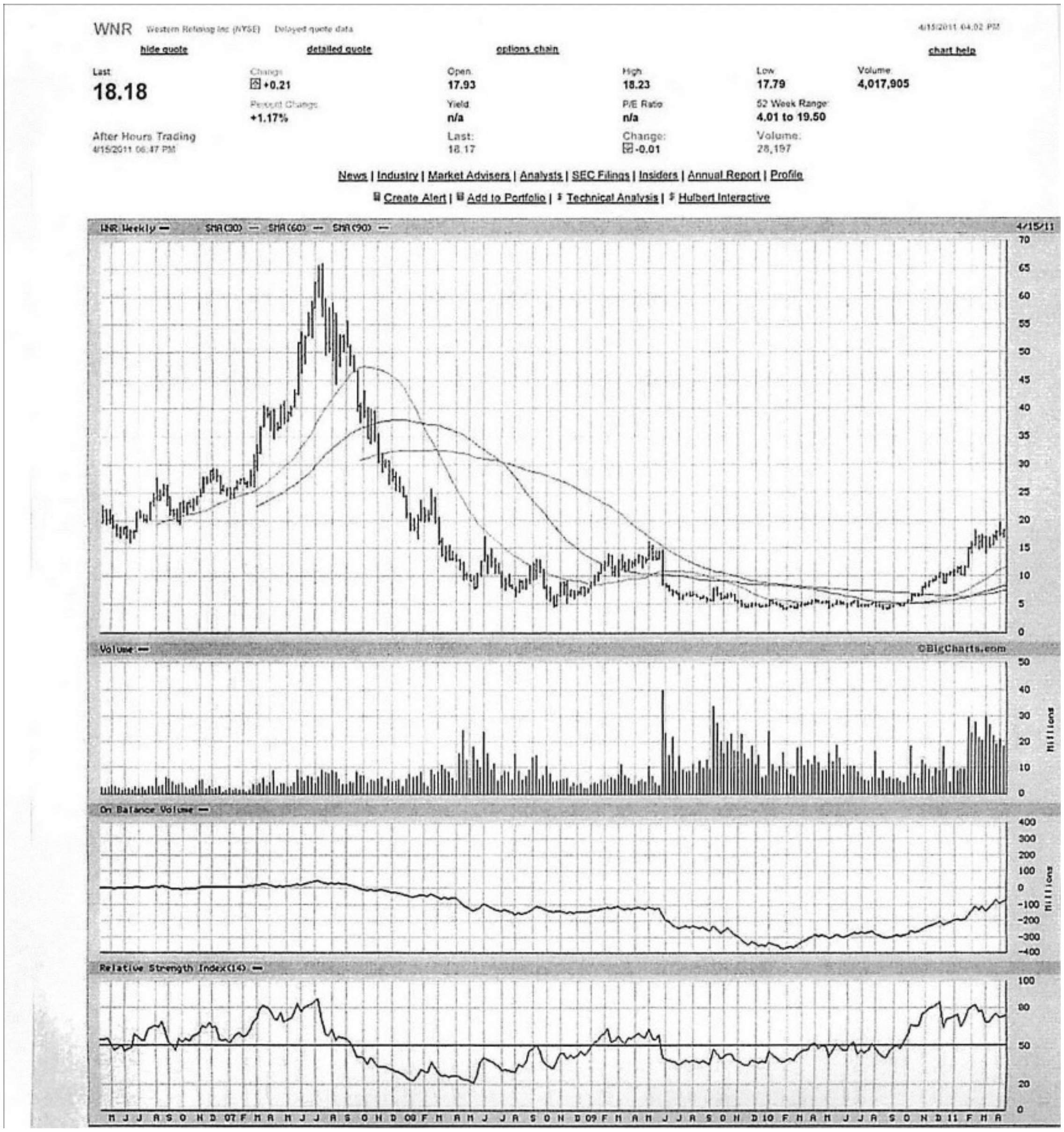
Pulte Homes PHM is perfect example of how frustrating turnaround stocks can be. PHM was a victim of the great housing bubble as its share price fell from $48/Sh in 2006 to $8/Sh in 2008. For the next three years PHM found solid support at $8/Sh. Fundamentally, PHM had adequate resources to survive the bust. However, starting in late 2010 the stock started to break the strong base at $8/Sh in 2011 and then had numerous starts and stops trying to get back over $8/Sh base with numerous whipsaws of buy and stops. It then crashed to $4/Sh. Those who stopped out were quite happy. However, as is the case with many turnaround stocks, PHM started to rise before anyone could see the recovery. For turnaround investors this puts us in the horns of a dilemma. The last thing you want is to see the stock take off without you. You have no choice but to reenter, the question is when. You can do it at first reentry signal or more conservatively, wait for it to reach and rise above $8/Sh.

Beverly Enterprises BEV

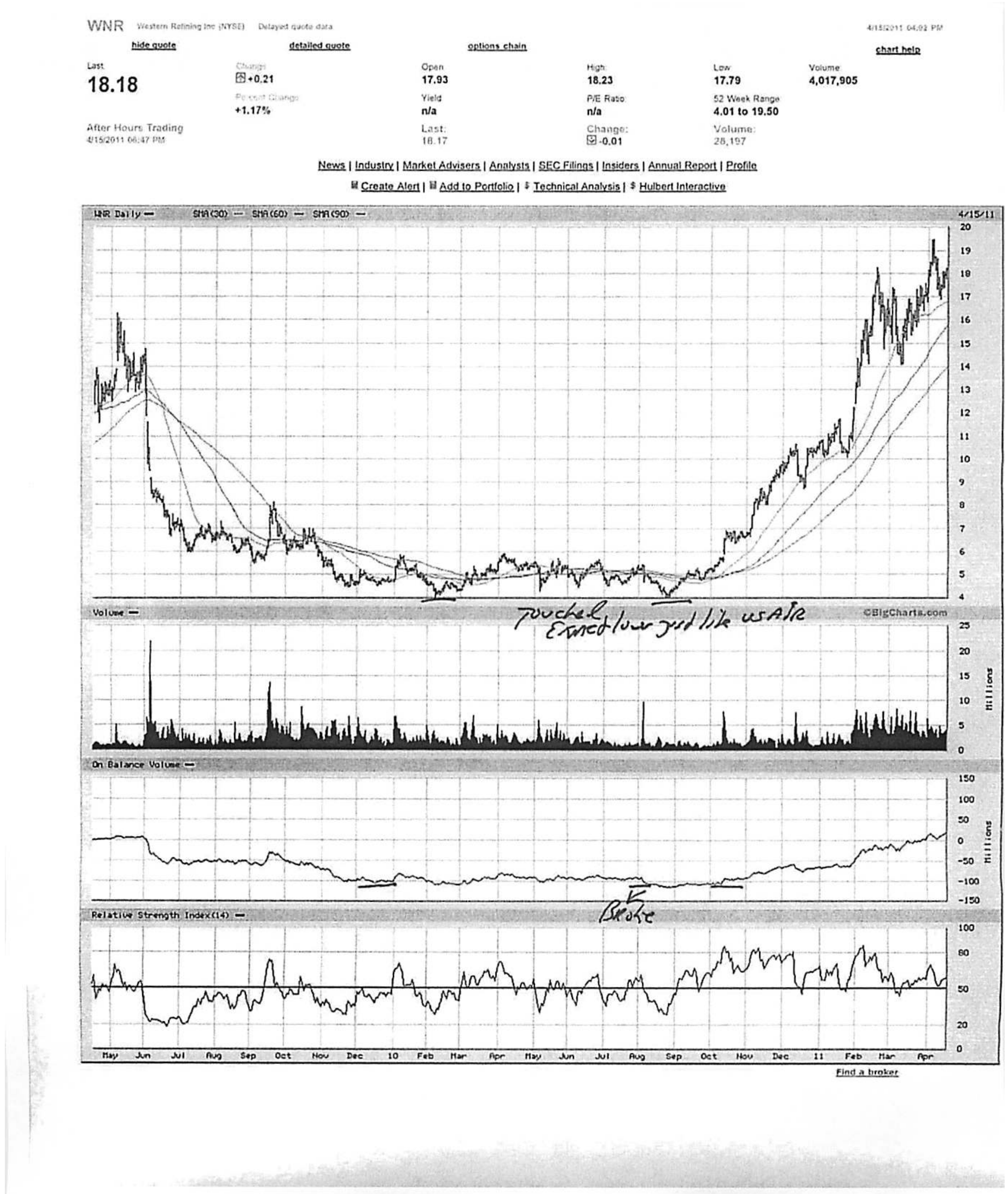


Beverly Enterprises BEV was a nursing home operator that had experienced falling cash flows when the government cut subsidies for the industry. Fundamentally, I believed that reimbursements would have to rise in the future some point, and Beverly had the resources to survive a multi year downturn. The stock appeared to be forming a double bottom at $4/Sh but was stopped out as the base broke. The shares then went down 50% to $2/sh. The stock then went on to form another double bottom with insider buying which proved to be a good reentry point. The stock eventually went to $12/sh

Western Refining WNR



Western Refining is a similar pattern to TNK. WNR is a refiner that went through an industry refining depression from 1987 to 2010. It stayed in a long base for close to two years. Fundamentally, WNR's balance sheet and cash flows were marginally strong enough to survive the depression. However, it was not a no brainer to buy shares at the lows, as no one knew how long refining margins would stay depressed. Despite bad news quarter after quarter the stock held its lows.



This chart gives a better picture of the WNR base. You can see how it rose out of this base and never looked back. Each time WNR approached the lows in the base it looked like it as going to break. An investor can never know for sure. That is why the stop and reenter strategy works for turnaround stocks. If refining margins had not improved WNR stock price may have gone substantially lower and the stop would save an investor..