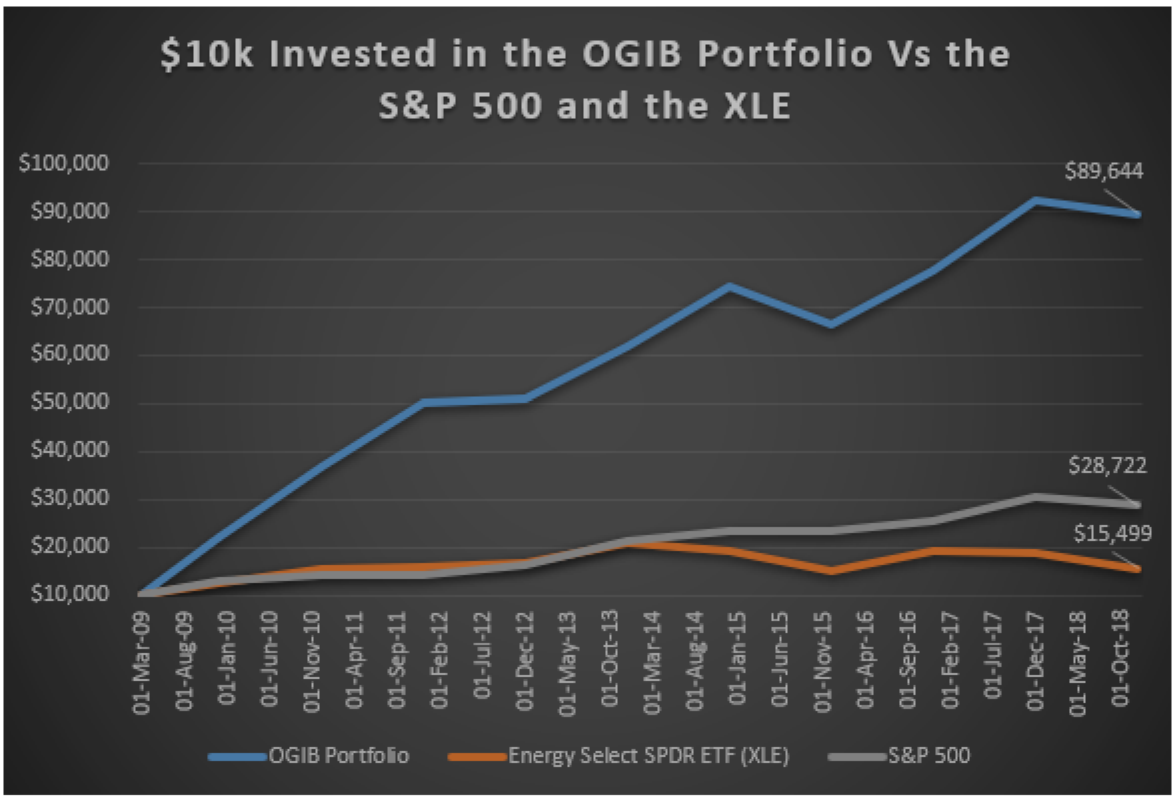
In March 2009 I launched the Oil and Gas Investments Bulletin (OGIB).

In the decade that followed the oil and gas sector has been a brutally tough sector for investors to make any money.

Over the past ten years some of the most high profile institutional and commodity fund managers have been forced out of energy investing – but my OGIB portfolio has flourished.

Let me show you the stats….

The graph below details how my real money OGIB portfolio has performed over its first decade. First relative to the Energy Select SPDR ETF (XLE) that I have been competing against and also against the S&P 500.



The results speak for themselves.

The OGIB portfolio hasn't just outperformed these two indices, it has massively outperformed both of them over this time period.

While energy focused hedge funds, mutual funds and newsletters have collapsed I haven't just widely outperformed the energy sector… I've widely outperformed a raging bull market for the S&P 500.

And I've done it with one arm tied behind my back, by only investing in one of the worst sectors of the stock market!

Today I'm here to fill in some details for you on two things:

1 - I'll describe in detail HOW I dramatically outperformed the energy indexes.

It truly is a sustainable, repeatable investment approach that identifies the best risk/reward stock opportunities in the market.

2 - Why I think I can do even better with my new Investing Whisperer subscriber service--where I'll be using my proven investment approach to every sector of the market.

With the Investment Whisperer my opportunity set just increased exponentially in size. That means more opportunity and higher rates of growth.

The Background – How The OGIB Portfolio Soared While The Sector Collapsed

A wise man once told me to never, ever underestimate the power of incentives.

An even wiser man also said this:

"*Never, ever, think about something else when you should be thinking about the power of incentives*."

That man was Charlie Munger. He's a billionaire investor--now 95 years young!--who is otherwise known as the great Warren Buffett's lifelong partner in crime.

What Charlie is saying, and what my OGIB portfolio outperformance is living proof of is--that there is <u>no better predictor of results</u> than how incentivized a person is to generate them.

Think of it this way…..

If I told you that I would give you $10 to run 10 kilometers tomorrow you would probably take a pass.

If I told you that I would give you $1 million to run 10 kilometers tomorrow your only question would be "what time"?

My point is this.

The OGIB portfolio performance smashed both the energy sector and the roaring S&P 500 bull market because it had to.

I had no other choice.

I have a seven figure portfolio on the line here – and my investment performance is what my entire family relies on.

Our house, our food, my kid's ability to go to college is all determined by how successful I am as an investor.

If my investments don't perform we don't have an income. There is no "Plan B" for the Schaefer house……

How is that for being incentivized?

I put my blood, sweat and tears into every idea.

I don't send out a stock pick to meet an editorial deadline – I send out a stock pick because I put my money into it and I believe the stock is going up!

There are no weekends for me. There are no days off.

I'm hungry for the next great investment idea 24 hours a day, 7 days a week because I have to be.

I can't afford to make mistakes and I have to come up with great ideas.

The reality is that I am a desperate investor. That desperation creates results.

Because every single investment that I make is crucially important it lead me (through trial and error) to develop an investment checklist.

This checklist is designed for two purposes – first to help me weed out the very best opportunities and second, to eliminate companies that carry too much risk.

This checklist has become the very core of my investing philosophy – so much so that my staff have taken to calling it ***The Schaefer Method***.

The reality is--it works.

It is the single most important reason for my decade of OGIB portfolio outperformance--***The Schaefer Method***.

Until now I've been restricted to mostly using ***The Schaefer Method*** on the energy sector…..and now the whole investment world is about to become my oyster.

As I unleash ***The Schaefer Method*** on the entire world of small-cap stocks I believe that I am going to generate some exceptional results.

Today I am going to share my investing checklist – ***The Schaefer Method--***with you. Hopefully it will help you identify the best possible risk/reward opportunities that Mr. Market has to offer.

The Schaefer Method And The Investing Whisperer

Just as it was with OGIB – ***The Schaefer Method*** is the very core of The Investing Whisperer.

It does two things:

1-Identifies the small-cap stocks with the most explosive upside potential

2-Eliminate companies that carry too much risk for my family's wealth

Yes I'm greedy. I demand the best of both worlds.

I want lots of upside and I want it with little downside.

Investing this way requires A LOT of patience – I have to say no to 99 stocks before I find one that ticks all of the boxes.

But…this method has worked extremely well for me for more than a decade.

And as an investor with my family's well-being riding on every pick I need to find great investments and also avoid making mistakes.

The Schaefer Method is forced discipline. It is my religion – I follow it devotedly.

If a stock does not meet the 8 stringent requirements of this checklist I take a pass and move onto the next opportunity.

The proof is in the past decade of OGIB results. The Investment Whisperer opens me up to the entire universe of stocks and is going to build on that outperformance and run with it.

Now let's go through the 8 requirements of ***The Schaefer Method***….

The Schaefer Method Requirement #1 - A Tight share structure

Another way to say this is--a small float; or few shares out.

Big money is there to be had for those of us investing in small and micro-cap companies. That is what my The Investing Whisperer is all about….finding the best small-cap growth stocks that the market has to offer.

A tight share structure is my first requirement for any small-cap stock. It gives me *leverage*. If I own 1 share in a company with 10 shares out, I own 10% of the company. If that company has 100 shares, I only 1%.

I'm looking only for companies that have a modest number of shares outstanding--preferably less than 100 million.

My view is this:

100 million shares outstanding = Strike 1

200 million shares outstanding = Strike 2

300 million shares outstanding = Strike 3

The Schaefer Method rules are just like baseball – 3 strikes and you are out.

The reason why I'm so focused on a tight share structure is what it tells you about management.

A tight share structure tells you that management hasn't been forced to raise cash very often. That is important because it means that they keep close tabs on how much money is being spent – and that they aren't blowing cash on executive perks.

A tight share structure also tells you that you are likely looking at a good business; one that generates cash internally rather than having to go to the capital market for cash infusions.

A good management team fights tooth and nail to not give away shares of their company – usually because they own a lot of them personally and want to retain as much value as possible for shareholders.

There's also a technical reason to pay attention to share structure.

It has to do with supply and demand. If the share structure is tight, there's less supply for investors to bid on — especially if insiders own a good chunk.

Proof of the tightness of share structure as a sign of success lies in the fact that only 10% of micro-cap stocks that have more than 100 million shares out are profitable…….while 60% of the micro-caps that have less than 20 million make money.

Some management teams treat their shares like toilet paper. Others treat them like gold.

Focusing on companies with tight share structures can make the difference between losing your shirt and finding the next 10-bagger.

Requirement #2 - Management owns A LOT of stock (not just stock options)

This requirement brings me back again to the incredible power of incentives.

I want to invest alongside management teams that have an enormous amount of "skin in the game"; where they have put a lot of their own hard-earned money into this investment.

With skin in the game, management teams are heavily incentivized to create value for shareholders. And I'm not talking about options that have been given to them….I'm talking about direct ownership of stock.

I honestly don't know why a person would invest any other way.

Employees – even the best ones come to work for one reason….the paycheck. An employee comes to work, does the least amount of work that they can while still getting paid and then go home.

Incentivized owners have a completely different focus, they are constantly motivated to help the company make more money so that their ownership stake increases in value.

Employees are passengers. Owners are driven value creators.

This isn't just common sense – the numbers back up the idea that stocks with high levels of management ownership outperform by a wide margin.

One study found that companies of all sizes that had at least 10% of shares owned by management outperformed the market by an average of 6.2% annually. (1)

The bottom line is that if a CEO isn't bullish enough on his own company to own a lot of stock why in the world would I be?

Nobody knows the prospects of a company better than the man running it from the inside.

Requirement #3 - No debt, or very low debt

The Schaefer Method's goal is to objectively identify the best small-cap risk/reward opportunities.

I will happily pass on a potential big winner if it presents an outsized amount of risk.

For example, a balance sheet with too much leverage (debt) can sink even the best business.

The truth is that good businesses shouldn't need to rely on a lot of debt.

My ideal company actually has no debt, because the market will reward a pristine balance sheet with a premium valuation. A premium valuation doesn't just mean a higher stock price….it is also a powerful weapon for growing a business through acquisitions.

Plus – the worst case scenario for a company without debt is a mediocre performance. The worst case scenario for a heavily indebted company is bankruptcy.

If your worst case scenario in every investment is always nothing worse than mediocre then your portfolio is going to do well over time.

I don't have a day job to fall back on to pay the bills. There is no room for companies that go bankrupt in my portfolio.

My decade of OGIB portfolio outperformance was built on companies that carried very little debt. The Investing Whisperer outperformance will be too.

Requirement #4 - A "moat" of some kind

(Usually a Technology or Business Model)

The first three requirements of The Schaefer Method are financial--aspects of a company that can be objectively quantified. It's hard data that can be measured.

Requirement #4 is more subjective. What I mean by moat is…some sort of unique advantage that a company has over its competitors……something that is difficult to mimic or replicate, and provides a barrier against competition taking market share.

A moat can come in many forms….

Examples of moats include:

A low cost business model – If a company can manufacture or produce products at a lower cost than competition it has a competitive moat. By being the low cost operator a company can forever win business by undercutting rivals on price and still operate profitably.

A technological patent or license – This one speaks for itself. If a company has the single best business solution that carries patent protection it essentially has no competition and a huge moat for the life of the patent.

Switching costs – In some cases the cost for switching from a company's service or solution for a customer is so large that it isn't financially worthwhile. That cost of switching is the moat that keeps competitors out.

A moat can take many forms…..***The Schaefer Method*** wants businesses that have the insulation from competition that a moat provides.

Requirement #5 - Internally generate 15-20% annual growth

Valuation is important, but over time it is growth in revenues earnings and cash flow that drives stock market returns.

A stock trading at a high valuation that can grow at a rate of 15-20% for years will massively outperform a slow growth business that trades at an attractive valuation.

Yes an investor can make 20% from a cheap stock as the valuation adjusts slightly higher but…….it is the stocks that grow at 15-20% year after year that generate the multi-baggers that drive portfolio outperformance.

The Schaefer Method is all about growth, but not just any type of growth.

What I want are companies that can grow at 15 to 20% without requiring outside capital (debt or equity issuances) to do it.

That is why a business moat is so important. Only companies that have a durable competitive advantage can grow at those rates while using only internally generated cash.

Any company can grow quickly using someone else's cash. Only great businesses can grow at high rates using internally generated cash flow.

Requirement #6 - Generating Free Cash Flow

This is what we are all looking for as investors…..FREE CASH FLOW.

Free cash flow is cash that is left over after a company pays its bills, covers interest on debt, remits to the tax man and reinvests cash into the business for growth.

The ability of a business to generate free cash flow is the single best sign that a company has a powerful moat; it's the single biggest indication of a good business.

When you find a growing business that is generating free cash flow--the results are spectacular.

The 5, 10 and 20 bagger stocks that can change a person's net worth come directly from this sort of business.

Free cash flow pays dividends. Free cash flow funds stock buybacks. Free cash flow creates flawless balance sheets.

Free cash flow drives stock market returns.

Requirement #7 - Compelling Value Proposition to Clients

A value proposition is the answer to the question of 'why' a customer should choose to do business with a company.

If I can't clearly see that a company offers a compelling value proposition to customers I'm going to take a pass on the stock. Without that, a business can't outperform for long.

The great companies of our age all have very clear value propositions for their customers.

Walmart – the massive economies of scale allow for customers to receive the lowest costs.

Apple – the value proposition has always been driven by the company's obsession with product design--which gave them the best products & customer experiences for years.

Google – a superior way for marketers/advertisers to identify and target specific high-potential customers.

A compelling value proposition isn't necessarily exactly the same as a business moat, but in some cases they are definitely related.

Requirement # 8 - Recurring Revenue if Possible

Since Salesforce went public in 2004, there have been almost 70 other pure-play SaaS/cloud companies that have followed them in the public markets.

The returns for these 70 or so companies have been extraordinary.

The average stock market return is 5.3 times, and on average this group of companies has only been trading for only 3.4 years!!! (2)

The market loves SaaS (Software as a Service) businesses for one reason – they have incredibly high rates of customers that generate *recurring* revenue.

The hardest thing for us as investors to do is make predictions about the future. Recurring revenue provides that certainty about future business performance that the stock market craves.

And….. recurring revenue makes it so much easier for a business to grow.

Finding value amongst stocks that offer recurring revenue is hard these days because everyone is looking for it. But it can still be found – especially amongst the smaller-cap companies that The Investment Whisperer is focused on.

CONCLUSION

The Schaefer Method is my recipe for success. It has worked extremely well for me, and everytime I pick a company missing even one of these eight factors--the opportunity for success goes down greatly.

Most of this information can be found in the quarterly financials (the MD&A in Canada (found at www.sedar.com) and the 10Q in the USA(found at www.edgar.com).

After that, I just get on the phone and start calling--management, other investors in my network, analysts, fund managers who own stock, and fund managers who own competitive stocks.

I'm lucky that I have relationships with many of these people, and that's A Big Edge for me.

The Schaefer Method is my bible. It has proven itself every year, for over a decade. Now I'm applying it to a much wider range of companies, where I expect my investing returns to be even greater than before.

Sign up for a free trial of my service at www.investingwhisperer.com and put this proven method to work for you TODAY.

Sources:

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