

## *NAIC Mid-Michigan Model Club Guide to Conducting an Industry Study*

The NAIC Mid-Michigan Model Club has decided that it will not purchase a new stock unless the club has completed an industry study. This means that after a stock has been presented to the club, identified as a quality company and placed on the WATCH LIST the next step will be to study some of the company's peers to make sure we have the very highest quality company in that particular industry. Completing an industry study does not guarantee that any companies from the industry will be purchased. Many times the best (or second best) company in the industry will not be available at a reasonable price. Sometimes, after hearing the study and looking at the choices, the club will decide it does not want a presence in the industry. Slowly, however, the club will create a list of stocks in desired industries that can be purchased when they become affordable and the club has money to spend. The stocks on this list (the POUNCE LIST) should be assigned to a member and followed just as if we owned the security.

An industry study should proceed as follows:

1. Identify all of the stocks in the OPS database that are in the designated industry. Using NAIC Stock Prospector can make this job quick and easy. If the list is manageable (12-15 stocks or fewer) assign them all for study by the members of the committee, two or three per member. The committee members should prepare SSG's on their assigned stocks. Stocks that exhibit at least five years of public data, are traded on the NYSE, NASDAQ or ASE, are priced more than \$2.00 and show the last 5 years of sales and earnings to be increasing should be presented to the committee when it meets. Stocks that do not exhibit these qualities should be immediately excluded from consideration. If the industry list has more than 15 stocks, the committee chair should do a preliminary screening before assigning stocks for study. If more criteria are needed to reduce the list to 15 or fewer stocks, it is up to the chair to set them. Again, NAIC Stock Prospector is an invaluable tool. If no member of the committee can use the software, seek help from someone who can.
2. After preparing SSG's on his/her assigned stocks and doing some preliminary research, each member should come to the committee meeting with a "do not consider further" or a "consider in committee" recommendation for each stock.
3. At the meeting the committee should carefully review the SSG of each stock still under consideration. Now is the time to adjust numbers on the SSG that seem out of line, to play the "What if?" game with some of the judgments and to listen to whatever the member has discovered about the company outside of the SSG (especially anything negative!). Now is also the time to be comparing margins (Section 2A), debt to equity loads, total return, dividend yield, etc. both company to company and company to industry as a whole.
4. After listening to all of the presentations, the committee must now reduce the list to what it considers the top contenders. Base your decision on the numbers, not on "the story". Be able to cite specific places on the SSG that convince you to include or exclude a stock. Remember that we teach if margins in the most recent fiscal year are down compared to the five year average, then that is usually cause to stop the study and not

consider the stock until another year of data is available. We also teach that if the most recent quarter's data shows significant decline in year-over-year sales and/ or earnings per share, then the stock should not be considered until another quarter's data is available. Also remember that the stocks to be included do not necessarily have to be in the BUY zone on the SSG.

5. Once the committee has its top stocks (no more than 5), each stock must be assigned to a member of the committee for presentation to the entire club. This is the time for extensive, added research to be done. When doing this research, a member of the committee may still pull the stock from consideration if he/she uncovers significant negative news. During this period, it is imperative that the member keep the entire committee apprised of changes he/she might deem necessary on the SSG. The club should see the SSG's exactly as the committee finally sets them except for a price update right before the club meeting. The presenter should be prepared to also give a synopsis of the most current news about the stock and to justify the committee's SSG judgments to the rest of the club, if necessary.

6. The chair of the committee should prepare 12 copies of the stock comparison guide listing the companies being presented. Make sure the committee decides on the "choice" criteria. Again, if no member of the committee is well-versed in preparing a stock comparison guide, find someone in the club who is and ask for help! After all of the stocks are presented, the President will divide the club into groups of two or three, hand them a stock comparison guide and ask them to decide which company should be considered for purchase or placement on the POUNCE LIST. The small groups can also opt to recommend that none of the companies be purchased or placed on the list.

7. After a maximum of 10 minutes, the club should reform and the President should poll each group, asking only for their decision. If consensus or near consensus is reached, the club is ready to proceed to an investment decision. If there is no consensus, then each group should be asked for the reasons behind their decision. Discussion should then follow until the group feels it can make a decision about the industry.

Good Luck! Studying stocks is not an exact science and there is plenty of "wiggle room" between all of the guidelines on this list. As we learn together we will refine our procedures, learn more about each other and become better investors. Have fun with this. Remember, our primary purpose is learning and in order to learn you might make mistakes. Let's just not make the same one twice!

(Revised 10/24/06)