

# Jordan Kimmel Of Magnet Investing

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*by David Penn*

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*Who put the technicals in my fundamental analysis? Who put the fundamentals in my technical analysis? Kimmel's Magnet Investing is another path to the perfect blend.*

For some, the rivalry between technical and fundamental analysis has all the bitterness of a blood feud. "I've never met a rich technician," taunt the fundamentalists. "Price never lies," retort the technicians. And for every story a fundamentalist tells of the geeky, harried technical analyst with frayed shirt sleeves and a coffee-stained desk blotter, technicians are quick to respond with an apparently endless list of hot-shot fundamental analysts with more allegiance to the companies they "cover" than the investors for whom the analysis is intended.

But for Jordan Kimmel, investor, portfolio manager and author of the book, *Magnet Investing*, these arguments and disputes are a distraction at best. "It is dangerous to invest without technical analysis," he says in a recent telephone conversation before adding that the opposite is also true.

"Some people say, 'cover up the name of the stock so you don't get biased.' I think that's a crazy approach to investing. I want to know what are [the company's] fundamental competitive advantages."

There's that word again. But for Kimmel, who is currently managing member at Magnet Investment Group, L.L.C., "fundamental" means less following Wall Street's preferred metrics for evaluating, anticipating, and reacting to a company's performance in the marketplace, and more about getting down to what really drives stock prices higher or lower.

"We weren't using some of the traditional criteria that Wall Street is overly focused on," he says, giving an example of quarterly earnings as one Wall Street obsession. And here it is clear that Kimmel's healthy skepticism extends as far

into the fundamental camp as it does into the technical camp. "The world of financial speculation is one of the few places where misinformation is deliberately leaked out to get you do to the wrong thing."

## **RULES OF ATTRACTION**

Reflects Kimmel, "you have to have certain kinds of ideas" before you get started investing. One particular inspiration for him was Gerald Loeb, whose book, *The Battle For Investment Survival*, written in 1935 remains a classic for investors and speculators even today, and who Kimmel calls "one of the great, great minds" in investing. Loeb was one of those who differed with the buy-and-hold implications of Benjamin Graham, who produced an investment classic of his own, *Security Analysis* within a year of Loeb's book. For Loeb, there were times to buy and times to sell, and the trends were there to be befriended.

Taking Loeb's words of wisdom to heart, Kimmel tried a variety of approaches to mastering the market. He says that in the beginning he made a point to try and meet great portfolio managers and learn what he or she did and how they did it. "What struck me," he recalls, "is how people would paint themselves into individual corners. 'I'm a value investor. I can't believe anyone would look at a price chart to make a choice.' Then I'd meet the momentum guy and he'd tell me that the charts tell [him] everything, that charts 'speak' to [him]."

How did Kimmel deal with this problem? The long answer is that he "tried to take the best of all approaches." That included trying to devise a mathematical and quantitative way to fit both value and momentum approaches to investing into a coherent stock selection method.

The short answer? Magnet Investing.

What is Magnet Investing? As he says in his book of the same title, Magnet Investing is a stock selection process (not unlike William O'Neil's CANSLIM system) that combines fundamental and technical analysis to find stocks and

build an investment portfolio that is capable of providing exceptional returns. Like CANSLIM, the term "magnet" is an acronym, with each letter standing for a different principle in the Magnet Investing process.

**M**anagement must be outstanding.  
(Momentum must be improving)

**A**cceleration of earnings, revenues and margins.

**G**rowth rate must exceed current valuation.

**N**ew product or management may be the driver.

**E**merging industry or product creates great opportunity.

**T**iming needs to be right.  
(Technically poised for large price increase)

Clearly, the technical and fundamental components are apparent. Management and earnings do matter; but so do momentum, timing, and technicals. And those who are familiar with the CANSLIM system recognize that there is nothing overly restrictive about a stock selection method that includes so many key technical and fundamental characteristics. But even it did, it is easy to suspect that this would be of little bother to Kimmel. If a stock selection system doesn't provide as many potentially winning stocks as he might prefer at a given point in time, then there's likely to be a reason why. And, so far, Kimmel sees little gain in fading that reason.

"Our model won't recognize companies until there's meat on the bones," says Kimmel — which echoes the sentiments of investors like Warren Buffett during the dot.com craze. At the same time, one sector that often eludes the probing eyes of the Magnet Investing stock selection process is biotechnology where profit margins and revenue growth is often scarce.

"We ignore those companies. We know (Magnet's) limitations," Kimmel admits.

"Biotech can make people a lot of money, but if we really can't understand something, we pass."

There is plenty, however, that the Magnet Investing methodology does understand. For one, Kimmel says that his process "helps us be early," tending to find companies both faster and quicker than other models and methods. At the same time, he adds, when really good companies "fall hard, we also catch them." "People always ask when is it a good time to buy Lucent or Sun Microsystems," he says. "One of these days the answer will be 'yes,' but [then] people will be disgusted and won't see it coming."

And unlike many investors who rely significantly on fundamentals, Kimmel is as proud of his method's selling discipline as he is of its buying discipline. That makes sense because, with Magnet Investing, selling is just the flip side of buying.

"Our sell discipline is the exact same as our buy discipline," he explains.

"Eventually the revenue growth slows down and the margin growth slows down and [the stock] stops ranking up. Instead of deciding we hate the stock or we love the stock, [the stock] de-selects itself."

Adds Kimmel: "we won't grab the peak. But we won't ride the stock down, either."

Speaking of revenue and margin growth, the "A" in Magnet Investing is one of the more interesting aspects of the methodology. While many fundamental stock selections processes — including CANSLIM — focus on revenue growth almost exclusively, Kimmel believes that Magnet Investing's emphasis on the combination of revenues and profit margins gives his methodology an important edge.

"The reality is that if you lie about revenue, you go to jail," explains Kimmel. "But it is perfectly legal to massage earnings. There are so many legal things that companies do."

Unfortunately, even with his emphasis on earnings growth and margins does not keep all of the chicanery, legal or not, at bay. Kimmel adds that "smart and tricky CFOs (chief financial officers) understood that some people really looked at

revenue not just earnings. So they started buying revenue to make revenue look better." Tactics for "buying revenue" included things like using mergers and acquisitions to increase revenues rather than relying on growth through increases in sales.

One way of working around this chief financial cleverness has been to evaluate revenues and profit-margin growth together. Another way is to examine not just actually reported earnings, but price-to-sales ratios. Why price-to-sales? In part, price-to-sales is much less volatile than price-to-earnings and paints a "clearer picture" as far as Kimmel is concerned. But even here there is no panacea. "Sometimes a company ranks out high in Magnet with a high price-to-sales," Kimmel says. "But sometimes that means that too much is already baked into the cake" — meaning, already discounted by the stock price.

Intra-industry analysis is also important with price-to-sales. Sure you might get low price-to-sales, but if you aren't comparing apples to apples, Kimmel warns "you'll just get a lot of supermarkets."

## **MAKING THE MOST OUT OF MAGNET**

Thinking about the financial world most investors have had to deal with since 2000, when the first edition of *Magnet Investing* was published, Kimmel wonders if the failure of many investors to understand what investing was all about might have played a disproportionately large role in making the years since then more difficult than they had to be.

"You see commercials on TV and everybody wants a new Lexus," Kimmel says. "People don't understand what the value of a dollar is." Reflecting on what he can teach his own children, he adds, "we've made a deliberate attempt in our family not to create a bunch of little stock pickers," trying instead to get his kids to think about the companies behind the things they want — like Nike sneakers.

This attitude is very much reflected in *Magnet Investing*. Not unlike the great Gerald Loeb, Kimmel in *Magnet Investing* takes great pains to explain what investing is and is not, what sort of discipline and dedication is involved, and how crucial goal setting and personal accountability are in making a person a

successful investor even before he or she has spent a dime on a share of stock. Indeed, a reader will spend more than a few fascinating chapters learning about planning, asset allocation, and "knowing thyself" even before being introduced to the stock selection system that is at the heart of the book.

And I don't think Jordan Kimmel — who started off at the age of eight with 35 shares of H.J. Heinz and by the time he was in high school was already trading options — would have it any differently. "[Successful] speculation is the hardest thing," he says, echoing the sentiments of perhaps hundreds of thousands of investors and traders throughout financial history. But with a system or method that works, and the will to see it through, Kimmel sees little reason why the average retail investor can't count on the markets to make even a few money dreams come true.

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#### **SUGGESTED READING**

Graham, Benjamin, and David Dodd [2005]. *Security Analysis: The Classic 1951 Edition*. McGraw-Hill. (Originally published in 1934)

Kimmel, Jordan L. [2000]. *Magnet Investing*, Next Decade, Inc.

Loeb, Gerald [1996]. *The Battle For Investment Survival*, John Wiley & Sons. (Originally published in 1935)

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