TREND HUNTING: HOW TO FIND HOT STOCKS OUT IN THE REAL WORLD

BY MICHAEL COMEAU

Let me tell you a little bit about myself.

My name is Mike, I'm 34 years old, and I've lived in New York my whole life.

I've been commuting daily on the NYC subway since I was a 14-year-old freshman at Xavier High School in Manhattan's Chelsea neighborhood.

During those 20 years, I was handed a literal goldmine of stock picks simply by looking around to see what other people were reading, eating, playing, watching, and wearing.

I acted on some of them -- like **Apple** (AAPL) after watching the iPhone become the accessory of choice for New Yorkers, and **Lions Gate** (LGF) when I couldn't turn around without seeing at least one person reading *The Hunger Games*.

But I ignored even more of them.

We're talking **True Religion** (TRLG), **Under Armour** (UA), **Lululemon** (LULU), **Chipotle** (CMG), and perhaps most painful of all -- **4Kids Entertainment** (KIDEQ).

4Kids produced the American version of Pokémon from 1998 to 2005, and handled licensing for Pokémon products -- like the cards with which just about every kid was playing.

4Kids (then trading under the ticker FKE), closed out 1998 at $11. On November 9, 1999, it hit a high of $93.25. That's a gain of 748% in less than a year!

Even after the subsequent crash, 4Kids closed out 1999 up 155%!

If I had only Googled "Pokémon stock" or "invest in Pokémon", I'd have been tipped off to a home run.

I mean, who heard of 4Kids before it was a stock-market monster?

Now, it's obvious that hot products and services translate into hot stocks that can make you big money.

However, it's not always as simple as chasing what's popular now. You definitely want to be in ahead of Wall Street and the rest of the crowd.

Take Lions Gate.

In early 2012, Lions Gate skyrocketed as investors grasped the likely blockbuster status of its film version of *The Hunger Games*, which was released on March 23.

However, the stock actually peaked before the film's release. The high on Lions Gate came on March 21, when it hit $16.19 for a 94% gain in less than three months.

As of the time I'm writing this (July 30, 2012), it's actually down 14% from that high!

But what is my point in all of this?

Well, if there's one thing I'd like to communicate to investors, it's that real-world observation should be your number-one source of new ideas and an integral part of your research process, along with analyzing financial statements and studying charts.

In this report, I'm going to take you through the methods I've used to spot hot consumer trends that turned into even hotter stocks.

Now, before we get started, I'll make one thing crystal-clear: In isolation, each tip I provide is completely useless. They only become useful when used in combination, and as just one part of your stock-selection methodology, as I'll explain later in this report.

So let's get started.

1) Accept That You May Be Out of Touch

It's safe to say that the older we get, the less likely we are to be truly in touch with emerging pop-culture trends.

Why is this?

I think it's because our priorities change.

We have children to take care of, careers to manage, bills to pay, and homes to clean.

The things that may be important to kids -- like toys, video games, fast food, and fashion trends -- simply no longer interest us.

From an investing standpoint, this means that we're missing out on an enormous amount of information regarding emerging consumer buying habits.

Therefore, it's important to consider that you may just be out of touch with much of what's going on around you.

So what does that mean?

Well, you're going to have to seek out information from the right people, which brings us to the most important people you'll need.

2) Listen to Young People

Let's talk about *The Hunger Games*, which as we discussed above, was the major driver behind Lions Gate's monumental stock move in early 2012.

I had never even heard of *The Hunger Games* book trilogy before September 2011, even though it had sold millions upon millions of copies.

Why? Because I'm a 34-year-old man. I just wasn't the target audience.

I only got tuned in because my younger sister tortured me into reading the books. Seriously. It was easier to just read the books than to listen to her yap at me every day.

Midway through the first book, I had a hunch that it would make a great movie, so I Googled "Hunger Games movie". And then, "Hunger Games book sales."

It took me about three minutes to figure out that by securing the movie rights for the books, Lions Gate likely had a monster hit on its hands, one at least as big, if not bigger, than its 2004 horror classic *Saw*. And yes, Lions Gate shares benefited from *Saw* they were up 22% in the fourth quarter of 2004.

At that point, my eyes really opened up to what was going on around me. Everywhere I went -- subway stations, parks, coffee shops—people were reading *The Hunger Games*. Barnes & Noble stores even had sections dedicated to books for fans of *The Hunger Games*.

I also asked every financial professional I knew if they'd heard of *The Hunger Games*, or how popular it had become. The usual answer was a flat out "no," though some folks identified it as “that book my daughter’s reading.”

So it was obvious that I stumbled onto what I called the “Hunger Games Trade” well ahead of the crowd.

The takeaway is simple: talk to as many young people as you can about the things they like and buy.

They know far more about what’s hot and what’s not than you and I ever will.

Want to know if anyone cares about Google’s new Nexus 7 tablet?

Ask a bunch of teenagers.

Which brings us to my next tip...

3) Ignore Techies

When it comes to gauging the popularity of technology products, never, ever listen to serious techies.

That may sound counterintuitive, but the reality is that techies know far too much about tech for their own good.

The problem is that techies overemphasize the importance of technical specifications, and have difficulty viewing the world from the perspective of the average consumer.

For example, at the start of the current video-game cycle, many hardcore gamers thought the Nintendo Wii couldn’t compete because it was underpowered relative to the Microsoft Xbox 360 and Sony PS3.

However, the Wii’s innovative motion-control systems, subsequently copied by Microsoft and Sony, resonated with the mass market in a major way.

As of July 2012, Nintendo has sold 96 million Wii units vs. 67 million for the Xbox 360 and 64 million for the PS3. In 2007, during Wii-mania, Nintendo shares were up a whopping 124%!

The needs of the nerds and the needs of the mass market don't always meet, so take techie "wisdom" with a grain of salt.

4) Explore Your Own Career and Industry

For most of this report, I've focused on consumer products, and for good reason.

It's a lot easier for the average person to really understand the market prospects for a smartphone than something like fiber-optic networking equipment.

Think about it.

Have you ever even seen a **Juniper Networks** (JNPR) router? Do you know who buys them and how much they cost? Or how often they get replaced?

I didn't think so.

However, I do think that people can look inside their own industry and glean investing insights that the so-called pros on Wall Street don't have.

Let me give you an example.

The **PHLX Housing Sector Index** (HGX) fell 38% in 2007 and 42% in 2008.

You know who I think could have predicted that collapse?

Independent homebuilders.

Mortgage brokers.

Construction workers.

Similarly, I bet operating-room nurses could have predicted the rise of **Intuitive Surgical** (ISRG).

Yoga instructors could have been all over **Lululemon** (LULU).

Why? Because they're on the ground seeing this stuff up close in a way that other people don't.

Look around your own industry, and I'm sure you'll find many products that are exploding -- or imploding.

5) Observe Retail Stores

I used to spend far too much time wandering around consumer electronics stores like **Best Buy** (BBY) and the now defunct **Circuit City**.

However, they can tell you an awful lot about what's hot.

In 2006, I began noticing ever-growing crowds standing around demo stations for what at the time looked like the stupidest video game ever conceived -- *Guitar Hero.*

I'm not kidding.

Everywhere I went, people were playing Pantera's "Cowboys From Hell" on goofy plastic guitars. I would go into the Best Buy on 23rd Street in Manhattan and say to myself, "Why are these morons so excited about this game? Why don't they just play real guitars?" It was crazy.

(full disclosure: I eventually owned Guitar Hero II and III and absolutely loved them.)

Then, I started asking Best Buy, **GameStop** (GME), and Circuit City store employees if they were selling a lot of Guitar Hero games.

The answer was usually something to the effect of, "we can't keep it in stock."

And then it dawned on me that something very big was going on here.

I was seeing *Guitar Hero* everywhere I went, and not just in Best Buy. Videos of people playing *Guitar Hero* were all over YouTube. I was seeing people carrying *Guitar Hero* boxes all over the street. Throughout New York, bars would set up *Guitar Hero* for drunken patrons to play. And it was very, very difficult to find in stores.

The whole of idea of *Guitar Hero* seems silly now.

But look at what it did for its publisher, **Activision** (ATVI).

Over its lifetime, *Guitar Hero* generated over $2 billion in sales. And from Activision's acquisition of *Guitar Hero* publisher RedOctane in June 2006 through the end of 2007, when the *Guitar Hero* boom really hit its peak, Activision shares rose an astounding 140%.

Furthermore, it pays to visit retail stores to research the retailers themselves. If you're thinking of investing in any type of retail stock, it pays to simply go in to see what makes them tick, up close.

But beware. The quality of a retail experience can vary wildly between different regions, or even different locations in the same city. One way around this is to ask friends and family in different areas of the country what they're seeing.

6) Conduct Online Channel Checks

Amazon.com (AMZN) has inadvertently become one of the greatest free research tools an investor can use.

Why?

Well, Amazon sells just about everything.

Need a computer?

A baseball bat?

Air Supply's *Greatest Hits* on vinyl?

Composting worms?

Furthermore, Amazon conveniently places everything into bestseller lists, so you can always tell who's on top and who's not.

However, keep in mind that Amazon constantly updates these lists, so you can't be sure something's really sticking unless you revisit the site a few times.

Amazon will also tell you when a particular product is not in stock. In general, when something new is regularly out of stock, that means people are buying.

But what's most interesting is that Amazon incorporates pre-orders of unreleased products into its rankings.

If you see something at the top of the charts before it's released, odds are it's a smash hit. This is especially valuable for book, DVD, and video game sales which can be prime earnings drivers for media companies.

In fact, the success of *Guitar Hero II* and *III* was completely telegraphed by the fact that they were at the top of the charts weeks before their release dates.

So let's talk real-world application.

In early 2012, what books never left Amazon's best-selling list?

You guessed it: *The Hunger Games* trilogy. In fact, Amazon was selling so many Hunger Games books that not only were all three individual volumes at the top of the list, so was the package containing all three!

What else?

Do you remember TMX, a.k.a. Tickle Me Elmo Extreme?

Well, even before it was released, TMX generated an enormous consumer buzz. Here's an excerpt from a *Wall Street Journal* article from September 15, 2006:

So far, the toy and the hype seem to be working: Retailers—the very few who've seen it, and the legions who haven't —say they are ordering the maximum number of the $39.99 Elmos that Fisher-Price will allow. The Muppet is already appearing on eBay for prices as high as $99, for delivery after it's released.

"Fisher-Price is only shipping 'X' amount of product —we want a lot more," says Bob Weinberg, senior vice president of merchandising for toy chain KB Toys, who hasn't seen it.

Now, you have to be careful with these kinds of anecdotes. Occasionally, a consumer product will be red-hot out of the gate before fizzling out in a jiffy.

TMX hit store shelves on September 19, 2006. Shares of Fisher-Price parent Mattel (MAT) had already been rallying in anticipation of the release, and were up 23% for the year.

However, TMX was red-hot for months after release, as evidenced by the fact that it was never in stock on Amazon.com or other retail sites like ToysRUs.com. In addition, when I called or visited toy stores, I couldn't ever find one in stock, and apparently, I was never the only one asking.

So it was obvious that TMX had some staying power -- as did Mattel's stock.

From September 19, 2006 until its April 9, 2007 peak, Mattel rose 53%. Catching just a fraction of that move would have generated a nice return.

Now what did I never see on the bestseller lists at Amazon?

The Microsoft Zune mp3 player.

The Motorola Xoom tablet.

Keep in mind that Amazon isn't the end-all be-all for online channel checks. If a site ranks sales for products you care about and can tell you when something's out of stock, pay attention. But in general, it usually pays to only follow the big sites like Amazon.com, BestBuy.com, **Target.com** (TGT), and **Wal-Mart.com** (WMT).

7) Conduct Phone Channel Checks

Conducting channel checks by phone is another very effective way to gauge a particular product's selling power.

The reason is that you can assess what's going on in multiple geographic areas with minimal effort.

My preferred method is to log onto a particular retailer's website, and search for store locations in major cities like New York, Los Angeles, Chicago, San Francisco, and Miami.

The next step is to pick a few stores from each region, and start dialing.

Now, if you do decide to do this, please have mercy on the store clerks whose time you're wasting and get off the phone quickly.

My preferred line of questioning goes something like this:

"Hi, do you have product X in stock?"

My typical follow-up (whether the answer is yes or no) is something like, "Oh, do you sell a lot of those? I'm not coming in until next week, and I want to make sure you'll have it."

Those two questions will tell you pretty much everything you need to know without wasting too much of their time.

So what are we learning here?

Well, if you hear from stores all over the country that they can't keep a particular product in stock (whether it's Tickle Me Elmo or Guitar Hero or the iPad), then you should be feeling more bullish.

Conversely, if you regularly hear things like "Oh, nobody's buying that, we have plenty," then you're getting a bearish look.

Wrapping It Up

Admittedly, the research methods I've outlined in this report are very simple.

However, I'd argue that it makes them more useful.

Not everyone can build complex financial models or perform detailed quantitative analysis on historical price data. Some of us just don't have the educational background or the math skills.

But just about everyone can observe, ask questions, and make phone calls.

Earlier I noted the following: "In isolation, each tip I provide is completely useless. They only become useful when used in combination, and as just one part of your stock-selection methodology."

I can't overstate the importance of this point. When you're trying to turn anecdotes into useful investing information, you need as many points of reference as possible.

Let's take Apple's iPhone 4, which was released in 2010.

If you recall, the iPhone 4 had the potential to turn into a public relations debacle for Apple when it was revealed that the phone had reception problems when held a certain way.

The so-called scandal, which we affectionately called "Antennagate," was making so much of a ruckus within the technology media sphere that some folks were starting to wonder if it would actually negatively affect sales. So the challenge was to determine how well the device was actually selling out in the real world.

Here's how I approached it:

First, I went to my local Apple and AT&T stores and asked the following questions:

1) Do you have the new iPhone in stock?

2) Are a lot of people buying it?

3) Are a lot of people returning it?

Everywhere I went, I heard the same answers. Yes, people are buying it, and no, we're not seeing many returns. The inventory equation was all over the place. Most places had none available for sale, but some had it in stock.

That gave me one piece of the puzzle.

I performed the same exercise over the phone, again, taking care not to waste too much of other people's time. The answers were virtually the same.

In addition, I went to Apple's website, which showed a three-week wait time for the iPhone 4. The AT&T website showed seven to 14 days.

I also received some personal anecdotes along the way from actual iPhone 4 owners. Most of them had not even heard about the reception problems, and all of them loved their phones and wouldn't dream of giving them up for another brand.

None of what I just told you was scientific. However, in a short amount of time, my methods painted a pretty solid picture of how well the phone was actually selling in the face of negative media scrutiny. Thus, I never even considered selling my Apple position.

And how did sales actually turn out? Well, during the iPhone 4S' first quarter on the market, Apple sold a whopping 14.1 million iPhones vs. Wall Street's 11.5 million-unit consensus.

To conclude, I'd like to thank you for taking the time to read this report.

If you have any feedback or questions, feel free to contact me at mcomeau@minyanville.com.

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