# CYBER GAINS

THE ONLINE FINANCIAL SECTOR WILL OUTPERFORM THE STOCK MARKET FOR THE NEXT DECADE.

By Michael Markowksi

Inevitably, after a major catastrophic event occurs, many investors try to guess what industry or sector will directly benefit. The direct beneficiary of the woes created by the global credit crisis is the online financial sector, and the global credit crisis will permanently alter our daily lives, as our access to real-time international business and economic news and information becomes a need instead of a luxury. The demand to learn how to digest and leverage financial information also goes up as the volatility increases in the markets and the returns generated by conventional brokers go down. Mortgages and home prices have now been directly linked to have a cause and effect on the stock market, and vice versa. The emerging market economies in China, India, etc., have now grown to the point where they can have a positive and negative impact on the U.S. market and economy.

The brands of the big brokers such as Merrill Lynch have been severely damaged and are probably beyond repair. If the sovereign funds had not bailed out Merrill and Citigroup, they would not have likely survived. They may not be so lucky next time. Even more troublesome is the fact that many of these low-quality subprime mortgages were packaged by the big brokers and banks and then sold to their clients. I can't imagine why anyone would want to be a long-term stockholder or a client of Merrill Lynch, Citigroup or any other financial institution that had to be bailed out by a sovereign fund in order to stay in business.

The narrow escapes by Merrill and Citigroup and the significant losses suffered by their clients who are holding their packaged paper are analogous to what happened with the aviation industry in the 1950s and 1960s, when there was an unusually high number of airline crashes, resulting in a lot of fear and insecurity about flying. In order to deal with it, a record number of individuals paid $1,000 or more—in 1960s dollars—to learn how to fly. They wanted to be able to land the plane in the event that the pilots were incapacitated, and they wanted to learn about airplanes and how they operated so they could better understand the risks they were taking when they boarded a plane. Now that the markets are going through a vicious correction and we're seeing the first extended bear market since the 1980s, more people are deciding to learn how to pilot their own portfolios. Once educated, many of these individuals will become clients of online brokers. They will also become subscribers to financial information.

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## INVESTOR EDUCATION

The biggest beneficiaries of the current subprime crisis are those individuals and businesses that provide education and training in investing and trading. Robin Dayne, the founder of RobinDayne.com, has been a professional trading coach for 16 years. Her specialty is helping traders deal with the critical mental and psychological aspects of trading. Since November 2007, she has seen a sharp increase in the demand for her services. According to Nick Maturo, CEO of TheRetirementSolution.com, the average dollar value per investor education buyer has increased by 50% for its investment tools and training division during the first month of 2008.

Since the dotcom bubble burst in 2000, over 500,000 investors have paid for and have graduated from stock-market education courses, and the bulk of those graduates paid between $5,000 and $20,000 for their education. But when one considers the amount of investors in this country, it's apparent that the industry has only scratched the surface. Two out of every three Americans now own shares in publicly traded companies. There are over 90 million investors alone

in the U.S. who hold mutual funds.

The leader of the stock market investor education industry is Investools (NASDAQ: SWIM). At the end of September 2007, SWIM had 321,000 graduates. It has enjoyed steady and uninterrupted growth since 2002, when its shares were trading below $1. Because of its leadership position, its partnership with Yahoo, and its intense television advertising campaign, Investools shares are well positioned to continue to outperform the stock market.

The only other public company that participates in the securities trading education industry is TheRetirementSolution.com (OTC BB: TRES). In January 2008, TRES announced that it had acquired Investment Tools & Training LLC (ITT). ITT has several principals who were previously affiliated with SWIM and/or Edutrades, a private company that is number two in the industry, with over 120,000 graduates. ITT has developed Investview, its state-of-the-art courseware. It has also adopted SWIM's marketing and advertising technique of utilizing multiple channel partners to assume the up-front risk of marketing and advertising costs and expenses. TRES is led by its CEO, Nicholas Maturo, the former CEO of Edutrades. Under his tutelage, Edutrades grew from $2 million to $120 million and racked up over 100,000 new customers between 2002 and 2006.

## ONLINE FINANCIAL INFORMATION

On Feb. 5, 2008, Bankrate (NASDAQ: RATE) announced an annualized revenue run rate of $100 million for the first time. Who would have thought that a company that was founded to be a free provider of bank certificates of deposit and mortgage rate information could have attained such levels? In his customary quarterly conference call, Bankrate's CEO stated that the company's websites had record visits during January 2008, and he increased Bankrate's guidance for sales and earnings for 2008. Obviously, the global financial mortgage crisis has had no negative impact on Bankrate. The Federal Reserve's frequent ratcheting down of the Fed funds and discount rate has most likely helped Bankrate in accelerating its growth in revenue and profit.

Record results will probably continue to be the norm for Morningstar (NASDAQ: MORN), which is primarily in the business of providing information that enables individuals, financial advisers, and institutions to outperform the stock market. MORN is also the leading provider of ratings and information on mutual funds. It is a full-service online financial information provider, and because it is the biggest online information providers, it is probably in the best position to benefit from the current situation.

TheStreet.com (NASDAQ: TSCM), a leading independent producer of financial news, ratings, and business and investment content, is another one that is well positioned to capitalize on those who are dissatisfied with the performance of their broker. It also has major ties to General Electric's (NYSE: GE) CNBC subsidiary because one of its major shareholders is Jim Cramer, the colorful Mad Money host on CNBC.

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Interactive Data (NYSE: IDC) is a subsidiary of London-based Pearson PLC (NYSE: PSO), which is the publisher of the daily newspaper Financial Times. IDC provides historical securities pricing data and quotes on 3.5 million securities to institutional investors, financial websites, and individual investors. IDC owns e-Signal, RagingBull.com, Quote.com, and several other Internet properties. Ties to their parent make them an obvious global play.

TheRetirementSolution.com and Investools both provide education and information.

## ONLINE SPECIALTY BROKERS

As investors become educated and more savvy, they will need the services of specialty brokers. This is especially true for those investors who learn how to employ sophisticated options and portfolio hedging strategies. There are two publicly held online brokers who cater to these educated investors: Options Express (NASDAQ: OXPS) and, again, Investools, via its ThinkorSwim subsidiary. The shares of both SWIM and OXPS have been bucking the recent trend on the financials. The shares of Options Express hit a five-year high on Dec. 27, 2007, and shares of Investools hit their five year high on Dec. 26, 2007.

There is a reason why the shares of these two Chicago-based rivals are not skipping a beat—both companies know something that the other brokers don't. They know that an educated client is the key to having and keeping a profitable long-term client. The customer metrics of the two specialty brokers point this out. According to analyst George Grose of American Capital Partners, both SWIM and OXPS generate significantly more revenue and profits per client than the larger name-brand brokers such as Etrade (NASDAQ: ETFC) and Ameritrade (NASDAQ: AMTD). Investool's ThinkorSwim subsidiary ranked No. 1 out of all online brokers, with an average of 170 trades per year per client. Options Express came in at a solid No. 2, with its average client generating 41 trades per year. Ameritrade and Etrade brought up the rear, with their clients generating an average of 10 to 12 trades per year.

Investools' big advantage over the other online brokers lies in its educational platform, and Options Express is fully aware that education is the key to increasing client-trading frequency and preservation of capital. Recently, Options Express hired Paul Eppen as its chief marketing officer, which is the position he previously held at Devry, a leading provider of for-profit education services. Grose believes that the investor education industry is still in its infancy and that a good part of its future growth could be driven by discount and online brokerage firms, which are seeking higher profits from their client bases.

In my September 2007 EQUITIES article, "From Supporting Role to Romantic Lead," I recommended Bankrate, Interactive Data, TheStreet.com, and

Morningstar. The shares of each of these online financial information providers hit five-year highs during November and December of 2007. In all the years that I have been writing articles and recommending stocks, I had never had anything like this happen—four picks from the same industry (and the same article) all simultaneously marched to five-year highs within 90 days. Looking back, I discovered that every company in the Online Financial Sector that I had recommended in StockDiagnostics.com's OPS Newsletter in 2002 and 2003 had also gone up significantly—four of the five appreciated by over 100%. Combine the two recommendation lists, and I was nine for nine on my recommendations.

**Online Financial Sector Recommendations in the OPS Newsletter and in EQUITIES (2002-2007)**

| Name | Symbol | Recommendation Date | Price on 12/31/07 | Change |
|---|---|---|---|---|
| Bankrate | RATE | 10/28/02 | $48.09 | 1870.90% |
| Multexx** | MLTX | 02/10/03 | $7.35 | 54.74% |
| Marketwatch* | MKTW | 03/31/03 | $18.03 | 142.34% |
| Investools | SWIM | 11/10/03 | $17.74 | 1456.14% |
| thestreet.com | TSCM | 12/01/03 | $15.92 | 253.78% |
| Bankrate | RATE | Sep-07 | $48.09 | 11.94% |
| Morningstar | MORN | Sep-07 | $77.75 | 21.83% |
| Interactive Data | IDC | Sep-07 | $33.01 | 18.19% |
| TheStreet.com | TSCM | Sep-07 | $15.92 | 38.68% |

*Acquired by Reuters on 3/26/03
**Acquired by Dow Jones on 11/16/04

Investools' shares paid for a good portion of my family's living expenses between 2004 and 2007. We purchased 40,000 Investools' shares for approximately $6,000 (17 cents per share) in 2002. By 2004, its shares were above $2. Between 2004 and 2007, our $6,000 investment in Investools generated over $100,000 of income for my family.

Investing in companies that are members of the online financial sector provides multiple once-in-a-lifetime investment opportunities. Here are the five main reasons why:

- **Cash-flow dynamics are superb.** The online financial sector is like no other when it comes to generating positive cash flow. All subscribers pay up front for subscription services. Approximately 40% are willing to pay for a year or more in advance. There is no other sector or industry that I know of that enjoys such an advantage. Even your garbage collector doesn't send you a bill until after he's collected your garbage.
- **Client-retention rates are high.** Once individual investors get comfortable with their providers, they are loathe to make changes. Also, the quality of customer service is rarely an issue because all business is conducted online.
- **The sector is low-risk.** The business models for all of the companies in this sector are very similar to that of the publishing industry, which is arguably among the lowest-risk industries to invest in since the invention of the printing press. How often do newspapers go out of business? This is because after the investment in plant and equipment is made the cost to support each additional acquired customer is incrementally lower.
- **The sector grows and thrives on increased volatility.** The sector is the only one that I know of in which the demand for its products and services actually increases in a bear market or a recession.
- **Bad advice from brokers will fuel growth.** Name-brand brokers have a long history of giving bad advice. Many investors are going to find out that they unknowingly purchased subprime loan portfolios from their broker that will soon be valued at 10 cents on the dollar. Those same brokers were the ones who had 27 buy ratings and no sells when Enron went out of business. The brokers will continue to suffer attrition, and the online financial sector will grow unabated for the next 10 years.

I am recommending the shares of the following companies in the online financial sector. I predict that each could see new 52-week highs in 2008.

I will continue to monitor this sector in *EQUITIES* Magazine. I believe that this sector will significantly outperform the stock market for the next 10 years. **E**

**Online Financial Sector Recommendations**

| Company | Symbol | 52-Week High | 52-Week Low |
|---|---|---|---|
| Bankrate | RATE | 57.32 | 32.70 |
| Interactive Data* | IDC | 33.68 | 22.63 |
| Investools* | SWIM | 18.23 | 9.29 |
| Morningstar | MORN | 85.50 | 44.78 |
| Options Express* | OXPS | 34.95 | 20.78 |
| TheRetirementSolution.com** | TRES | 0.53 | 0.15 |
| TheStreet.com* | TSCM | 16.74 | 9.57 |

*American Capital Partners has "buy" rating.
**American Capital has provided financing within last 12 months and Markowski holds shares.