

NAIC Fundamentals Always Apply

- *Seven ways to make money in stocks*
- *Seven ways to lose money in stocks*

Presentation information: H. Bradlee Perry

David L. Babson & Company Inc.

BetterInvesting - March 2000

The handout for this class in a larger
color format is available on my website

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Please turn pages
and cell phones off

7 ways to **Make** money in stocks

Mr. Perry's full article is available:

[www.betterinvesting.org/Members/Tools/Articles/Archives/
PrintMagazine/Archive/2000/03/200003AsTimeGoesByFu
ndamentalsAlwaysApply.htm](http://www.betterinvesting.org/Members/Tools/Articles/Archives/PrintMagazine/Archive/2000/03/200003AsTimeGoesByFundamentalsAlwaysApply.htm)

I will send the address—send an email request

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7 ways to **Make** money in stocks

1. Invest in good businesses with superior growth and profitability

What to look for:

(Portfolio core companies)

- Industry with stable growth potential
- Industry immune from economic woes (non-cyclical)
- Good profit margins

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7 ways to **Make** money in stocks

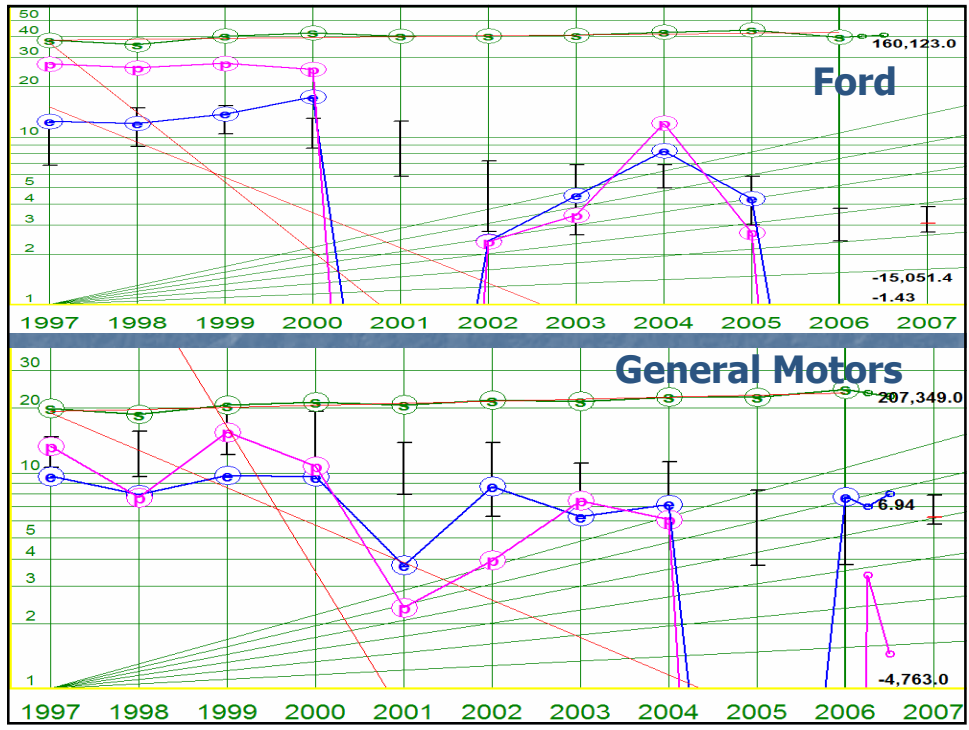
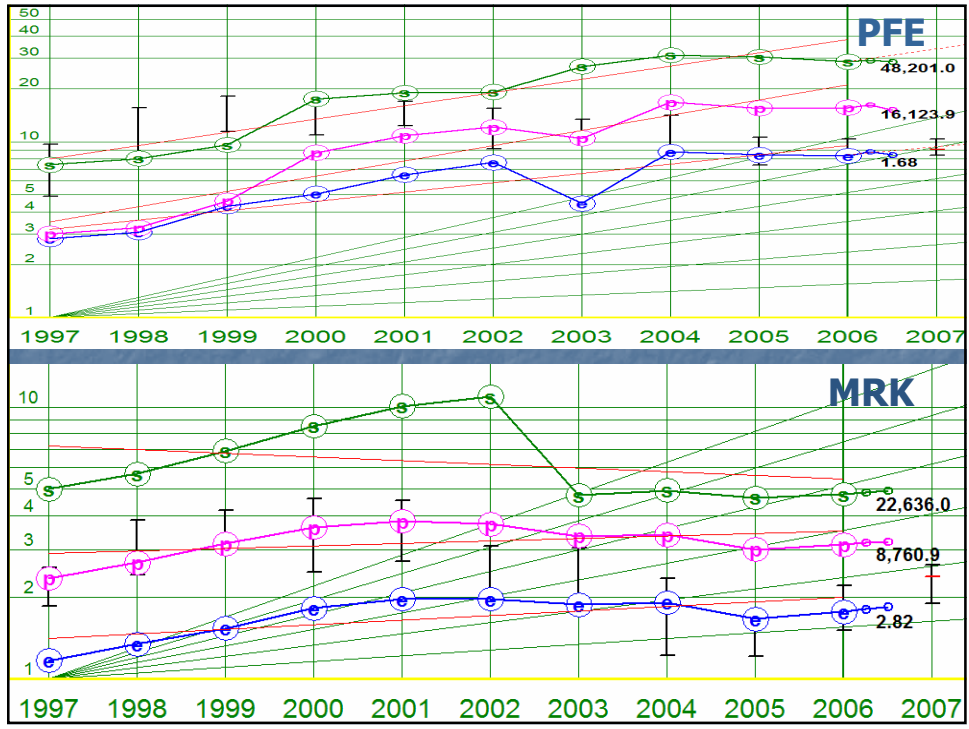
1. Invest in good businesses with superior growth and profitability

-- Example:

- Companies growing faster than the general economy
- Pfizer and Merck have grown earnings about 45 times in past 35 years
- Auto manufacturers have grown earnings about 5 times in that same period

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7

7 ways to **Make** money in stocks

1. Invest in good businesses with superior growth and profitability
 - Competitors
 - Yahoo

<http://finance.yahoo.com/q/co?s=GE> (Note symbol)
 - Earnings and Growth Estimates
 - Industry average comparisons
 - MSN (Note symbol)

<http://moneycentral.msn.com/investor/invsub/analyst/earnest.asp?Page=EarningsGrowthRates&Symbol=ge>

*

Yahoo

Enter Symbol(s):
e.g. YHOO, ^DJI

GO Symbol Lookup | Finance Search

General Electric Co (GE)

On Sep 17, 34.22 ↑ 0.69 (2.06%) Reuters

More on GE

- Quotes
- Summary
- Real-Time Mkt/ECN
- Options
- Historical Prices
- Charts
- Basic Chart
- Technical Analysis
- News & Info
- Headlines
- Company Events
- Message Board
- Company
- Profile
- Key Statistics
- SEC Filings
- Competitors
- Industry
- Analyst Coverage
- Analyst Opinion
- Analyst Estimates
- Research Reports
- Buy Analysis
- Ownership
- Major Holders

Competitors

Get Competitors for: GO

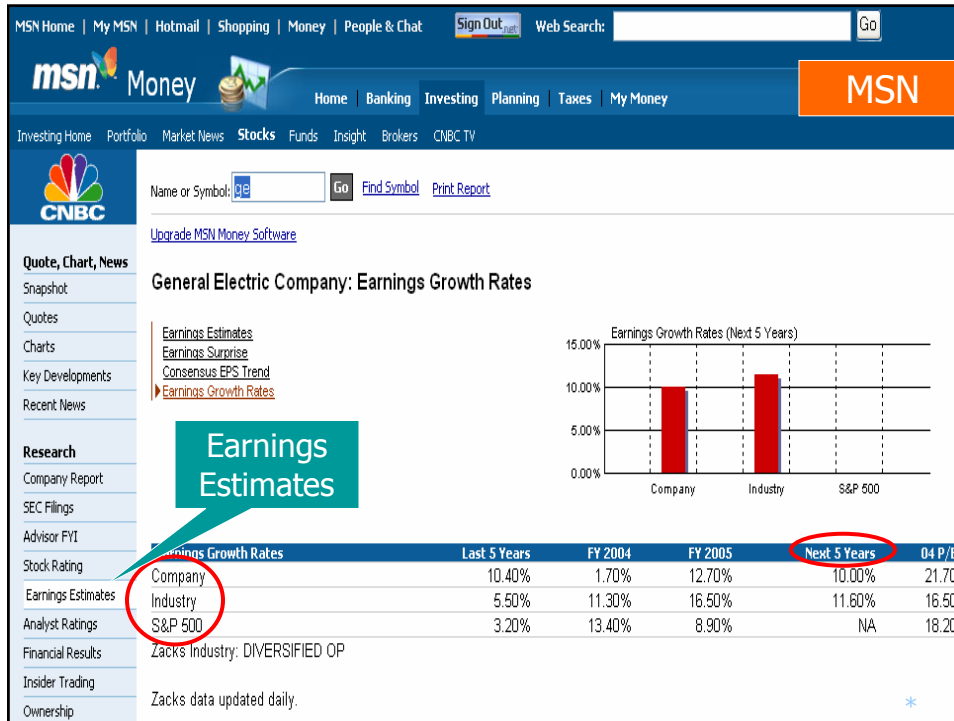
	GE	ALSGY.PK	CIT	SI	Industry
Market Cap:	361.30B	549.46M	7.92B	66.14B	3.86B
Employees:	305,000	118,995	5,800	415,000	30.99K
Rev. Growth (ttm):	1.90%	N/A	280.60%	4.40%	7.40%
Revenue (ttm):	140.74B	20.30B	4.54B	90.16B	6.06B
Gross Margin (ttm):	52.62%	14.76%	66.38%	28.70%	34.43%
EBITDA (ttm):	27.23B	462.25M	2.07B	9.07B	495.81M
Oper. Margins (ttm):	13.93%	0.38%	24.14%	5.32%	10.34%
Net Income (ttm):	15.74B	-2.18B	668.90M	4.23B	256.61M
EPS (ttm):	1.544	-4.82	3.111	4.686	1.61
PE (ttm):	22.16	N/A	12.08	16.19	22.88
PEG (ttm):	2.12	N/A	1.28	2.30	1.85
PS (ttm):	2.52	0.02	1.76	0.72	-0.91

ALSGY.PK = Alstom
 CIT = CIT Group Inc
 SI = Siemens AG
 Industry = Conglomerates

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7 ways to **Make** money in stocks

2. Focus on high quality companies with strong competitive positions

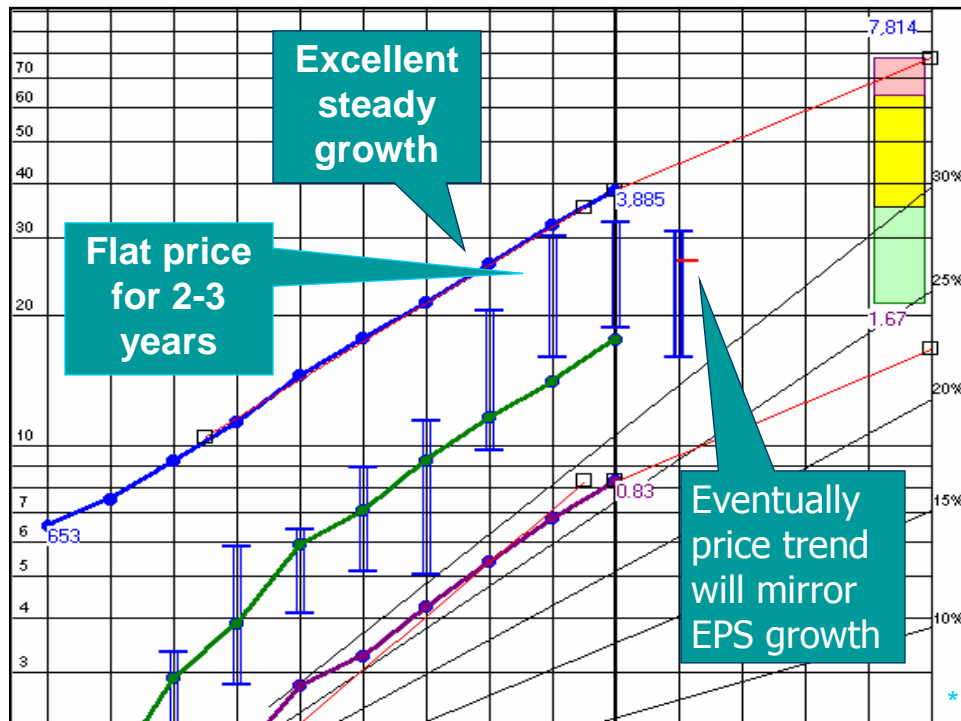
**Today's leader will be tomorrow's leader
(following start-up -- with 5 year history)**

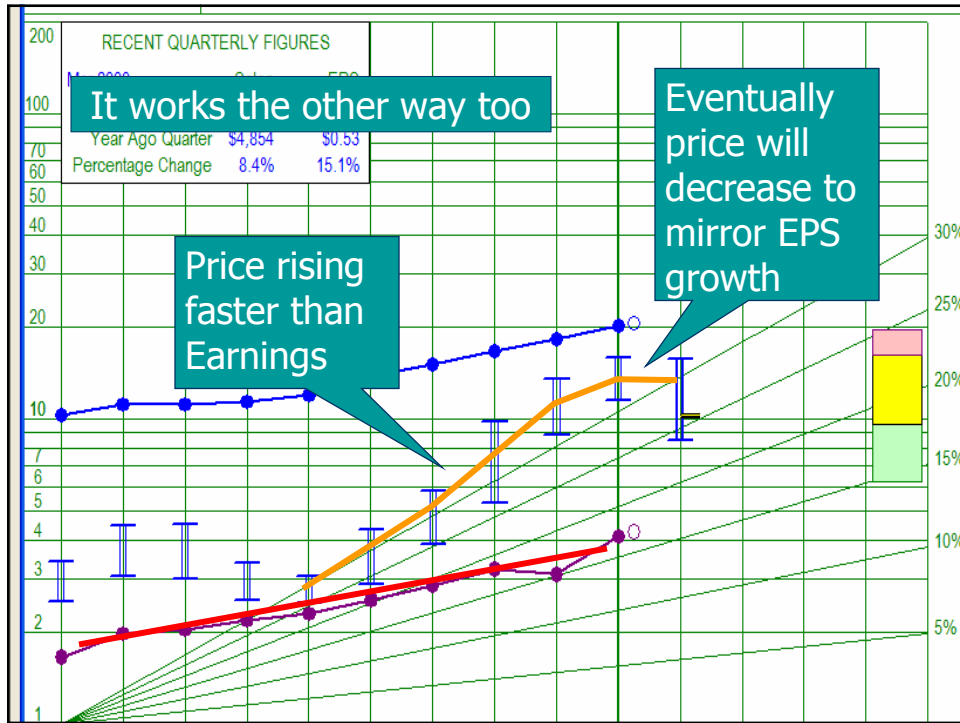
Today's laggard will be tomorrow's laggard

(Remember our Merck-Pfizer and Ford-GM comparison)

7 ways to **Make** money in stocks

3. Concentrate on the long-term
 - Sales follows the Economic growth
 - Earnings follows Sales
 - Price follows Earnings
 - (Eventually)





7 ways to **Make** money in stocks

4. Be willing to go against the consensus

- The market **FLUCTUATES!**

- About 50% each year

Let the price come to you – don't chase it

(Stay calm)

*



7 ways to **Make** money in stocks

- 5. Pay close attention to valuation
 - The best companies become overvalued
 - Wait for the stock's PE ratio to be near or below the average PE ratio of the last five years (Relative Value)
 - Try to buy a stock whose PE ratio is comparable to its expected growth rate (PEG Ratio)

*

3 PRICE-EARNINGS HISTORY as an indicator of the future

This shows how stock prices have fluctuated with earnings and dividends. It is a building block for translating earnings into future stock prices.

WM Current Price: \$44.94 52 Wk High: \$46.85 52 Wk Low: \$32.40 Dividend: \$1.64

Year	PRICE		C Earnings Per Share	D Price Earnings Ratio		F Dividend Per Share	G % Payout F=C X 100	H % Hi. Yield F+B X 100
	A HIGH	B LOW		LOW (B=C)	HIGH (A=C)			
1 1999	\$30.50	\$26.46	\$3.15	11.0	7.5	\$0.65	30.0%	4.0%
2 2000	\$37.29	\$32.40	\$3.86	9.7	7.5	\$0.76	32.2%	5.3%
3 2001	\$32.40	\$26.54	\$3.15	10.4	7.5	\$0.65	30.0%	4.0%
4 2002	\$32.40	\$26.54	\$3.86	8.4	7.5	\$0.76	32.2%	5.3%
5 2003	\$46.85	\$40.00	\$4.21	11.1	7.5	\$0.65	30.0%	4.0%
6 WTT TOT		\$398.85		6.6	112.3		45%	
7 WTT AVG		\$26.54		2.2	7.5		3%	
8 AVERAGE PE			9.9			10.5	EPS=\$4.27	RV=106.3

Projected Values: PE=9.5 EPS=\$4.75 RV=95.5 EPS Gr=11.8% PEG Ratio=0.89

4 EVALUATING RISK and REWARD over the next 5 years

Assuming one recession over the next 5 years, the upside-downside ratio might sell. The

PEG Ratio = Proj. PE / Proj. growth rate

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7 ways to Make money in stocks

6. Diversify

- *Offensive* as well as *Defensive*
- 1995-1998 Healthcare a big winner
- In the 1990s
 - Technology
 - Consumer Cyclicals
 - Energy ("tired old industry")
- Compare a Company with the Industry:
- Compare Industry charts

<http://www.bigcharts.com/industry/marketwatch-com/>

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Industry Start

Sectors

Dow Jones U.S. Sectors THURSDAY, JULY 05, 2005

- Oil & Gas
- Basic Materials
- Industrials
- Consumer Goods
- Health Care
- Consumer Services
- Telecommunications
- Utilities
- Financials
- Technology

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[Show All Industries](#)

Search for Industry:
Enter Symbol or Keyword:

Compare a stock's performance to its industry:
Enter Symbol or Keyword:

3 month Top Performer
DJ US Water Index (WAT)
Last: 635.81
Percent Change: -0.53%

WAT Daily 7/05/2005

Select the performance time period to sort the best and worst performers listed below:

10 Best Performing Industries

Industry Name	Percent Change (over time selected)
DJ US Water Index	25.12%
DJ US Real Estate Holding & Develop...	23.66%
DJ US Internet Index	18.46%
DJ US Home Construction Index	17.79%
DJ US Chemicals Index	14.63%
DJ US Retail Index	14.29%
DJ US Food & Beverage Index	13.48%
DJ US Pharmaceuticals Index	12.97%
DJ US Distillers & Vintners Index	12.48%
DJ US Mobile Telecommunications Ind...	12.04%

Enter Ticker to compare company with Industry

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Industry Start · [Health Care Industry List](#) · Health Care · Health Care · [Pharmaceuticals & Biotechnology](#) · Pharmaceuticals · Stock Chart

PFE Pfizer Inc (NYSE)

Last: 27.0

Time Frame: Compare to Index: Compare to Symbol: Compare to Industry:

S&P 500

Company

Industry

Volume

© BigCharts.com

Millions

Change Symbol:

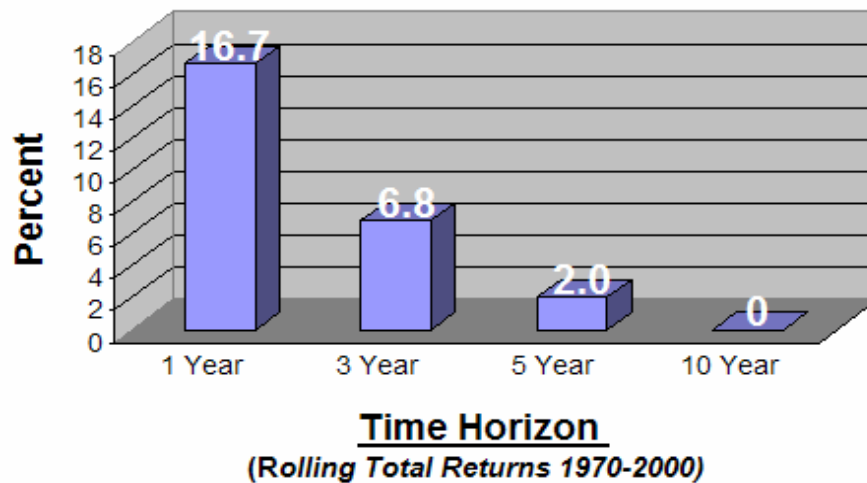
7 ways to **Make** money in stocks

7. Have realistic expectations
 - What's the average growth long-term?
 - Think long-term
 - Shooting stars are highly visible - but short lived

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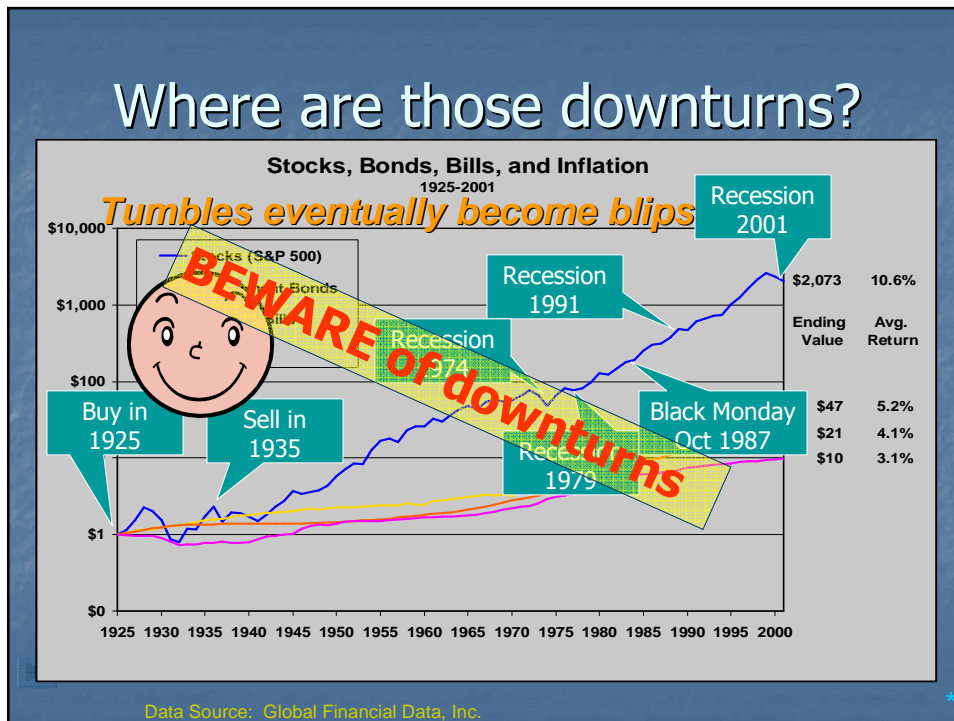
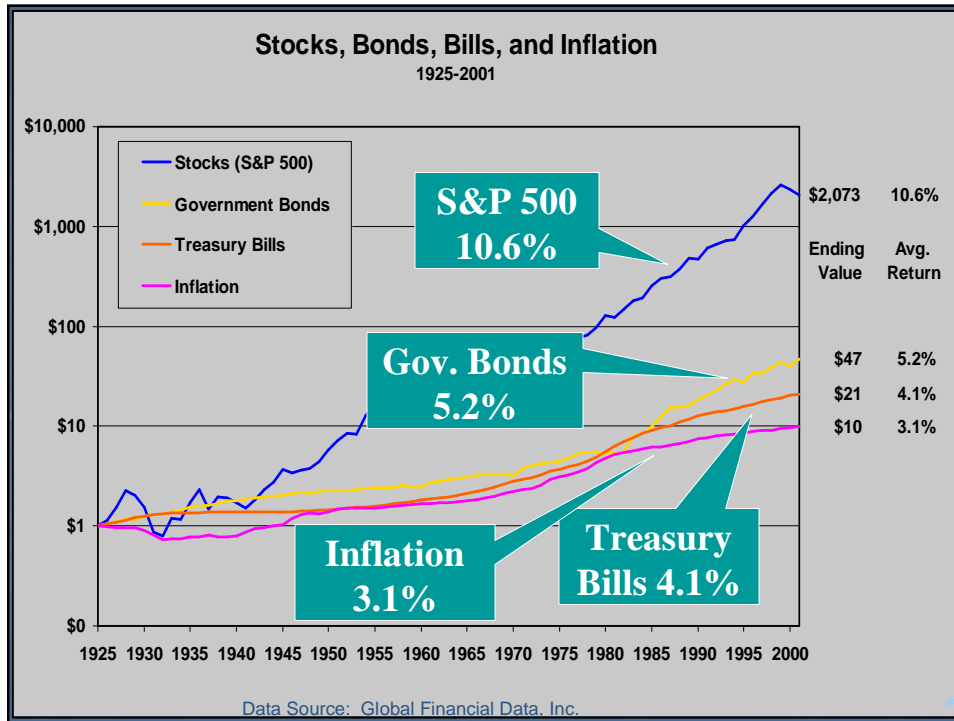
The longer the time period the less the risk

Probabilities of Losses (S&P 500)



Based on data from Merrill Lynch Quantitative Strategy

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7 ways to **Make** money in stocks

1. Invest in good businesses with superior growth and profitability
2. Focus on high quality companies with strong competitive positions
3. Concentrate on the long-term
4. Be willing to go against the consensus
5. Pay close attention to valuation
6. Diversify
7. Have realistic expectations

7 ways to **LOSE** money in stocks

1. Buy the most popular stock
 - (Buy high -- sell low)
 - Popular stocks = high earnings at the moment
 - High earnings = high competition
 - Wang Laboratories - word processor
 - Digital Equipment - Minicomputer market
 - Apple - #1 PC producer
 - Snapple - iced-tea & fruit flavored drinks

7 ways to **LOSE** money in stocks

2. TIME THE MARKET

Scenario: You invested in the S&P 500 every year from 1965 through mid 1995

- If you invested at the start of every year -- Annualized return: 11.0%
- If you invested at the peak of every year -- Annualized return: 10.6%
- If you invested at the low of every year -- Annualized return: 11.7%

7 ways to **LOSE** money in stocks

2. TIME THE MARKET

Solomon Brothers study
1980 - 1989 2,550 trading days

- S&P total return averaged 17.6% per year
- If you missed best 20 days; return dropped to 9.3%
- If you missed best 40 days; return dropped to 3.9%

7 ways to **Lose** money in stocks

3. Ride the strong upsurges in cyclical stocks
 - “Catch the wave” mentality
 - Cyclical stocks:
 - Automobile
 - Chemical
 - Paper
 - Steel
 - Peak out when earnings still rising & economic picture is bright

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7 ways to **Lose** money in stocks

4. Become mesmerized by Dividend yield
 - Look for Total Yield – Growth + Dividend
 - (Total Return)

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7 ways to **Lose** money in stocks

5 5-YEAR POTENTIAL

This combines price appreciation with dividend yield to get an estimate of total return. It provides a standard for comparing income and growth stocks.

A PRESENT YIELD

$$\frac{\text{Present Full Year's Dividend}}{\text{Present Price of Stock}} = \frac{\$2.26}{\$43.34} \times 100 = 5.2\% \text{ Present Yield or \% Returned on Purchase Price}$$

B AVERAGE YIELD OVER NEXT 5 YEARS

$$\frac{\text{Avg. Earnings Per Share Next 5 Years} \times \text{Avg. \% Payout}}{\text{Present Price of Stock}} = \frac{\$3.03 \times 71.0\%}{\$43.34}$$

5% Dividend – but. . .

C ESTIMATE

	Simple	Compounded
Avg. 5 Year	2.1%	2.0%
Average Yield (5%)	+ 5.0%	+ 5.0%
Average Total Annual Return Over the Next 5 Years (5%)	= 7.1%	= 7.0%

Don't forget the IRS wants a piece of your dividends

7 ways to **Lose** money in stocks

5. Invest in weak competitors
 - The rich tend to get richer
 - The poor usually stay poor
 - Westinghouse - now CBS
 - Texas Instruments and Advanced Micro Devices
 - Consistently run behind Intel

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2 EVALUATING MANAGEMENT		Company ADVANCED MICRO DEVICES (AMD)										08/29/07		
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	LAST 5 YEAR AVG.	TREND		
												UP	DOWN	
A	% Pre-tax Profit on Sales (Net Before Taxes + Sales)	-3.2	-7.3	-11.0	19.7	1.1	-32.7	-9.4	2.6	2.7	6.0	-6.2	UP	
B	% Earned on Equity (E/S + Book Value)	-1.1	-4.9	-17.8	23.9	0.8	-27.9	-11.8	4.4	8.6	2.5	-4.8	UP	

2 EVALUATING MANAGEMENT		Company TEXAS INSTRUMENTS INC (TXN)										08/29/07		
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	LAST 5 YEAR AVG.	TREND		
												UP	DOWN	
A	% Pre-tax Profit on Sales (Net Before Taxes + Sales)	43.7	12.8	22.7	25.3	-1.0	3.7	12.2	19.2	22.3	24.4	16.4	UP	
B	% Earned on Equity (E/S + Book Value)	5.0	10.7	15.6	15.8	0.1	2.9	9.5	13.8	17.8	20.2	12.8	UP	

2 EVALUATING MANAGEMENT		Company INTEL CORPORATION (INTC)										08/29/07		
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	LAST 5 YEAR AVG.	TREND		
												UP	DOWN	
A	% Pre-tax Profit on Sales (Net Before Taxes + Sales)	42.5	35.4	39.5	38.6	10.0	17.2	26.8	30.7	32.8	19.5	25.4		DOWN
B	% Earned on Equity (E/S + Book Value)	29.5	24.9	22.2	23.6	4.3	9.1	14.4	18.8	23.9	13.2	15.9		DOWN

7 ways to **Lose** money in stocks

- 6. Buy stocks on tips
 - Buying a stock without researching and understanding the company is usually disastrous

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"Spend at least as much time researching a stock as you would choosing a refrigerator".

Peter Lynch:

"Never invest in any idea you can't illustrate with a crayon."

7 ways to **Lose** money in stocks

7. This Time it's Different
 - "Earnings don't matter?"
 - "Bigger is better - at any cost."
 - "Market share, market share."
 - "Baby boomers will drive the market."
 - 1997 "Asian countries will continue their breakneck growth."

7 ways to **Lose** money in stocks

1. Buy the most popular stock
2. TIME THE MARKET
3. Ride the strong upsurges in cyclical stocks
4. Become mesmerized by Dividend yield
5. Invest in weak competitors
6. Buy stocks on tips
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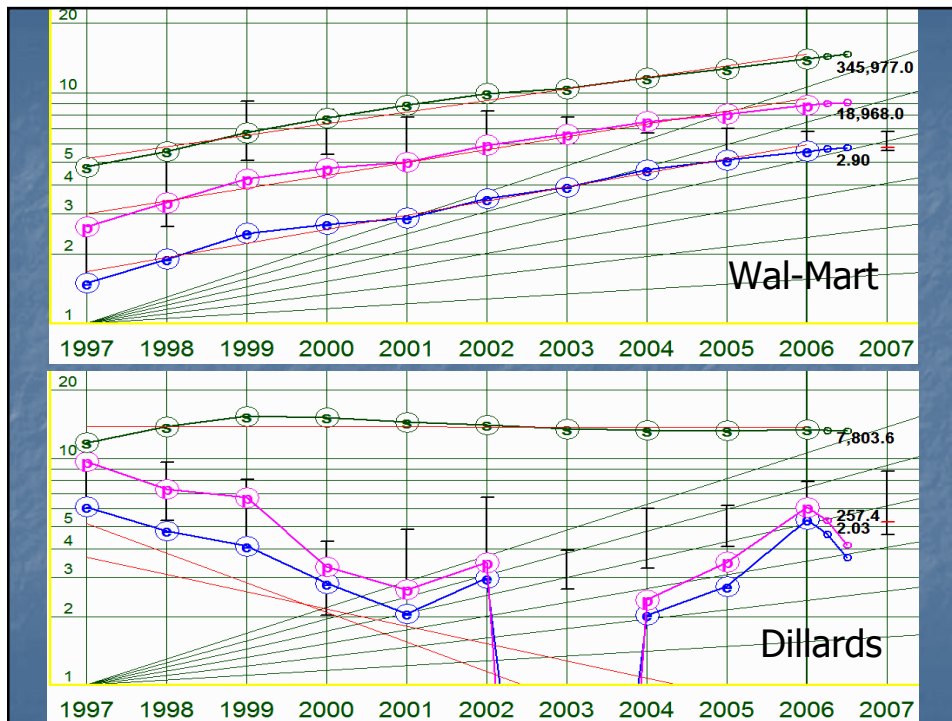
Summary

. . . Mr. Perry's other admonitions and more.

- The bottom line. . .

Focus on High Quality Companies with Strong Competitive Positions

- From history, in 9 out of 10 cases
 - Today's leader in any established business will be tomorrow's leader
 - Today's laggard will be tomorrow's laggard
 - The exception is in start up industries where leaders can falter
 - DO YOU REALLY THINK **Dillards** WILL TAKE OVER **WAL MART**?



Invest Only in High-Quality Growth Companies

- Profit margins and return-on-equity above the average for their industry
 - COMPARE Intel WITH Adv. Micro Devices
- If using Value Line, avoid companies with Financial Strength ratings lower than B
- Avoid companies with excessive debt
 - Especially during recessions
- Look for management ownership

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B	% Earned on Equity (EIS + Book Value)	29.5	24.9	22.2	23.6	4.3	9.1	14.4	18.8	23.9	13.2	15.9		DOWN

Look for stability and superior returns

Don't Overpay for a Stock

- Wait for the stock's PE ratio to be near or below the average PE ratio of the last five years
- Try to buy a stock whose PE ratio is comparable to its expected growth rate

3. PRICE-EARNINGS HISTORY as an indicator of the future
 This shows how stock prices have fluctuated with earnings and dividends. It is a building block for translating earnings into future stock prices.

Current Price: \$44.94 52 Wk High: \$46.85 52 Wk Low: \$32.40 Dividend: \$1.64

Year	A PRICE		C Earnings Per Share	D Price Earnings Ratio		F Dividend Per Share	G % Payout F=C X 100	H % Hi. Yield F=B X 100
	HIGH	LOW		HIGH (A÷C)	LOW (B÷C)			
1 1999	\$30.50	\$16.46	\$2.18	14.0	7.5	\$0.65	30.0%	4.0%
2 2000	\$37.29	\$14.42	\$2.36	15.8	6.1	\$0.76	32.2%	5.3%
3 2001	\$42.99	\$26.52	\$3.15	13.6	8.4	\$0.90	28.5%	3.4%
4 2002	\$39.98	\$27.80	\$3.86	10.4	7.2	\$1.06	27.5%	3.8%
5 2003	\$46.85	\$32.40	\$4.21	11.1	7.7	\$1.40	33.3%	4.3%
6 Wt TOT		\$398.05		183.6	112.3		455.9%	
7 Wt AVG		\$26.54		12.2	7.5		30.4%	
8 AVERAGE PE			9.9		10.5		EPS=\$4.27	
Projected Values: PE=9.5 EPS=\$4.75 RV=96.5 EPS Gr=11.3% REG Ratio=0.89								

4 EVALUATING RISK and REWARD over the next 5 Years
 Assuming one recession and one business boom every 5 years, calculations are made of how high and how low the stock might sell. The upside-downside ratio is the key to evaluating risk and reward.

Take action to Investigate if:

- Price is in the Sell Zone
- P/E is above 150% average PE
- Upside/Downside Ratio equal to or less than 1
- Expected Annualized Growth less than 10-12%
- Profitability is slowing
- PERT-A shows deterioration (Especially in Sales)
 - EPS growth well above Sales growth or decreasing

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