

STOCK RESEARCH

TIPS and “RULES of THUMB”

from Subject-Matter Expert

Disclaimer: The STARS program is a learning process intended for classroom use and then only to make students and teachers aware of the benefits and risks of saving and investing. Invest Ed[®] does not recommend any particular investment strategy or plan, any type of product, or any securities professional over another. No part of the STARS program is to be taken as investment advice.

“the market” – generally refers to the S&P 500

<http://www.standardandpoors.com/indices/sp-500/en/us/?indexId=spusa-500-usdof--p-us-l-->

Invest in good companies. Research the *company*. Is the company involved in innovation? Prospects for growth? Compare to other companies in same industry. Compare to market.

Look for smaller firms that have managers with lots of “skin in the game.”

MARKET CAPITALIZATION = price per share x number of shares

large cap	over 10B
mid cap	2 to 10B
small cap	under 2B

Recommendation: Do not select stocks with a market cap of less than \$200M.

Stocks with market cap less than \$200M – not as much research material available so more difficult to make informed decision.

STOCK SELECTING TIPS

ROE – 15%+

ROA – 10%+

Industry & competitors

high profit margin (how much profit for every \$1 we sell) – Compare to others in same industry.

P/E relative to growth rate

expected growth rate higher than current P/E (last 12 months of earnings)

PEG

market cap – greater than \$200M

Trading volume per day – 50,000 shares (filters out limited partnerships)

Learn about business.

Review last quarterly report.

Price chart – may highlight events or news—last 3 to 6 mos. could be meaningful.

HINTS

Picking 3 or 4 good stocks out of 10 is excellent. The key is to pay the right price.

Avoid message boards.

retail company – open more than one year

Subject-matter expert likes high ROE (over 15%), high profit margins, and small companies.

When company is out of favor, may be good time to buy. Do the research.

management – in place for minimum of 3 years

P/E RATIO a/k/a P/E multiple

P/E answers the question “What price are you willing to pay for \$1 in earnings?”

P/E ratio = price per share ÷ earnings per share

A measure is needed to show how much the marketplace values a company’s earnings. P/E indicates how much market participants are willing to pay for earnings. Or, P/E is the measure of what investors are willing to pay for one dollar in earnings.

Typically, growth stocks have higher P/Es; however, that does not necessarily mean the stock is growing. A P/E gives the market’s [Wall St.’s] opinion [price] on growth expectation. [future growth]

P/E (ttm) trailing, past 12 months – today’s price; earnings past 12 months

P/E (ftm) forward, future 12 months – today’s price; earnings forecasted next 12 months

Low P/E indicates “value.” But remember, stocks may have low P/E for a reason. They may not be growing; business may be declining due to a fundamental shift in the economy. High P/E indicates growth. Investors are willing to pay a premium in hopes of growth. Low P/E stocks “tend” to be out of favor. P/E tells us the market’s *opinion*—not if a stock is good or bad.

low P/E	below 15
average	15 to 20
high P/E	25 to 30
S&P 500 P/E	15 to 20

example

price per share of 30 ÷ earnings per share of 2 = P/E of 15
company trades 15 times earnings
for every \$1.00 in earnings, the market is willing to pay \$15.

Higher P/E stocks tend to be more volatile, more risky—usually small companies.

P/E Rules of Thumb

Compare growth to P/E.

Do not pay more for P/E than growth rate.

Growth rate higher than trailing P/E = ideal

1.5 times growth rate = rule of thumb

When growth stops, P/E and price get hammered.

YAHOO! FINANCE

More On WFM	
QUOTES	
Summary	
Order Book	
Options	
Historical Prices	
CHARTS	
Interactive	
Basic Chart	
Basic Tech. Analysis	
NEWS & INFO	
Headlines	
Financial Blogs	
Company Events	
Message Boards	
Market Pulse	
COMPANY	
▶ Profile	
Key Statistics	
SEC Filings	
Competitors	
Industry	
Components	
ANALYST COVERAGE	
Analyst Opinion	
Analyst Estimates	
Research Reports	
Star Analysts	
OWNERSHIP	
Major Holders	
Insider Transactions	
Insider Roster	
FINANCIALS	
Income Statement	
Balance Sheet	
Cash Flow	

- (1) <http://biz.yahoo.com/p/>
- (2) Click **Industries** link from list of options.
(or **Industry Center**, depending on which screen appears)
At times, this step is skipped altogether which jumps you to step 3.
- (3) Click **Complete Industry List**, left column.
- (4) Results: a list of industries broken down by sector. Click on industry of your choice to view top performers based on various criteria. Click on any company name for detailed information—as in column to the left on this handout: Quotes, Charts, News & Info, etc.

Top Industries	Industry Top Performers	Industry Statistics																																																		
<ul style="list-style-type: none"> Auto Manufacturers - Major Biotechnology Business Software & Services Chemicals - Major Diversified Communication Equipment Conglomerates Diversified Computer Systems Diversified Investments Diversified Utilities Drug Manufacturers - Major Electric Utilities Food - Major Diversified 	<table border="1"> <thead> <tr> <th>Intraday Price Performance</th> <th>% Change</th> <th>Market Cap</th> </tr> </thead> <tbody> <tr> <td>MONSANTO COMPANY [MON]</td> <td>+6.05%</td> <td>\$41.8 B</td> </tr> <tr> <td>Converted Organics Inc. [COIN]</td> <td>+2.96%</td> <td>\$15.5 M</td> </tr> <tr> <td>KMG Chemicals, Inc. [KMGB]</td> <td>+2.09%</td> <td>\$79.5 M</td> </tr> <tr> <td>TERRA NTR CO LP [TNIH]</td> <td>+1.99%</td> <td>\$2.0 B</td> </tr> <tr> <td>POTASH CP SASKATCHEW [POT]</td> <td>+1.89%</td> <td>\$27.0 B</td> </tr> </tbody> </table> <table border="1"> <thead> <tr> <th>Market Capitalization</th> <th>% Change</th> <th>Market Cap</th> </tr> </thead> <tbody> <tr> <td>MONSANTO COMPANY [MON]</td> <td>+6.05%</td> <td>\$41.2 B</td> </tr> <tr> <td>POTASH CP SASKATCHEW [POT]</td> <td>+1.89%</td> <td>\$27.1 B</td> </tr> <tr> <td>SYNGENTA AG ADS [SYT]</td> <td>-0.25%</td> <td>\$22.1 B</td> </tr> <tr> <td>MOSAIC COMPANY (THE) [MOS]</td> <td>+1.38%</td> <td>\$22.0 B</td> </tr> <tr> <td>AGRIUM INC. [AGU]</td> <td>+0.61%</td> <td>\$6.4 B</td> </tr> </tbody> </table>	Intraday Price Performance	% Change	Market Cap	MONSANTO COMPANY [MON]	+6.05%	\$41.8 B	Converted Organics Inc. [COIN]	+2.96%	\$15.5 M	KMG Chemicals, Inc. [KMGB]	+2.09%	\$79.5 M	TERRA NTR CO LP [TNIH]	+1.99%	\$2.0 B	POTASH CP SASKATCHEW [POT]	+1.89%	\$27.0 B	Market Capitalization	% Change	Market Cap	MONSANTO COMPANY [MON]	+6.05%	\$41.2 B	POTASH CP SASKATCHEW [POT]	+1.89%	\$27.1 B	SYNGENTA AG ADS [SYT]	-0.25%	\$22.1 B	MOSAIC COMPANY (THE) [MOS]	+1.38%	\$22.0 B	AGRIUM INC. [AGU]	+0.61%	\$6.4 B	<table border="1"> <thead> <tr> <th>Industry Statistics</th> </tr> </thead> <tbody> <tr> <td>Market Capitalization:</td> </tr> <tr> <td>Price / Earnings:</td> </tr> <tr> <td>Price / Book:</td> </tr> <tr> <td>Net Profit Margin (mrq):</td> </tr> <tr> <td>Price To Free Cash Flow (mrq):</td> </tr> <tr> <td>Return on Equity:</td> </tr> <tr> <td>Total Debt / Equity:</td> </tr> <tr> <td>Dividend Yield:</td> </tr> </tbody> </table> <table border="1"> <thead> <tr> <th>Community Spotlight</th> </tr> </thead> <tbody> <tr> <td>Most Active Boards</td> </tr> <tr> <td>Board Popularity</td> </tr> <tr> <td>AGU</td> </tr> <tr> <td>CF</td> </tr> </tbody> </table>	Industry Statistics	Market Capitalization:	Price / Earnings:	Price / Book:	Net Profit Margin (mrq):	Price To Free Cash Flow (mrq):	Return on Equity:	Total Debt / Equity:	Dividend Yield:	Community Spotlight	Most Active Boards	Board Popularity	AGU	CF
Intraday Price Performance	% Change	Market Cap																																																		
MONSANTO COMPANY [MON]	+6.05%	\$41.8 B																																																		
Converted Organics Inc. [COIN]	+2.96%	\$15.5 M																																																		
KMG Chemicals, Inc. [KMGB]	+2.09%	\$79.5 M																																																		
TERRA NTR CO LP [TNIH]	+1.99%	\$2.0 B																																																		
POTASH CP SASKATCHEW [POT]	+1.89%	\$27.0 B																																																		
Market Capitalization	% Change	Market Cap																																																		
MONSANTO COMPANY [MON]	+6.05%	\$41.2 B																																																		
POTASH CP SASKATCHEW [POT]	+1.89%	\$27.1 B																																																		
SYNGENTA AG ADS [SYT]	-0.25%	\$22.1 B																																																		
MOSAIC COMPANY (THE) [MOS]	+1.38%	\$22.0 B																																																		
AGRIUM INC. [AGU]	+0.61%	\$6.4 B																																																		
Industry Statistics																																																				
Market Capitalization:																																																				
Price / Earnings:																																																				
Price / Book:																																																				
Net Profit Margin (mrq):																																																				
Price To Free Cash Flow (mrq):																																																				
Return on Equity:																																																				
Total Debt / Equity:																																																				
Dividend Yield:																																																				
Community Spotlight																																																				
Most Active Boards																																																				
Board Popularity																																																				
AGU																																																				
CF																																																				

These instructions complete with screen prints are located in the *Project Supplements* section of your resources in the *Stock Research* section.

Every category in screen print column at left is for the same, one company.

The *Interactive* charts [under Charts] are a visual way to compare companies within an industry and also to the S&P.

The company *Profile* [under Company] provides a summary of the business. Also, find a link to the company's site so you can review the **investor relations** section.

The Key Statistics [under Company] is full of important information: dividends, market cap, P/E, PEG, ROA (return on assets), ROE (return on equity), and much more.

ROE – a profitability measure - how much profit generated for every dollar; rate of return in business

$$ROE = \text{net income} \div \text{shareholder's equity}$$

ROE is useful to compare profitability of a company to other companies in same industry.

ROA – how much profit a company generates for every dollar of assets – total level of assets required by a company to generate \$1 in sales

$$ROA = \text{net income} \div \text{total assets}$$

Rule of Thumb = ROA and ROE in double digits, 10% +

Analyst Estimates [under Analyst Coverage] – growth estimates for next 5 yrs. is good indicator; look for growing revenue, earnings per share [Industry & Sector columns unreliable in YAHOO!.] analysts more accurate in forecasting short-term growth rather than long-term growth.

Debt, on Balance Sheet [under Financials] – compare to others in industry

International companies' information is not always reliable in YAHOO! Finance.

Analyst Opinion [under Analyst Coverage] – Analysts rarely recommend sell, so hold & underperform may indicate sell.

Analysts have to review everything, all forms.

DEF 14A – definitive proxy statement

Shareholders decide who will be on board of directors—ideally, want independent board. 1/3 up for re-election each year. Sometimes a wealthy investor will buy 10% of a company and demand his/her choices be on the board.

10Q – everything financial in the quarter is listed. Sometimes companies will “sneak” important info into the 10Q, bury it and not put out a press release. So, analysts have to read everything.

Major Holders [under Ownership] Sometimes it is a good thing if not a lot of people own your stock.

Profile – go to company's site; look for investor relations; all publicly traded companies have an investor relations section. There you can view the annual report. Of course, this will contain company's best spin on things.

Recommended - Create/show **benchmark** portfolio to give students something to compare their portfolios to.

Stocks Size	Value	Benchmark Portfolio	Symbol
small cap	less than 2 billion	Russell 2000	IWM
mid cap	2 to 10 billion	NASDAQ	QQQQ
large cap	over 10 billion	S&P 5000	SPY

index funds like the 3 in benchmark table – lowest fees available

Where do I find information on 'new' public company?

SEC site, <http://www.sec.gov/>, Prospectus

BULL/BEAR

historically, last 3 years

bull prices have risen 10% from their low

bear prices have fallen 10% from their high

Goodwill – on balance sheet, premium paid over book value at acquisition

PEG RATIO – compares P/E to future growth rate

trailing P/E divided by future earnings growth rate = PEG

less than 1 – desirable, do not want to overpay for growth; way higher than 1, overlook

Recommendation: Avoid PEG over 1.5 to 2. (large premiums for earnings)

WARREN BUFFET ON STOCKS

- My favorite holding period is forever.
- Leave yourself an enormous margin of safety. You build a bridge that 30,000 pound trucks can go across, and then you drive 10,000 pound trucks across it.
- Forget what you think the stock market will do; focus on what the business will do over time.
- There are no called strikes in investing; you don't have to swing at every opportunity.

PETER LYNCH'S FUNDAMENTALS

- Know what you own.
- Don't try to predict the economy, interest rates, and the market.
- You have plenty of time.
- Avoid long shots.
- Buy a business any fool can manage because eventually one will.

One Up On Wall Street, Peter Lynch (recommended by subject-matter expert)

INITIALS FOLLOWING STOCK SYMBOL

.PLC – (public limited co.) incorporated in United Kingdom

.OB – over the counter bulletin board – not especially large or stable, considered very risky

.PK – pink sheet, does not trade on exchange; lack of SEC filing requirements, no disclosure

http://en.wikipedia.org/wiki/Ticker_symbol Ticker symbol history

List provides examples including single-letter ticker symbols.

INTERESTING FACTS

Every one pound of beef raised requires 7 pounds of grain.

Only 1% of traders are predictably profitable. Transaction costs are a major factor.

What company founded in 2008, whole new industry, made \$1B in revenue in the first 3 years and in 2012 was valued at over \$8B? Groupon (super example of innovation)

Most profitable business in the world – i-phone

An IPO (initial public offering) costs 7% of the money raised.

Why go public? valuation of company

Public companies have to disclose, report to SEC. Public companies are worth more than private.