

Most Dangerous Stocks for August 2014

20 Large/Mid Cap and 20 Small Cap Stocks

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- **Figure 1 shows 7 new stocks that make our August lists.**
- **FREE Company Valuation Reports for 2 of the new stocks are in the Free Archive on our website.**
- **The Dangerous Stocks (-5.9%) fell more than the S&P 500 (-2.2%) and outperformed as a short portfolio last month.**
- **Figure 4 shows the 25 stocks from July's report that outperformed as shorts.**
- **See Appendix C for data on returns, volatility and portfolio turnover for our Most Dangerous Stocks Portfolio.**
- **Most Dangerous Stocks have misleading earnings, which means reported earnings are rising while true economic earnings are declining.**
- **Barron's recently highlighted our stock-picking as amongst the best of all Wall Street firms. See our website for details.**

Figure 1: Additions for August

Large Cap Additions		Small Cap Additions	
Ticker	Company Name	Ticker	Company Name
ACC	American Campus Communities	AF	Astoria Financial Corp
ACIW	ACI Worldwide, Inc.	POWR	PowerSecure International, Inc.
AMZN	Amazon.com Inc.		
LNKD	LinkedIn Corporation		
TDS	Telephone & Data Systems, Inc.		

Sources: New Constructs, LL

Please see Appendix B for explanations of additions and deletions to the large and small cap lists.

The 20 Most Dangerous Large/Mid Cap Stocks for August

We recommend that investors equal-weight holdings in all 20 Large/Mid Cap Most Dangerous Stocks.

Figure 2: 20 Most Dangerous Large/Mid Cap Stocks for August

Ticker	Company Name	Misleading Earnings			Expensive Valuation			Market Value (\$mm)
		As of Last Fiscal Year			as of 07/31/14			
		Rising GAAP Earnings (\$mm)	Declining Economic Cash Flows (\$mm)	Low-Ranking ROIC (by Quintile)	Low or Negative Free Cash Flow Yield	High or Negative Price-to-Economic Book Value	Long Market-Implied GAP (years)	
1 DLR	Digital Realty Trust, Inc.	\$99.92	(\$101)	Bottom Quintile	-3%	149.2	Greater than 100	\$8,715
2 ACC*	American Campus Communities	\$47.93	(\$42)	Bottom Quintile	-4%	31.8	Greater than 100	\$4,083
3 AMZN*	Amazon.com Inc.	\$313.00	(\$414)	Bottom Quintile	-2%	29.7	Greater than 100	\$144,613
4 LNKD*	LinkedIn Corporation	\$5.16	(\$48)	Bottom Quintile	-2%	14.8	Greater than 100	\$21,995
5 POL	PolyOne Corporation	\$171.90	(\$52)	4th	-10%	11.7	Greater than 100	\$3,572
6 BXP	Boston Properties, Inc.	\$452.10	(\$59)	4th	-7%	11.4	Greater than 100	\$18,281
7 EXR	Extra Space Storage, Inc.	\$54.20	(\$14)	4th	-5%	10.7	Greater than 100	\$5,998
8 PDM	Piedmont Office Realty Trust, Inc.	\$5.52	(\$26)	Bottom Quintile	-4%	8.7	Greater than 100	\$3,001
9 HIW	Highwoods Properties, Inc.	\$45.86	(\$5)	4th	-3%	6.6	Greater than 100	\$3,791
10 O	Realty Income Corp	\$89.10	(\$137)	4th	-28%	6.5	84	\$9,533
11 ACIW*	ACI Worldwide, Inc.	\$15.02	(\$3)	3rd	-10%	5.3	Greater than 100	\$2,132
12 STZ	Constellation Brands, Inc.	\$1,555.30	(\$65)	4th	-23%	4.4	28	\$15,791
13 RLJ	RLJ Lodging Trust	\$71.43	(\$6)	4th	-2%	4.3	Greater than 100	\$3,446
14 ABG	Asbury Automotive Group	\$26.90	(\$7)	4th	-2%	4.2	Greater than 100	\$2,049
15 WYN	Wyndham Worldwide Corp	\$32.00	(\$114)	4th	-9%	4.1	39	\$9,456
16 AXLL	Axiall Corporation	\$45.36	(\$219)	4th	-64%	3.5	38	\$2,995
17 BG	Bunge Ltd.	\$202.00	(\$251)	Bottom Quintile	-3%	3.2	83	\$11,606
18 USM	United States Cellular Corp	\$29.03	(\$356)	Bottom Quintile	1%	-0.9	Greater than 100	\$3,291
19 TDS*	Telephone & Data Systems, Inc.	\$60.53	(\$239)	Bottom Quintile	-3%	-1.2	Greater than 100	\$2,719
20 DDR	DDR Corp	\$16.88	(\$34)	Bottom Quintile	-10%	-1.8	Greater than 100	\$6,303

* Addition to the Large/Mid Cap Most Dangerous list in August

Most Dangerous Stocks are Ranked by Price-to-Economic Book Value in Descending Order

Sources: New Constructs, LLC

The 20 Most Dangerous Small Cap Stocks for August

We recommend that investors equal-weight holdings in all 20 Small Cap Most Dangerous Stocks.

Figure 3: 20 Most Dangerous Small Cap Stocks for August

Ticker	Company Name	Misleading Earnings			Expensive Valuation			Market Value (\$mm)	
		As of Last Fiscal Year			as of 07/31/14				
		Rising GAAP Earnings (\$mm)	Declining Economic Cash Flows (\$mm)	Low-Ranking ROIC (by Quintile)	Low or Negative Free Cash Flow Yield	High or Negative Price-to-Economic Book Value	Long Market-Implied GAP (years)		
1	CHFN	Charter Financial Corp	\$1.28	(\$4)	Bottom Quintile	-47%	192.1	Greater than 100	\$247
2	QDEL	Quidel Corporation	\$2.41	(\$5)	Bottom Quintile	-4%	46.2	Greater than 100	\$819
3	LOJN	LoJack Corporation	\$11.55	(\$1)	Bottom Quintile	-10%	19.8	91	\$94
4	TNGO	Tangoe Inc	\$1.92	(\$2)	Bottom Quintile	1%	15.8	Greater than 100	\$534
5	PATR	Patriot Transportation Holding	\$7.58	(\$1)	Bottom Quintile	-1%	9.7	Greater than 100	\$321
6	NUVA	NuVasive Inc.	\$4.76	(\$25)	Bottom Quintile	2%	9.2	Greater than 100	\$1,742
7	RP	Real Page Inc.	\$15.51	(\$2)	4th	-3%	6.7	Greater than 100	\$1,269
8	HOS	Hornbeck Offshore Services	\$74.38	(\$12)	4th	-7%	6.6	26	\$1,584
9	OKSB	Southwest Bancorp, Inc.	\$4.85	(\$14)	Bottom Quintile	0%	5.3	Greater than 100	\$305
10	ASGN	On Assignment, Inc.	\$41.86	(\$24)	4th	-2%	5.3	Greater than 100	\$1,467
11	CHSP	Chesapeake Lodging Trust	\$12.68	(\$15)	4th	-11%	4.9	79	\$1,485
12	KVHI	KVH Industries, Inc.	\$0.95	(\$1)	Bottom Quintile	-5%	4.7	Greater than 100	\$206
13	NGS	Natural Gas Services Group	\$1.71	(\$2)	4th	-3%	4.3	Greater than 100	\$389
14	EXAR	Exar Corporation	\$2.92	(\$8)	Bottom Quintile	-8%	4.0	Greater than 100	\$455
15	ICON	Iconix Brand Group, Inc.	\$18.64	(\$20)	4th	-4%	4.0	62	\$1,934
16	KFRC	Kforce Inc.	\$24.49	(\$2)	4th	-2%	3.7	Greater than 100	\$670
17	DWA	DreamWorks Animation Skg.	\$91.51	(\$51)	Bottom Quintile	-7%	3.7	11	\$1,693
18	NFBK	Northfield Bancorp Inc.	\$3.12	(\$15)	Bottom Quintile	-37%	3.6	Greater than 100	\$683
19	POWR*	PowerSecure International, Inc.	\$1.33	(\$1)	Bottom Quintile	-22%	3.6	Greater than 100	\$220
20	AF*	Astoria Financial Corp	\$6.03	(\$2)	Bottom Quintile	-10%	2.8	Greater than 100	\$1,280

* Addition to the Small Cap Most Dangerous list in August

Most Dangerous Stocks are Ranked by Price-to-Economic Book Value in Descending Order

Sources: New Constructs, LLC

Most Dangerous Stocks: Monthly Updates

The Dangerous Stocks (-5.9%) fell more than the S&P 500 (-2.2%) and outperformed as a short portfolio last month. 25 stocks from our July Most Dangerous Large Cap and Small Cap lists outperformed the S&P 500 as shorts, and 33 stocks had negative returns. See Figure 4 for details. For updates on the performance of all of last month's Most Dangerous stocks, see Appendix A. We measure our July performance based on closing prices from July 02, 2014 to July 31, 2014. We published last month's report to subscribers on July 02, 2014 and to the general public, for purchase, on July 09, 2014.

Figure 4: 33 Stocks with Negative Returns From July's Report

Large Cap			Small Cap		
Ticker	Company Name	Change From 07/02/14	Ticker	Company Name	Change From 07/02/14
CRS	Carpenter Technology Corp	-14.9%	RP	Real Page Inc.	-28.8%
GPI	Group 1 Automotive, Inc.	-14.1%	ASGN	On Assignment, Inc.	-25.8%
POL	PolyOne Corporation	-11.2%	DWA	DreamWorks Animation Skg.	-15.2%
AXLL	Axiall Corporation	-11.2%	LOJN	LoJack Corporation	-14.5%
B	Barnes Group, Inc.	-11.1%	TPC	Tutor Perini Corp	-13.9%
STZ	Constellation Brands, Inc.	-7.9%	EXAR	Exar Corporation	-13.7%
JNS	Janus Capital Group, Inc.	-7.8%	OKSB	Southwest Bancorp, Inc.	-10.7%
USM	United States Cellular Corp	-4.8%	KFRC	Kforce Inc.	-9.3%
ABG	Asbury Automotive Group	-3.8%	PATR	Patriot Transportation Holding	-7.4%
O	Realty Income Corp	-3.4%	CSFL	Centerstate Banks, Inc.	-7.3%
EXR	Extra Space Storage, Inc.	-3.2%	HOS	Hornbeck Offshore Services	-5.2%
RLJ	RLJ Lodging Trust	-3.1%	TNGO	Tangoe Inc	-4.8%
S&P 500	S&P 500	-2.2%	NGS	Natural Gas Services Group	-4.4%
PEB	Pebblebrook Hotel Trust	-1.8%	S&P 500	S&P 500	-2.2%
DDR	DDR Corp	-1.1%	NFBK	Northfield Bancorp Inc.	-2.1%
WYN	Wyndham Worldwide Corp	-0.6%	CHFN	Charter Financial Corp	-1.8%
			KVHI	KVH Industries, Inc.	-1.5%
			ICON	Iconix Brand Group, Inc.	-1.3%
			CHSP	Chesapeake Lodging Trust	-0.6%

Sources: New Constructs, LLC,

Note: Gain/Decline performance analysis excludes transaction costs, dividends and rebates.

Most Dangerous Stocks: Methodology

Stocks make our Most Dangerous list because they have:

1. **Poor-Quality Earnings** based on:

- a. Misleading earnings: rising and positive GAAP earnings while economic earnings are negative and falling; and
- b. Low Returns on Invested Capital (ROIC).

AND

2. **Expensive Valuations** based on:

- a. *Free-Cash Flow Yields*¹ that are very low or negative;
- b. *Price-to-Economic Book Value (EBV)*² ratios that are relatively high; and
- c. *Growth Appreciation Periods*³ (GAP) that are relatively high.

Only stocks that earn an Overall Rating of Very Dangerous are allowed on our Most Dangerous Stocks lists.

The above characteristics also qualify stocks for a 'Very Dangerous' or 'Dangerous' Rating, according to our Risk/Reward Rating system. Figure 4 shows our Risk/Reward Rating analysis, which we apply to the 3000+ companies that we cover. Stocks get a grade of 1 to 5 for each criterion, 5 being the worst and 1 being the best score. The Overall score is based on the average score of all five criteria. Stocks must get an average score of 4.25 or above to be rated Very Dangerous. For the most part, only Very Dangerous stocks qualify for our Most Dangerous Stocks lists.

Figure 5: New Constructs Risk/Reward Rating for Stocks

Overall Risk/Reward Rating	Quality of Earnings		Valuation		
	Economic vs Reported EPS	Return on Invested Capital (ROIC)	FCF Yield	Price-to-EBV Ratio	Growth Appreciation Period (yrs)
Very Dangerous	Misleading Trend	Bottom Quintile	<5%	> 3.5 or < -1	> 50
Dangerous	False Positive	4th Quintile	-5%<-1%	2.4 > 3.5 or < -1	20 > 50
Neutral	Neutral EP	3rd Quintile	-1%<3%	1.6 > 2.4	10 > 20
Attractive	Positive EP	2nd Quintile	3%<10%	1.1 > 1.6	3 > 10
Very Attractive	Rising EP	Top Quintile	>10%	0 > 1.1	0 > 3

Sources: New Constructs, LLC

¹ Free-Cash Flow Yields measure the % of the total value of the firm for which the Free Cash Flows of the firm account. The formula is FCF/Current Enterprise Value.

² Economic Book Value (EBV) measures the no-growth value of the business based on its annual after-tax cash flow. The Formula for EBV is: (NOPAT / WACC) + Excess Cash + Non-operating assets – Debt (incl. Operating Leases) - Value of Outstanding Stock Options – Minority Interests.

³ Growth Appreciation Period measures the number of years, implied by the market-price, that a company will grow its economic earnings. This measure assigns a numerical value to the width of the moat around a firm's business.

Explanation of Risk/Reward Rating System

Our Risk/Reward Rating System assigns a rating to every stock under our coverage according to what we believe are the 5 most important criteria for assessing the risk versus reward of stocks. See table that follows for details.

Overall Risk/Reward Ranking	The Overall Risk/Reward Ranking provides a final rating based on the equal-weighted average rating of each criterion.
Very Dangerous	FCF Yield is not included in the average.
Dangerous	FCF Yield is not included in the average.
Neutral	All criteria are equal-weighted in the average calculation.
Attractive	All criteria are equal-weighted in the average calculation.
Very Attractive	All criteria are equal-weighted in the average calculation.

Economic vs Reported EPS	Rates stocks based on how their Economic Earnings compare to their Reported Earnings. Values based on Latest Fiscal Year.
Very Dangerous	Negative and declining Economic Earnings despite positive and rising Reported Earnings
Dangerous	Same as above except Reported Earnings are not rising or Reported Earnings are not positive
Neutral	Negative Economic and Reported Earnings
Attractive	Economic Earnings are positive
Very Attractive	Economic Earnings are positive and rising

Return on Invested Capital (ROIC)	Rates stocks based on their ROIC. Values based on Latest Fiscal Year.
Bottom Quintile	Very Dangerous = the bottom 20% of Russell 1000 companies
4th Quintile	Dangerous = the bottom 40% of Russell 1000 companies
3rd Quintile	Neutral = the middle 20% of Russell 1000 companies
2nd Quintile	Attractive = the top 40% of Russell 1000 companies
Top Quintile	Very Attractive = the top 20% of Russell 1000 companies

FCF Yield	Rates stocks based on their Free Cash Flow Yield. Values based on Latest Closing Stock price and Latest Fiscal Year.
<-5%	Very Dangerous = less than or equal to -5%
-5%<-1%	Dangerous = more than -5% but less than or equal to -1%
-1%<3%	Neutral = more than -1% but less than or equal to +3%
3%<10%	Attractive = more than +3% but less than or equal to +10%
>10%	Very Attractive = more than +10%

Price-to-EBV Ratio	Rates stocks based on their Price-to-Economic Book Value Ratio. Values based on Latest Closing Stock price and Latest Fiscal Year.
>3.5 or -1>0	Very Dangerous = greater than or equal to 3.5 or less than 0 but greater than -1
2.4>3.5 or <-1	Dangerous = greater than or equal to 2.4 but less than 3.5 and less than or equal to -1
1.6>2.4	Neutral = greater than or equal to 1.6 but less than 2.4
1.1>1.6	Attractive = greater than or equal to 1.1 but less than 1.6
0>1.1	Very Attractive = greater than or equal to 0 but less than 1.1

Growth Appreciation Period (yrs)	Rates stocks based on their Market-Implied Growth Appreciation Period. Values based on Latest Closing Stock price and Default Forecast Scenario.
>50	Very Dangerous = greater than or equal to 50 years
20>50	Dangerous = at least 20 years but less than 50
10>20	Neutral = at least 10 years but less than 20
3>10	Attractive = at least 3 years but less than 10
0>3	Very Attractive = at least 0 years but less than 3

Appendix A – Performance of Stocks on July’s Report

Figure 6: Performance of All Stocks from July’s Report

Large Cap			Small Cap		
Ticker	Company Name	Change From 07/02/14	Ticker	Company Name	Change From 07/02/14
CRS	Carpenter Technology Corp	-14.9%	RP	Real Page Inc.	-28.8%
GPI	Group 1 Automotive, Inc.	-14.1%	ASGN	On Assignment, Inc.	-25.8%
POL	PolyOne Corporation	-11.2%	DWA	Dreamworks Animation Skg.	-15.2%
AXLL	Axiall Corporation	-11.2%	LOJN	LoJack Corporation	-14.5%
B	Barnes Group, Inc.	-11.1%	TPC	Tutor Perini Corp	-13.9%
STZ	Constellation Brands, Inc.	-7.9%	EXAR	Exar Corporation	-13.7%
JNS	Janus Capital Group, Inc.	-7.8%	OKSB	Southwest Bancorp, Inc.	-10.7%
USM	United States Cellular Corp	-4.8%	KFRC	Kforce Inc.	-9.3%
ABG	Asbury Automotive Group, Inc.	-3.8%	PATR	Patriot Transportation Holding	-7.4%
O	Realty Income Corp	-3.4%	CSFL	Centerstate Banks, Inc.	-7.3%
EXR	Extra Space Storage, Inc.	-3.2%	HOS	Hornbeck Offshore Services	-5.2%
RLJ	RLJ Lodging Trust	-3.1%	TNGO	Tangoe Inc	-4.8%
SPX	S&P 500	-2.2%	NGS	Natural Gas Services Group	-4.4%
PEB	Pebblebrook Hotel Trust	-1.8%	SPX	S&P 500	-2.2%
DDR	DDR Corp	-1.1%	NFBK	Northfield Bancorp Inc.	-2.1%
WYN	Wyndham Worldwide Corp	-0.6%	CHFN	Charter Financial Corp	-1.8%
HIW	Highwoods Properties, Inc.	0.4%	KVHI	KVH Industries, Inc.	-1.5%
BXP	Boston Properties, Inc.	1.3%	ICON	Iconix Brand Group, Inc.	-1.3%
PDM	Piedmont Office Realty Trust	3.5%	CHSP	Chesapeake Lodging Trust	-0.6%
BG	Bunge Ltd.	3.5%	NUVA	NuVasive Inc.	6.2%
DLR	Digital Realty Trust, Inc.	9.7%	QDEL	Quidel Corporation	8.9%
Large Cap Portfolio Return		-4.1%	Small Cap Portfolio Return		-7.7%
Combo (Large and Small Cap) Return			-5.9%		

Sources: New Constructs, LLC,

Note: Gain/Decline performance analysis excludes transaction costs, dividends and rebates.

Appendix B – Additions and Deletions

Most Dangerous Large/Mid Cap Stocks

Deletions:

- CRS - Stock price decreased 14.9% since July report.
- GPI - Stock price decreased 14.1% since July report.
- B - Stock price decreased 11.1% since July report.
- JNS - Stock price decreased 7.8% since July report.
- PEB - Stock price decreased 1.8% since July report.

Additions:

- LNKD - Stock price increased 4.8% since July report.
- ACC - Addition by improved rank of other stocks.
- ACIW - Addition by improved rank of other stocks.
- AMZN - Addition by improved rank of other stocks.
- TDS - Addition by improved rank of other stocks.

Most Dangerous Small Cap Stocks

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Deletions:

- TPC - Stock price decreased 13.9% since July report.
- CSFL - Stock price decreased 7.3% since July report.

Additions:

- POWR - Stock price increased 2.8% since July report.
- AF - Addition by improved rank of other stocks.

Appendix C – Portfolio Metrics

Figure 7: Performance and Risk Metrics

Portfolio	Portfolio Returns			Volatility (Annualized)			Sharpe Ratio			Beta		
	1 year annualized	3 year annualized	Since Inception	1 year annualized	3 year annualized	Since Inception	1 Year	3 Year	Since Inception	1 Year Average	3 Year Average	Average Since Inception
Most Dangerous Large	29%	14%	4%	16%	20%	21%	1.8	0.7	0.2	1.2	1.2	1.2
Most Dangerous Small	15%	12%	3%	14%	22%	26%	1.1	0.6	0.1	1.24	1.19	1.14
Most Dangerous Small and Large	22%	13%	4%	14%	20%	22%	1.5	0.6	0.2	1.24	1.21	1.15
S&P 500	22%	14%	6%	12%	13%	17%	1.9	1.0	0.3			
Russell 2000	21%	13%	7%	17%	20%	22%	1.2	0.6	0.3			

Source: New Constructs, LLC

Figure 8: Portfolio Turnover

Portfolio	Monthly Turnover		
	1 Year Average	3 Year Average	Average Since Inception
Most Dangerous Large	40%	29%	27%
Most Dangerous Small	38%	28%	28%
Most Dangerous Small and Large	39%	29%	28%

Source: New Constructs, LLC

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1. Based on the complete set of financial information available.
2. Standard for all companies.
3. A more accurate representation of the true underlying cash flows of the business.

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