5 Safe Stocks In A Dangerous Market

Back in the peak bull days of 2013, it seemed like you could buy just about anything and its price would increase. It's safe to say those days are gone as the market has rediscovered volatility. The S&P 500 is down nearly 3% so far this year and was down 9% just a few weeks ago. More than ever, investors that want to make money in the stock market need to do their due diligence and find companies with strong economic profits and cheap valuations.

Our past 48 long calls have outperformed the market by an average of 4 percentage points, increasing about 1% compared to a 3% loss for the S&P 500. Five of our long calls over the past year stand out for their impressive returns and continued stability. Investors should take another look at these five stocks that are up 10% or more since our original calls and still earn an Attractive-or-better rating.

Universal Insurance Holdings (UVE: $34/share)

We love companies that consistently earn a strong return on invested capital (ROIC) and UVE has an impressive record here. Its current ROIC of 43% ranks highest of the 45 property and casualty insurers we cover, and since 2007 it's only earned an ROIC below 20% once, in 2007. This long-term track record of efficiency led us to recommend UVE to investors in mid-July.

Since then, the stock has risen by 27% on the back of strong earnings and a $10 million buyback announcement. Over this same time, the market has dropped nearly 6%. Nothing has changed about the quality of the company and best of all the valuation remains appealing.

UVE has a price to economic book value (PEBV) of just 1.2, which implies that the market expects the company to grow after-tax operating profit (NOPAT) by no more than 20% for the remainder of its corporate life. Given the fact that UVE has more than doubled its NOPAT in just the past two years, we believe it can continue to exceed market expectations.

Foot Locker (FL: $70/share)

Foot Locker has ridden the consumer recovery to big time profit growth and outperformance for investors since the recession. Its ROIC has improved from 3% in 2008 to 11% so far this year, and over the past five years the stock is up 387% compared to 70% for the S&P 500.

In May, we argued that FL's strong underlying fundamentals and reasonable valuation meant that its streak of outperformance should continue. Sure enough, the stock is up 10% even as the market has dropped by 6% since our initial report. Steady growth in revenues and margin expansion has helped the stock keep rising.

At its current price of $70/share, FL has a PEBV of 2.1. This ratio implies that the market expects the company to grow profits by no more than 20% over the remainder of its corporate life. However, since 2009, FL has grown NOPAT by 20% compounded annually. If Foot Locker can grow NOPAT by 10% compounded annually for the next decade, the stock is worth $99/share today – a 41% upside. Such strong business operations coupled with low expectations make Foot Locker an opportunity worth looking into.

Inteliquent (IQNT: $20/share)

The market keeps looking for reasons to doubt IQNT. When the company reported full year earnings for 2014 in February, the market responded by sending shares tumbling 14%. This response came despite the fact that the company beat on earnings and revenue and earned an ROIC of 28%, its highest since 2009.

We responded to the drop in the share price by urging investors to buy IQNT in early April. Since then, the stock has risen 23% while the market has dropped by 4%. IQNT received a big boost in August after landing a big contract with T-Mobile, which adds the wireless carrier to its list of major customers along with Verizon and AT&T.

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The recipient of this report is directed to read these disclosures.

Even with this great news, IQNT still has a PEBV of just 1.2. With the new T-Mobile deal providing a big boost to revenue, its margins continuing to expand, and plenty of cash on hand with which to invest in growth, we think IQNT can do much better than the market seems to expect.

Goodyear Tire (GT: $32/share)

Investors in GT need to look beyond the top line. Declining revenues kept the share price low early this year, but that is in part due to GT's strategy of focusing more on its high value added (HVA) tires, which have higher margins. Even as revenue has fallen in each of the past three years, the company has continued to grow NOPAT and improve ROIC.

With increased efficiency offsetting revenue declines, we made GT our stock pick of the week in February. Since then, the stock is up 18% against a 5% decline in the market. Cheap commodity prices mean improved margins for GT, more people driving, and more needing replacement tires. These trends have manifested in strong profit growth so far this year.

Despite its track record of profit growth, GT trades at a PEBV of 0.7, which implies that the market expects the company's NOPAT to permanently decline by 30%. There's no reason to believe such a drastic decline is going to happen. If Goodyear can grow NOPAT by just 3% compounded annually for the next decade, the stock is worth $39/share today – a 22% upside from current prices.

Cigna (CI: $139/share)

Like UVE, CI tops its peer group in terms of ROIC, having earned a 13% return on capital last year. With the strong fundamentals, a cheap valuation, and growth opportunities from the Affordable Care Act and an aging population, we made CI one of our two stocks to own in 2015.

We're not the only one to see value in CI, as competitor Anthem (ANTM) announced a deal to acquire it for $54 billion in July. The deal consists of ~55% cash and 45% stock and would make the combined company the largest health insurer in the nation. It would be a tie up of two great companies, as ANTM also earns an Attractive rating.

CI is up 37% since our call, but it still trades at a 21% discount to the acquisition price of $175. Concerns about the deal failing to pass regulatory muster have weighed on the share price, but investors shouldn't be worried. The upside if the deal goes through is great, but even if it doesn't CI is still worth the same $175 share price if it can grow NOPAT by 8% compounded annually for the next 10 years. This scenario seems even more realistic given that over the past five years Cigna has grown NOPAT by 10% compounded annually.

Diligence Matters

Making money in a market like this is tough. It requires lots of effort to dig through the footnotes and discover the true profitability and value of companies. That effort pays off when you find stocks like these that earn great returns in a down market. There's still value to be had in this market, it's just going to take more and more work to find.

Disclosure: David Trainer and Sam McBride receive no compensation to write about any specific stock, sector, style, or theme.

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ANSWER: They should not.

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2. Standard for all companies.
3. A more accurate representation of the true underlying cash flows of the business.

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