Featured Stocks in December's Most Attractive/Most Dangerous Model Portfolios

Recap from November's Picks

The best performing Most Attractive large cap stock gained 10% last month and the best performing Most Attractive small cap stock was up 13%. Overall, 18 out of the 40 Most Attractive stocks outperformed the S&P 500 in November.

Our Most Dangerous Stocks (-2.0%) outperformed the S&P 500 (-0.8%) as a short portfolio last month. The best performing Most Dangerous large cap stock fell by 13% and the best performing Most Dangerous small cap stock fell by 25%. Overall, 21 out of the 40 Most Dangerous stocks outperformed the S&P 500 as shorts in November.

The successes of these model portfolios highlight the value of our machine learning and AI Robo-Analyst technology[1], which helps clients fulfill the fiduciary duty of care and make smarter investments[2].

15 new stocks make our Most Attractive list this month, and 20 new stocks fall onto the Most Dangerous list this month. December's Most Attractive and Most Dangerous stocks were made available to members on December 5, 2018.

Our Most Attractive stocks have high and rising returns on invested capital (ROIC) and low price to economic book value ratios. Most Dangerous stocks have misleading earnings and long growth appreciation periods implied by their market valuations.

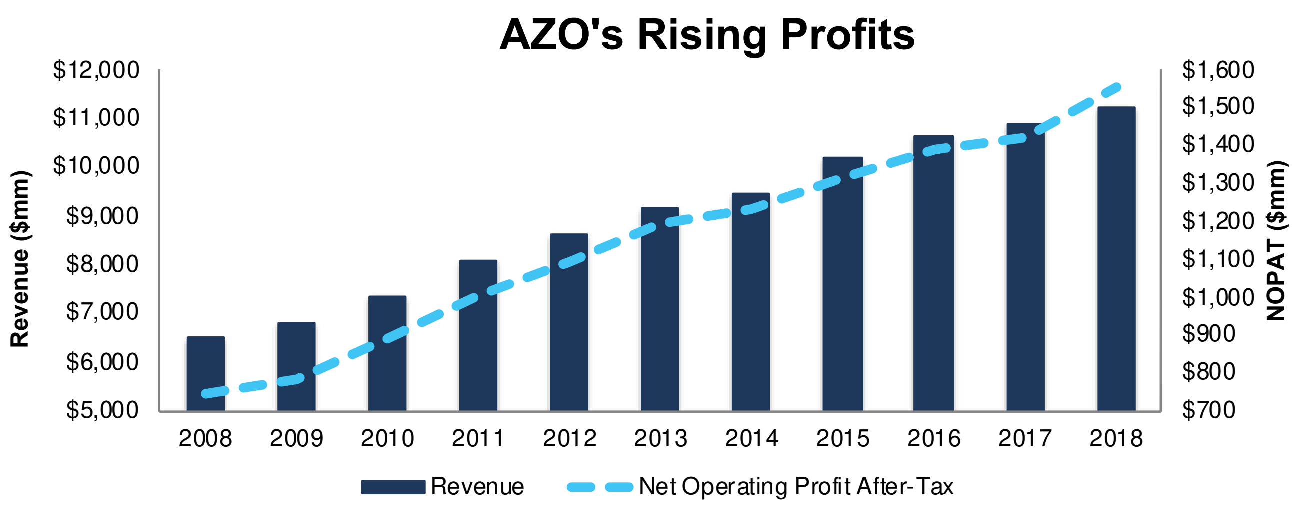
Most Attractive Stocks Feature for December: AutoZone Inc. (AZO: $870/share)

AutoZone Inc. (AZO) is the featured stock from December's Most Attractive Stocks Model Portfolio. AutoZone has been a favorite stock for quite some time and remains undervalued.

Over the past decade, AZO's revenue has grown by 6% compounded annually, and its after-tax profit (NOPAT) has grown 7% compounded annually. The company's NOPAT margin has improved from 11% in 2008 to 14% in 2018. AZO has earned a double-digit return on invested capital (ROIC) each year since 1998 and currently earns a top-quintile 24% ROIC.

[1] Harvard Business School features the powerful impact of our research automation technology in the case New Constructs: Disrupting Fundamental Analysis with Robo-Analysts.
[2] Ernst & Young's recent white paper "Getting ROIC Right" proves the superiority of our holdings research and analytics.

Figure 1: AZO's Revenue & NOPAT Since 2008



Sources: New Constructs, LLC and company filings

AZO Valuation Provides Significant Upside

At its current price of $870/share, AZO has a price-to-economic book value (PEBV) ratio of 1.0. This ratio means the market expects AZO's NOPAT to never meaningfully grow from current levels. This expectation seems pessimistic for a firm that has grown NOPAT by 7% compounded annually over the past decade and 10% compounded annually over the past twenty years.

If AZO can maintain 2018 NOPAT margins (14%) and grow NOPAT by just 4% compounded annually for the next decade, the stock is worth $1,164/share today – a 34% upside. See the math behind this dynamic DCF scenario here.

Critical Details Found in Financial Filings by Our Robo-Analyst Technology

As investors focus more on fundamental research, research automation technology is needed to analyze all the critical financial details in financial filings. Below are specifics on the adjustments we make based on Robo-Analyst findings in AutoZone's 2018 10-K:

Income Statement: we made $1 billion of adjustments, with a net effect of removing $215 million in non-operating expense (2% of revenue). You can see all the adjustments made to AZO's income statement here.

Balance Sheet: we made $2.3 billion of adjustments to calculate invested capital with a net increase of $2.3 billion. One of the largest adjustments was $1.7 billion in off-balance sheet operating leases. This adjustment represented 40% of reported net assets. You can see all the adjustments made to AZO's balance sheet here.

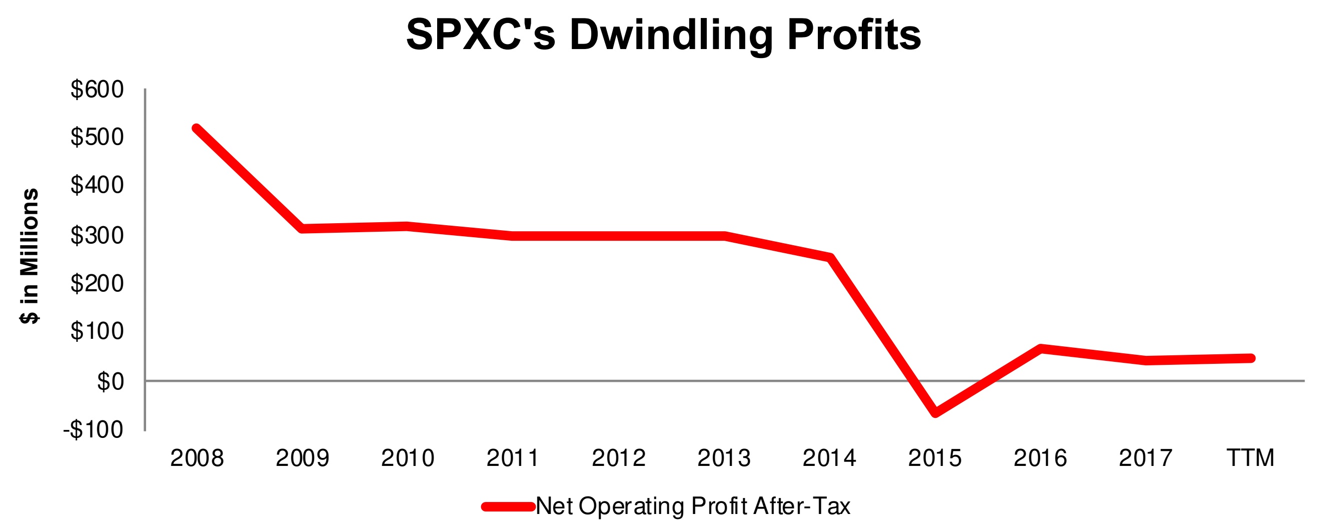
Valuation: we made $7.5 billion of adjustments with a net effect of decreasing shareholder value by $7.5 billion. There were no adjustments that increased shareholder value. Apart from total debt, which includes the operating leases noted above, the largest adjustment to shareholder value was $458 million in outstanding employee stock options. This stock adjustment represents 2% of AZO's market cap.

Most Dangerous Stocks Feature: SPX Corporation (SPXC: $27/share)

SPX Corporation (SPXC) is the featured stock from December's Most Dangerous Stocks Model Portfolio.

SPX Corporation's NOPAT has fallen 24% compounded annually since 2008. Aside from the rebound year in 2016, the company has not had a year where NOPAT grew by more than 3% over the past decade. Its NOPAT margin has declined from 10% in 2008 to 3% TTM while its ROIC deteriorated from 10% to 2% over the same time.

Figure 2: SPXC's NOPAT Since 2008



Sources: New Constructs, LLC and company filings

SPXC Provides Poor Risk/Reward

The market is finally catching on to SPXC's poor fundamentals. The stock is down 16% year-to-date after rising over 50% from late 2016 to July 2018. However, even after this year's price decline, shares remain significantly overvalued.

To justify its current price of $27/share, SPXC must maintain TTM NOPAT margins (3%) and grow NOPAT by 13% compounded annually for the next 14 years. See the math behind this dynamic DCF scenario. This expectation seems lofty given that SPXC's NOPAT has fallen consistently over the past decade.

Even if the company can maintain current margins and grow NOPAT by 6% compounded annually for the next decade, the stock is worth just $4/share today – an 85% downside. See the math behind this dynamic DCF scenario.

Critical Details Found in Financial Filings by Our Robo-Analyst Technology

As investors focus more on fundamental research, research automation technology is needed to analyze all the critical financial details in financial filings. Below are specifics on the adjustments we make based on Robo-Analyst findings in SPX Corporation's 2017 10-K:

Income Statement: we made $153 million of adjustments, with a net effect of removing $46 million in non-operating income (3% of revenue). You can see all the adjustments made to SPXC's income statement here.

Balance Sheet: we made $2.2 billion of adjustments to calculate invested capital with a net increase of $1.4 billion. One of the largest adjustments was $1.6 billion in write-downs. This adjustment represented 101% of reported net assets. You can see all the adjustments made to SPXC's balance sheet here.

Valuation: we made $671 million of adjustments with a net effect of decreasing shareholder value by $671 million. There were no adjustments that increased shareholder value. Apart from total debt, which includes $33 million in off-balance sheet debt, the largest adjustment to shareholder value was $157 million in underfunded pensions. This adjustment represents 13% of SPXC's market cap.

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Disclosure: David Trainer and Kyle Guske II receive no compensation to write about any specific stock, style, or theme.

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3. **Transparent** - Advisors should be able to show how the analysis was performed and the data behind it.
4. **Relevant** - Empirical evidence must provide tangible, quantifiable correlation to stock, ETF or mutual fund performance.

Value Investing 2.0: Diligence Matters: Technology is Key to Value Investing With Scale

Accounting data is only the beginning of fundamental research. It must be translated into economic earnings to truly understand profitability and valuation. This translation requires deep analysis of footnotes and the MD&A, a process that our robo-analyst technology empowers us to perform for thousands of stocks, ETFs and mutual funds.

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