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

Eight new stocks made our Most Attractive list this month, while 12 new stocks joined the Most Dangerous list. We published November's Most Attractive and Most Dangerous stocks to members on November 3, 2022.

October Performance Recap

Our Most Attractive Stocks (+4.7%) outperformed the S&P 500 (+1.9%) from October 5, 2022 through November 1, 2022 by 2.8%. The best performing large cap stock gained 20% and the best performing small cap stock was up 24%. Overall, 25 out of the 40 Most Attractive stocks outperformed the S&P 500.

Our Most Dangerous Stocks (+6.9%) underperformed the S&P 500 (+1.9%) as a short portfolio from October 5, 2022 through November 1, 2022 by 5.0%. The best performing large cap short stock fell by 12% and the best performing small cap short stock fell by 10%. Overall, 13 out of the 35 Most Dangerous stocks outperformed the S&P 500 as shorts.

The Most Attractive/Most Dangerous Model Portfolios underperformed as an equal-weighted long/short portfolio by 2.2%.

Buy the Most Attractive Stocks Model Portfolio

Buy the Most Dangerous Stocks Model Portfolio

This report leverages our cutting-edge Robo-Analyst technology to deliver proven-superior[1] fundamental research and support more cost-effective fulfillment of the fiduciary duty of care.

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

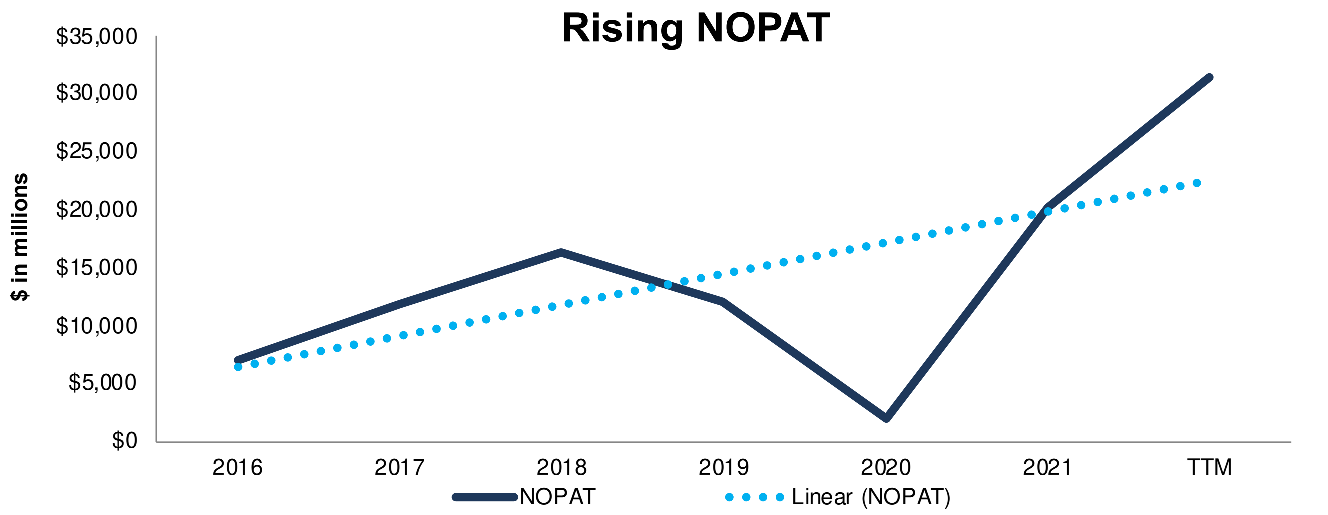
Most Attractive Stocks Feature for November: TotalEnergies SE (TTE: $59/share)

TotalEnergies is the featured stock from November's Most Attractive Stocks Model Portfolio. We made TTE a Long Idea on May 25, 2022. Since then, the stock is down 2% compared to a 1% decline for the S&P 500.

TotalEnergies has grown net operating profit after-tax (NOPAT) by 30% compounded annually since 2016. At $31.5 billion, the company's TTM NOPAT is 2.6x its average NOPAT from 2012–2021. TotalEnergies' NOPAT margin has increased from 5% in 2016 to 12% over the trailing-twelve-months (TTM), while invested capital turns rose from 0.9 to 1.2 over the same time. Rising NOPAT margins and invested capital turns drive TotalEnergies' return on invested capital (ROIC) from 4% in 2016 to 14% over the TTM.

[1] Our research utilizes our Core Earnings, a more reliable measure of profits, as proven in Core Earnings: New Data & Evidence, written by professors at Harvard Business School (HBS) & MIT Sloan and published in The Journal of Financial Economics.

Figure 1: NOPAT Since 2016



Sources: New Constructs, LLC and company filings

TotalEnergies Is Undervalued

At its current price of $59/share, TTE has a price-to-economic book value (PEBV) ratio of 0.3. This ratio means the market expects TotalEnergies' NOPAT to permanently decline by 70%. This expectation seems overly pessimistic for a company that has grown NOPAT by 30% compounded annually since 2016.

Even if TotalEnergies' NOPAT margin falls to its five-year average of 7% (vs. 12% TTM) and revenue falls 1% compounded annually for the next decade, the stock would be worth $75+/share today – a 27% upside. In this scenario, TotalEnergies' NOPAT would fall 4% compounded annually for the next 10 years. See the math behind this reverse DCF scenario. Should TotalEnergies grow profits more in line with historical levels, the stock has even more upside.

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

Below are specifics on the adjustments we made based on Robo-Analyst findings in TotalEnergies' 6-Ks and 20-Fs:

Income Statement: we made $9.3 billion in adjustments, with a net effect of removing $4.2 billion in non-operating expenses (2% of revenue). Clients can see all adjustments made to TotalEnergies' income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made $97.0 billion in adjustments to calculate invested capital with a net increase of $22.2 billion. One of the most notable adjustments was $30.3 billion in asset write-downs. This adjustment represents 15% of reported net assets. Clients can see all adjustments made to TotalEnergies' balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

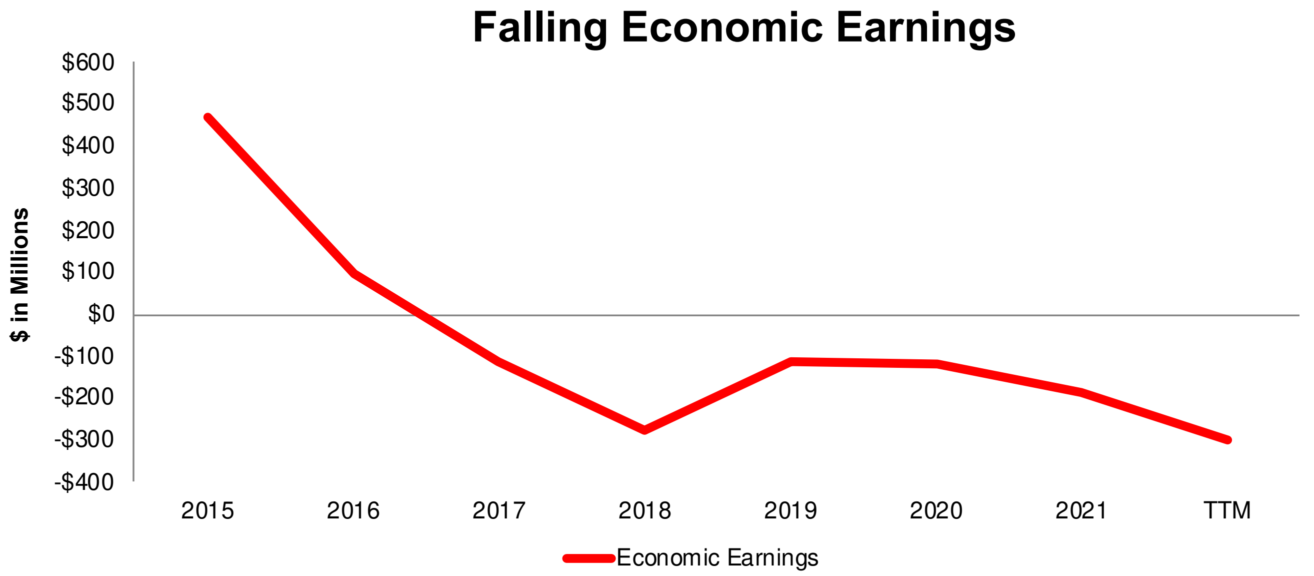
Valuation: we made $117.3 billion of adjustments, with a net decrease to shareholder value of $41.7 billion. Apart from total debt, the most notable adjustment to shareholder value was $37.5 billion in excess cash. This adjustment represents 26% of TotalEnergies' market cap. Clients can see all adjustments to TotalEnergies' valuation on the GAAP Reconciliation tab on the Ratings page on our website.

Most Dangerous Stocks Feature: Trinity Industries, Inc. (TRN: $30/share)

Trinity Industries, Inc. (TRN) is the featured stock from November's Most Dangerous Stocks Model Portfolio.

Trinity Industries' economic earnings, the true cash flows of the business, have fallen from $467 million in 2015 to -$298 million over the TTM. Over the same time, Trinity Industries' NOPAT margin has fallen from 13% to 6%, while invested capital turns fell from 0.8 to 0.2. Falling NOPAT margins and invested capital turns drive Trinity Industries' ROIC from 10% in 2015 to 1% over the TTM.

Figure 2: Economic Earnings Since 2015



Sources: New Constructs, LLC and company filings

Trinity Industries Provides Poor Risk/Reward

Despite its poor fundamentals, Trinity Industries' stock is priced for significant profit growth, and we believe the stock is overvalued.

To justify its current price of $30/share, Trinity Industries must improve its NOPAT margin to 10% (compared to 6% in the TTM) and grow revenue by 13% compounded annually for the next ten years. See the math behind this reverse DCF scenario. In this scenario, Trinity Industries' NOPAT would grow 15% compounded annually for the next decade. Given that Trinity Industries' NOPAT has fallen 27% compounded annually since 2015, we think these expectations are overly optimistic.

Even if Trinity Industries can improve its NOPAT margin to 9% (five-year average) and grow revenue by 11% compounded annually for the next decade, the stock would be worth no more than $5/share today – an 83% downside to the current stock price. See the math behind this reverse DCF scenario.

Each of these scenarios also assumes Trinity Industries can grow revenue, NOPAT, and FCF without increasing working capital or fixed assets. This assumption is unlikely but allows us to create truly best-case scenarios that demonstrate how high expectations embedded in the current valuation are.

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

Below are specifics on the adjustments we made based on Robo-Analyst findings in Trinity Industries' 10-Qs and 10-Ks:

Income Statement: we made $463 million in adjustments, with a net effect of removing $48 million in non-operating income (3% of revenue). Clients can see all adjustments made to Trinity Industries' income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made $3.2 billion in adjustments to calculate invested capital with a net increase of $831 million. One of the most notable adjustments was $2.2 billion in deferred tax assets. This adjustment represented 29% of reported net assets. Clients can see all adjustments made to Trinity Industries' balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

Valuation: we made $6.7 billion in adjustments, all of which decreased shareholder value. Apart from total debt, the most notable adjustment to shareholder value was $1.1 billion in deferred tax liabilities. This adjustment represents 48% of Trinity Industries' market cap. Clients can see all adjustments to Trinity Industries' valuation on the GAAP Reconciliation tab on the Ratings page on our website.

This article originally published on [November 11, 2022.]

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

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It's Official: We Offer the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
2. Only our "novel database" enables investors to overcome these flaws and apply reliable fundamental data in their research.
3. Our proprietary measures of Core Earnings and Earnings Distortion materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

Forthcoming in The Journal of Financial Economics, a top peer-reviewed journal, Core Earnings: New Data & Evidence proves our Robo-Analyst technology overcomes material shortcomings in legacy firms' data collection processes to provide superior fundamental data, earnings models, and research. More details.

Key quotes from the paper:

- "[New Constructs'] *Total Adjustments* differs significantly from the items identified and excluded from Compustat's adjusted earnings measures. For example… 50% to 70% of the variation in *Total Adjustments* is not explained by *S&P Global's (SPGI) Adjustments* individually." – pp. 14, 1st para.
- "A final source of differences [between New Constructs' and S&P Global's data] is due to data collection oversights…we identified cases where Compustat did not collect information relating to firms' income that is useful in assessing core earnings." – pp. 16, 2nd para.

Superior Models

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg's in Getting ROIC Right. See the Appendix for direct comparison details.

Key quotes from the paper:

- "…an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [as New Constructs does] can investors get an accurate calculation of ROIC." – pp. 8, 5th para.
- "The majority of the difference…comes from New Constructs' machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies." – pp. 4, 2nd para.

Superior Stock Ratings

Robo-Analysts' stock ratings outperform those from human analysts as shown in this paper from Indiana's Kelley School of Business. Bloomberg features the paper here.

Key quotes from the paper:

- "the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant." – pp. 6, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are here.

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