Want exciting long-term returns? Look for boring-sounding businesses

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0 COMMENTS

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Which two stocks from this group interest you most: Tesla Motors, Mueller Industries, Amazon.com, Crane Co.?

If you're like most investors, Tesla and Amazon leap off the page at you. It makes sense. Tesla makes flashy cars using cutting-edge technology, and Amazon is just about everywhere, having redefined what it means to be a retailer in the modern world. Mueller and Crane, meanwhile, are – um, what exactly are they?

The truth is that over many thousands of years, we have come a long way as a species, but some things don't change. Like cavemen drawn to quartz-filled rocks, we still like shiny, flashy things – regardless of whether or not they are useful or valuable. That's why investors have flocked in recent years to Tesla, which has lost nearly $700-million (U.S.) over the past year and has twice as much debt as equity, and Amazon, which trades for more than 100 times projected 2016 earnings per share.

On the other hand, the lack of flash and shine in Mueller and Crane (the former makes plumbing, HVAC, and industrial products, while the latter manufactures commercial valves and pumps for water treatment) leads many investors to overlook them, even though both have grown earnings impressively over the long haul and trade for 11 to 12 times EPS.

After more than a decade of studying history's most successful investors, I've learned that far more often than not, it is the Muellers and Cranes of the world – not the Teslas and Amazons – that lead to long-term gains. In fact, the best-performing U.S. stock over the past three decades isn't Apple or IBM or McDonald's; it's Balchem Corp., a New York State-based company that makes flavourings, fumigating gases and nutritional additives for animal feed. Since the end of 1985, Balchem shares have returned more than 26 per cent annualized, compared with about 10 per cent for the S&P 500, The Wall Street Journal's Jason Zweig recently reported. Like most top-performing stocks, Balchem has gone through some rough periods over that three-decade stretch, Mr. Zweig says, but investors who've stuck with the stock have been rewarded.

This is not to say that Tesla and Amazon shares can't continue to rise; there are certainly exceptions to the rule. It's also not to say that those flashy companies' businesses won't be extremely successful over the long-term. But it's about price and risk. Amazon's per-share earnings are expected to nearly quadruple in 2016 and then nearly double in 2017; even if all that goes right, at their current price, Amazon shares would trade for more than 60 times those 2017 earnings. Continued huge growth would likely be needed for the stock to keep rising.

With their boring names and boring-sounding businesses, however, people don't expect much from companies such as Mueller and Crane – and that means you should pay attention to their shares. A boring name plus a boring business "is guaranteed to keep the [professional investors] away until finally the good news compels them to buy in, thus sending the stock price even higher," mutual-fund legend Peter Lynch wrote in his classic book, *One Up on Wall Street*. "If a company with terrific earnings and a strong balance sheet also does dull things, it gives you a lot of time to purchase the stock at a discount. Then when it becomes trendy and overpriced, you can sell your shares to the trend-followers."

Mr. Lynch knew what he was talking about. He guided Fidelity's Magellan fund to annual returns of nearly 30 per cent during his 13-year tenure, just about doubling the S&P 500's gain. His writings are the basis of one of my Guru Strategy investment models, quantitative approaches inspired by history's most successful investors. My Lynch model is high on Crane ($3-billion market cap), which trades for 12.6 times trailing 12-month earnings and has grown EPS at a 31-per-cent long-term clip. Mr. Lynch famously used the P/E-to-growth ratio to find bargain-priced growth stocks, and when we divide Crane's P/E by its growth rate, we get an excellent "PEG" of 0.4.

Mueller, meanwhile, gets high marks from my Kenneth Fisher-based approach. Mr. Fisher, a well-known money manager and columnist, pioneered the use of the price/sales ratio (PSR) as a way to assess value. My Fisher-based model likes that Mueller ($1.4-billion market cap) has a bargain-priced 0.7 PSR. The model also likes Mueller's reasonable 27 per cent debt-to-equity ratio and 40 per cent long-term inflation-adjusted EPS growth rate.

How about a boring Canadian company worth a look: Medical Facilities Corp. The generic-sounding name is one most investors are likely to skip right over, but they shouldn't. The Toronto-based firm (market cap of $430-million Canadian), which has majority interests in a handful of ambulatory surgical centres, has a stellar 47-per-cent return on capital, part of why my Joel Greenblatt-based model ranks it as the fifth-most attractive stock in Canada. Mr. Greenblatt, a fund manager with an impeccable track record, developed a simple approach that looks at just two variables: a high return on capital indicates a business is strong, while a high earnings yield indicates its shares are cheap. At 15.1 per cent, Medical Facilities' earnings yield fits the bill.

Talking about Medical Facilities' stock – or Mueller's or Crane's – isn't going to excite anyone at a cocktail party. But if you're looking for excitement, the stock market really isn't the place for you. Ironically, your best path to exciting long-term returns is probably a boring one.