



Adviser Soapbox

Late Summer Stocks To Love

David Trainer, [New Constructs](#) 08.23.07, 11:20 AM ET

Many investors have become jittery with recent market turbulence, but our most attractive stocks still earn a passing grade. We separate the A+ stocks from those that earn an F by studying what makes stocks succeed in the market and looking for stocks that meet those criteria.

In this month's most attractive stocks report, available at www.newconstructs.com, we have included 40 stocks, 20 large-caps and 20 small-caps, that should help an investor build an A+ portfolio. For the stocks that get an F grade, see our most dangerous stocks for August.

All of our most attractive stocks are scrutinized to help better understand the true earnings of the companies. Pushing aside Wall Street research and company press releases, we look at the official filings the company has submitted to the Securities and Exchange Commission.

In Pictures: Most Attractive Small-Caps

Special Offer: Get on the drink! Americans are hooked on energy drinks like Monster, made by Hansen Natural (HANS). Jim Oberweis recommended Hansen at a split-adjusted \$2.27 in 2004. It now trades near \$45. Click here for four new buys in the Oberweis Report.

Ceradyne is up nearly 75% since October but still has a P/E of less than 13. Click here for more undervalued "best buys" in Upside.

To ensure we have gathered all the financial facts needed to understand corporate profitability, we examine income statements, balance sheets, cash flow statements and, most importantly, the notes to the financial statements. Our analysis of these notes produces financial insights that give our models and research an analytical advantage.

Most attractive stocks have high-quality profits based on rising returns on invested capital (ROIC) and positive economic earnings. Additionally, these stocks have cheap valuations based on a positive two-year average free cash flow yield, a relatively low price-to-economic book value ratio and a relatively low-growth appreciation period, which is the number of years the company can earn a positive economic profit margin on new projects.

Before revealing some of the stocks on our most attractive stocks report, let's look at the performance of our stocks from July's report (see "[July's Most Attractive Stocks](#)"). Fourteen of the stocks on our report from last month outperformed the S&P 500, which fell 4.8%.

And while the market was down overall for July, seven of our stocks actually had positive gains. Southern Copper, which rose 10.9%, was the large-cap leader for the month. Mueller Industries led the small-caps with a 6.2% gain.

Here are a three of the A+ large-cap stocks from August's most attractive stocks report:

Lexmark International is a new addition to our most attractive stocks for August. The company's stock price has taken a beating, decreasing nearly 20% since our July report, making the stock, in our opinion, more attractive. Though Wall Street clearly feels differently about L XK, it is among the few companies that actually has a rising return on invested capital (ROIC increased 6% in the last fiscal year) and positive economic earnings per share (a healthy \$2.18).

Despite this positive news, the market undervalues Lexmark's shares. L XK has a 9.6% free cash flow yield. Strong economic profits will have L XK earning straight A's for investors.

Special Offer: Make money on the short side of the market with put options. Click here for more than a dozen current recommended trades from Larry McMillan in the Option Strategist.

Darden Restaurants is another new addition to our most attractive stocks for August. Based on new filing data, we believe that investors should be eating up shares of this company that operates chains such as Red Lobster and Olive Garden. The company has positive economic EPS of \$1.66 and has increased ROIC by 1% in its last fiscal year.

The stock has a positive free cash flow yield of 5% and a low price-to-economic book value ratio of 1.3. Darden

Restaurants will be earning good grades for investors for those who hold it in their portfolios.

BJ Services remains on our list of most attractive stocks for August. Investors have little downside risk and strong upside potential with any stock that has a 0.7 price-to-economic book value ratio. That ratio implies the stock market believes the company's profits will permanently decline by 30%.

In this situation, the stock market has taken most of the risk out of the stock, leaving investors with more upside potential. When looking at the positive economic earnings per share (\$1.95), top-quintile ROIC in the last fiscal year and a free cash flow yield at 3%, this stock holds little risk of earning anything but high marks for investors.

Click below for details on the most attractive small-caps for August.

In Pictures: Most Attractive Small-Caps

David B. Trainer is president of New Constructs, LLC. For more details on these stocks or any of the 40 most attractive stocks, please go to www.newconstructs.com.

Send comments and questions to newsletters@forbes.com.