CHUCK JAFFE

Stupid Investment of the Week

Big yield, bounce-back potential aren't enough to make this REIT a good deal

By Chuck Jaffe, MarketWatch
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BOSTON (MarketWatch) -- There's no place in the stock market creating more disagreement and intrigue for investors right now than financial services and real estate. For every expert predicting dire straits, there is another one saying the turnaround is about to start.

With "buy low, sell high" being the basic instinct for every average investor, the temptation is to try to catch a falling star, and ride it right back to the top again. The danger is that you've caught a falling knife, the kind of stock that's going to cut you deeply before it ever rallies again.

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Investors looking for protection from a possible dagger may look for a high-dividend payout, figuring the cash distributions help offset losses. And that type of search could bring an investor to iStar Financial, a mortgage REIT play that has a big payout, enormous bounce-back potential -- and enough trouble to make it Stupid Investment of the Week.

Stupid Investment of the Week highlights the concerns and characteristics that make a security less than ideal for the average investor, in the hope that showcasing trouble in one case will make it easy to root out in similar situations elsewhere. While obviously not a purchase recommendation, neither is this column intended as an automatic sell signal.

For investors in iStar Financial (SFI) , anyone who has ridden the stock down this far -- a 40% loss this year and a decline of 70% from its 52-week high of 10 months ago -- there is some reason for hope that the stock can bounce back. While current market conditions affecting the mortgage business are perilous, iStar's long-term credit record is nearly unblemished over its 14-year history. Just as important for a company focused in the commercial real estate area, iStar's ability to consistently lease roughly 95% of its corporate-tenant space is a huge plus, as it guarantees a steady flow of cash that will keep things rolling.

Missing the message?

That, in turn, keeps investors looking at the dividend; with the stock price shrinking, the yield has ballooned and today it stands just north of 28%. The dividend is suspect, but there's some comfort in knowing that tax regulations governing REITs do require most of that money to keep going out (if indeed it keeps coming in). With the stock already down so

much and a cushion of 28% from current levels -- assuming the dividend is steady -- an optimist would suggest that a lot of the downside risk has been priced out of the stock at this point. That message is underscored by the fact that insiders have been buying the stock hard.

Alas, it's the wrong message.

That 28% yield isn't going to be much solace if the stock price gets cut in half, and there's never a guarantee that today's yield is tomorrow's payout, especially when a stock has been hammered. And there's good reason to believe that iStar remains overvalued.

Independent research firm New Constructs had iStar on its list of "most dangerous stocks" as the beating first commenced and recently upgraded the shares off the list, moving the company up a level to simply "dangerous."

"It is still a dangerous stock, technically," said David Trainer, president of the Nashville-based research firm, "and the main reason is that the economics of the business are not as good as people think because the balance sheet is growing faster than the earnings. ... The valuation remains sky high. People may think this stock is cheap, but it's not cheap by any measure we can see."

By Trainer's estimate, the stock would need to grow earnings by 20%, compounded annually, for the next decade, in order to justify the price.

Not even SFI's biggest supporters would expect that to happen any time soon.

Institutions are selling

Ken Shreve, markets desk anchor at Investor's Business Daily, notes that iStar is the classic example of a stock that has been hammered by institutional selling in recent months. "The trick to making money in the market is to buy when the institutions are buying," Shreve said, "not selling. This stock [has a] tough row to hoe."

One more factor: iStar has had strong revenue growth in recent quarters, while also taking some serious write-downs. David Brown, chief market strategist at Sabrient Systems said that his firm's analytical systems would make the stock a "buy" right now, but notes that he personally would downgrade the stock to a "hold" because he's concerned there might be more write-downs to come. Said Brown: "Management in the past has shown a penchant for swallowing their pill quickly, but did they this time and were they fully aware of the dangers of this environment?"

It's a reasonable question to ask, particularly in an environment that has the stock and its competitors hopping around like jumping beans, popping up one minute and failing to defy gravity the next. Volume has been huge of late, and moves of 5% to 10% or more in a day have become commonplace.

In short, not only is this no place for the faint of heart, it's the kind of investment that average investors buy more on impulse and hope -- how do you resist a 28% dividend? -- than with the sense that this stock is poised for a speedy recovery. In fact, the continuing troubles in the mortgage and real estate industry almost ensure that a recovery is likely to be slow, with the possible exception of occasional pops.

There's a thin line between a stock that's beaten down into a bargain and one that has been knocked out. While iStar Financial will live to fight another day, it's not getting up off the canvas right now, not without some more heartbreak first.

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