Stocks To Hold Through A Bear Market

We've previously shown that companies with consistently high returns on invested capital (ROIC) are stocks that are able to withstand market downturns, especially bear markets like the market crash of 2008. With 2016 providing many investors angst and concern that a bear market or market crash may be just beyond the corner, it's important to focus on companies with strong fundamentals.

It's time to look beyond technical price movements, earnings estimates, or analyst opinions. The reconciliation between cash flows and valuations has arrived. The market is beginning to distinguish between those companies that earn a quality ROIC and those that do not. Figure 1 identifies four companies with strong ROICs that we believe investors can turn to in a turbulent market.

Add in an impressive dividend yield and these stocks could be the difference between a portfolio that outperforms and one that doesn't.

Figure 1: Stocks To Hold Through A Bear Market

Company	Ticker	Return On Invested Capital (ROIC)	Price-to-Economic Book Value	Dividend Yield
Oracle	ORCL	23%	0.9	1.7%
American Express	AXP	22%	0.8	2.2%
Traveler's Companies	TRV	12%	0.6	2.3%
Wal-Mart	WMT	11%	0.8	2.9%

Sources: New Constructs, LLC and company filings

1. Oracle (ORCL –$35/share – Very Attractive rating)

Our appreciation for Oracle as a business dates back to April 2013, when we first highlighted its merits as a value investment. While investors have become increasingly short-term focused (on all things cloud and in general), they fail to recognize the quality business Oracle has built.

Over the past 17 years, Oracle has grown after-tax profit (NOPAT) by an impressive 18% compounded annually. Throughout this time, the lowest return on invested capital (ROIC) Oracle earned came in 2009, but was still 22%. Oracle currently earns a top quintile ROIC of 23%. Oracle's lead in database software allowed it to build a cash generating business, one that has generated nearly $41 billion in free cash flow over the past five years. Such large cash resources allow Oracle to take its time transitioning to cloud services and ensure the company "gets it right," which is a luxury smaller competitors don't possess.

Best of all, at its current price of $35/share, Oracle has a price-to-economic book value (PEBV) ratio of 0.9. This ratio means that the market expects Oracle's profits to decline by 10% over the life of the corporation. As it stands, the current no growth value, or economic book value of ORCL is $38/share. If Oracle can grow NOPAT by just 5% compounded annually for the next decade, well below its historical NOPAT growth rate, the stock is worth $57/share today – a 63% upside. Add in the nearly 2% dividend yield paid by Oracle, and our bull case only becomes more compelling. An undervalued stock, quality cash generation and return on cash, and a positive dividend yield make ORCL a stock to buy and hold during all market environments.

2. American Express (AXP – $53/share – Very Attractive rating)

We made American Express our stock pick of the week in January 2015 and still believe AXP has great investment prospects moving forward. While investors will tout concerns about American Express losing its Costco (COST) deal, these concerns are shortsighted and ignore the long track record of American Express.

Since 1998, American Express has grown NOPAT by 6% compounded annually. In this time, the company has earned a double digit ROIC in all but two years, 2001 and 2010 (still 6% and 8% respectively). American Express currently earns a top quintile ROIC of 22%. Just like the other stocks on this list, American Express has generated over $14.9 billion in free cash flow over the past five years and currently earns a 6% free cash flow yield.

Despite the strong fundamentals at AXP, the stock is down 40% over the past two years. Such a drastic price decline has created an excellent buying opportunity. At its current price of $53/share, American Express has a

PEBV ratio of 0.8. This ratio means the market expects American Express' NOPAT to permanently decline by 20%. However, if American Express can continue to grow NOPAT by 6% compounded annually over the next decade, the stock is worth $91/share – a 72% upside. American Express' 2.2% dividend yield, which was paid throughout the last market crash, is just an added bonus to an already great company and stock.

3. Traveler's Companies (TRV – $108/share – Very Attractive Rating)

We first highlighted Traveler's Companies in November 2010 and then again in November 2014. Since that initial report, TRV is up 94% while the S&P is up only 58%. This outperformance doesn't mean TRV is out of room to run. In fact, the stock is the most undervalued in Figure 1.

Since 2004, Traveler's Companies has grown NOPAT by 12% compounded annually. Traveler's has consistently earned a double digit ROIC, which currently stands at 12%. Similar to Oracle, Traveler's has built an extremely profitable business and has generated $14.9 billion in free cash flow over the last five years. Better yet, Traveler's earns a 13% free cash flow yield. Despite the excellent fundamentals and the broad reach of offerings, TRV is significantly undervalued.

At its current price of $108/share, Traveler's has a PEBV ratio of 0.6. This ratio means that the market expects Traveler's profits to permanently decline by an astounding 40%. This expectation seems beyond pessimistic given Traveler's profitable history, even in light of the current market environment. If Traveler's can grow NOPAT by just 3% compounded annually for the next decade, the stock is worth $195/share today – an 81% upside. Add in Traveler's 2.3% dividend yield (which continued to be paid during 2008), and its clear that TRV is worth a look.

4. Wal-Mart (WMT – $66/share – Attractive rating)

We first recommended investors buy Wal-Mart's stock as far back as 2011. Our stance on the stock has not changed. However, Wal-Mart has become a company that market pundits and talking heads love to bash. When you look through this noise, you find that Wal-Mart is an extremely well run company that continues to exploit its strengths across the entire retail industry.

Since 1998, Wal-Mart has grown NOPAT by 9% compounded annually. Over this time, the company has earned a double digit ROIC in each year and currently earns an 11% ROIC. Best of all, Wal-Mart business has become a cash machine, generating $57 billion in free cash flow over the past five years alone.

Despite the impressive fundamentals, at its current price of $66/share, Wal-Mart has a PEBV ratio of 0.8. This ratio means that the market expects WMT's profits to permanently decline by 20%. This expectation seems out of tune with reality given Wal-Mart's nearly two decades of profit growth.

If WMT can grow NOPAT by just 2% compounded annually for the next decade, the stock is worth $104/share today – a 58% upside. Add in Wal-Mart's 2.9% dividend yield and it's easy to see why WMT is a stock worth holding.

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

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