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

16 new stocks made our Most Attractive list this month, while 22 new stocks joined the Most Dangerous list. We published December's Most Attractive and Most Dangerous stocks to members on December 7, 2022.

November Performance Recap

Our Most Attractive Stocks (+10.6%) outperformed the S&P 500 (+7.5%) from November 3, 2022 through December 5, 2022 by 3.1%. The best performing large cap stock gained 39% and the best performing small cap stock was up 42%. Overall, 20 out of the 40 Most Attractive stocks outperformed the S&P 500.

Our Most Dangerous Stocks (+6.0%) outperformed the S&P 500 (+7.5%) as a short portfolio from November 3, 2022 through December 5, 2022 by 1.5%. The best performing large cap short stock fell by 8% and the best performing small cap short stock fell by 29%. Overall, 26 out of the 39 Most Dangerous stocks outperformed the S&P 500 as shorts.

The Most Attractive/Most Dangerous Model Portfolios outperformed as an equal-weighted long/short portfolio by 4.6%.

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.

All of our Most Attractive stocks 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.

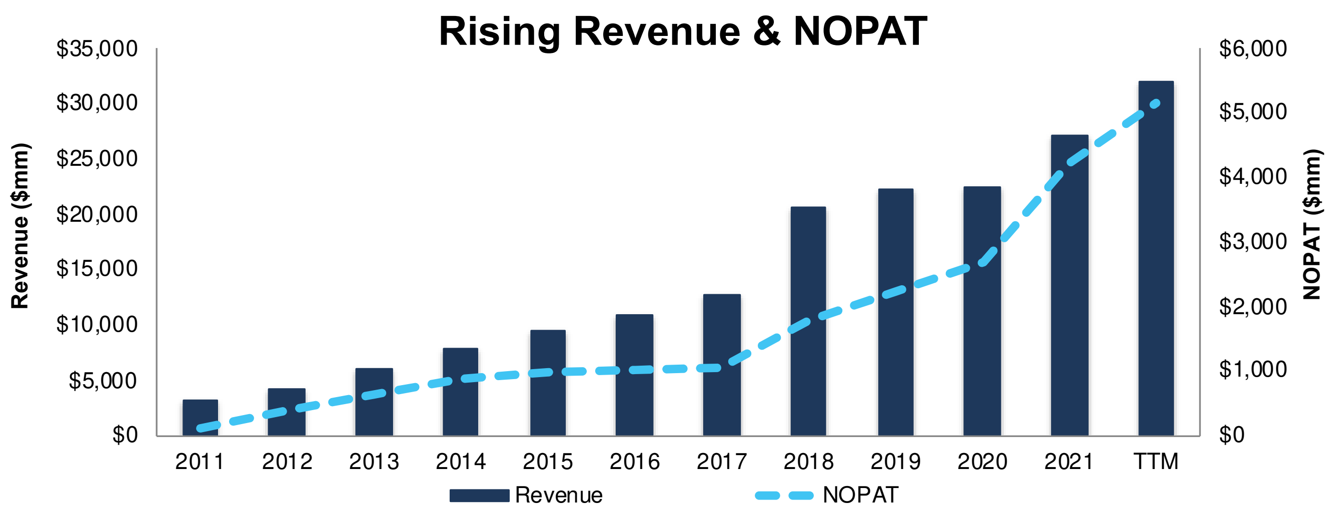
Most Attractive Stocks Feature for December: Lennar Corporation (LEN: $94/share)

Lennar is the featured stock from December's Most Attractive Stocks Model Portfolio.

Lennar has grown revenue by 24% compounded annually and net operating profit after tax (NOPAT) by 43% compounded annually since 2011. Longer term, Lennar has grown NOPAT by 15% compounded annually since 1999. Lennar's NOPAT margin has increased from 4% in 2011 to 16% over the trailing-twelve-months (TTM), while invested capital turns rose from 0.3 to 1.0 over the same time. Rising NOPAT margins and invested capital turns drive Lennar's return on invested capital (ROIC) from 1% in 2011 to 16% 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: Revenue and NOPAT Since 2011



Sources: New Constructs, LLC and company filings

Lennar Is Undervalued Even with Housing Slowdown

At its current price of $94/share, LEN has a price-to-economic book value (PEBV) ratio of 0.5. This ratio means the market expects Lennar's NOPAT to permanently decline by 50%. This expectation seems overly pessimistic for a company that has grown NOPAT by 33% compounded annually since 2016 and 43% compounded annually since 2011.

Even if Lennar's NOPAT margin falls to its 10-year average of 11% (vs. 16% TTM) and revenue grows just 3% compounded annually for the next decade, the stock would be worth $115+/share today – a 22% upside. In this scenario, Lennar's NOPAT would fall 1% compounded annually for the next 10 years. See the math behind this reverse DCF scenario. Should Lennar 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 Lennar's 10-Qs and 10-Ks:

Income Statement: we made $1.3 billion in adjustments, with a net effect of removing $165 million in non-operating income (1% of revenue). Clients can see all adjustments made to Lennar's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made $6.4 billion in adjustments to calculate invested capital with a net increase of $724 million. One of the most notable adjustments was $3.5 billion in asset write-downs. This adjustment represents 12% of reported net assets. Clients can see all adjustments made to Lennar's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

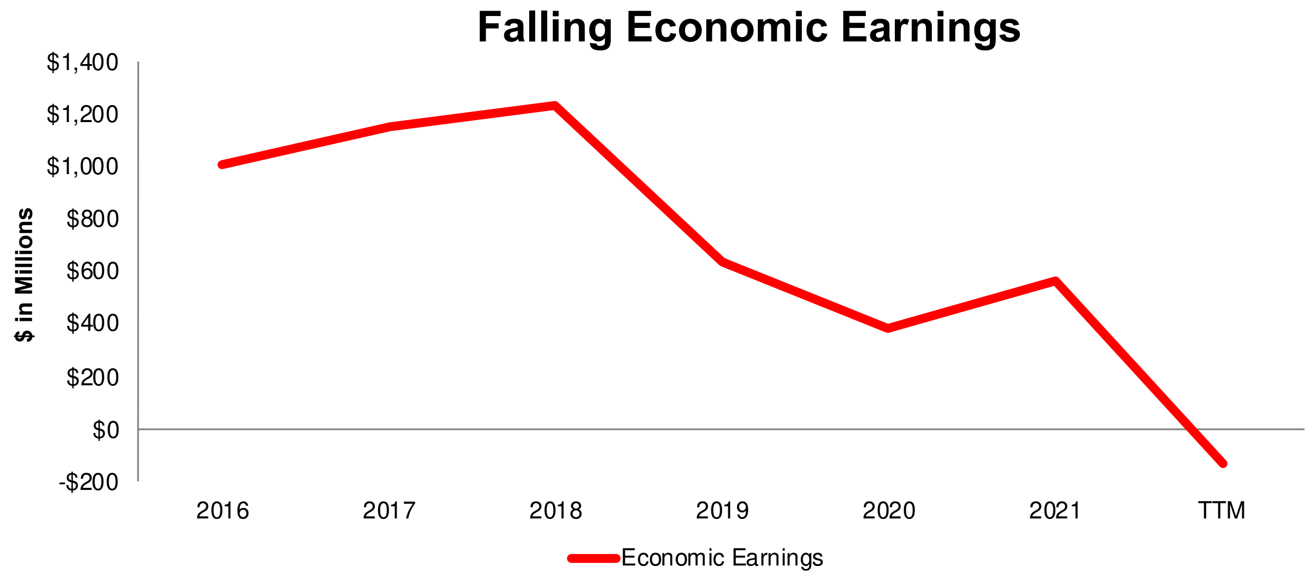
Valuation: we made $4.4 billion in adjustments, all of which decreased shareholder value. Apart from total debt, the most notable adjustment was $150 million in minority interests. This adjustment represents 1% of Lennar's market cap. Clients can see all adjustments to Lennar's valuation on the GAAP Reconciliation tab on the Ratings page on our website.

Most Dangerous Stocks Feature: Stryker Corporation (SYK: $245/share)

Stryker Corporation (SYK) is the featured stock from December's Most Dangerous Stocks Model Portfolio.

Stryker's economic earnings, the true cash flows of the business, have fallen from $1.0 billion in 2016 to -$125 million over the TTM. Over the same time, Stryker's NOPAT margin has fallen from 16% to 11%, while invested capital turns fell from 0.8 to 0.6. Falling NOPAT margins and invested capital turns drive Stryker's ROIC from 13% in 2016 to 6% over the TTM.

Figure 2: Economic Earnings Since 2016



Sources: New Constructs, LLC and company filings

Stryker Provides Poor Risk/Reward

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

To justify its current price of $245/share, Stryker must improve its NOPAT margin to 12% (compared to 11% in the TTM) and grow revenue by 18% compounded annually for the next 10 years. In this scenario, Stryker's NOPAT would grow 17% compounded annually over the next decade. See the math behind this reverse DCF scenario. Given that Stryker's NOPAT has grown just 0.7% compounded annually since 2016 and 2% compounded annually since 2011, we think these expectations are overly optimistic.

Even if Stryker maintains its TTM NOPAT margin of 11% and grows revenue by 10% compounded annually for the next decade, the stock would be worth no more than $105/share today – a 57% downside to the current stock price. See the math behind this reverse DCF scenario.

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

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 Stryker's 10-Qs and 10-Ks:

Income Statement: we made $1.9 billion in adjustments, with a net effect of removing $102 million in non-operating expenses (1% of revenue). Clients can see all adjustments made to Stryker's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made $5.6 billion in adjustments to calculate invested capital with a net decrease of $2.6 billion. One of the most notable adjustments was $1.8 billion in deferred tax assets. This adjustment represented 6% of reported net assets. Clients can see all adjustments made to Stryker's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

Valuation: we made $14.1 billion in adjustments, with a net decrease to shareholder value of $12.9 billion. Apart from total debt, the most notable adjustment to shareholder value was $2.2 billion in outstanding employee stock options. This adjustment represents 2% of Stryker's market cap. Clients can see all adjustments to Stryker's valuation on the GAAP Reconciliation tab on the Ratings page on our website.

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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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