Sell or Keep:

Stocks Removed from my Growth Recommendation List

Since knowing when to sell is just as important as, but more difficult than, knowing when to buy, I will try to keep you up-to-date on the outlook for stocks that I have recommended to you in the past.

In the last year I have removed 16 stocks from my Growth List; some have been on-again/off-again. More often than not these companies remain keepers, some having been removed because they had already grown so much. Others were removed because their growth outlook had weakened below my cutoff criterion, which is “better than the S&P 500.”

But things change. If you have continued to hold one or more of these companies, you need to be alerted when to sell.

Reasons to Sell

First here is a review of the four reasons or situations that should trigger a sell:

1. When your security has reached your predetermined selling price (for profit or loss).
2. When you need the money for something else.
3. When you decide that you made a mistake in buying it in the first place.
4. When your opinion on the outlook for the security, the market, or the economy has changed; your original reason for buying is no longer valid.

The first three changes are fairly easy to recognize and act on. The last reason, **the outlook change**, is the toughest to identify and/or admit, especially a change of view on an individual company you’ve held for a long time. The following situations are examples of outlook changes that should trigger a sell:

- The **economy** is headed drastically downward, and your stock will go with it.
- Your stock is in an **industry** that is headed downward.
- A **negative event** or change at the company has negatively impacted the stock.
- It’s obvious the stock is “**dead money**”—the price is not going up any time soon. Since this is difficult to admit, ask yourself if there is another, more profitable investment you’d make if you had the funds to pay for it. If yes, refer to reason #2.

Sell or Keep

Using these guidelines, I will try to make a Sell or Keep judgment on these stocks, which I have recommended in the past. Here are summaries of each stock’s outlook Then (when it was removed) and Now, along with my judgment:

Costco

Then: In August 2003 ($30) I removed Costco because the company warned earnings would disappoint due to increasing costs for employee healthcare and compensation. Their long-term growth outlook had sunk below that of the S&P 500, but I still considered it a long-term hold.

Now: ($38) Management has controlled expenses and increased comparable store sales by 11% in the recently reported quarter. Earnings and sales are forecasted to increase about 12% annually. S&P has a price target of $40.

Keep: The company has a stellar history of increasing revenues. Going into a period of rising interest rates, investors will favor such a consumer staple company.

First Data

Then: When I removed this stock in February 2004 ($38), I was concerned about the number of large customers Concord EFS had recently lost, since FDC was acquiring Concord. Also up for grabs was the business of the newly combined JP Morgan/Bank One. On top of that Western Union was being investigated by the Department of Justice. I sold my shares.

Now: Now the stock price is at its 52-week high ($44); the company recently raised its earnings guidance for 2004 by 8%. If their earnings estimate and the 15% annual growth estimate are correct, the current price is not terribly expensive, resulting in a P/E/G of 1.27.

Keep: Even though my original concerns have not been erased, investors like this stock.

General Dynamics

Then: In August 2003 ($80) the stock had risen 15% in two months, but earnings estimates were coming down (to $4.84 from $4.94 for 2004), and the growth rate was forecasted to be substantially lower than the S&P rate. I didn't recommend selling because of the company's recent increase in defense contracts and its solid history.

Now: At $92 the price has increased another 15% in six months. Estimates for earnings in 2004 have improved to $5.59, and are expected to increase another 11% to $6.24 in 2005. The growth rate is still only estimated at 9%, which calculates into a rather expensive P/E/G of about 2. Still orders from the US Army for its Land Warrior program for the Abrams battle tank have quadrupled, and S&P has a $100 price target.

Keep: Don't fight the trend—this company is on a roll as long as defense demand continues.

Home Depot

Then: In October 2003 ($37) the company was "home-improving" itself, and sales were not expected to increase more than 10%, less than the S&P. I expected positive results from the renovation and recapturing of market share from Lowe's over the next year.

Now: Now at $36 the stock price has held, and in February they reported higher sales growth than Lowe's. Earnings are expected to increase 15% in 2005 over 2004. The stock is about fairly valued, with a P/E of 19 and a P/E/G of 1.44.

Keep: There is no reason to sell this company that has no debt, great management, and ever-increasing revenues.

KINDER MORGAN

Then: I removed this natural gas company in August 2003 ($53) because analysts were lowering its growth outlook (to 15% from 17%) and because profits were being squeezed due to prohibitively high operating costs. I did not recommend selling, but felt the price was too high for its growth outlook.

Now: ($62) The five-year growth outlook is now only 12%, but the stock price is up 17%. KMI has increased its earnings each of the last three years and recently increased its dividend to yield 3.6%. S&P considers the stock fairly valued now.

Keep: KMI is well-run, and its assets (energy pipelines) will only become more valuable as natural gas demand increases.

LABORATORY CORP OF AMERICA

Then: Lab Corp was just removed earlier this month ($39) because the CEO had guided earnings growth down to 11$ to 13%, and S&P had lowered their target price to $46.

Now: It's still at $39, and I have no new news in the last two weeks. Fundamentals are quite good. Analysts project 17% annual growth.

Keep: No apparent pressure to sell.

LENNAR

Then: When I removed this homebuilder in February 2004 ($45) for the second time, the stock was already up 100% in a year, and the company was still increasing its earnings estimates for 2004 and 2005. But the market was starting to anticipate interest rate hikes that would ultimately put a big wet blanket on the homebuilders, the reasoning went.

Now: At its current $48, the stock is down from its $56 high a month ago. At that time management had increased its 1Q new home orders by 30%, upped its earnings guidance for the year, and reaffirmed its goal of 37,000 homes delivered this year. The company is still trading at a low P/E of 10 and P/E/G of .60.

Toss-up: Can new home orders continue so strongly when interest rates rise?

OUTBACK STEAKHOUSE

Then: Like Laboratory Corp, this company was just removed two weeks ago ($50), when it was trading near its 52-week high and at a premium to peers.

Now: The company is trading at $48, and there is no new news. S&P anticipates earnings growth of 10% to 11% over the next few years.

Keep: There is nothing wrong with this company—it's just trading as high as it should according to earnings and growth potential.

UNITED TECHNOLOGIES

Then: In August 2003 ($76) I removed UTX because commercial airline demand was so weak for their Pratt & Whitney division's jet engines, and because overall growth estimates had dipped below that of the S&P. Because other divisions, especially Otis elevators, were doing well, and the company is so well run, I suggested keeping and even buying on price dips.

Now: At $88, down from a recent high of $97, the stock had done well, as industrials do in a recovering economy, but it has experienced several setbacks. The government recently cancelled its Comanche helicopter order from UTX's Sikorsky division, and they have delayed a decision on who will replace the Sikorsky presidential helicopter. Pratt & Whitney lost the bid to build the jet engines for Boeing's next generation aircraft.

Toss-up: This is a very good company. More than half its revenues come from its Otis and Carrier (heating and air conditioning) divisions, which are healthy and expanding. It could be a long-term hold, or you could take your profits and look to buy again when it's cheaper, which is what I did.

WELLPOINT HEALTH NETWORKS

Then: In October 2003 ($89) the company agreed to be acquired by Anthem, for what amounted to approximately $93 per share. I sold my shares, thinking the integration would take awhile to be beneficial, and that the stock would languish for at least a year.

Now: I could not have been more wrong. The stock has steadily moved up to $111 now, not far off its $116 high, and reported a 51% increase in profits in January. S&P expects the combined entity to have an enhanced business position. A P/E/G of just over 1 suggests the company is not overpriced.

Keep: I wish I had.

Final Comments: Eight of the ten stocks reviewed are still judged keepers; two are toss ups; no sells. I think that's because all of the companies were quality firms when they were recommended, and they still are. Mostly their growth outlook has changed, and that is why I am no longer recommending them as growth buys. Please understand that "Keep" does not mean "Buy".

You have to consider your own circumstances before you decide to sell a stock. You may have a gain you don't want to be taxed for, and you may have valid reasons for disagreeing with my Sell or Keep judgments.

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19 April 2004