

IN SEARCH OF STABLE GROWTH, INCOME STOCKS

My new Stable Growth and Income Recommendation List features stocks that will not be so volatile as more growth-oriented companies, and they add cash to your portfolio. With these stocks the growth is more evident in their ability to consistently grow earnings and increase dividend payouts. Rather than reinvesting all of their profits to expand the company, these firms reward shareholders more directly with quarterly, or in some cases, monthly cash payouts. This is not to say that share price will not also increase, but that is not the main reason for owning these stocks. Their purpose is to give you some peace of mind and some cash.

One reason I started researching for high-yielding companies was the total lack of more traditional opportunities for fixed income and stability, like bonds and money market funds. It's not that bonds or money markets disappeared; it's just that their yields vanished. The stocks on this list should yield at least 10% annually.

The other reason was simply that growth investing has become so difficult. Momentum, the lifeblood of growth investing, is squelched by the ongoing threat of terrorism and by each increase in the price of oil. The stocks on this list do not require momentum.

Some of my criteria for stocks on this list are the same as those of the GARP recommendations: exceptional management, a history of increasing revenues, reasonably priced as measured by P/E vs. the S&P, and not too much debt.

Special criteria for this list include:

- A substantial dividend yield that, when combined with earnings growth, is greater than 10%
- A history of increasing dividends or maintaining a high payout ratio
- An outlook for increased earnings

With respect to that last criterion, there are two energy companies on this list for whom 2005 earnings consensus estimates are lower than 2004 estimates. I believe these future estimates will be revised upward. As you know I believe that strong demand and diminishing supply will support higher prices and greater earnings for most energy stocks in the coming months and years.

For the next seven or eight months I expect stock prices in general to increase, reflecting the strong earnings increases companies have been reporting throughout the second and third quarters. The resulting price to earnings ratio (P/E) is about 18, down from 31 one year ago. This means stock prices are generally no longer over-valued. It also means investors are not willing to pay such high prices as they once were, chasing after high-flying growth stocks and counting on momentum.

STABLE GROWTH AND INCOME RECOMMENDATION LIST

According to the criteria outlined above, the following stocks represent my stable growth and income recommendations:

FINANCIAL

American Capital Strategies (ACAS \$31, Dividend Yld 9.2%, EPS Growth 9%) – American Capital Strategies is a business development and financing company, serving mid-size borrowers, which is to say businesses that are beyond the start-up stage, preferably with a 10-year operating history. American Capital invests in these private companies by directly providing capital, by providing senior debt financing for buyouts by private equity firms, or by becoming an equity partner in management and employee buyouts. As a shareholder of American Capital you are also invested in these otherwise privately-held companies. From their website's list of exited portfolio companies it appears that their investments average two to three years before they exit. For a better understanding of companies in their portfolio and the criteria for investing in them, amounts and nature of their investments, and returns they have reaped from these investments, I strongly recommend a visit to their website: <http://www.american-capital.com>. Meanwhile fundamentals for this stock are sound: not overpriced, dividend yield above 9% (and they just increased their quarterly dividend to \$.73 payable in December), and share price easily has 10% upside.

Bank of America (BAC \$45, Dividend Yld 3.98%, EPS Growth 10%) – I think this one is pretty straightforward. Everybody knows who BofA is, and, frankly, I never thought I'd be recommending this company (since they were bought by North Carolina's Nations Bank, which completely changed the culture of San Francisco's beloved former Bank of Italy). But, as Morningstar simply put it, "Bank of America is an impressive institution that's likely to continue throwing off some of the strongest operating profits in the banking industry." In fact they just reported third quarter results of \$.91 a share, beating expectations by a penny, on quarterly net income of \$3.76 billion. Retail deposits increased 11%. They pay a \$.45 dividend, which they have increased each of the last eight years. The stock trades at a modest P/E of 12, making a 10% increase in the stock price to \$50 not unlikely.

INDUSTRIALS

Ingersoll Rand (IR \$68, Dividend Yld 1.46%, EPS Growth 9%) – The company began in the 1870s as a drill company. Now it is a leading global provider of industrial equipment and security solutions. Recognizable IR brands and products include Schlage locks, Thermo King transport and temperature control equipment, Bobcat construction machinery, and Club Car golf cars and utility vehicles. The current macroeconomic environment suggests capital spending will continue on infrastructure and building, which supports the anticipated 12% increase in 2005 earnings (\$5.50) over already strong 2004 earnings (\$4.91). Using S&P's discounted cash flow and historical P/E methods for calculating their \$90 price target, the share price could increase as much as 30%. That kind of growth is atypical for this list, but is possible because of the company's efforts to diversify away from the cyclical construction sector into other, faster growing businesses.

RAIT Investment Trust (RAS \$26, Dividend Yld 9.2%, EPS Growth 9%) – RAIT Investment Trust is a Real Estate Investment Trust (REIT) that provides mortgage financing to commercial owners of real estate in the form of bridge loans and mezzanine loans. (The first is short-term, meant to be refinanced soon; the second is subordinate to a primary loan.) More than half of its loans are to office properties, and 51% of revenue for 2003 was from mortgage interest. RAIT also acquires real estate for itself (accounting for about 23% of its assets), and 31% of its income for 2003 was rental income. Real estate lending can be risky, but this trust has been doing this for a long time and has developed a very disciplined screening process for what they consider to be worthwhile deals. Their average five-year return on investment beats the REIT industry average. They paid a third quarter dividend of \$.60 per share, and they have not paid less than \$.51 per share in the last 25 quarters, i.e. more than six years. On top of the 9% dividend yield, growth for the company is estimated by analysts to be between 5% and 14%.

ENERGY

ChevronTexaco (CVX \$52, Dividend Yld 3.07%, EPS Growth 8%) – ChevronTexaco is the second-largest U.S.-based oil company behind ExxonMobil. It is an integrated oil company involved in exploration and production, refining, marketing, and transportation. The company has been selling off its least profitable assets, using proceeds and the extraordinary revenue from this year's commodity price increases to buy back stock and to reduce debt. Chevron has signed an agreement with Gazprom of Russia to assess the possibility of a liquefied natural gas project. They would take the natural gas from northwest Siberia, liquefy it, and transport it to the U.S. for regassification. On a P/E basis the stock is cheap, and I think the earnings estimates for next year will turn out to be too conservative. However, the stock price is up 60% over the last 52 weeks, and the stock recently split 2-for-1. So you might want to wait for the price to take a breather. Buy, if the stock dips back below \$50.

Enerplus Resources Fund (ERF \$32, Dividend Yld 10.78%, EPS Growth ?%) – Enerplus is an oil and natural gas income fund that offers investors the opportunity to own a diversified portfolio of mature, income-producing properties (primarily in western Canada) with predictable production and long reserve lives. The cash flow from these properties is distributed to Unitholders *on a monthly basis*, recently to the tune of about \$0.27 per share, and averaging about \$3.30 per share per year, an approximate 10% annual yield. The November payout will be \$.29 per share. Payments are always on the 20th of the month.

Enerplus is financially conservative, keeping debt low, close to 20% of capital. Its properties are a good mix of natural gas and oil fields, and the company continues to increase their reserves and production through acquisitions. Management is well-regarded.