

Cyclical Stocks



Mini Investment Class by the OKI Tri-State Chapter

*Courtesy Cincinnati Model Investment Club
Based on Original Presentation by Gretchen and Jim Hurt
Revised 10/09 by Sandy and Bob Lowery*

NON-PROFIT VOLUNTEER BASED MEMBER DRIVEN

Disclaimer

- **The information in this presentation is for educational purposes only and is not intended to be a recommendation to purchase or sell any of the stocks, mutual funds, or other securities that may be referenced. The securities of companies referenced or featured in the seminar materials are for illustrative purposes only and are not to be considered endorsed or recommended for purchase or sale by BetterInvesting™ National Association of Investors Corporation (“BI”) or the National Investors Association, or the OKI Chapter Board. The views expressed are those of the instructors and do not necessarily represent those of BetterInvesting™, or OKI. Investors should conduct their own review and analysis of any company of interest before making an investment decision.**

Looking at Cyclical Stocks

B LOW PRICE -- NEXT 5 YEARS		(3D7 as adj.)	[4A1]
(a) Avg. Low P/E	<input type="text"/>	X Estimated Low Earnings/Share	<input type="text"/> = \$. Growth Stock
(b) Avg. Low Price of Last 5 Years =	<input type="text"/>	(3E7 as adj.)	} Cyclical Stock
(c) Recent Severe Market Low Price =	<input type="text"/>	(3B7)	
(d) Price Dividend Will Support	<input type="text"/>	<u>Present Divd.</u> = <input type="text"/>	Income Stock
Selected Estimate Low Price	<input type="text"/>	<u>High Yield (H)</u> = <input type="text"/>	
			[4E1]

Not all Stocks are growth stocks

Some are

- *Income Stocks*
- *Cyclical Stocks*

Cyclical Stocks

- **Cyclical companies follow the economy.**
 - **Fundamentals grow when economy is improving**
 - **Fundamentals decline when the economy declines**

Cyclical Stocks

Two types of Cyclical Stocks

- *Durable Goods* - **track the economy and interest rates**
- *Basic Materials* - **track the price of the commodity they sell**
 - **Price follows supply and demand**
- **Found in certain industries**

Cyclical Industries

- **Financial Sector**
 - **Property & Casualty Insurance**
 - **REITS**
- **Industrial Sector**
 - **Construction**
 - **Farm Machinery**
 - **Heavy Trucks**

Cyclical Industries

- **Basic Materials Sector**
 - Aluminum
 - Chemicals
 - Iron & Steel
 - Paper & Forest products
- **Technology Sector**
 - Semiconductors

Cyclical Industries

- **Consumer Cyclical Sector**
 - **Automotive (including parts & tires)**
 - **Airlines**
 - **Home Construction & Furnishings**
 - **Leisure Goods & Services**
 - **Casinos, Restaurants, Toys, etc.**
 - **Clothing & Footwear**
 - **Retail**
 - **Media (Advertising, Entertainment, etc).**

Cyclical List from
www.marketwatch.com

DJ Consumer, Cyclical Index (US) (CYC)

Consumer Services

Food & Drug Retailers

Drug Retailers

Food Retailers & Wholesalers

General Retailers

Apparel Retailers

Broadline Retailers

Home Improvement Retailers

Specialized Consumer Services

Specialty Retailers

Media

Broadcasting & Entertainment

Media Agencies

Publishing

Travel & Leisure

Airlines

Gambling

Hotels

Recreational Services

Restaurants & bars

Travel & Tourism

Includes Five Industries

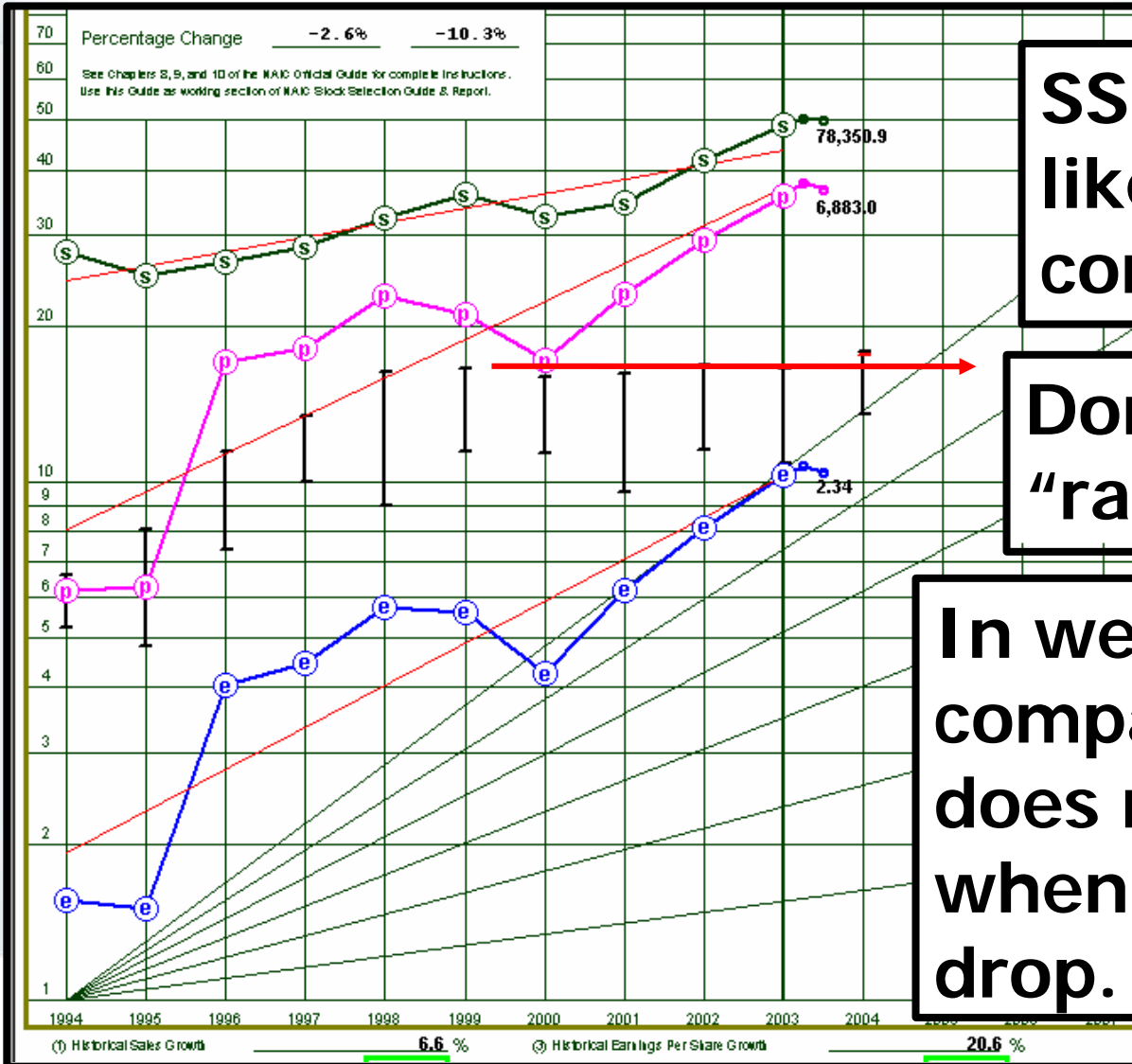
Cyclical Stocks

- **Beginning investors should avoid investing in cyclical companies.**
 - **Require more knowledge about investing**
 - **Have to be somewhat contrarian**
 - **Be aware of where the economy and the company are in their cycle.**

Cyclicals Require More Work

- **Always ask yourself -- is this an economic downturn or a problem with the company?**
 - **More knowledgeable about investing**
 - **Includes things like the financial statements**
 - **More knowledgeable about the company and the industry**
 - **Industry problems or opportunities**

SSG For A Cyclical



SSG does not look like a growth company.

Don't expect "railroad tracks."

In well managed companies, price does not plunge when fundamentals drop.

SSG For A Cyclical

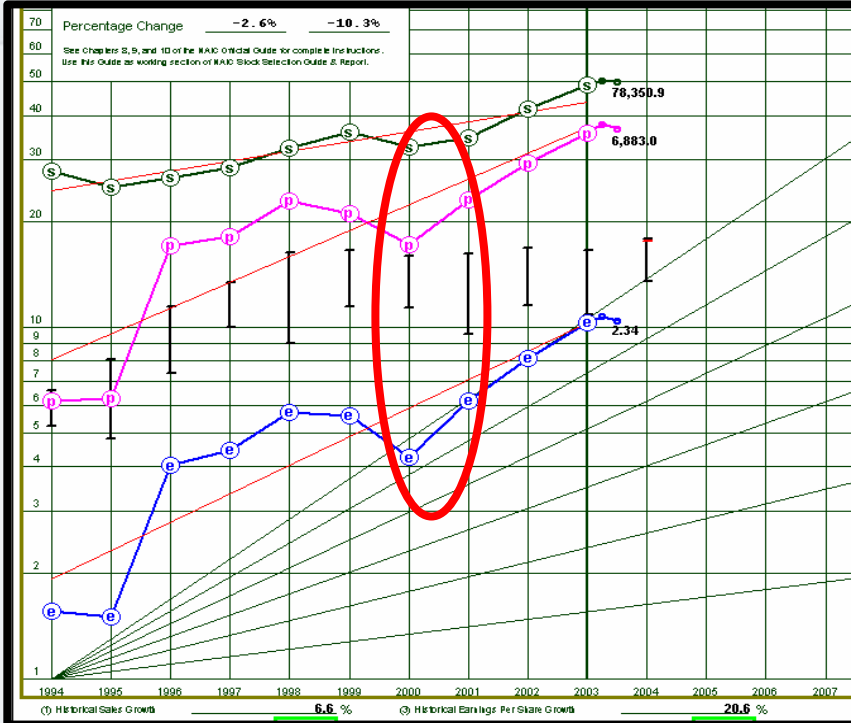
2 EVALUATING MANAGEMENT		Company		HONDA MOTOR CO LTD (HMC)							03/09/05			
		1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG.	TREND	
													UP	DOWN
A	% Pre-tax Profit/Sales (Net Before Taxes +Sales)	2.7	3.0	7.7	7.7	8.6	7.1	6.4	8.1	8.4	8.8	7.7	UP	
B	% Earnings Equity (ES + Book Value)	6.0	6.2	15.9	16.2	17.3	13.6	10.4	14.1	16.1	16.0	14.0	UP	

- The management numbers in Section 2 will go down with the fundamentals.
- This is not a sign of bad management.

Be Contrarian

- **In order to get the greatest price appreciation, invest in cyclical stocks when the economy is near the bottom of a cycle.**
- **Buy when the fundamentals are down and just beginning to improve.**
 - Gives you the greatest price appreciation
 - Often means you are buying when the P/E is high.

SSG for Cyclical



Structure

translating earnings into future stock prices.

HIGH THIS YEAR 25.500 LOW THIS YEAR 19.250

D Price Earnings Ratio		F Dividend Per Share	G % Payout F ÷ C × 100	H % High Yield F ÷ B × 100
HIGH A ÷ C	LOW B ÷ C			
18.5	12.8	0.109	8.6	0.7
23.6	16.7	0.097	10.1	0.6
16.5	9.7	0.115	8.2	0.8
12.9	8.9	0.133	7.2	0.8
10.1	6.6	0.192	8.2	1.2
81.6	54.7		42.3	
16.3	10.9		8.5	

B CURRENT PRICE EARNINGS RATIO 10.6
 S [0.00] Current P/E Based on Last 4 qtr. EPS [2.36]

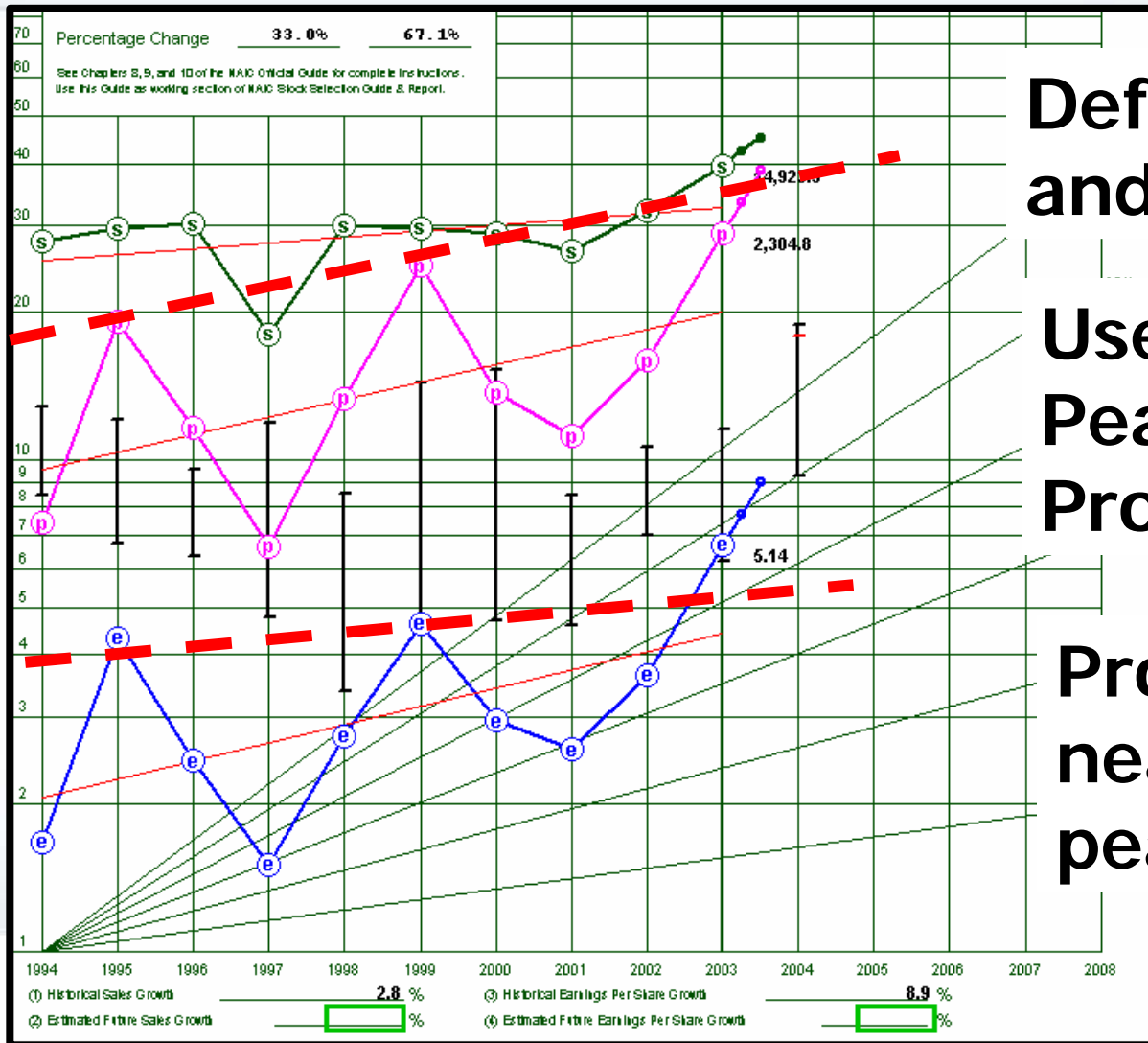
Invest when the fundamentals are starting to recover.

Often that is when P/Es are the highest.

Projecting Growth

- **Projecting the future sales and earnings growth on cyclicals is much more difficult.**
- **Historical growth rates may only be of limited value.**
- **Knowledge of company and industry are crucial.**

Textbook Example

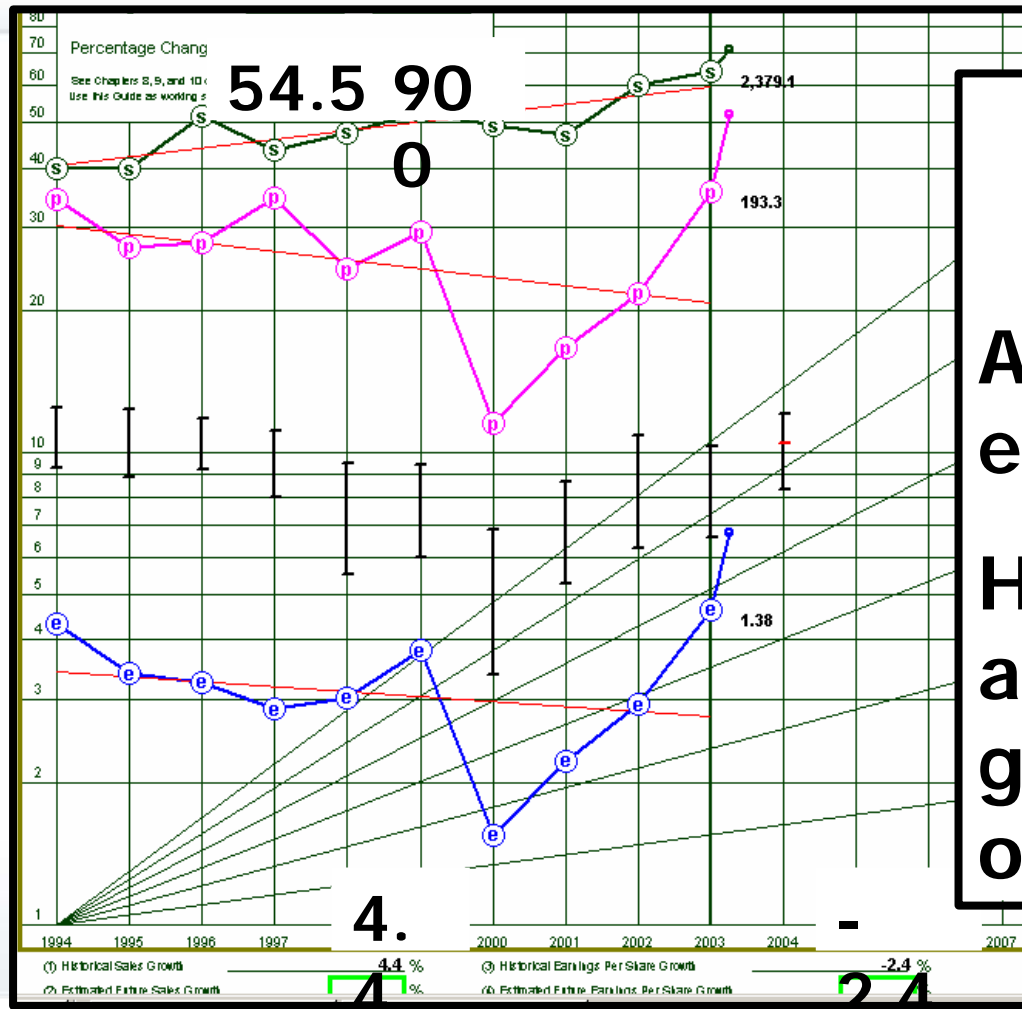


Definite peaks and valleys.

Use the Peak to Peak Method for Projections.

Probably nearing a new peak.

Projecting Growth

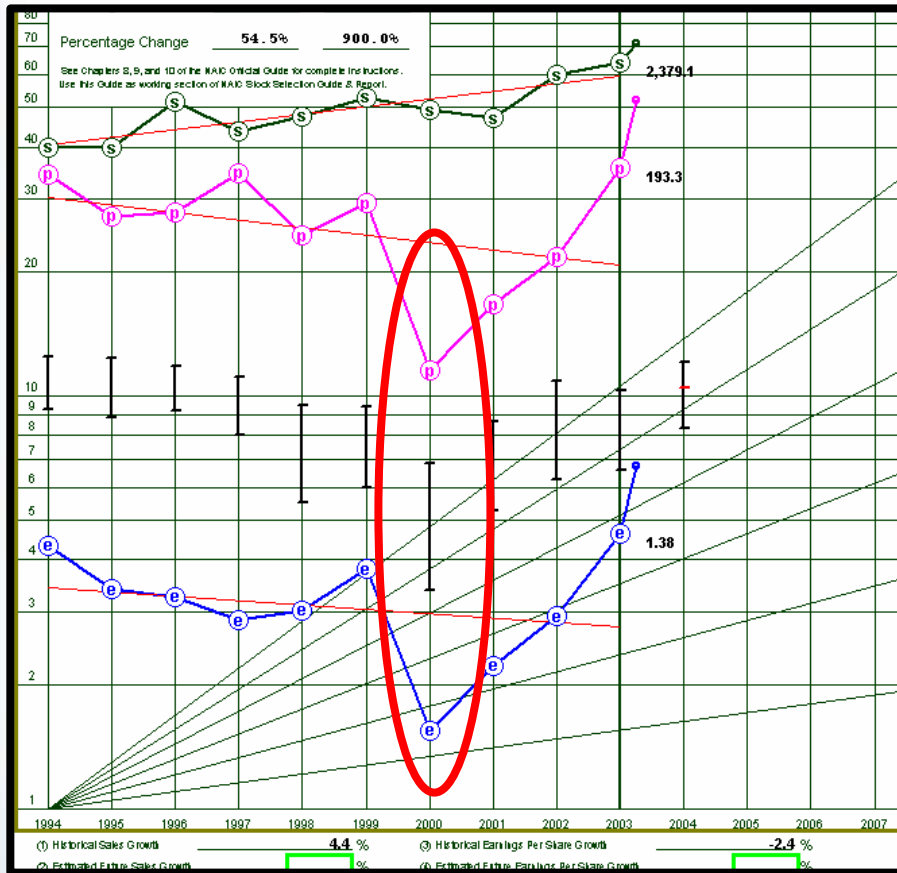


Worthington Industries

A more typical example.

Historic sales and earnings growth rates are of limited value.

Cyclicals That Pay Dividends



ing earnings into future stock prices.

THIS YEAR **22.730** LOW THIS YEAR **15.700**

D Price Earnings Ratio		F Dividend Per Share	G % Payout F ÷ C X 100	H % High Yield F ÷ B X 100
HIGH A ÷ C	LOW B ÷ C			
15.7	10.0	0.600	53.1	5.3
28.0	13.9	0.640	139.1	10.0
24.7	15.0	0.640	97.0	6.5
23.4	13.6	0.640	73.6	5.4
14.1	9.0	0.640	46.4	5.2
105.9	61.5		409.2	
21.2	12.3		81.8	

CURRENT PRICE EARNINGS RATIO

9.8

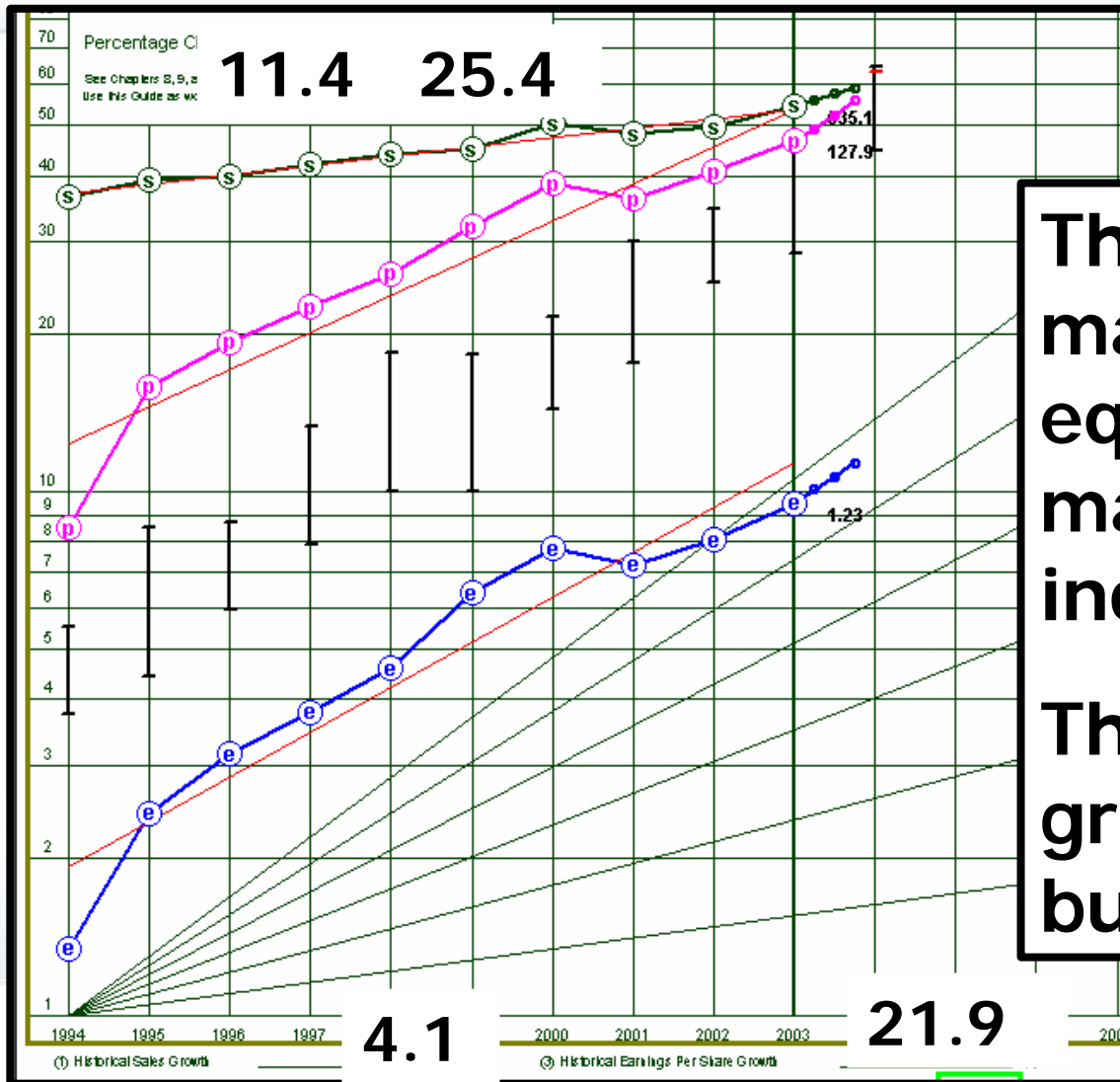
0.00]Current P/E Based on Last 4 qtr. EPS [2.01]

Cyclicals will pay dividends even when earnings drop.

Growth Cyclical

- **Some cyclical stocks will behave like growth companies.**
 - Look like a growth company
 - Analyze them like a growth company.
- **Beginner investors who want to invest in a cyclical should select a growth cyclical.**

Graco Inc.



This company manufactures equipment for many cyclical industries.

They look like a growth company but are cyclical.

Selecting a Low Price

		(3D7 as adj.)			(4A1)
B LOW PRICE -- NEXT 5 YEARS					
(a) Avg. Low P/E	<input type="text"/>	X Estimated Low Earnings/Share	<input type="text"/>	= \$	<input type="text"/>
(b) Avg. Low Price of Last 5 Years =	<input type="text"/>				
(c) Recent Severe Market Low Price =	<input type="text"/>				
(d) Price Dividend Will Support	<input type="text"/>	=	<input type="text"/>	=	<input type="text"/>
Selected Estimate Low Price	<input type="text"/>			= \$	<input type="text"/>

(3E7 as adj.) (3B7) (4E1)

Cyclical Stocks

- For a growth cyclical select the Average low price which is 4Bb.
- For a cyclical stock select the recent severe low price which is 4Bc.
 - May want to look at low prices for last ten years.

For more ways to learn:

**Contact the OKI Chapter Board for a One Hour “Classes to Clubs”
(We Bring OKI Classes Directly to Your Club) Or
Attend One of our OKI Special Events or Edufests**



Cincinnati:

Mary Thomas

Mcthomasp@fuse.net

Dayton:

Gene Senter

EMIDDLE42@aol.com

Columbus:

Dianne Jordan

dijord00@aol.com

And . . . Don't Forget

The OKI Online Classes



**Learn From The Comfort
Of Your Own Home - For Details:**

**Refer To Your Printed
OKI Newsletter**

**Or Visit The OKI Website:
www.betterinvesting.org/okitri**