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Escape Volatility In These Graham-And-Doddsville Stocks

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In 1984 Warren Buffett delivered a speech at Columbia Business School that has become something of a manifesto for value investors. In the speech, entitled "The Superinvestors of Graham-and-Doddsville," Buffett talked about a small group of investors who worked under Benjamin Graham (the man known as the "Father of Value Investing") and David Dodd at the Graham-Newman Corp. in the mid-1950s. Three of the firm's four associates–Walter Schloss, Tom Knapp and Buffett–established easily traceable and tremendous track records after leaving the firm (they nearly doubled the S&P over periods ranging from 13 to 28 years).

In his speech Buffett also highlighted the track records of several other Graham/Dodd disciples, including Buffett's future Berkshire partner Charlie Munger, all of whom posted exceptional results of their own. His conclusion: "A concentration of winners that simply cannot be explained by chance can be traced to this particular intellectual village." In other words, value investing pays off in the long term.

In *The Little Book That Beats the Market*, Joel Greenblatt wrote that if his value-oriented "Magic Formula" always worked, everyone would start using it and compromise the formula's success. The share prices of those stocks identified, he said, "would be pushed higher almost immediately," making the bargains disappear. But because the strategy sometimes falls short, many investors bail, allowing the tenacious to get good stocks on the cheap. The formula works, therefore, because it doesn't always work.

Tempting as it may be for you to cut bait and follow the crowd, focusing on short-term performance rather than on value and fundamentals usually leads to trouble. That's why Graham wrote in *The Intelligent Investor* that an investor needed to be "armed with mental weapons that distinguish him in kind–not in a fancied superior degree–from the trading public," most of whom are short-term-minded speculators. In other words, good investors don't succeed because they are better at guessing what the market will do in the short term; they succeed because they have the mental strength to steer clear of the short-term guessing game and stay focused on value, fundamentals and the long term.

While the market has changed over the past several decades, Graham's advice still rings true. Using investment strategies based on that advice as well as the philosophies of value gurus like Greenblatt and Buffett, I have identified four promising stocks:

Valero Energy is a $24 billion international manufacturer and marketer of transportation fuels and other petrochemical products. Its price-to-sales ratio is a low 0.3, and its long-term earnings-per-share growth is 23.7%. In addition, our model, based on Ben Graham's value approach, scores the stock highly due to its low P/E (8.6), reasonable price/book (1.2) and long-term debt, which is less than net current assets.

Lear, an $8.13 billion leading supplier of electrical systems to the global automotive industry, recently reported strong second- quarter earnings, upped its full-year outlook and announced continued stock buybacks. This midcap stock looks attractive according to my John Neff-inspired guru model, which favors the stock's low P/E of 9.1 and free cash flow per share of $9.09.

Westinghouse Air Brake Technologies, doing business as Wabtec Corp., is a leading supplier of technology-based products and services for rail, transit and other global industries. The company's cost-reduction initiatives have bolstered second-quarter operating margins, and our Buffett- based investment model favors WAB's stable earnings-per- share, return-on-equity and return-on-capital metrics. The Buffett model estimates a long-term return of 15% on the stock.

Bridgestone, the tire-and-rubber company, is expanding operations with plans to open a second location in Nashville in the first quarter of 2017 and add 450 employees. Our Graham-inspired investment model likes the company's modest price/earnings and price/book ratios of 10 and 1.3, respectively, as well as the firm's debt ($1.6 billion) in relation to net current assets ($8.5 billion).

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