

INSIGHTS FROM CFA SOCIETY SINGAPORE

# Book review: *The Little Book of Picking Top Stocks*



JANET J MANGANO

hold category, with a recommendation to sell rarely seen. Is there really such a rating as “hold”, which could be a “wink-wink” sell?

Analysts deserve recognition for what they do best – the fundamental analysis of a group of companies in an industry and tracking their fortunes. But can such analysis be relied on to hit the home run of the best performing stock?

Fridson details the fundamental and industry-specific stories of the top S&P 500 Index stocks in each of the years 2017 through 2021.

He also delves into the importance of identifying free cash flow and estimating its trend in contrast with net income, or EPS, and even generally accepted accounting principles earnings. Another suspect item to consider is “earnings management”, which many corporations use to “smooth” reported earnings.

Each stock’s unique and detailed analysis is presented, with the “worst case” achieving an 80 per cent return in 2018, when the S&P 500 stocks delivered a return of -6.24 per cent.

Readers will recognise each of the names, but may be startled to learn the catalysts for performance that Fridson identifies. The items that stood out for me more than others are an uptick in free cash flow generation, improving credit (generally from bad to less bad), restructuring, the choice of special dividends versus consistently raising dividends, and unique market circumstances.

Identifying the winners of the past and understanding the pulse points for exceptional price performance provide clues as to what follows later in the book.

Keep in mind the non-S&P 500 stocks that delivered eye-popping performance for the same period.

Fridson details their circumstances for the years 2017 to 2019. The catalysts are similar to the names of the bigger stocks.

Here, though, one is dealing with smaller (but not necessarily so) capitalisations, a lack of sequential positive earnings, and perhaps fewer publicly traded shares.

If one reviews the records of top stocks for the years that are not included in *The Little Book of Picking Top Stocks* – 2020 and 2021 – one will find unusual catalysts that could not have been identified before their time in the sun.

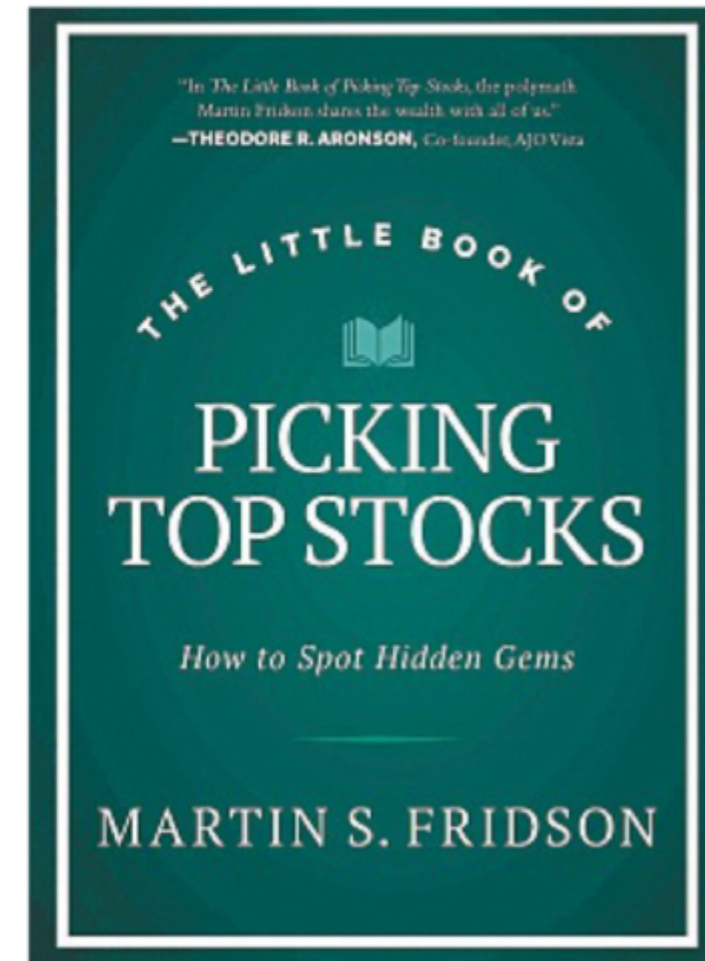
In 2020, Nio gained 1,103 per cent, making it the only large-cap issue in the top 10 non-S&P 500 stocks that year. And in 2021, the top stock was GameStop, rising 815 per cent.

## Zooming in

The book crescendos to its detailed quantitative and qualitative presentation in its back half. The quantitative characteristics presented are strikingly evidence-based and give readers a green light of sorts to initiate their own analysis.

These are based on stock price volatility (the higher, the better), dispersion in EPS forecasts (the greater, the better), bond ratings, and market capitalisation. The reader may be surprised to find “EPS dispersion” on the list, given that EPS typically runs quite tight in Wall Street research, as discussed at length.

Fridson and researcher John Lee have devised a strikingly simple statistic, the Fridson-Lee statistic. Markedly greater EPS estimate dispersion is observed in the top stock as compared with the “average” S&P 500 stock that is 250th stock.



Martin S Fridson’s latest tome will encourage analysts and investors to do something they may be unfamiliar with – going for No 1 systematically.

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The qualitative characteristics Fridson addresses focus on outside pressure for change, dynamic technology, signs of potential credit improvement, and competitive dominance.

Do I hear the name Tesla? Readers will remember the 2020 narrative fondly – even though that particular year began with more “sell” ratings than “buy” ratings on the stock.

Fridson’s *The Little Book of Picking Top Stocks* will encourage analysts and investors to do something they may be unfamiliar with – going for No 1 systematically.

The goal need not be attaining the very pinnacle of stock price performance in a single year, but investors could come satisfyingly close.

He states that this process is not to be overlaid on a total portfolio, but can be implemented on a part of a portfolio that one can dedicate to higher risk and potentially higher rewards. And one can have a lot of fun in the process.

The writer, formerly a senior portfolio manager with PNC Wealth, is in Short Hills, New Jersey, US.

WHEN I first saw the title of Martin Fridson’s latest masterwork, I wondered what the focus could possibly be, other than hitting pay dirt or selecting the winning horse, which happened to be a long shot.

Considering Fridson’s deep background in fixed-income analysis, I initially thought a secret edge could be found by using intense credit analysis or tracking the rise and fall of a company’s credit ratings.

But what happens when a company does not have credit ratings – or has very low ones? This “little” book with big ideas presents a novel approach that, to date, has not been systematised in such an evidence-based style as presented here.

## Ratings racket

Do you want to get hooked into identifying the best performing stock? One may consider this instant gratification, and it certainly is!

Yet, there is a clear method to it that lies outside the world of the Wall Street analysts, who are essentially spoon-fed the same information by corporations – especially when it relates to forecasting earnings per share (EPS) for a quarter or a year – and then who set a price target and make a “buy” or “sell” call.

The author states that the bulk of stock ratings falls into the buy/