

Turnaround Portfolios - February 26, 1999

The October 1995 Investment Review introduced the idea of using screening to identify companies that are undergoing a turnaround in net operating earnings per share after at least 2 quarters of flat or negative earnings changes. The investment rationale is simple. Buying stocks that have shown the best improvement in net income from operations after having had a period of poor earnings performance and holding them as long as earnings continue to improve should provide positive excess returns over the market average.

For this study we created a 20-stock portfolio of turnaround stocks monthly from 12/78 to 12/98. The portfolio required the above mentioned criteria of at least two quarters of flat or negative earnings comparisons followed by a quarterly earnings improvement. The 20 stocks with the largest quarterly improvement, as measured by the increase as a percent of normal earnings, are included in the portfolio. These stocks are held as long as the latest quarterly operating earnings per share exceeds the comparable prior year quarter. The original study required that the latest trailing 12-month earnings per share be positive. However, without this criterion, the test portfolios also showed positive return comparisons and low turnover when executed on a B- or better quality universe and the S&P 500 stocks, as shown below.

*Turnaround portfolio on B- or better quality stocks
(equal-weighted total return %)*

	Turnaround Portfolio	B- or better Universe	Portfolio % Turnover
12/78-12/79	50.2	31.8	85.3
12/79-12/80	37.9	30.4	175.0
12/80-12/81	2.1	8.4	95.0
12/81-12/82	36.1	29.5	176.8
12/82-12/83	49.4	32.7	105.1
12/83-12/84	-12.9	2.4	105.0
12/84-12/85	52.5	31.7	128.4
12/85-12/86	25.8	16.0	118.3
12/86-12/87	-1.5	-0.1	130.8
12/87-12/88	28.8	24.2	116.7
12/88-12/89	20.1	21.6	120.6
12/89-12/90	-10.2	-11.1	126.2
12/90-12/91	66.9	39.2	140.4
12/91-12/92	18.2	15.6	80.0
12/92-12/93	29.0	15.8	125.0
12/93-12/94	2.8	0.7	105.0
12/94-12/95	38.4	28.5	80.9
12/95-12/96	26.0	21.7	95.3
12/96-12/97	23.2	29.0	85.4
12/97-12/98	35.3	2.1	100.8

Cumulative Return %

	Turnaround Portfolio	B- or better Universe	Portfolio % Turnover
12/78-12/98	7376.8	2499.5	
Annualized	24.1	17.7	114.3
Annual STD	21.4	16.0	

*Turnaround portfolio on S&P 500 stocks
(equal-weighted total return %)*

	Turnaround Portfolio	S&P 500 Universe	Portfolio % Turnover
12/78-12/79	59.6	29.2	80.4
12/79-12/80	37.6	30.7	130.0
12/80-12/81	-8.1	5.2	90.0
12/81-12/82	55.8	29.9	186.2
12/82-12/83	46.9	31.3	80.0
12/83-12/84	-13.7	3.4	65.0
12/84-12/85	44.6	31.3	128.6
12/85-12/86	13.6	17.1	102.9
12/86-12/87	16.9	5.4	75.4
12/87-12/88	20.4	21.0	106.6
12/88-12/89	39.2	26.0	101.4
12/89-12/90	-2.7	-11.9	105.0
12/90-12/91	52.5	35.8	160.0
12/91-12/92	37.3	15.2	55.0
12/92-12/93	34.5	14.9	70.0
12/93-12/94	-0.8	1.1	65.0
12/94-12/95	35.5	32.4	35.0
12/95-12/96	35.0	19.8	82.5
12/96-12/97	34.7	28.9	80.3
12/97-12/98	24.7	13.3	120.0

Cumulative Return %

	Turnaround Portfolio	S&P 500 Universe	Portfolio % Turnover
12/78-12/98	10614.2	2774.9	
Annualized	26.3	18.3	95.6
Annual STD	20.4	16.5	

The following lists include 20 turnaround stocks each from the B- or better quality and S&P 500 universes that would be included in portfolios started 2/19/99:

Turnaround stocks in the S&P 500

Company Name	Ticker Symbol	Latest Price	Latest Op EPS	Op EPS 1 Qtr ago	Op EPS 2 Qtrs ago	Op EPS 3 Qtrs ago	Latest qtr chg as % ENO
3COM	COMS	33.19	0.79	0.47	0.71	1.02	22.9
Niagara Mohawk	NMK	14.63	0.75	0.54	0.64	0.72	21.0
Tele-Commun A	TCOMA	65.75	-0.75	-0.89	-0.86	-0.85	15.6
ITT Industries	IIN	38.75	1.90	1.63	1.85	1.88	12.3
Boeing	BA	35.69	1.39	1.21	1.22	1.43	12.0
Adobe Systems	ADBE	42.31	1.89	1.69	1.87	2.01	11.8
Sunoco	SUN	31.88	2.67	2.37	2.80	2.90	10.2
Hasbro	HAS	37.88	1.63	1.47	1.49	1.55	10.0
Gen Motors	GM	85.44	7.80	7.19	7.78	7.83	8.7
Freeport-Mcm Cop	FCX	9.19	0.69	0.64	0.69	0.90	7.3
FDX Corp	FDX	86.13	4.02	3.79	3.90	3.90	5.9
Amer Stores Co	ASC	32.06	1.20	1.13	1.14	1.16	5.8
Battle Mtn Gold	BMG	3.44	-0.15	-0.16	-0.12	-0.08	5.0
King World Prod	KWP	27.25	1.90	1.81	1.85	1.88	4.7
Consol Nat Gas	CNG	56.25	3.11	2.99	3.02	3.03	3.6
Raytheon	RTNB	52.69	3.34	3.24	3.26	3.37	2.9
Aetna	AET	77.00	3.77	3.66	3.68	4.16	2.6
Bankamerica Corp	BAC	64.94	3.45	3.35	3.81	3.88	2.3
Hewlett-Packard	HWP	68.31	2.83	2.77	2.84	2.84	2.1
Texas Instr	TXN	93.00	1.79	1.75	1.94	2.12	2.0

Turnaround stocks in Ford's B- or better quality universe

Company Name	Ticker Symbol	Latest Price	Latest Op EPS	Op EPS 1 Qtr ago	Op EPS 2 Qtrs ago	Op EPS 3 Qtrs ago	Latest qtr chg as % ENO
Hutchinson Tech	HTCH	38.13	-1.35	-2.45	-1.76	-0.61	91.7
Centigram Comm	CGRM	11.13	-1.54	-2.29	-1.98	-1.43	83.3
Beckman Coulter	BEC	47.75	1.65	0.63	0.84	1.24	63.8
Watkins-Johnson	WJ	23.44	-4.21	-5.22	-1.90	-1.05	50.5
Driefontein	DRFNY	3.75	0.06	-0.03	0.00	0.08	45.0
Mesa Air Group	MESA	7.50	-0.61	-0.87	-0.80	-0.74	43.3
Catalina Light	LTG	3.63	0.27	0.15	0.26	0.26	40.0
Warrantech	WTEC	4.63	0.16	0.10	0.16	0.34	37.5
Gottschalks	GOT	7.13	0.27	0.14	0.25	0.35	37.1
Natl Discnt Bkrs	NDB	23.38	0.65	0.41	0.71	0.72	36.9
Oregon Steel	OS	9.94	0.30	-0.06	0.05	0.18	36.0
Act Manufacturng	ACTM	14.63	-0.12	-0.28	0.10	0.59	35.6
Robinson Nugent	RNIC	4.13	-0.79	-0.85	-0.61	-0.11	30.0
Elec For Imaging	EFII	34.94	0.86	0.59	0.71	0.99	30.0
Rouge Inds	ROU	8.50	1.07	0.52	0.59	0.79	27.5
3COM	COMS	33.19	0.79	0.47	0.71	1.02	22.9
First Team Sport	FTSP	1.94	-0.77	-0.85	-0.73	-0.51	22.9
Franklin EI Pub	FEP	6.13	0.28	0.09	0.26	0.29	21.1
Niagara Mohawk	NMK	14.63	0.75	0.54	0.64	0.72	21.0
Calif Amplifier	CAMP	1.94	-0.31	-0.37	-0.28	-0.23	20.0