BUFFETT AND BEYOND...

RECESSION PROOF RETAIL STORES

Stocks That Went Up in 2008 While the Market Fell 37%

Are They Good, Bad or Ugly?

Dr. J.B. Farwell

About the Author.

Dr. J.B. Farwell, author of a best-selling investment book, "*Buffett and Beyond*" is the World's foremost expert on the continuing research and application of a stock selection method and predictability model called Clean Surplus. Clean Surplus, developed by the accounting profession is the only statistically tested method able to truly compare the operating efficiency of one company to the operating efficiency of any other company just the way you would compare returns from one bank to another bank. Clean Surplus allows portfolio creation of the most efficient companies which research has shown consistently outperform the market averages.

Warren Buffett is known to use this method and Dr. Farwell, through his research, book, courses and seminars, takes Buffett's methods and Clean Surplus one giant step *BEYOND…*

Clean Surplus is a model developed by the accounting profession which allows investors to both compare stocks and predict future portfolio returns relative to the benchmark S&P 500 index. Comparability and predictability are not available through the use of traditional accounting methods. The research and later CPA reviewed portfolios indicate that portfolios made up of stocks with higher Clean Surplus ROEs (Return on Equity) outperform portfolios made up of stocks with lower Clean Surplus ROEs. The statistically measured comparisons (correlations) of high Clean Surplus ROEs and high future returns are statistically significant.

DOLLAR TREE, FAMILY DOLLAR AND ROSS STORES

Recession Proof Stocks

One of the best results to come out of preparing for a radio program is the amount of research I and my staff must perform in order to bring you consistent and up to date information on the stock selection method called Clean Surplus. As you all know by now, Clean Surplus was "invented" by the accounting profession as a method of predictability and comparability. During my original research on Clean Surplus beginning in the late 1990s, I discovered that Warren Buffett also used this method as his main stock selection method. After years of statistical research and nine years of actual portfolio implementation I found this stock selection method to be the best and most consistent method of structuring portfolios.

During recent research in the retail industry, I just happened to find some stocks that did not decline during the market crash of 2008.

Our Model Portfolio Results using the Buffett and Beyond Methodology

Compounded Model Returns as of November 16, 2012								
Period	9 yr	7 yr	5 yr	3 yr	1 yr	YTD	Comp	Avg.
PORTFOLIO	169%	46%	25%	91%	15%	7.9%	169%	18.4%
S&P 500	91%	46%	10%	65%	15%	7.6%	91%	9.8%
OUT-PERFORMANCE	78%	12%	15%	26%	0%	0.3%	78%	9%

These retail stocks are considered by us as being recession proof, but we were very surprised to find that these stocks were able to actually increase in value while all those stocks around them were falling apart.

All of these stocks have a great Clean Surplus Return on Equity (ROE) and thus are stocks we like even if they weren't recession proof. In other words, we have double winners on our hands which is a very good thing for our portfolios.

Let's look at the Clean Surplus ROE of these companies and see which company should be in your portfolio and which one should be in someone else's portfolio. As you read on, I think we have a real possibility that we just might consider all of them for our portfolios.

Please remember that when we speak of ROE or Return on Equity, it is the Clean Surplus ROE and not the traditional accounting ROE. These two ROEs are configured in totally different ways and do not garner nearly the same results.

	DOLLAR TREE	FAMILY DOLLAR	ROSS STORES	S&P 500
Symbol	DLTR	FDO	ROST	SPX
YEAR	ROE	ROE	ROE	ROE
2013	26%	19%	23%	13.5%
2012	30%	19%	25%	13.5%
2011	31%	19%	26%	13.5%
2010	32%	18%	25%	13.5%
2009	32%	16%	23%	13.5%
2008	29%	14%	18%	14.5%
2007	33%	15%	16%	14.5%
2006	41%	15%	17%	14.5%
2005	53%	15%	15%	14.5%
2004	19%	20%	15%	14.5%
2003	22%	22%	22%	14.5%
2002	24%	23%	23%	14.5%
2001	24%	24%	21%	14.5%
5 Year Return	300%	180%	320%	-5%
YTD	-9%	15%	20%	9%
DIV	0.0%	1.3%	1.0%	2.0%

Stocks with Higher ROEs Outperform Stocks with Lower ROEs over the Long Term

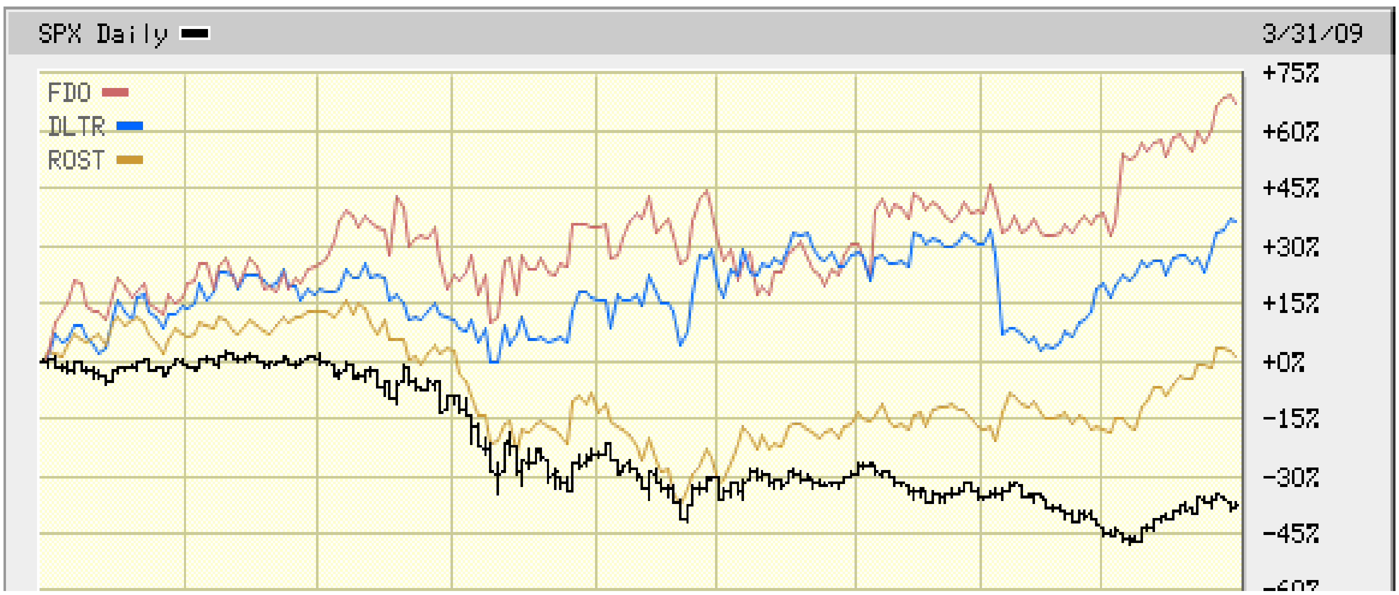
In order to be a candidate for our model portfolio, we want to see stocks with ROEs 20% or above. We see that Dollar Tree and Ross Stores certainly fill this requirement with Family Dollar knocking on the door.

Listen to us on WSBR 740 AM in South Florida 5 to 5:30 PM M-F or go to our website and listen to our archived shows at your convenience.

In other words, these retail companies that cater to middle and lower income salaries do very well during recessions. Look at the years 2003 and also 2009 in the above table. These were recession years and one statistic we look at for consistency is the ROE. A very important question we ask is does the ROE decline during recession years? When we say decline, we are looking to weed out cyclical companies such as the automobile companies and airlines which may see ROEs of 15% during good times and a negative 15% during bad times.

From the above table, we see that these retail companies continued to add value to their bottom line during the two recessions of 2002-3 and 2008-09. This consistency of the ROE during recessions tells us that these companies are not cyclical and thus are candidates for our portfolios. We don't like inconsistency as cyclical stocks fall more than the average stock during severe market declines.

Now comes the amazing discovery of stock behavior during the market crash of 2008 and we can best observe this miracle from a chart.



	DOLLAR TREE	FAMILY DOLLAR	ROSS STORES	S&P 500
Symbol	DLTR	FDO	ROST	SPX
6/30/08 to 3/31/09				
Return	39%	69%	1%	-37%

The above chart spans the period from June 30, 2008 to March 31, 2009. During this period the market fell almost 38%.

Dollar General which is not shown, was not publically traded during this time frame, but it has a 20% ROE and is a company that fits into this retail store group.

We presently have Ross Stores and Dollar Tree in our model portfolio. I think Family Dollar may be a nice candidate for our portfolio beginning in a few months when we make the changes to our model portfolio.

You see folks, the ROE (Clean Surplus Return on Equity) tells all, but the added dimension of looking at certain industries that may be recession proof will help our portfolios during severe market declines. After all, looking back at the first table, you can see these stocks are up considerably over the past five years while the market as a whole is down about 5%. As they say, the market is made up of a lot of stocks and it is up to us to determine which companies are making the most money for their shareholders.

****