Here's How to Spot Wall Street's Blue-Light Specials

When I was a kid, my mom and dad would drag me along on their weekly errands. This usually included a stop at our hometown Kmart, followed by the nearby grocery store.

It was always exciting to me, in an otherwise boring trip, when the store suddenly flashed a blue-light special. The aisle would be brightly illuminated by the flashing light, like a police car that just pulled over a speeding car.

Shoppers couldn't help but flock to that aisle in search of bargain-priced merchandise they could scoop up on sale.

Investing in value stocks is kind of like finding the blue-light specials on Wall Street.

Lots of stock pickers dream of bagging the next hot growth stock like **Nvidia (NVDA)**. But just as many, if not more, simply can't resist the bargain-priced appeal of value stocks.

And believe me, investors are every bit as passionate about their preference for growth versus value as they are about Coke versus Pepsi, Mac versus PC, and Star Wars versus Star Trek.

In a recent column, I showed you how to build a simple but effective *TradeSmith* stock screen to find leading growth stocks that may be good buy-the-dip opportunities. And today, I'll take the other side of the debate by showing you how to find outstanding value stocks "the *TradeSmith* way."

Defining the Debate

First, let's start by understanding that the debate between growth versus value isn't about absolutes. There are plenty of shades of grey to consider.

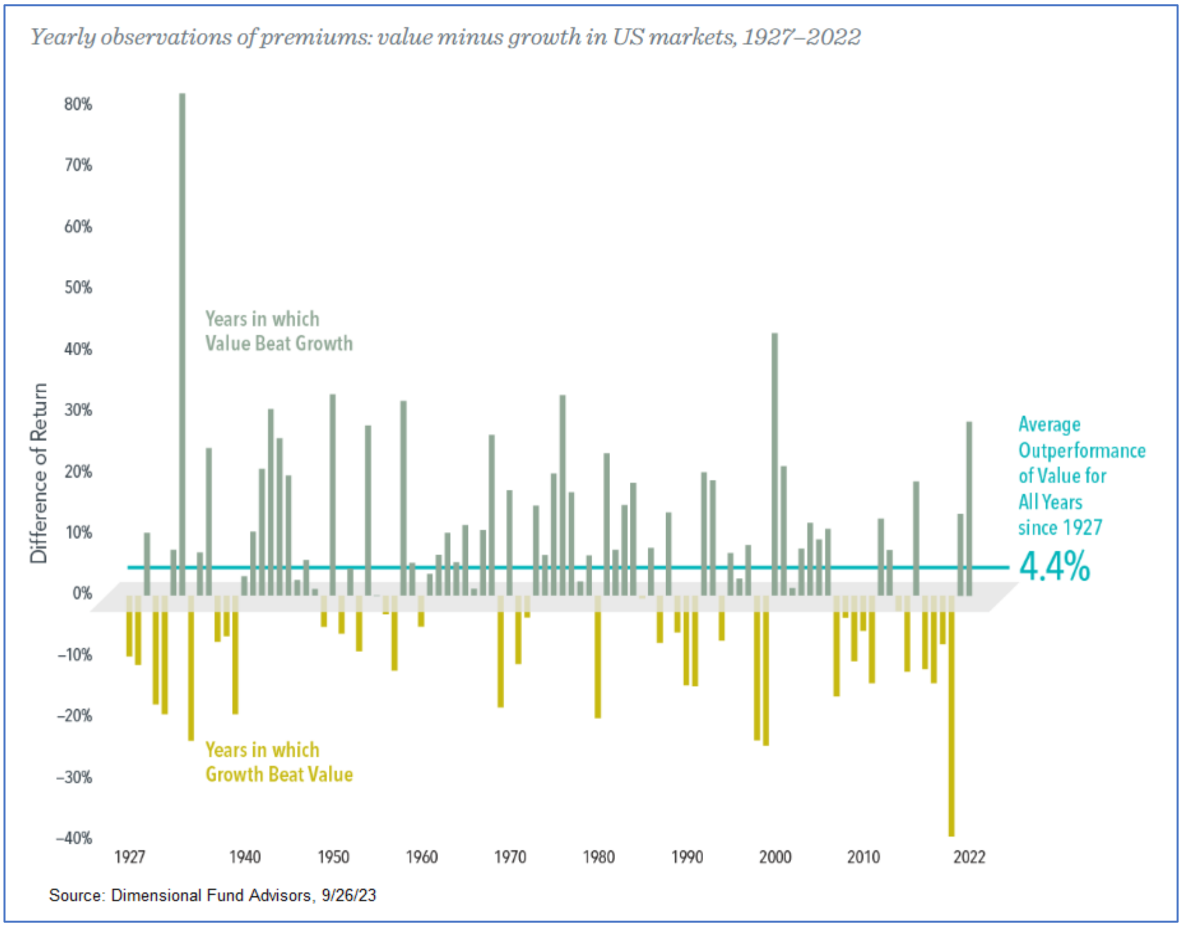
What exactly is a value stock? There are many ways to define value, but I prefer our definition as found in our exclusive Value Strategy.

Our quants crunched the numbers and found that certain fundamental factors work well at identifying value stocks. Namely, a low price compared to:

- Book Value per share
- Earnings per share

- Sales per share

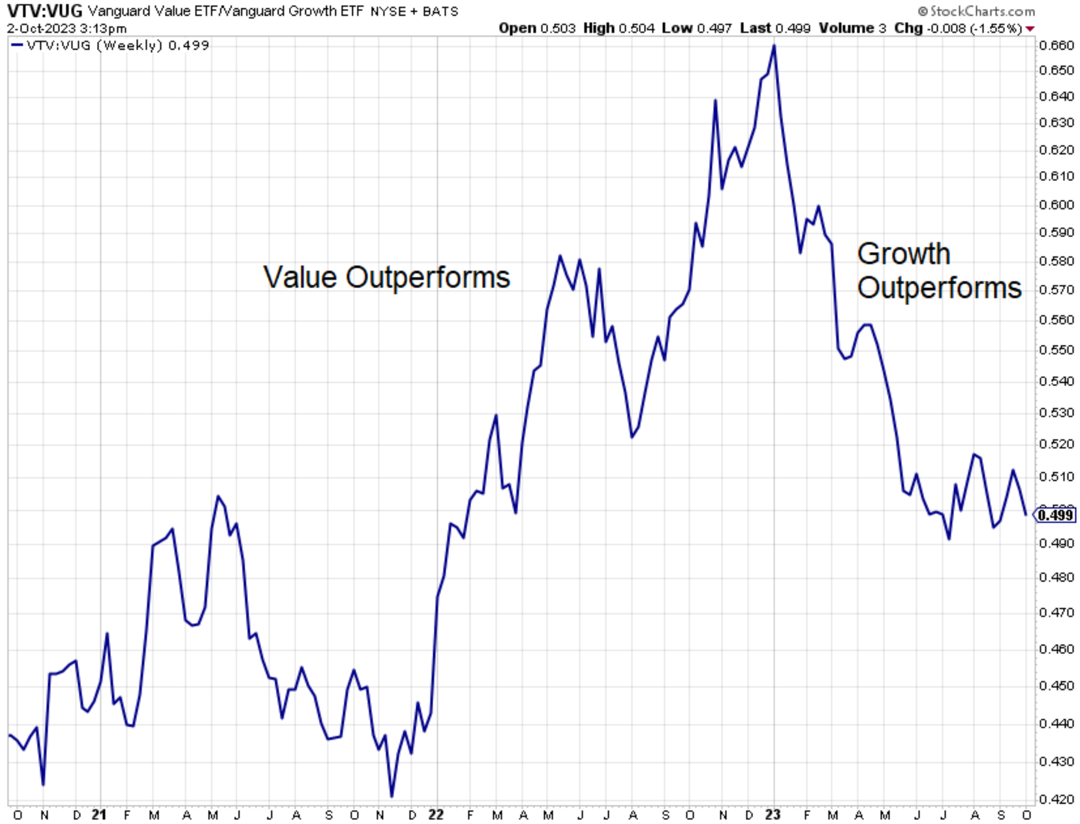
In fact, growth and value stocks take turns outperforming each other over time, although value does hold a slight historical edge. And the shifts between growth and value can carry on for years at a time. Let's start with the big picture.



As you can see above, stocks with lower relative prices (value) have outperformed growth stocks historically by an average of about 4.4%. Of course, that average masks some pretty wild year-to-year swings. Outperformance for value versus growth or vice versa tends to come in bunches.

Often, either one will outperform over several years straight. Most recently, growth stocks outperformed from roughly 2015 to 2020. But since the pandemic, value stocks have had the upper hand, at least until this year.

One of the easiest ways to track value versus growth for yourself is by keeping an eye on two popular low-cost ETFs: **Vanguard Value ETF (VTV)** and **Vanguard Growth ETF (VUG)**.



In the chart above, I'm directly comparing the ratio of VTV to VUG. As the line moved up, VTV outperformed by a wide margin – surging 17.7%, while VUG fell 15.9% – in 2021 and 2022.

So far this year, however, it's a different story. As the line moves down, it means growth (VUG up 27.8%) is beating value (VTV down 1.74%). But overall, value still has the upper hand over the past several years.

Know This Before Loading Up on Value Stocks

Just like you don't want to pay too much for overpriced growth stocks, there's also a warning that comes with value-stock investing. Namely, [you don't want to buy value traps].

These are stocks that just can't seem to get their act together, with the stock price going nowhere for years. Value-trap stocks can become a black hole for your hard-earned money. Your cash is tied up waiting for a turnaround that never comes.

One great example is **AT&T (T)**. This beleaguered communications stock is still below its 2008 bear market low as investors wait in vain for a turnaround. And to add insult to injury, the company just cut its dividend to investors, something that used to be a point of pride.

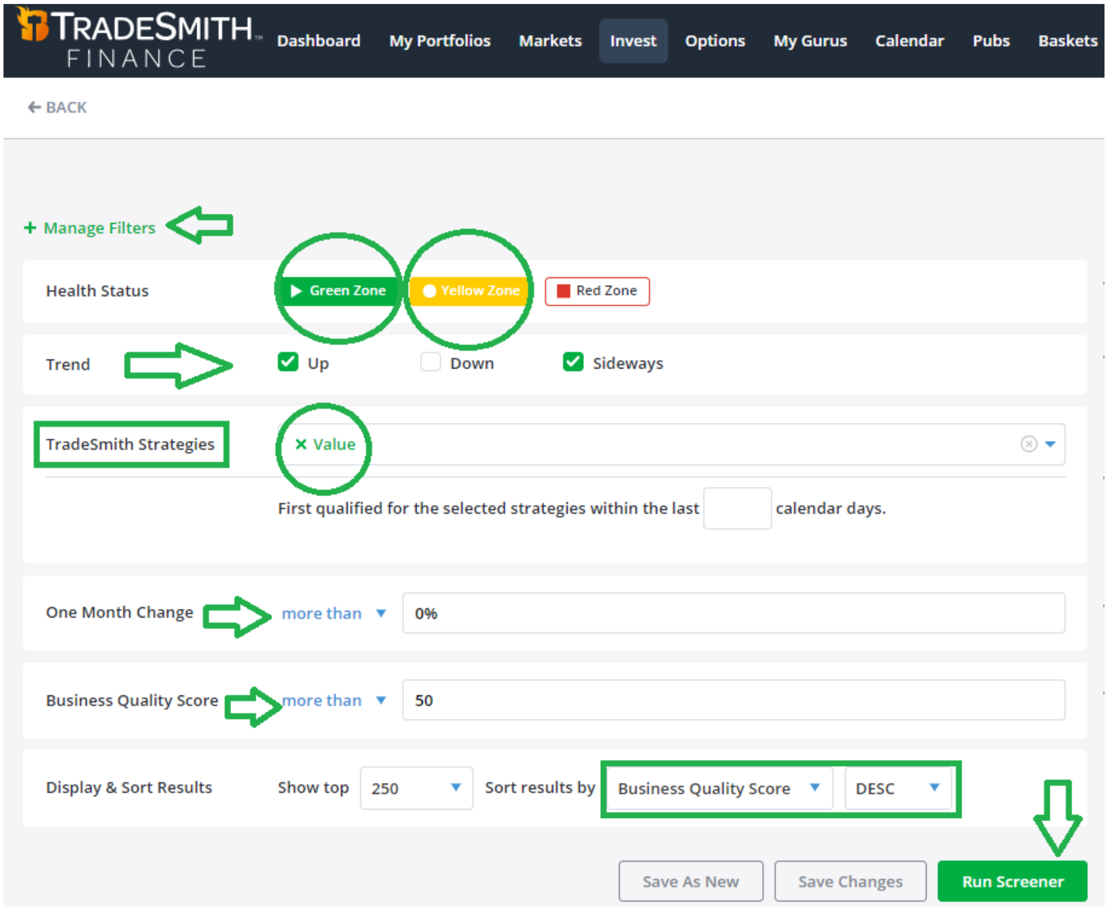
So, when looking for value stocks to invest in, be sure to also insist on *quality* value stocks: those stocks that show consistent returns, positive cash flow, and balance-sheet strength.

Above all, the best way to avoid value traps is to look for healthy stocks in a confirmed uptrend according to our *TradeSmith* indicators – or at the very least a sideways trend.

Let me show you exactly how to create a custom screener with our *TradeSmith* Value strategy as the centerpiece, plus filters to help weed out potential value traps and uncover quality value stocks that are performing well.

Our Screener tool is available to our *Ideas by TradeSmith* Premium-level subscribers and higher, as well as *Trade360, TradeSmith Essentials*, and *TradeSmith* Platinum.

First, be sure you are logged in to *TradeSmith Finance*. Click on the **Invest** menu, then on the **Screener** tab, and click on the "+ Create new screener" button. On the next page, click on the "+ Manage Filters" link (as shown below). Note that because I have Platinum-level access, I may have options you don't see in your account.



Shown above are the filters I applied recently to find quality value stocks that are performing well.

Now, let me walk you through each filter and why I chose it.

First, **Health Status:** Start with healthy stocks, which include:

- Green Zone, which means the stock is trading normally based on historic performance and is "good to go," or
- Yellow Zone, which means caution but can be a great buy-the-dip opportunity.
- Avoid Red Zone stocks for initial screening purposes because they are unhealthy.

Trend: Again, for most screens, you should focus on stocks in a confirmed uptrend or at the least in a sideways trend based on our price-trend analysis algorithms. Avoid down-trending stocks.

***TradeSmith* Strategies:** Here I'm using another one of our proven *Ideas by TradeSmith* strategies under **Ideas Lab: Value**, which screens for stocks with the value characteristics I listed above.

One Month Change: To help avoid value traps (or stocks that are going nowhere fast), let's add a **Performance** filter. We know the S&P 500 was down about 5% last month, so let's screen for stocks that are outperforming with a **One-Month Change** of "more than 0%."

Business Quality Score: Finally, you know by now that I'm a big fan of quality. And stocks with a high **Business Quality Score** will also help you avoid value traps. So, let's set the BQS filter to more than 50, the top half of stocks in our database by quality.

Once you have the filters you want, be sure to click "**Save as New"** so you can go back to your work later, and then click "**Run Screener**."

Display & Sort Results: I found a very select list of just 17 stocks, with the top 10 shown below sorted by "Business Quality Score, DESC" (descending) to get the cream of the crop at the top.

Ticker	:gies	Volume	P/E Ratio	Trailing Divi...	Market Cap	Sector	Latest Close	52 Week High	1 Y Change %	Business Quality Score ▼
YUMC Yum China Hld		1,435,210	31.62	0.92%	$23.2B	Consumer Discretio...	$55.72	$64.39	18.81%	96
VST Vistra		4,839,877	8.17	2.41%	$12.2B	Utilities	$33.18	$34.07	62.86%	96
OXY Occid.Petrol Cor		10,063,323	9.37	1.03%	$57.4B	Energy	$64.88	$75.30	6.72%	94
TXT Textron Inc		1,700,234	17.98	0.10%	$15.5B	Industrials	$78.14	$80.60	34.27%	80
TMUS T-Mobile US		2,804,755	28.10	N/A	$164.8B	Communication Ser...	$140.05	$154.38	4.38%	77
AFL AFLAC		2,916,953	10.30	2.16%	$45.6B	Financials	$76.75	$78.00	39.86%	76
AIG American Intl Gr		2,913,931	10.10	2.24%	$43.1B	Financials	$60.60	$63.65	30.75%	70
SCS Steelcase-A		1,267,604	23.55	4.52%	$1.0B	Industrials	$11.07	$11.28	80.64%	68
LAUR Laureate Edu		843,580	22.67	N/A	$2.2B	Consumer Discretio...	$14.10	$14.80	41.71%	66
FNF Fidelity Nat Fin		3,007,987	21.73	4.36%	$11.2B	Financials	$41.30	$43.85	24.66%	66

Several financial and industrial stocks made the cut, and both of these sectors look cheap right now. This includes insurer **Aflac (AFL)**, with a solid 2.16% dividend yield.

Plus there's one of Warren Buffett's favorite energy stocks, **Occidental Petroleum (OXY)**, which is also among my favorite recommendations in my *Ultimate Income* service model portfolio.

Mike Burnick's Bottom Line: Think of value stocks as the other side of the coin from growth. Each strategy takes turns outperforming the other. Over the past few years, the blue-light special has been flashing on Wall Street's value-priced merchandise. And our

TradeSmith screening tools are a great way to uncover quality value stocks that are rising to the top in performance.

Good investing,

Mike Burnick
Senior Analyst, *TradeSmith*

P.S. If you have any questions or concerns, feel free to reach out to me at **emailmikeburnick@tradesmith.com,** and include "Inside TradeSmith" in the subject line or at the top of your message.