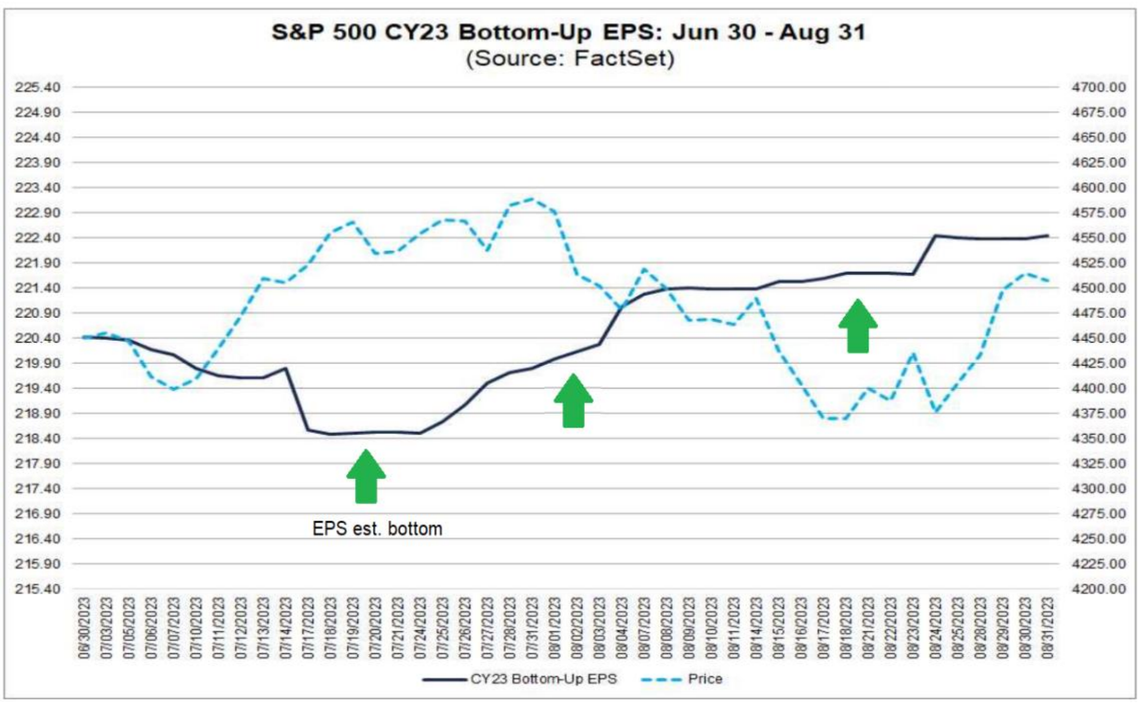
Here's How to Identify Growth Stocks at a Reasonable Price

The S&P 500 may be up 15% so far this year, but since stocks peaked in August, it's been down – 1.55% over the past month, and the blue-chip index dropped almost 3% in the last week alone.

So is it time to sell in September and go to cash, or is it a great buy-the-dip opportunity?

No doubt longtime *Inside TradeSmith* readers already know my answer. I believe it's time to go shopping for high-quality stocks trading at a discount. And I have a very good reason for saying so.

As I shared with you last week, S&P 500 earnings estimates are on the rise, as you can see below.



Granted, changes in analyst estimates have flattened out recently, even falling a bit in the past week or so.

But the trend in profit estimates for this year (and next) is clearly pointing higher, ever since Wall Street earnings forecasts bottomed in July. And that's extremely bullish, because earnings are *the* single most important driver of stock prices over the long run.

So if you believe – as I do – that this could be a great opportunity to buy quality stocks on sale, the question is: Which stocks do you jump on now?

Today I'll show you how to use our tools to tailor your search to specific investment styles that are working well right now.

Find the Stocks that Best Suit Your Investment Style

For my money, there's no better way to take advantage of this market dip than by using *TradeSmith*'s powerful stock-screening tools to find bargain growth stocks now.

As I pointed out in my column last week, Screening for Winners: *TradeSmith's* "Quick Start Guide" To Finding the Market's Best Stocks, our stock screener lets you search for stocks based on criteria that *you* specify.

You can sift through thousands of stocks based on sectors, investment styles (think growth vs. value), market cap, financial strength, valuation measures, share-price momentum, risk levels, and much more.

Now, let's dive a bit deeper.

Specifically, let's say you're interested in buying proven growth stocks on the cheap thanks to the recent market dip.

Growth stocks have been leading the market higher all year. Why?

These are the stocks posting the best profit right now while growth has been scarce, because overall S&P 500 earnings growth has been declining year over year. So, stocks with the ability to consistently grow earnings are in high demand.

But in volatile markets like this you ***do not*** want to pay too much – even for great growth stocks. That's because any hiccup in profit expectations can be devastating to overpriced growth stocks.

So, when looking for growth stocks to invest in, be sure you're screening for growth at a reasonable valuation. The best way to do that is with a simple metric called the PEG ratio.

I'll show you exactly how to use this filter in our screener tool. But first, a brief explanation.

Popularized by Peter Lynch in his book "One Up on Wall Street," PEG stands for P/E (or **P**rice/**E**arnings ratio) to **G**rowth rate. It directly compares the P/E ratio of a stock to its earnings growth rate.

Lynch said the P/E ratio of any stock that's fairly priced should roughly equal its growth rate. That may have been true in the 1980s, but today, valuations are generally higher across the board.

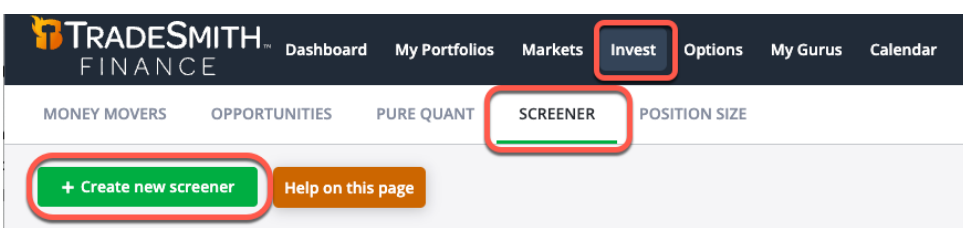
So, to avoid overpaying for a growth stock today, you want to consider those with lower PEG ratios. A good rule of thumb is a PEG less than or equal to 2.

In other words, you would be willing to pay up to 20x earnings for a stock growing profits at a rate of at least 10% (20/10 = 2 PEG ratio), or 30x earnings for growth of 15%, and so on.

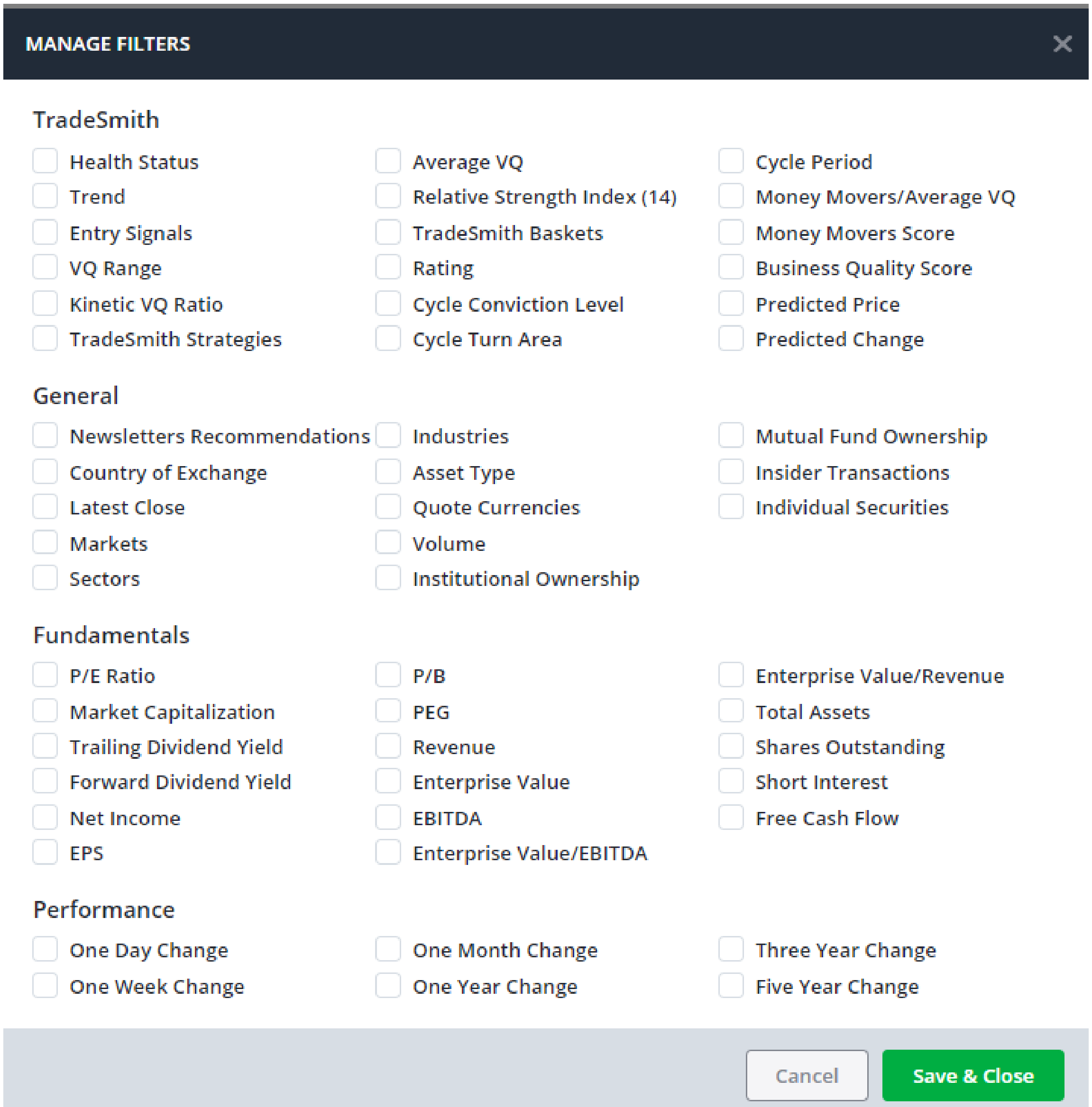
Using PEG to Find Growth Opportunities

Let me show you how to create a custom screener using the PEG ratio to help uncover growth-stock opportunities trading at a reasonable price.

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, as shown below, then click on the "+ Create new screener" button.



Next, click on the "+Manage Filters" link. Shown below are the filter options you can choose from in the pop-up menu. Note that because I have Platinum-level access, I may have options you don't see in your account.

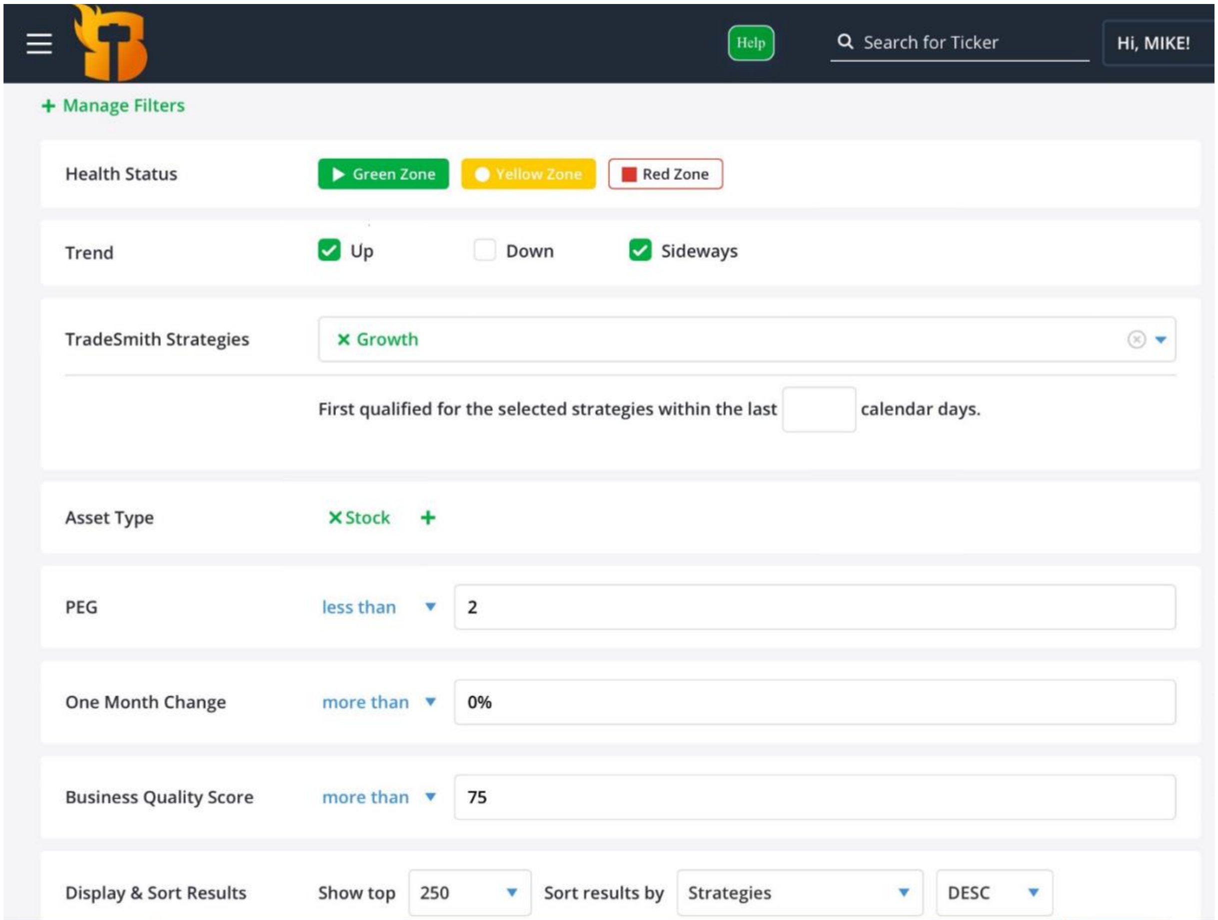


You have a wide array of filter choices at your disposal. These fall into several broad categories:

- *TradeSmith* exclusive filters
- General filters
- Fundamental filters (including PEG)
- Performance filters

Now, let's apply some of my favorite filters to find growth stocks trading at a reasonable price following the recent market pullback.

Below you can see the filter options I selected and the values I've used to build this custom screener. Some may be self-explanatory, but I'll walk you through each one.



First, **Health Status:** We always want to start with healthy stocks either in the:

- Green Zone, which is good; it's trading normally based on historic performance, or
- Yellow Zone, which means caution but can be great buy-the-dip candidates

Avoid Red Zone stocks for initial screening purposes because they are unhealthy.

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

***TradeSmith* Strategies:** Here's where it gets interesting. *TradeSmith* has a wide range of proprietary strategies we've developed that are proven winners.

Ideas by TradeSmith subscribers will find between four and seven different strategies under the **Ideas Lab,** including **Growth**, which screens for stocks with growth characteristics.

Under **Asset Type** we're looking for **Stocks** (under **General** filters).

But what about the reasonable valuation part?

That's where the **PEG** filter comes in (under **Fundamentals** filters). You can set PEG to be more than, between, or less than any value or range of values. I chose less than 2. But you may want to experiment with this filter.

You could choose a range between 2 and 4 to get additional higher-priced stocks. Or you can get more conservative by filtering on Peter Lynch's strict definition of less than 1.

Side note: Some big-name stocks including **Home Depot (HD)**, **Amazon.com (AMZN),** and Google-parent **Alphabet (GOOGL)** currently have PEG ratios of less than 1.

Now let's add two more filters to narrow the results. Under the **Performance** filter category, you'll find **One-Month Change**. Click on it and set your filter value to "more than 0%."

We're in a market pullback right now; as I mentioned above, the S&P 500 Index is down 1.55% over the past month. So we want to focus on growth stocks trading at a reasonable valuation that are also bucking the market trend. A stock that's up even slightly in a falling market is a bullish signal.

Finally, let's add one of my all-time favorite filters -- **Business Quality Score** -- and set the value to more than 75. That should limit our results to:

- Healthy Growth stocks in an up or sideways trend
- A PEG ratio less than 2 for stocks that are up over the past month
- Among the top 30% by quality of all stocks we rank

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**."

I found 66 results from this screen I ran just yesterday. I further sorted the list by "Market Cap DESC" (descending) to place the larger-cap stocks at the top. Here's a partial list.

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Saved Screeners (66 results)

Ticker	Rating	Health	VQ%	Volume	P/E Ratio	Trailing Divi...	Market Cap ▼	Sector
GOOGL Alphabet-A	Strong Bullish	▶ 1m+	24.57%	20,094,644	18.16	N/A	$777.9B	Communication Ser...
GOOG Alphab-C-NV	Strong Bullish	▶ 5m+	24.55%	14,650,032	18.31	N/A	$766.7B	Communication Ser...
META Meta Platforms-A	Strong Bullish	▶ 4m+	32.93%	18,987,014	35.23	N/A	$668.6B	Communication Ser...
XOM Exxon Mobil	Strong Bullish	▶ 12m+	26.11%	11,316,012	9.26	3.13%	$465.3B	Energy
CVX Chevron	Strong Bullish	▶ 1m+	22.69%	5,509,956	10.67	3.53%	$315.0B	Energy
CAT Caterpillar	Strong Bullish	▶ 3m+	22.77%	1,257,517	17.09	1.79%	$139.9B	Industrials
SYK Stryker	Strong Bullish	▶ 9m+	20.84%	922,036	40.60	1.02%	$109.1B	Health Care
MMC Marsh & McLennan	Strong Bullish	▶ 3m+	16.73%	1,339,678	29.83	1.27%	$96.5B	Financials
VMW Vmware Inc.	Strong Bullish	▶ 6m+	21.74%	837,194	50.33	N/A	$72.0B	Information Techno...
FDX Fedex	Strong Bullish	▶ 5m+	24.00%	2,356,057	16.21	1.81%	$67.0B	Industrials

I was a bit surprised to find so many high-quality growth stocks with a reasonable PEG ratio. This includes **GOOGL** and Facebook-parent **Meta Platforms (META)**, plus industrial blue-chips **Caterpillar (CAT)** and **FedEx (FDX)**.

Mike Burnick's Bottom Line: This is just one example of how our powerful Screener tool can point you to the best stock opportunities in any market climate, even after a pullback. Growth stocks are just one winning style you can filter for using our tools. In my next column, I'll show you how easy it is to run a Value screen.

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.