Adviser Q&A
Alan Lancz: *Confessions Of A Stock Swinger*
Nikhil Hutheesing, 01/10/03, 10:29 AM ET
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This is a reprint of an interview conducted by FORBES back in January 2003. A good deal of our clients had just come off their first down year with us and despite having outperformed the averages we were not satisfied – particularly after doing exceedingly well in both 2000 and 2001, when many investors were suffering from major losses. This time period was an excellent chance to see our risk reduction strategies work out. We realize losses are impossible to avoid, but investors must implement strategies to limit and learn from them. As with any discussion on investing, past performance can never guarantee future success.

Alan Lancz, president of Alan B. Lancz & Associates (ABL), got some early tips on how to make money in the stock market when he was just ten years old. His father, who wasn't pleased with his stock broker, started bringing home S&P and Value Line and began making his own investment decisions. Young Lancz developed a fascination with investing. Shortly after graduating from the University of Toledo in 1979, Lancz founded his Toledo, Ohio-based investment advisory firm. Lancz is also the editor of The Lancz Letter, created in 1981. His portfolios have consistently beaten the stock market, though 2002 was a disappointing year. We spoke to Lancz about how he is changing his approach to investing and how he plans to fine tune the art of profit taking in 2003.

Forbes: Last year was a rough market and your portfolios did poorly. What do you predict for 2003?

ABL: Like last year, there are many variables that have yet to unfold. There is the potential war with Iraq, problems with North Korea and the threat of terrorism remains. It is unclear what will happen with energy prices. Until the global political problems are alleviated the market will have difficulty making significant progress.

The big difference between this year and last year is in valuations and expectations. We began 2002 with most investors thinking that it would be a positive year, albeit not like the days of the 1990s. The expectation was that we hadn't had three down years in a row since 1941 so 2002 was bound to be better. But it was a negative year for most investors. Expectations have come way down. So I think there is a better chance to make money in 2003 though the market will still be tremendously volatile.

Forbes: So what is the key to making money this year?

The key to making money will be to take full advantage of market volatility. Be nimble. Buy and sell on the swings.

Forbes: Is buying and selling on the swings your approach to investing?

More now than ever before. The market hasn't gone anywhere since Sept. 11, 2001, on a secular basis. But if you look at the extremes--the lows and highs--and focus on quality companies and short overvalued companies you can make tremendous amounts of money with short-term swings. This goes against the way real wealth has been built over the decades. History shows that holding for the long term is how the John Templetons and Warren Buffets made money. But in this environment, investors must be more short-term oriented and take advantage of the swings. In July 2002, the market plunged 18.5%, then moved up 22%, then declined 19% and rallied another 22% by the end of November. Those are big opportunities. If you buy a stock and it rockets up, the buy-and-hold mentality must be out on the back burner.

Forbes: How much success have you had by buying and selling on the swings?

We've been successful but it took time. In the late 1990s the market became severely overvalued and the prices were ridiculous. So in 2000 we sold our position in a lot of technology companies, but not all of them. That was the mistake we made. We had a six-fold increase in Oracle (nasdaq: ORCL) and Adaptec (nasdaq: ADP), for example. We sold some of our positions, but, in retrospect, we should have sold them all.

We learned from the experience and began buying and selling according to market swings in 2001. When we sold Oracle and Adaptec we found other bargains such as Johnson & Johnson (nyse: JNJ) and Proctor & Gamble (nyse: PG) that hit new lows in March 2000. We bought Proctor & Gamble for around $50, down from $120. When P&G's stock went to the $90s we sold all of our position figuring the stock had gone up 80% in a down market. That was the right move. P&G is getting the point of being overvalued. Now we are doing the same thing with Kimberly Clark (nyse: KMB). Its stock is hitting new lows. I've been buying it this week and over the past few weeks.

Another company, Boston Scientific (nyse: BSX), we bought at $18 and continued to buy it down to $12. Wall Street was overreacting negatively about its growth prospects. But the company has new management and we liked what management was doing. This past year, Boston Scientific was the best-performing large-cap stock in 2002--up 76%. The problem is that now it is getting recognition. The company is on buy lists as one of the top picks for 2003. In the past, I probably would have continued to hold it, but the stock has almost quadrupled and this is a volatile market. So we are selling it and buying Medtronic\ (nyse: MDT), a similar company, and Guidant (nyse: GDT), which has been hitting new lows.

Forbes: What other companies are good buys right now?

We look for industry leaders trading at bargain prices. While many good companies still aren't cheap, there are more now than in prior years. One example is Toys R Us (nyse: TOY). The stock is down from $30 to about $10. New management is sprucing up the stores and enhancing service. We like the company's international growth prospects. Yes, it's a very competitive business which is why the stock is down, but Toys R Us is a leader and 25% of its sales are exclusively available only at Toys R Us.
The last time we bought this stock was when it was getting hammered. Everyone was asking how it could compete with Etoys--which didn't have brick-and-mortar costs. But the stock eventually tripled. Now things look similar. The stock will go up 40% to 50% in the next two years, which is the kind of risk-reward ratio I look for.

Another example is Costco (nasdaq: COST). The stock is hitting new lows so we've started to buy it this week. We think Costco has lots of advantage. SAM'S Club, a division of Wal-Mart (nyse: WMT), is the main competitor, but Costco has nearly double the sales per square foot of SAM'S Club and Wall Street doesn't focus on that. Wall Street is worried that if we get a slowdown, sales will continue to decline. But more than half of Costco's profits come from membership fees. That base acts like an annuity for the company. I think the stock offers a good risk-reward ratio over the next three-to-five years. But if it goes up 50% because of a rally, we'd take profits. Remember, take advantage of the swings.

Finally, I think Pharmacia (nyse: PHA) is a great buy. It is being acquired by Pfizer (nyse: PFE) so buying it right now is like buying Pfizer at a 2% discount. This is a high-quality company, an industry leader, and the stock is down almost by half from its highs of two to three years ago. Yet the pipeline of products and the company's cash flow fundamentals have never been stronger.

Forbes: Do you ever take speculative positions?

Yes. Elan (nyse: ELN)--a company we sold at around $40--then traded down to $1.50 a month or two ago. We spent some days with Elan's management and realized that Wall Street was trading it down because it has a big debt due at the end of this year. With its current cash levels, Wall Street figured it would go bankrupt. But we found out that Elan is getting bids for some of the assets it has for sale that will cover its loan covenants. And the company has other prospects in the pipeline which make it very intriguing. Wall Street's overreaction to negative news has led to low expectations, but we think the appreciation potential is tremendous.

Forbes: How do you uncover the companies that you think will do well?

We try to open the universe as widely as possible to find undervalued companies that have strong industry leadership, good management and attractive valuations. We screen for companies using some 30 metrics. For example, we look for positive cash flow, attractive debt-to-market cap ratios relative to other companies in the industry and we compare future annual growth to the price-to-earnings multiple. The important thing to understand, though, is that the criteria in our screens isn't rigid. It changes according to the sectors we evaluate and a company's particular circumstances. Elan, for example, has high debt, making it unsuitable for non-aggressive accounts. While we like to see a company's growth rate exceed its price-to-earnings multiple, not every company we own grows at a greater clip.

Also, we don't limit ourselves to any one sector or segment or to small-cap, medium-cap or large-cap companies. The only caveat is that if a company is too small, say about $50 million to $100 million market cap, we buy a much lesser dollar amount because liquidity concerns are one of our valuation criteria. Besides looking at what all investors look at, we also spend time with management to get an idea of how they plan to enhance shareholder value. If that can't be explained to us, we avoid the stock.

Thank you.