Previous Page

Reasonable Risks, Powerful Payoffs

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Selena Maranjian
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All other things equal, low risks are better than high risks. But sometimes, a riskier investment can be worth the danger -- if the price is right.

As either a substance or a business, no one wants to go anywhere near asbestos ... except for Warren Buffett. Over the past few years, he has taken on several billion dollars' worth of asbestos litigation risk from commercial insurers. But in this as in all other cases, Buffett only accepted the risk when he felt well-compensated for doing so.

Buffett's **Berkshire Hathaway** is a major insurance enterprise, but he strives to make sure it won't get wiped out by any major fiasco. He expects big catastrophes now and then, such as Hurricane Katrina, but knows that he has the cash to cover claims, and he's confident that over the long haul, he'll come out ahead.

Reasonable risk
Like Buffett, you can also juice your portfolio by taking on a reasonable amount of risk. To achieve a better ratio of risk and reward, it's best to seek a margin of safety by buying companies priced below their actual value.

To find a few candidates, I screened for companies that earned the maximum five stars from our CAPS community of investors. Furthermore, they all have three-year revenue growth rates of at least 5%, P/E ratios of no more than 20, and returns on equity of 16% or more. Bear in mind that these aren't ironclad recommendations -- just ideas to kick off your own further research:

- **Ebix** (Nasdaq: EBIX) is appealing because it offers software -- not the most capital-intensive business -- to the insurance industry. It also enjoys plenty of recurring revenue.
- Based in Switzerland, **ABB** (NYSE: ABB) is becoming a global alternative energy player, winning contracts in the Middle East and South America. As developed nations upgrade their power plants, and developing nations build them, ABB can profit.
- The big spill in the Gulf has made nuclear energy more attractive, and major uranium producer **Cameco** (NYSE: CCJ) is well-positioned to profit from expected increases in demand and prices.
- **Becton, Dickinson** (NYSE: BDX) makes medical supplies such as needles and catheters. As our population grows and ages, and health-care reform brings in more customers, its fortunes are looking rosy. It may even be one of the best dividend stocks of the decade.
- **Alliance Resource Partners** (Nasdaq: ARLP) is a coal company with a dividend yield topping 6%, a steep return on equity, and management that really believes in it. Insiders own more than 40% of the company.
- **Gilead Sciences** (Nasdaq: GILD) is a cash-generating drugmaker specializing in HIV treatments. Some investors question its attractiveness right now, but the company has been buying back shares and buying out other businesses, which bodes well for its future.
- **McDermott International** (NYSE: MDR), an oil-related engineering and construction company, is poised to profit from the recovering global economy. It's spinning off its nuclear energy business soon; those who buy now will end up with two companies.

No stock is a guaranteed winner, and all bear some risks. But by seeking growing, undervalued companies, you can focus on those more likely to go up than down.

Value-focused investing can also help you identify doomed stocks you need to avoid.

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Previous Page