How to Find the Best Long-Term Stocks

Description

When looking for new stocks, investors may often wonder what they should be looking for to identify wonderful companies. You may wonder what variables you should enter in a stock screener to help identify companies that fit what you are looking for.

There are a number of things you can look at, such as past growth numbers, or price-to-earnings ratios, but the number one thing to identify solid companies to buy and hold for the long term is consistently high returns on equity.

The key word is *consistently.* A company may be able to post one or two years of decent returns, but it's a whole other thing to do it year in and year out.

If you can buy a company for a reasonable price to book value that has a consistent return on equity above 15%, that company will be a top performer long term.

It is important not to over pay on price to book though, because that is essentially the equity number you are basing your ratio on. Combining these two ratios will identify a company that isn't overvalued and that is able to achieve great returns consistently.

An example would be a company like **Russel Metals** (TSX:RUS).

It has been returning equity at an incredible rate with its three-year average north of 15%. Its trailing 12-month return on equity is even more impressive at nearly 19%. On top of that, its price to book is only 1.3 times, showing that is has value as well as exceptional business operations.

To confirm this, we can look to the price-to-earnings ratio, which has a current value of just 7.2 times. Similarly, the earnings yield is at 13.8%, showing just how much value the company has.

Continuing to check other metrics would confirm to investors whether or not it's worth an investment, but to identify companies that will perform the best long term, you should start by look at the historical return-on-equity numbers.

goeasy (TSX:GSY) is a different example, it's a high-growth stock that has been putting up impressive numbers the last few years. Its five-year average return on equity is more than 17%. The returns have been growing as well, for the trailing 12 months, goeasy's return on equity is 24.7%.

Investors have taken notice, however, and the stock has been bid up to a price to book of roughly 2.5 times. This means its return on equity of 24.7% is going to be nearly twice as expensive as Russel Metals's 19% return on a price-to-book basis.

This can be expected, because goeasy's growth is so much faster than Russel Metals. Looking at other ratios, it's clear goeasy can deliver superior returns, but it's not as undervalued. However, its 12.2 times price-to-earnings ratio and 8.2% earnings yield still show it has fair value, especially for a growth company of its potential.

Using the return-on-equity ratio to weed out poor stocks is the best way to find top companies that you can hold for the long term; however, you will have to combine other ratios and metrics to get a better overall view of the company and understand how much value it has.

The bottom line for investors is that the best companies will be top performers in the present as well as historically. Things happen and companies can't always have a squeaky-clean track record, but if the history shows for the most part it's consistent, reliable, and well run, then a stock that can produce superior returns and is trading for cheap is a clear winner.

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TICKERS GLOBAL

1. TSX:GSY (goeasy Ltd.)
2. TSX:RUS (Russel Metals)

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