ScreeningRoom

USING THE SCREENS

Each month, our stock screens find hundreds of companies, but not all are winners. After digging through each company's financials, we feature the one or two most compelling investments from each screen, then list in an accompanying chart others that are worth a look.

UNCOMMON VALUE

Just because a stock is cheap, don't call it a bargain. Instead of looking just for low valuation ratios, we compare a stock's valuation with its industry average to derive our Value Rating. The lower a stock's score, the more we like it.

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HOT STOCKS

Even after a stock soars, it may have further to run because the Street often fails to bid up shares enough to reflect good news, such as a strong earnings report or a lucrative contract. So we screen for companies hitting new price highs.

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STREET BEATERS

A stock's price depends on future earnings, so we screen for companies that have exceeded analysts' expectations. If the earnings surprise came from an improvement in a company's core business, it's a sign of better things to come.

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AMERICA'S FASTEST GROWING COMPANIES™

You can be pretty sure that business is booming when a company doubles profits in its most recent quarter. Each month, we screen for companies clearing that hurdle, because sooner or later the market will recognize their success.

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INSIDERS' EDGE

Insiders know their businesses best, so when a director or an officer reports a purchase of his company's stock to the SEC, investors should take note. That's the logic behind screening for companies whose insiders have bought big.

RETURNS NEXT MONTH

SCREEN OF THE MONTH

Each month, we invite a strategist to take account of market conditions and present a screen that searches for stocks positioned to profit from them. We'll give you his best picks, then tell you which we like and why.

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UNCOMMON VALUE

The Good Hands Network

Allstate is plugged in and fast becoming a New Economy insurer

BY BILL GLOVIN

ALLSTATE AND ITS "GOOD HANDS" TRADEMARK SEEM AS old as insurance itself—the company's store-fronts have been cornerstones of Main Street since the Great Depression, and images of Allstate agents meeting customers face to face have appeared in advertisements for as long as most Americans remember. But the insurance business is changing: customers are more interested in low premiums and fast, efficient service than in befriending their agent. And such competitors as Geico and State Farm Mutual Automobile Insurance are exploiting that trend by offering low-cost products over the telephone and on the Internet, leaving more and more Allstate agents with time on their hands.

To be sure, the good hands' people have helped make Allstate (NYSE: ALL) one of the most successful insurers in the country. The Northbrook, Illinois, company is second only to State Farm in sales of personal-property and casualty insurance (Allstate insures more than 20 million Americans, including one out of every eight cars and homes), and it is the nation's 17th-largest life insurer. The company's stock first traded publicly in 1993, after Sears spun it off, in what was then the largest public offering in U.S. history. For four years the insurer could do little wrong—1997 earnings reached \$3.56 per share on \$25 billion in revenue, and shares had more than tripled from the IPO.

By 1998, though, Allstate's car-insurance business, which accounts for more than 60% of profits, began taking a beating from direct-marketing specialists Geico and Progressive, which had managed to use their low overhead and cheaper premiums to carve out an 8% share of that market (compared with Allstate's 12%). Then in September 1999, after Hurricane Floyd wrecked homes and cars from Florida to New Jersey, Allstate was faced with more than \$1.5 billion in insured losses. Normally, the insurer would have raised premiums, but in light of pricing pressures from competitors, it could not. No wonder, then, that 1999 profits of \$2.7 billion were down 17% from the previous year, and that Allstate's share price plummeted more than 35%.

But Allstate was not caught completely off guard—the company had anticipated earnings shortfalls related to its hands-on way of selling insurance. To compete, it hired Edward Liddy as CEO with a mandate

individualinvestor.com

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risk scores than the buy-and-hold portfolio, which steadily held a lower percentage of its assets in bonds. But the buy-and-hold portfolio outperformed the rebalancers by one percentage point or more annually. And for a high-income investor in a taxable account, the real gap was greater: each time a rebalancer sells fund shares at a profit, it generates taxable capital gains. The buy-and-holder has few capital gains because it never sells.

Many analysts now dismiss annual rebalancing as an idea suitable only a generation ago, when bear markets occurred regularly and when bonds sometimes outperformed stocks for long periods. Now, says Craig Evans Carnick, a money manager located in Colorado Springs, it's "outdated in view of tax problems and the performance of the markets."

But investors should still monitor their asset allocations. When a fund's weighting has shifted up or down by more than 25% from the original plan, it's time to consider making an adjustment, says Peter Di Teresa, an analyst with Morningstar. Say that in 1995, a portfolio had 20% invested in large-cap growth stocks and 20% in small-cap value. Within a few years, the large-cap growth fund would have made up 25% of assets, with the small-cap value fund dipping below 15%. The investor would then have to decide whether the new allocation served his needs. Someone comfortable with an aggressive stance might decide to leave the positions alone.

Keep in mind, though, that there's often no need to rush into rebalancing, because the markets usually correct excesses over time. Today's hot sector may turn cold and be outdone by last year's loser. This year, for example, small-cap value stocks have outperformed large-cap growth issues, so an investor who held both categories and stood pat would have enjoyed natural rebalancing—without tax bills.

Extra Insurance

For all its flaws, rebalancing does reduce risk. Di Teresa says that investors who rebalance should pay attention to taxes, rebalancing as much as possible in tax-sheltered accounts. If there is no way to avoid Uncle Sam's grasp, then whenever feasible, postpone sales, waiting at least 18 months to rebalance instead of 12. Allowing winners to run for the extra time does not increase risks much, Di Teresa says, and the wait can cut tax bills substantially. Profits from sales of fund shares held for 12 months or less are considered short-term gains that can be taxed at rates up to 39.6%. Gains from assets held more than 12 months can only be taxed at a maximum of 20%.

To reduce the tax bite even more, pay attention to distributions, which typically occur once or twice a year when funds pay out dividends and capital gains accumulated in the portfolio. Say a fund is selling for $11 a share and distributes $1 per share on December 15. To reflect the payout, the share price is adjusted to $10, but an investor who had one share on December 14 and automatically reinvests the dividends now has 1.1 shares, so the value of his holding hasn't changed. What has grown is tax liability; on April 15, he must pay for the income and capital gains in the distribution.

How can rebalancers change that? Sell the fund before the distribution date. Only those who actually hold shares on payday owe taxes. And with the proceeds from selling the winning fund, buy a loser—after its distribution—once again dodging the tax bill.

Cutting back on winners may be frustrating. But Di Teresa says that for conservative investors the effort is worthwhile. "What you're really doing is protecting your gains," he says. "When things have had a good run, there's always a risk that the hot streak can end quickly."

CORRECTING COURSE

- **To cut taxes, sell before funds make distributions.**
- **Rebalance first within retirement accounts.**
- **Let winners run for at least 18 months.**

THE RIGHT MIX

ONE-STOP SHOPPING

There are dozens of mutual fund companies, but some investors deal only with one, either to keep everything under one roof or because their 401(k) plan offers funds from just one family. Sticking to a single family needn't result in dismal returns—provided the company offers enough solid choices to build a diversified portfolio. Major companies that fit the bill include Vanguard, Fidelity, Invesco, and Putnam.

For investors who prefer taking limited risks, T. Rowe Price can be a solid choice. For a core of large stocks, take T. Rowe Price Blue Chip Growth and T. Rowe Price Growth & Income. Add smaller stocks with T. Rowe Price Mid-Cap Growth and T. Rowe Price Small-Cap Value. For diversification, buy T. Rowe Price International Stock. Finally, pick up solid bonds with T. Rowe Price Spectrum Income.

The All-Price Portfolio

20% LARGE-CAP GROWTH/VALUE
T. Rowe Price Blue Chip Growth (TRBCX)
Five-year annual return: 23.9%
Telephone: 800-638-5660

15% LARGE-CAP VALUE
T. Rowe Price Growth & Income (PRGIX)
Five-year annual return: 15.8%
Telephone: 800-638-5660

15% MIDCAP GROWTH
T. Rowe Price Mid-Cap Growth (RPMGX)
Five-year annual return: 26.2%
Telephone: 800-638-5660

20% SMALL-CAP VALUE
T. Rowe Price Small-Cap Value (PRSVX)
Five-year annual return: 12.1%
Telephone: 800-638-5660

15% FOREIGN STOCK
T. Rowe Price International Stock (PRITX)
Five-year annual return: 13.8%
Telephone: 800-638-5660

15% MULTISECTOR BOND
T. Rowe Price Spectrum Income (RPSIX)
Five-year annual return: 8%
Telephone: 800-638-5660

Edd Patton (icon)