5 Stocks to Buy as the Market Rally Broadens

Plus our take on Tesla and Alphabet ahead of earnings.

Susan Dziubinski and David Sekera, CFA • Jul 23, 2024

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Susan Dziubinski: Hello, and welcome to *The Morning Filter.* I'm Susan Dziubinski with Morningstar. Every Monday morning, I sit down with Morningstar Research Services Chief US Market Strategist Dave Sekera to discuss what's on his radar this week, some new Morningstar research, and a few stock picks or pans for the week ahead.

Hi, Dave. So, on the economic front, we have the Fed's favorite inflation number coming out this week, that's the PCE. What's the market expecting?

Dave Sekera: Hey, good morning, Susan, and good morning to everybody watching. Yeah, I hope everyone had nearly as good of a weekend as I had this weekend. Weather was awesome, got to spend some great time with my family, so it was just such a nice time that I really didn't spend a huge amount of time going through earnings and earnings expectations. But let's get into it here today.

PCE expenditure price index, of course, that's the inflation reading that the Fed is really going to focus the most on when they set policy for their monetary policy. Now, we did have CPI coming out better than expected. We also looked at those components in PPI that feed into the PCE calculation. A lot of those were under control or maybe even showed a little bit of deflation as well. So PCE this month really shouldn't be a concern. It should be pretty well under control.

I looked through the consensus estimates here this morning. For headline PCE on a year-over-year basis, we're looking for 2.6% as compared to 2.5% last month. A slight tick up, but nothing that concerns me all that much. And then for the same thing on a month-over-month basis, we're looking for only 1/10 of a percent increase as compared to flat last month. Now, of course, the most important number is the core number for PCE, and on a month-over-month basis, that consensus is expected to be 2/10 of a percent as compared to 1/10 of a percent last month. So again, when we put all of this together, I spoke with our US economics team, they're still looking for September to be when the Fed's going to start cutting monetary policy, followed by another cut in December, and then still looking for ongoing cuts in 2025 as we expect inflation to continue to keep moderating next year.

Dziubinski: Now Dave, what if that PCE number comes in a little hotter than expected? Could that lead to some volatility to the downside, given that the market really seems to be anticipating that rate cut in September?

Sekera: Well, of course, it always just depends on how much hotter than expected. But yeah, I do think if it came in much higher than what the consensus is forecasting, that probably would hit the market now, especially considering the market sentiment we've seen over the past week or two. So I do think that if it came in hotter, that people might look just to go ahead, take profits off the table. It's been a very strong market thus far this year.

And with what we've seen over the past couple of weeks is really this ongoing rotation under the headlines. The market has been rotating out of AI stocks, which, of course, have really surged higher this year on top of how much they've gone up last year as well. Valuations there getting very high. So I think people are looking around seeing value stocks and small-cap stocks being much more undervalued. So I think people are doing some profit-taking when they can and then reinvesting in those areas that have been left behind. Just taking a look at the rate-cut probabilities, the market right now is pricing in a 97% probability of a cut in September. So anything that could jeopardize that certainly could hit the market.

Dziubinski: Now, you alluded to a little bit what's been going on in the market the past couple of weeks. So let's talk a little bit more about that, that rotation out of those large-cap stocks that had been doing so well and into other parts of the market. Why is this rally, despite the fact that the S&P had a nasty week last week, why is the market rally finally broadening, and more importantly, Dave, do you think it's going to last?

Dave Sekera: It's always impossible to know ahead of time just how long it's going to last, but historically, when you look at different market cycles, small caps tend to outperform when the Fed begins to ease monetary policy. So I think the market is looking for that as really being a catalyst. But at the same point in time, we do expect that the rate of economic growth is going to slow in the second half of this year and going in the next year. And I think that's a pretty much a consensus call across the market as well. So I think people are looking at value stocks, should at least be able to hold or at least outperform growth stocks in an environment where the economy is slowing and earnings growth rates could slow as well.

But there's really a number of contributing factors right now. First, that CPI report was much better than expected. Inflation is going to continue to keep moderating. So again, that will provide the Fed the confidence it needs to start cutting rates here in September. And then even more importantly to me is really valuations. So valuations of large-cap stocks have gotten pretty far ahead of themselves, according to a composite of our valuations. They were trading at about a 10% premium over fair value. That's an area that we just hadn't seen over time, really, getting to that much of a premium over our fair valuations. Whereas when you look at small-cap stocks, they were still trading at a 17% discount, so not necessarily the most undervalued that they've ever been, but pretty high up there.

So in my mind, I think this rotation is really a combination of two things. It's a combination of one, the potential catalyst of the Fed starting to cut rates, but really on top of that cheaper valuation for small-cap stocks as well.

And it's really a somewhat similar story for value stocks. Now, value stocks should outperform as earnings growth rates slow, as the economy slows. Value stocks have lagged both core and growth stocks for several years now, and both those categories are trading well above fair value at 10% and 12% premiums, respectively. Whereas value stocks are still pretty close to a 9% discount. So to some degree, this is another example of a catalyst, although in this case I would call it more about soft catalyst, expecting the economy to slow end valuation.

So getting back to your original question, is this the beginning of an ongoing market rotation? Always impossible to know. Hindsight is going to be 20/20, but I'd say it certainly looks like it. And even if not, I do think now's a good time—start looking to take profits and those stocks have become overvalued and overextended, and in our view, you're never going to go wrong as a long-term investor reinvesting into those stocks that have lagged and are undervalued.

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Dziubinski: All right, well let's talk a little bit about some companies reporting earnings this week. And we have a couple of those large-cap stocks that had been driving a lot of the market's performance, Alphabet and Tesla. Let's start with Tesla. The stocks really behaved like a comeback kid this year. What's been going on, and does the stock look attractive heading into earnings?

Sekera: I looked at the charts here. It's interesting, as you said: Tesla popped 30%, really, over maybe the past month or so, and I don't really know why. I looked around. I don't really see anything that I would consider new news on that stock. So after this little 30% rally off of its lows, it's now trading at almost a 20% premium, still in that 3-star category. But again, getting to be a little overextended at this point.

So there's going to be a couple things our team is going to be listening to on the earnings call this time around. Probably one of the more important things is going to be the timeline for their affordable vehicle platform that they're expecting to roll out here in 2025. So again, I think that's going to be something the market is going to focus on. We'd also like to hear any updates on their full self-driving, although our analyst team noted there's probably not going to be anything really new there. They have an event later this year where they're going to be talking about their robo taxi. And then, of course, your fundamentals, the profits and the margins. I think the question is going to be if margins are continuing to decline and, if so, any kind of management commentary regarding that.

The only thing is I would say net-net and I talked to Seth Goldstein, our equity analyst on this one, we have seen some softness in EV sales in general over the past couple of months. But for long-term investors, our outlook for electrified vehicles, so either battery electric vehicles or hybrid vehicles, is still unchanged. Net-net, I think it's one of these things where he still sees cheaper electric vehicles still coming out over the next five to seven years that'll be much more price competitive with those that are internal combustion engines. We're still seeing an increase in just the number of chargers that are being built, rolled out nationwide in order to help people be comfortable that they're not going to run out of electricity while they're on the road. So we're still looking at over the long term by 2030, about two thirds of all global new auto production to be electrified, whether that's a battery electric or a hybrid.

Dziubinski: Now what about Alphabet, Dave? The stock has pulled back a bit in the past week or two. What's Morningstar think of the stock heading into earnings?

Sekera: It's a 3-star-rated stock, and it trades pretty much right on top of our fair value here. So I think with earnings, talking to our equity analyst team there, I think everyone's really going to be focused on AI for the most part, specifically which AI tools they're going to be talking about on the conference call, how the cloud revenue is benefiting from clients running their AI workloads on their servers, and, of course, any changes that Alphabet may have on their capex spending or their investment plans. And I think that's going to be an early read-through for how Nvidia does this quarter.

Now, from a fundamental perspective, I think the most important thing is going to be the level of ad demand and search volume. What's interesting is our equity analyst team noted that the main ad agencies did come out with earnings relatively recently. Everything there indicates that ad demand remains relatively strong even in an economy where it looks like maybe we are starting to slow. I think the biggest comparison here that's going to be tough for them this quarter, so you had a number of different Asian retailers like Temu, which were very aggressive over the past year in their ads for the US market, so if they're pulling back there, that could be a bit of a pullback in the ads overall. And then on the search side, the big question is whether or not existing AI competition like OpenAI, whether or not that might be pulling any search volume away from Alphabet, but in my opinion, it's probably still too early to tell whether or not that's actually occurring.

Dziubinski: And we have two tech companies reporting this week that we've talked about on the show before, starting with NXP Semiconductor. You recommended this one a couple of months ago, and it's up a bit since then but still looks undervalued. So what's Morningstar think of the stock heading into earnings?

Sekera: It looks like we recommended NXPI on our May 6 show. The stock actually had a pretty good run after that, but then it gave back most of those gains. It's still up 4% since then. But with this AI selloff that we've seen over the past couple of weeks with the market rotation, it did give up some of those gains. Having said that, we still think that it's undervalued. Trades at a 16% discount, puts it in that 4-star territory. And of course, as we talked about before, this is one where we actually recently upgraded our moat rating to a wide economic moat from a narrow economic moat.

Now, as far as earnings go, our analyst team noted that this one will be pretty closely watched. It's the first broad-based chip semiconductor company to report. Now, they also have a very large portion of their business in the vehicles and specifically electric vehicles. So I think that might provide a good indication of how electric vehicles are doing here in the short term. Now, the other thing other than that, I think our team talked about that the company's done a pretty good job in managing their chip inventory. We're hoping to see more of the same, that they're not trying to stuff the channel in order to generate any short-term inventory, which then causes problems in the inventory channel going forward. So again, we'll see really a read through for electric vehicles and maybe just a read through for semis in general.

Dziubinski: Now, ServiceNow is another tech stock you've recommended before, and the company is reporting this week. How's this one look?

Sekera: It looks OK. It trades at a 5% discount, puts it in that 3-star category. This is one of those stocks that we've long recommended. I think we actually recommended it back in May 2023, but it's one of those few large tech growth stocks right now that's still trading a bit of a discount. So again, if you're looking for something in large cap right now, we do think it's just a very strong company. Dan Romanoff, who covers the company, has long said he thinks it just has the best combination of growth, valuation, and a strong balance sheet.

As far as this quarter goes, I don't think we're looking for anything out of the ordinary. I think it's just going to be more of the usual. We'll be looking for uptake in their artificial intelligence-enabled products, really watching their non-GAAP operating margins pretty closely. Just want to hear how health of large deals are doing in an environment where the economy might be softening and, of course, any updates that they might have for their guidance.

Dziubinski: Now moving on to some nontech companies reporting this week that we've talked about before, we'll start with UPS. The stock's turned around a bit during the past few weeks but still is in the red for the year to date. So what's the story here, and what does Morningstar think of the stock?

Sekera: It looks like we recommended this one earlier this month. Now, it was a 4-star stock when we recommended that. It's a stock that rarely trades at much of a discount, but it didn't really stay there for long. It's already moved into 3-star territory, still the 8% discount to fair value. So again, there's still a little bit of undervaluation left to go. So I think we're looking for volumes to turn positive here in the second half of the year, and I think that could be the catalyst for additional growth or additional move up in momentum for that stock. But really with UPS, I think the big thing right now everyone's going to be looking for is for progress on their domestic operating margins. We're going to be looking for whether or not their productivity and headcount reductions have really started to improve the operating margin there. And then the other thing that we're expecting is for management to reiterate their guidance for the end of 2024 to end the year at a 10% run rate for the margin there in the domestic package segment.

Dziubinski: Now, Starbucks also reports this week. Stock's having a rough year. It's down about 16%, and reports surfaced late last week that activist investor Elliott Investment Management has been building a position in the company. Remind viewers what's been going on with Starbucks and what Morningstar thinks of the stock today.

Sekera: Yeah, Starbucks has had a rough go of it the past couple quarters. And in fact, this is one of those anecdotal stories that really struck me last quarter when they reported earnings of just how much middle-income consumers are really feeling the pain of inflation and not necessarily just inflation this year, but that compound impact of inflation over the past two years. We've noted that middle-income consumers, for the most part, have probably used up all of their excess savings. Credit card debt is getting back toward normal historical levels. Savings rates are now below where they were prepandemic. So I think a lot of people are really looking to figure out where they can cut back spending, especially in discretionary products. Starbucks, which I consider to be more of an indulgent purchase, their traffic declined 7% last quarter, which is really a pretty big decline for someone like Starbucks.

So in our opinion, right now, traffic is probably the company's number-one priority, but we do think that the company needs to have a balance between how much they're going to spend on promotions to try and bring the consumers back into the store versus how much they have to spend on those discounts in order to get people to come back in and buy those higher-margin drinks.

So this quarter, I talked to Sean who covers it, he expects traffic in comp store sales will probably look slightly better than last quarter. We don't have the same headwind from weather that we saw last quarter, but he does expect those both to weaken over the course of the rest of the year. So again, I think this is a story which is still going to be under some pressure for a couple of quarters.

Now, you also mentioned activist investor Elliott in there. They are reportedly building a stake. So I want to hear if the company makes any kind of commentary on maybe some of those proposals that Elliott might be mentioning to them that they think can help the company here in the short term. Net-net, it is a 4-star-rated stock, trades at a 17% discount. But my concern here is I really think you're going to need to see an upturn in traffic for this stock to start to work, and that might be a couple quarters out at this point.

Dziubinski: And the last company reporting this week that you're keeping an eye out for is ExxonMobil. Is this one still a buy heading into earnings, Dave?

Sekera: It is. It's still a buy, 4-star-rated stock, 16% discount, 3.3% dividend yield. In my mind, I think that Exxon is really just a good core holding for most portfolios, and I still like having that energy exposure in your portfolio today. I think it just provides that natural hedge that investors should have just in case inflation, for whatever reason, does start to bounce back or if we have any additional geopolitical conflict.

Dziubinski: Now, let's pivot over to some new research from Morningstar. And we had both Taiwan Semiconductor and ASML report earnings last week, and both stocks sold off. So first, how did the earnings look for both companies?

Sekera: Fundamentally, taking a look at our notes here, the takeaway from both is that earnings and guidance were both fine, in our opinion. Just taking a look at revenue, margins, their order books all coming in at or above consensus, and all of that really should have soothed investors' fears that AI spending might be slowing. So everything from that fundamental perspective is holding up at least as well as expected, if not even better.

Dziubinski: So then why the selloff, do you think?

Sekera: It had nothing to do with earnings or guidance. And I think these are also good examples of, like with ASML, what can happen to a stock where it's not trading in a margin of safety below its intrinsic valuation. There were a number of published reports out there by a couple of different publications that the US government might be considering new, more-severe trade restrictions on the semiconductor companies, so I think the investors just looked at that as an opportunity maybe to take a little risk off the table and lock in some gains here.

Dziubinski: Now, so after those pullbacks, does Morningstar think both or either of the stocks look attractive?

Sekera: From the perspective of ASML, I'd say there's probably nothing to do. It is trading at a 9% discount, but it's a 3-star-rated stock. I think for investors that might be looking for a way to invest in artificial intelligence, maybe invest in large-cap growth stocks in the semiconductor industry as far as just the long-term secular growth for semis, should take a look at Taiwan Semi. That is a 4-star-rated stock at a 22% discount, so this pullback here might be a good entry point.

Dziubinski: Netflix also reported earnings last week. The report was solid, and Morningstar raised its fair value estimate on the stock by 14%. Give us the takeaways from earnings, Dave, and tell us, is the stock a buy today?

Sekera: According to our evaluations, no, the stock is not a buy today. It's a 2-star-rated stock, still trades at 27% premium to our fair value. So I would just say that, fundamentally, they did have a relatively strong quarter. The momentum from the benefit that they had for the past couple quarters from their crackdown on passwords, the increase in subscriptions they've got from their ad-supported business, the momentum from that has lasted longer than I think what we necessarily anticipated, but we still think the market is probably pricing in too much growth for too long.

And in fact, in our note here, the analyst noted that he thinks this quarter might actually be the peak for growth. The company's now starting to lap that year-over-year comparison on the crackdown of the password-sharing. And that's really been what's been largely responsible for the growth that we've seen over the past year. So again, I'd be very careful of this one. We do think growth should be slowing, and with the stock valued where it is today, that could be one that could be under some pressure, especially if we still see this market rotation away from some of these high-valued growth stocks.

Dziubinski: Now, a couple of stocks that you've liked as picks, Johnson & Johnson and US Bancorp, reported earnings last week. Seems like both companies put up good results, and Morningstar didn't make any changes to its fair value estimate on either stock. What do you think of the stocks after earnings? Do they still look undervalued?

Sekera: They do. As you noted, just good solid quarters, nothing necessarily to write home about, but US Bank is still a 4-star-rated stock, 16% discount, 4.4% dividend yield. Again, that's been, really since the selloff last year, our go-to stock for US regional bank exposure. And of course, Johnson & Johnson, in my view, I think that's just a core holding, a solid holding for pretty much anyone's portfolio, 4-star-rated stock at a 6% discount, 3.2% dividend yield.

Dziubinski: In nonearnings news last week, we heard some positive obesity drug test results from Roche, and that drove up Roche's stock and drove down Eli Lilly and Novo Nordisk. What did Morningstar think of the news, and what's it mean for all three stocks?

Sekera: Roche put out some efficacy data from two obesity drug programs. According to our analyst, she thinks the data looks pretty encouraging and that the drugs here that they put that data out on are going to be very competitive to Novo and to Eli Lilly. Now, I would note, Roche is just entering phase 2 data this year. So even if everything works out, that still only puts it in position to be able to roll out those drugs probably in the late 2020s. So it's not necessarily a short-term catalyst. In our model, the analyst puts a 50/50 probability that those drugs end up getting to market at the end of the day. So we've left our fair value unchanged on Roche for right now. Having said that, the stock's been on a multiyear decline. It's fallen throughout 2022 and pretty much all the way until just a couple of weeks ago when the stock looks like it's bottomed out. It's a 5-star-rated stock at a 29% discount. So for people that are looking for that large pharma exposure, I think this is definitely a one to take a look at.

Now, whereas Roche is 5 star, on the other side of the barbell is Lilly and Novo, Lilly being a 1-star-rated stock at a 59% premium, Novo, a 2-star-rated stock at a 53% premium. Both stocks, in our view, significantly overvalued. The share prices in our mind really don't properly account for what could happen over the next five to seven years. We are looking for price declines. We're looking for additional competition. In addition to Roche, Amgen had put out some news not that long ago that they also have a weight loss drug that they're moving into phase 3 trials. So there will be a lot of competition in this space over the next couple of years. And of course, even in the shorter term, there's always the risk of patients discontinuing therapy, whether or not it's due to tolerability, the high cost of these drugs, or any potential safety issues.

Dziubinski: It's time to move on to the picks portion of this week's program. Given the rotation we've been seeing in the market, you've brought viewers five stocks to buy that could benefit from the market broadening, and these are all small-cap stocks.

Before we get to the individual picks, Dave, comment a little bit about what types of investors are best suited to buy individual small-cap stocks?

Sekera: I think it's really those investors that just really have that natural inclination and desire really to do their own homework, really dig into these stocks, learn about the companies, understand the forecast, and make sure that they have a very good comfort level fundamentally with what's going on with these companies and then have that valuation overlay. I'd say to some degree, investing in individual stocks in the small-cap space is going to require a lot more homework, and I think it's going to be best suited to those investors that are willing to do that amount of homework. Now, of course, there's also a lot of reward for those investors that are willing to do that.

So for exposure in that small-cap space, for a lot of investors, I think you're probably better off to start off with investing in small-cap mutual funds or ETFs so that you can immediately get the benefit of diversification that those funds offer. And then from there, after you've done your homework on a lot of these names, start layering on top of that, investing in these individual small-cap stocks. As you see with a lot of price swings here, investing in the individual small caps can be riskier to your portfolio.

Dziubinski: Now, viewers can find a link to a list of Morningstar's top-rated small company mutual funds and ETFs beneath this video. Now, on to the individual stock picks this week. Dave, your first is FMC. Tell viewers about it.

Sekera: FMC was a top pick by our equity analyst team in the first quarter. There have been two issues that really have been plaguing the stock. First, during 2021 and 2022, the agricultural industry overordered crop-protection chemicals. Really, that was just in response to the shipping bottlenecks and supply constraints that we saw in 2021 and

2022. Of course, then they had too much excess inventory in 2023, so they started using that up, and we saw a decrease in their revenues as people burned through that inventory. I'd say, generally, the investment thesis here is we think 2024 is shaping up to be a much more normalized year. We're looking for a recovery in those crop-protection products. Again, looking for that really to have bottomed out and start moving up.

Now, specific to FMC: FMC is losing patent protection in 2026 on one of their products. It's really the manufacturing process for diamides, which is one of their more important products. But we think the market is underestimating their R&D pipeline. We see a number of different productfs that we think will help offset that loss of that patent protection.

Now, we do have earnings coming up in a couple of weeks here. I think the key takeaway is whether or not we see the end of that inventory de-stocking, which we do think we're going to see that end. That should then lead to improved results throughout the second half of this year. When I look at that stock, it does trade at a very deep discount to our intrinsic valuation, only trades about half of our fair value. It puts it well into that 5-star category. While you wait, you get paid a 4% yield. And we do think the company has long-term durable competitive advantages. We rate the company with a narrow economic moat.

Dziubinski: Now, your second pick this week is Chart Industries. Now, this one may surprise viewers as a stock pick since it's currently trading at 3-star levels, which suggests that Morningstar thinks it's fairly valued. So explain yourself on this one, Dave.

Sekera: Sure. Now, we initially highlighted this stock on our March 11 show. And back then, what initially caught my eye was the stock analyst note written by Stephen Ellis, who covers this company for us. And he thought that consensus estimates were just far too low for 2024. Now, the company itself, I like the way that it's positioned. It provides a cryogenic equipment for storage and distribution for industrial gases and liquefied natural gas. Of course, the LNG market, we see long-term structural tailwinds there. When they reported first-quarter results, sales were up to 17%. Their operating margin on an adjusted basis expanded by 620 basis points to 18%, led to a 73%

increase in EBITDA, management reaffirmed guidance, which was well above the consensus expectations.

I think this is just a situation where we have a good combination of strong underlying fundamental growth, a tailwind as the Street has to catch up to management guidance here. As you noted, it's a 3-star-rated stock, but in my mind, it's still got really good upward momentum, just taking a look at the charts. It's deep in that 3-star territory, trades at a 18% discount to fair value. It's a company we rate with a narrow economic moat. It does have a Very High Uncertainty Rating, but even though it's a 3-star stock, at that large margin of safety and with the momentum, I'm still pretty comfortable with this one here.

Dziubinski: Your next undervalued pick this week is Bath & Body Works. Now, this stock fell off a cliff after it reported earnings earlier this summer. What triggered that selloff, and why do you like the stock?

Sekera: Well, it may have fallen off a cliff after that, but I'd say when you look at the longer-term chart here, we actually first recommended it in November 2023, and the stock even after that selloff is still up 24% since then. I think the market is getting very concerned. We do have middle-income consumers under pressure cutting back on the expenses in discretionary categories, especially those that we consider to be indulgent. But when you look at Bath & Body Works and you look at the portfolio of products, it specializes in what we consider to be more-affordable luxury. They're also what our analyst considers to be very gift-worthy, has very accessible price points for the different products that they have.

So in this environment where we're expecting a consumer discretionary to pull back, our analytical team is expecting their price points to help them keep customers coming into the store, maintaining that traffic, and still holding up their sales growth. So it's a 5-star-rated stock. After that pullback, it's back close to trading at almost half of our fair value estimate. Company we rate with a narrow economic moat, so again, for long-term investors, we think they do have durable long-term competitive advantages. And from our valuation standpoint, it's just one of the most undervalued stocks under our US coverage. And I think with the market sentiment being negative against the stock, now is a good time to take a look at it.

Dziubinski: Now, Sealed Air is your next pick, and this is a stock you've recommended before. Remind viewers why you like it.

Sekera: We recommended it back in January coming into the year. The stock is down, I think, maybe 3% or 4% since then. For people that don't know or hadn't heard of the company: What the company does is they sell flexible packaging, flexible resin packaging. Of course, that's used in shipping materials and integrated packaging systems for industrial users. We rate the company with a narrow economic moat based on their switching costs. Now, what happens is that their equipment is usually embedded within a customer's production process. So there's a big switch in cost, even if you wanted to try and move away from Sealed Air to a competitor. So we're very comfortable with this company's economic moat. Stock is currently rated 4 stars, trades at a 35% discount, I'd say pretty mediocre dividend yield at 2.3%.

Now, the stock is down 30% since the end of 2022. And to some degree, I think this is an example of how the pandemic led to really large shifts in the business cycle. So initially, the stock ramped higher in 2021. Consumers, of course, were ordering online. The company was selling a huge amount of their product into that channel. And then, of course, people were then overordering. We had the shipping bottlenecks in 2021 that people were trying to get ahead of. So then they had too much excess inventory that was getting burned through in 2023. We're looking for that to start normalizing here in 2024. So in the short term, we're only looking for what I consider to be relatively modest growth of 2.4% compound annual growth rate this year and for next. But I think the big differentiation here between our forecast and the market view is that we're looking for operating margins to average about 16%, and that's higher than the long-term average of 13.9 as they have a number of different programs, efficiency programs, that we think will help boost that operating margin over the next couple of years.

Dziubinski: And then your final pick this week is a name I don't think we've talked about on the show before, and it's also a bit of a rarity in that it's a small-cap company with a wide economic moat. It's Bio-Rad. So tell us about it.

Sekera: And it's really that wide economic moat that caught my eye here as I just using some of the Morningstar products to screen for undervalued small-cap stocks. So it's a 4-star-rated stock, trades at a 31% discount. So what Bio-Rad does is it develops products for the life sciences research and for clinical diagnostics. Now, their business model is that razor-blade business model. So they sell the equipment at a pretty low margin, but then they sell the reagents and the products that are used in that equipment at much higher margins. So once they're embedded within the company's process, people aren't going to switch out of using the equipment that they've already bought. And as you noted, this is one of those few small-cap stocks we rate with a wide economic moat based on the switching costs from that installed equipment.

When I take a look at our financial model here, we're really not modeling anything crazy. We're only looking for 3% top line growth on average over the next couple of years. We're only looking for 4% increase in earnings per share. So again, we're not looking for anything like any kind of hockey stick projections, but when we put that into our model at that 31% discount and a 4-star-rated stock, I think this is a really interesting one in a sector in the healthcare industry probably holds up even if we do have a bit of an economic downturn.

Dziubinski: Well, thanks for your time this morning, Dave. Viewers interested in researching any of the stocks that Dave talked about today can visit Morningstar.com for more analysis. We hope you'll join us for *The Morning Filter* again next Monday at 9 a.m. Eastern, 8 a.m. Central. In the meantime, please like this video and subscribe to Morningstar's channel. Have a great week.

Correction: A previous video and transcript were originally posted.

The author or authors do not own shares in any securities mentioned in this article. Find out about Morningstar's editorial policies.

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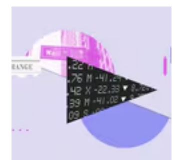

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