If You're in Your 40s, Consider Buying These 3 Stocks

A.O. Smith, Apple, and Visa have traits that investors entering the second half of their careers should be seeking.

Tyler Crowe (TMFDirtyBird)
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Investors in their 40s are likely starting to realize that retirement isn't quite as far off as it used to be, and all of a sudden, it feels like what happens in one's stock portfolio matters more. For anyone out there in that situation, here is a little encouragement: You likely have somewhere between 15 to 25 years before you retire. That's a decent amount of time to accumulate wealth in a well-constructed portfolio.

Still, its normal for the fear of losses to start creeping more and more into your thought process at this point. That makes this the right time to look for companies with two attributes: A visible growth trajectory and a stable foundation from which to build. Three businesses that fit that mold are **A.O. Smith** (NYSE:AOS), **Apple** (NASDAQ:AAPL), and **Visa** (NYSE:V).

IMAGE SOURCE: GETTY IMAGES.

Dominant market share in an industry where few want to compete

I'm guessing the last time you thought about your water heater was when you had to buy a new one. But if you take a step back and think about the water heater business, you'll realize why it's so solid. While they certainly aren't appliances that anyone purchases frequently, they are must-haves in just about every household. When they fail, they'll be replaced no matter where we are in an economic cycle. In fact, more than 85% of water heaters sold in North America are replacements. Tack on the other 15% going into new construction, and you have an incredibly stable and modestly growing revenue base.

It just so happens that A.O. Smith is North America's largest water heater manufacturer, with a more than 40% market share in residential and commercial heaters and boilers. Management has turned this seemingly sleepy business into one that generates high margins, throws off lots of free cash flow for dividends and buybacks, and provides returns on equity in excess of 20%. Those facts alone give it an attractive investment thesis, but A.O. Smith is looking to capture an even more massive global trend: The emergence of the middle class in China and India.

One of the fixtures of a middle-class lifestyle is a water heater, especially a higher-quality one that will last for years. In less than a decade, A.O. Smith has done an incredible job of growing its sales and brand recognition in China. It has increased sales there by more than 22% annually, and owns the largest share of the market. Now, it's taking the lessons it learned in China and looking to compete in India. With the foundation of the North American market providing it the financial stability to aggressively pursue growth in overseas and developing markets, A.O. Smith looks poised to be a great wealth generator over the next decade or more.

Underappreciated value

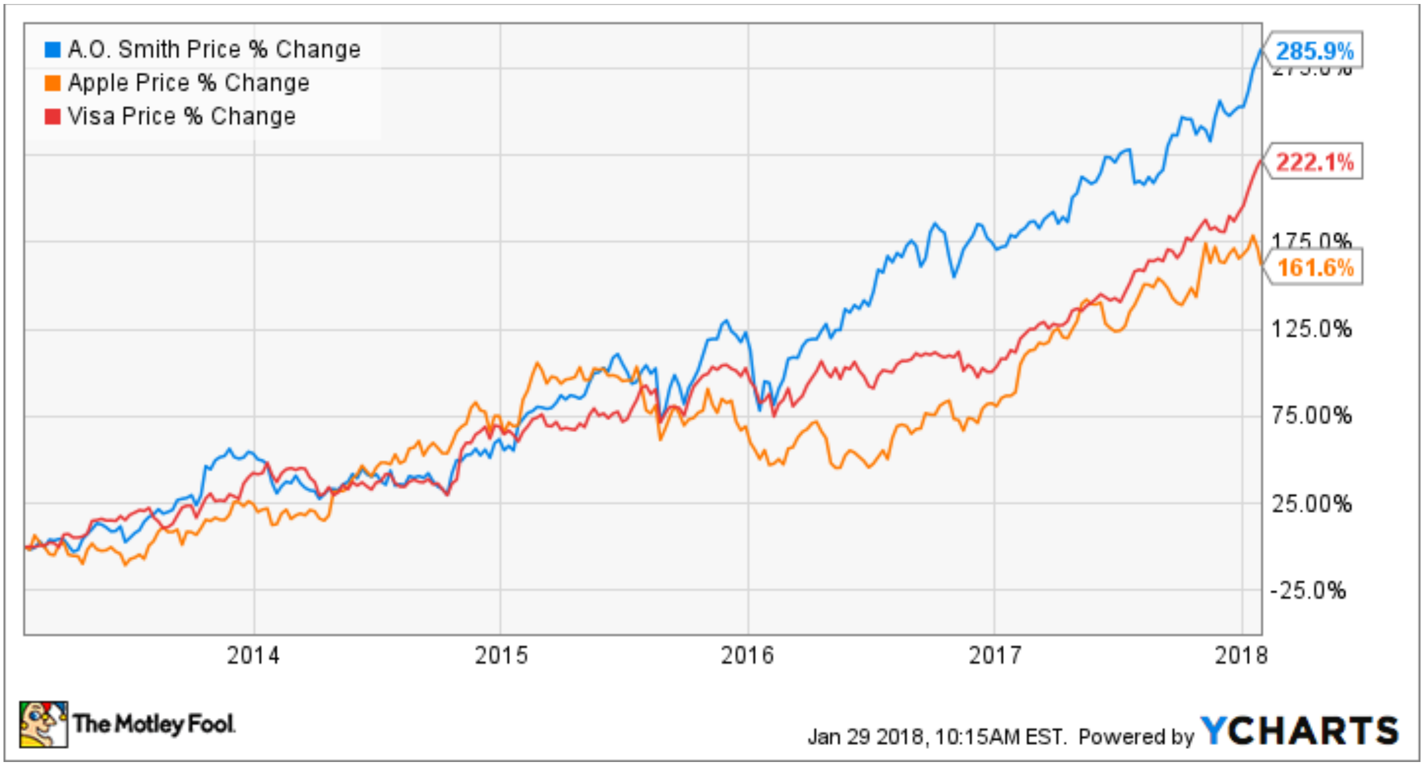
When it comes to Apple, two topics constantly get discussed: The next product or idea it's working on and the size of its cash pile. Those are all well and good, but one thing that consistently surprises me is how the company can generate value for shareholders and still trade for what seems like an incredibly large discount.

For a moment, let's forget that this company's name is Apple, and that it just happens to have one of the most valuable brands in the world, or that it commands incredible pricing power in a rapidly commoditized industry. Instead, answer this question. What kind of valuation would you pay for a business with these characteristics over the past five years?

- Net income margin of 21% or better
- Diluted EPS growth of 53%
- Net cash position (cash minus debt) is 17% of its market capitalization
- Repurchased 21% of shares outstanding
- Increased its dividend payments by 66%
- Generated an average return on equity of 35.7%

A stock like that would surely command a market premium, right? Not in the case of Apple, which currently trades for a price to earnings ratio of 18.5 times, well below the 26.8 ratio of the S&P 500.

A lot of investment theses on Apple will get much more in-depth than this, but the company's ability to generate returns seems to be an underappreciated trait. Unless you foresee Apple's brand name losing its luster soon, it seems reasonable to think that its stock will continue to be an incredible wealth builder for investors.



AOS DATA BY YCHARTS

A near monopoly in an incredibly wide-moat business

> **Network effect** (noun): A phenomenon whereby a product or service gains additional value as more people use it. -- *Oxford Dictionary.*

What makes a credit card valuable? In a market like North America, the things that come to mind are interest rates, low fees, and maybe points programs. But what we might overlook, because it's so obvious now that it goes without saying, is that you can use your cards almost anywhere because nearly all merchants accept them. Conversely, the reason that merchants take credit cards is that there are enough customers who want to pay with them to make it worthwhile. The virtuous cycle that enlisted more merchants and more customers to use plastic has built a powerful network effect that gives then an almost insurmountable competitive advantage.

As it stands today, more than 44 million merchants accept Visa, and more than 3 billion Visa cards are in use, which translates to about 53% of global credit card transactions according to *The Nilson Report*. That's more than twice the market share of its next-largest competitor, **Mastercard**. With that much market penetration compared to its peers, Visa is the front-runner to capture more of the global payment market thanks to the virtues of the network effect. Visa gets a cut of every transaction plus a swipe fee; it's incredibly hard to find a business with that kind of competitive advantage and captive customer base.

While Visa may have not produced the margins or returns of an Apple, it's no slouch either. Its five-year average return on equity is 19.8%, and the company has generously returned cash to shareholders with buybacks and dividend hikes over that time frame. Any investor with a time horizon of a decade or longer should seriously consider Visa, because its market opportunity and the advantages it already holds are unparalleled.

10 stocks we like better than Visa
When investing geniuses David and Tom Gardner have a stock tip, it can pay to listen. After all, the newsletter they have run for over a decade, *Motley Fool Stock Advisor*, has tripled the market.*

David and Tom just revealed what they believe are the ten best stocks for investors to buy right now… and Visa wasn't one of them! That's right -- they think these 10 stocks are even better buys.

See the 10 stocks

**Stock Advisor returns as of January 2, 2018*

Tyler Crowe owns shares of A. O. Smith, Apple, and Visa. The Motley Fool owns shares of and recommends Apple, Mastercard, and Visa. The Motley Fool has the following options: long January 2020 $150 calls on Apple and short January 2020 $155 calls on Apple. The Motley Fool has a disclosure policy.

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Industrials

STOCKS

Apple
NASDAQ:AAPL
$166.64 $-1.32 (-0.79%)

Mastercard
NYSE:MA
$166.72 $-1.83 (-1.09%)

Visa
NYSE:V
$123.19 $-1.65 (-1.32%)

A. O. Smith
NYSE:AOS
$65.74 $0.90 (-1.35%)

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