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This Is Exactly the Time to Buy These Stocks

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For many investors, picking the precise time to buy a stock is one of the most anguishing aspects of investing. Too often, we're plagued with fear that we're too early -- or too late.

Certainly, this is a volatile time for stocks, but investors focused on building long-term wealth know that this recessionary period offers one of the best chances to buy stocks on the cheap. Seasoned value investor Bill Lippman has admitted to seeing great opportunities in the market today, and even President Obama has encouraged people to buy stocks for long-term investment.

OK, I'll buy. But which ones?
If you're like many other investors looking to buy a cheap stock today, you're probably tempted by large caps like **Altria** (NYSE: MO), **Caterpillar** (NYSE: CAT), or **Disney** (NYSE: DIS), which are trading below highs seen in recent years. But if history is any lesson, you're selling yourself short -- precisely because this is the same conservative approach that many other investors are taking.

Looking back, many of the market's best performers since the last recession -- like **Quality Systems** (Nasdaq: QSII), **Deckers Outdoor** (Nasdaq: DECK), and **Green Mountain Coffee Roasters** -- were all very small companies before their big runs began. You may know that small caps outperform others over the long term, but small-cap companies have also handily beaten large caps in the year following the past 10 recessions.

For instance, *MONEY Magazine* points out that after the 1973-74 downturn, small caps beat large stocks for 10 years between 1974 and 1983. And after the Great Depression, small stocks led the market for 11 of the next 13 years.

Yeah, but this time could be different
So how is the "small caps outperform everything" theory holding up in this recession? If we look from what many are now acknowledging as the start of the recession (early December 2007) to the market bottom in March, we see that stocks -- small and large alike -- took a severe pounding.

Index	Return From Dec. 3, 2007 to March 9, 2009
Russell 2000 U.S. Small Cap Index	(46.2%)
Russell 1000 U.S. Large Cap Index	(44.9%)
Russell 3000 Broad-Market Index	(45.0%)

Source: Russell Index Calculator.

Despite all of the predictions flying around, no one knows whether March will turn out to have been the bottom. But since the March low, small caps have once again bolted out of the gate.

Index	Return From March 9, 2009 to Jan. 8, 2010
Russell 2000 U.S. Small Cap Index	86.0%
Russell 1000 U.S. Large Cap Index	72.6%
Russell 3000 Broad-Market Index	73.5%

Source: Russell Index Calculator.

This is only a small window to compare performance, of course, but the data do lend evidence that, once again, small-cap stocks tend to be more significantly underpriced. For this reason, an investor is more likely to uncover a good value on a small-cap stock with strong fundamentals before the mainstream market catches on.

And don't get too caught up in timing the end of the recession. According to State Street Global Advisors, in the three years following the midpoint of each of the last three recessions, small-cap stocks delivered a solid advantage, particularly relative to large caps, returning an annual average of 8% more than large-cap stocks.

Many places to start

Here are some small caps I've been looking at for their strong growth and return on equity, as well as low to nonexistent debt-to-equity ratio:

Company	Return on Equity (TTM)	3-Year EPS Growth
Wonder Auto Technology (Nasdaq: WATG)	17.6%	30.6%
ClickSoftware Technologies	35.4%	98.1%
Ebix (Nasdaq: EBIX)	28.7%	63.5%

Source: Motley Fool CAPS, as of Jan. 8.
TTM = trailing 12 months. EPS = earnings per share.

Wonder Auto Technology is supplying auto parts to China's fast-growing auto industry and Ebix has been blazing a trail in recent years in the insurance industry with its data management software.

You may find these stocks an interesting place to start your own research, or you may eschew them based upon your personal investment plan. For more ideas, you may want to tap the talent of some Foolish small-cap experts: the analysts at the *Motley Fool Hidden Gems* newsletter service.

The risk and volatility inherent in today's market make it even more important for investors to seek solid businesses, rather than simply chase cheap stocks. *Hidden Gems* will help there, too, giving you plenty of in-depth research on companies and lots of great stock ideas. These are available with a no-cost, risk-free, 30-day trial, just by clicking here.

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Fool contributor Dave Mock would have avoided an embarrassing incident if he had known that the lap pool was not for wading. He owns no shares of companies mentioned here. Walt Disney is an Inside Value *recommendation. Ebix and Green Mountain Coffee Roasters are* Rule Breakers *selections. Walt Disney and Quality Systems are* Stock Advisor *picks. The Fool owns shares of Ebix. The Fool's disclosure policy is always thinking small to go big.*

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