Standpoint Research / Weekly Picks # 4 / March 29, 2009

For the week of March 30, I am carrying over all four recommendations from WP # 3 (March 15): HON, SNDK, ZMH and CQB. As you will see in the table on the fourth page, ZMH is the one (of the four) that under-performed since March 15, but it did out-perform last week. I am hoping defensive sectors do well this week and ZMH can build on last week's momentum.

We are adding four new names, and those are UNG, CPO, WCC & ADS (see write-ups on Pages 2 & 3). Our bias this week is defensive with only three high beta stocks … SNDK (1.83), WCC (1.66), and ADS (1.31). All eight of our recommendations this week, including the four carry-overs from WP # 3, are still 45%-80% off their highs. In my opinion SNDK and CQB are still under-valued, but both are up 40% month-to-date. Nothing moves up or down in a straight line and they could be due for minor corrections.

The past week ended with highly regarded analyst Dan Niles from Neuberger Berman being interviewed on CNBC. He thinks the current rally continues in the near-term, but that we reverse and hit new lows later in 2009 or 2010. That is quite a bold statement. As bearish as I have been for most of the last two years, I don't think I would bet on a rise above 8,000 on the Dow, **followed by a drop of more than 20% from there** as he is forecasting. I wouldn't bet against it either. Niles feels home prices drop will drop another 10%-20% from here and that will hurt the banks. He went on to point out that the consumer is saving and the rising deficit will hurt the US$ and lead to tax hikes. His area of expertise is the tech sector and his bias there is towards semiconductors (if he was forced to choose an industry within the sector). Within 24 hours of Niles' statement a friend forwarded me the following news item; we may see similar stories develop in other States; **this may be the first domino to drop**:

ALBANY -- Personal income taxes for the upper middle class and the rich are about to skyrocket under a secret, soak-the-wealthy tax deal reached last night by Gov. Paterson and leaders of the Legislature, sources told The Post. The two-tier tax plan would bring in $4 billion annually, in part by hiking income taxes a stunning 31 percent for all New Yorkers making more than $500,000 a year, sources said. A second, slightly lower tier would increase incomes taxes by 14.5 percent for singles earning $250,000-$500,000 annually and for married and joint filers earning $300,000-$500,000. Taxpayers now hit the current top rate of 6.85 percent when their incomes reach $65,000. The Paterson plan would tax top-tier earners at 8.97 percent and second-tier earners at 7.85 percent. The staggering hike was one of the last elements of a $121 billion spending deal Paterson and legislative leaders forged behind closed doors in a race to make the Aprilñ1 budget deadline. Its inclusion in the budget represents a dramatic retreat for Paterson, who repeatedly argued such a proposal would drive some of the most productive citizens out of the state and stunt any economic recovery. A Paterson spokesman did not return a call.

There is no shortage of portfolio managers who have at one time or another seen gains versus their benchmarks reversed into losses by year-end because they failed to lock in gains as many of you (who went from low-beta to high-beta a few weeks ago) are currently showing. If you are up 250-500 basis points year-to-date, and the 'bears' get their way (re-test), that 250-500 basis point out-performance can turn into a 2009 under-performance. I think it makes sense to lock some of that in. Going into the week on March 30th my *Weekly Picks* will have a defensive bias. I don't see any reason for the market to rally in advance of Q1 reports and Q2 guidance. It is very difficult to forecast which way we go from here. In fact, it probably is a waste of time trying to do so. The market is already down sharply and can go either way right now. It is difficult to say what the market has priced in and what it hasn't. One day the market values stocks on 2008-2009 earnings, the next day they attach multiples to 2010-2011. One day the 'bears' drive the market down, the next day it is short-sellers covering their positions and long-term investors seeing opportunity driving it back up. Last week we probably saw portfolio managers who missed the first half of the 25% bounce since March 6th trying to play catch-up, spending cash and raising the beta on their portfolios afraid to under-perform their benchmarks in a rising market.

I did not quite understand why the market rose as it did in the last three weeks. There was an oversold short-term bounce due from the March 6 intra-day low of 666, but hitting 833 was a surprise to me. **That is a 25% move**; the sharpest of the four bounces by far during the last year. The Dow Jones went from 11740 on 03-10-08 to 13058 on 05-02-08 … **an 11% rise**. The Dow Jones went from 8176 on 10-27-08 to 9625 on 11-04-08 … **an 18% rise**. The Dow Jones went from 7552 on 11-20-09 to 8924 on 12-16-08 … **a 17% rise**. The first three bounces ended with us re-testing and setting new lows. I would not bet on (**or against**) a repeat scenario at this stage in the game. **We actually dropped three high-beta positions at the close on Friday** and those were FCX (materials), SPIL (technology) and CPKI (discretionary). The market has bounced 1400 points off its low and I think it is a good time to cash out on stocks that under-performed in 2008 and bounced sharply in 2009. We are ahead of the S&P by a few hundred basis points year-to-date and I want to lock some of that in by selling some high-beta. **All three of these are now at relative strength > 90, have bounced 174%, 180% and 104% off their lows respectively** and now trade at 16X, 19X and 15X 2009 EPS estimates (respectively). There is a chance we re-test 7,000 (and 6,500) on the Dow Jones and high-beta stocks could get pounded once again if we do so. If you are holding high-beta stocks that doubled off their lows in recent weeks, you may want to take some profit. Selling high-beta stocks here is only advised if you are out-performing y-t-d with a high-beta portfolio. I am doing a bit of (usually unadvised) market timing here, hoping we can repurchase these (or similar stocks) at lower levels later in Q2.

Bullet points for Weekly Picks # 4 (UNG, CPO, WCC, ADS); *Carry-overs (HON, SNDK, ZMH & CQB)*

U.S. Natural Gas ETF **UNG** – $15.16 -- Energy – *Natural Gas* – Market cap: N/A – Beta: 0.26

- Natural gas prices dropped sharply in Thursday's energy trading. Inventories **rose** 3 billion cubic feet in the week ended March 20, the Energy Information Administration reported. Analysts had expected a **decline** of more than 5 billion cubic feet. After the data, natural gas for April delivery fell $0.38, or 8.8%, to $3.94 per million British thermal units.
- Natural Gas prices fell further on Friday and the commodity is now trading well below $4.00 … a seven-year low. A glance at the historical price chart shows this to be a good entry point (as does the current unsustainable 14:1 price ratio between crude oil and natural gas).
- Natural gas prices dropped to $4.00 in October 2003. NG prices were at $6.00 by the end of the year and at $15 within two years (September 2005). There was a drop to $4.00 again in September 2006. **We were at $8.00 by the end of November 2006** and at $13 within two years (June 2008). For whoever is not comfortable going long natural gas, you could pair this off with a short on crude oil as that commodity may have run its course in the near-term..
- We are recommending the Natural Gas ETF **UNG** for the week of March 30, 2009. I was looking at Chesapeake CHK but am concerned with the fact that it has already bounced 100% off its low. In my opinion, there is less downside risk (and more upside) in the near-term with UNG, now at an all-time low 75% below its high from June 2008. Trailing twelve months natural gas prices are down 56%, CHK is down 59% and UNG is down 65%. On the two-year charts the returns were -46%, -42% and -68% respectively, so UNG has some catching up to do on this deviation.
- This ETF is liquid, trading more than 4,000,000 shares per day. The shares were probably oversold on bad news, down 23.8% since February 9 and 14.6% in just the last three trading days. At the very least a near-term bounce is due. We are trying to pick a bottom here. Some of you may wish to wait for a reversal back above $4.00 in the commodity before entering here.

Corn Products Int'l **CPO** – $23.04 – Cons. Staples – *Agricultural Products* – Mkt cap: $1.72 bln – Beta: 0.88

- We added CPO to our list of open recommendations at the close on Wednesday. *We will have a four-page write-up prepared on the stock in April*. The shares rose 8% on Thursday and held their ground in the down market on Friday (up 1.1% in a down market). The relative strength last week (up 16%), has me adding it to our short-term ideas as well.
- CPO earned $1.19 in 2005, $1.63 in 2006, $2.59 in 2007 and $3.58 in 2008. EPS should drop to $2.25-$2.50 in 2009 before recovering to $2.75-$3.00 in 2010. The company beat estimates handily in each of the last four quarters so I am relatively comfortable with these projections. I am attaching a 14X multiple to that 2010 estimate in order to arrive at a $40 target for those who want to *buy and hold*. -- that $40 target is 20% below its all-time high from 2007-2008.
- CPO has historically traded at 0.8X-1.4X the S&P multiple; it is now at 0.6X. The shares have historically traded at 14X-24X EPS … CPO is now trading at just 9X. The multiple on book value, sales and cash flow are also all near historic lows at 1.2X, 0.4X and 4.4X respectively.
- Trailing six months only 5,000 shares (out of 500,000) were sold by insiders. Short interest (3.8% of the float) is less than $65,000,000. Revenues are expected to rise 6% in 2010 from 2009 levels (of $3.6 bln). ROE is 18%, while the five-year average for CPO is 12%. Earnings Purity is 98% and EV/EBITDA is 4.5X. Five-year historical growth rates on revenues and EPS are 14% and 29% respectively.
- For those who are not aware, Bunge **BG** was supposed to take-over Corn Products Int'l last year, but CPO broke off the deal (and paid a $10 mln break-up fee) after the BG share price collapsed. The CPO balance sheet is sound, they have diversified revenue streams and should be able to navigate through the current environment that includes volatile currency markets and flat sales at many of their customers such **PEP** and **KO**.

Corn Products Int'l manufactures and sells various food ingredients to food and industrial customers in North America, South America, Asia, and Africa. It offers food ingredients and industrial products derived from wet milling, and the processing of corn and other starch-based materials. The company provides sweetener products, including fructose and glucose corn syrups and starch products (to name a few). It also offers refined corn oil to packers of cooking oil and to producers of margarine, salad dressings, shortening, mayonnaise and other foods. In addition, the company provides corn gluten feed used as protein feed for chickens, pet food, and aquaculture; and steep-water, which is used as an additive for animal feed. The company was founded in 1906 and is headquartered in Illinois.

Wesco **WCC** – $19.67 – Industrials – *Electrical Supplies* – Market cap: $831 mln – Beta: 1.66

WESCO Int'l distributes electrical construction products and industrial maintenance, repair, and operating supplies primarily in North America. The company offers electrical supplies, such as wiring devices, fuses, terminals, connectors and boxes (to name a few), and power distribution supplies, such as circuit breakers, transformers, switchboards and panel boards (to name a few). It also provides lighting products, lighting control products and data communications products. It primarily serves industrial customers; electrical contractors; utilities; and commercial, institutional, and governmental customers.

- There has been insider buying in recent months by several directors (29,000 shares total at $15-$20 per share). There is $30,000,000 short interest (4.3% of the float; down versus the prior period). WCC gained 22% last week and has been an open recommendation of ours since March 10, 2008. This stock is more volatile than the market and most stocks in the Industrials sector, as it is quite levered to the economy (commercial and residential construction in particular).
- Five-year average ROE is 30.2% … Earnings Purity is 98% … debt-to-capital ratio is 53% … EV/EBITDA is 5.0X … WCC now trades at less than 0.2X sales and < 4X cash flow. 2010 revenues and EPS should remain flat at $5.3 bln and $3.00 respectively. Consensus EPS for 2009 is now at $3.11 down from $3.76 (90 days ago) and for 2010 the estimates dropped from $4.04 to $3.12. In each of the four most recent quarters, WCC delivered at least $1.00 EPS and only missed one time (in the most recent quarter by $0.05).
- WCC has cut expenses and restructured in its effort to get through the current recession. WCC has delivered ROE of at least 14% in each of its ten years in business. Profit margins have dropped a bit recently, but are still above 3% (versus 2% and below in 1999-2004). For 'buy and hold' investors, WCC delivered $4.99 EPS in 2008. I look for the company to return to the ~ $4.00 level within three years (from ~ $3.00 in 2009), and would attach an 11X-12X multiple to those earnings of $4.00; that would get us a 125% move from here and a return to the 52-week high in the mid-$40s. WCC has historically traded in the low- to mid-teens and is now at just 7X.
- WCC operates approximately 400 branches (and seven distribution centers) located in the United States, Canada, Mexico, the UK, Nigeria, the UAE, Singapore, Australia and China. WESCO Int'l has more than 7,000 employees, and was founded in 1998 with headquarters in Pittsburgh, PA. **This is the riskiest of the four recommendations we are making this week**. The shares have already bounced 80% off the low and could re-test that low if the market does the same. This company is tied to residential and commercial construction, but a rising tide lifts all boats, and WCC shares can build on recent gains if the market goes still higher from here.

Alliance Data Systems **ADS** – $36.34 – Technology – *Data Processing* – Market cap: $2.16 bln – Beta: 1.31

- On May 14, 2007, Blackstone agreed to merge with ADS in a deal that would pay ADS shareholders $81 per share. ADS shares were trading for $64 per share (at the time). When the planned deal with BX was cancelled in Q1 2008, ADS shares collapsed to $43. This caught my attention as the shares were then trading > 30% below where the share price was when the deal was announced. We added the stock to our portfolio shortly thereafter, in May 2008.
- **ADS recently announced its 32nd consecutive quarter of meeting or beating expectations**! Five-year EPS and revenue growth rates are at 29% and 16% respectively. Current ROE is relatively high in the industry at 31.9%, but the five-year average is in the bottom half in the group (of 21) at 14.6% versus (for example) 19.6% at FIS, 22.4% at TSS and 16.8% at GPN. ADS is one of the most levered (debt) in the industry and that is a concern (but not on a short-term pick as this is).
- There are very few red marks on the ADS profile according to our 155-variable computer model. ADS has historically relied on exclusion of *one-time charges* in their earnings reports. In fact, ADS has excluded expenses from their EPS calculation in 11 of the last 12 quarters and this led to an over-statement (by > 30%) of earnings and in effect, an artificially deflated P/E ratio. We leave it to the reader to decide whether to look forward or backwards with regards to this metric. This was more of a concern when ADS traded at 20X-30X EPS in 2002-2007, not so much here at just 7X.
- **Note**: there is **significant** short interest on this stock. It was > 30% of the float before the recent rally (50% off the March 6th low). There is obviously a short squeeze in progress. The shares actually continued their rise on Friday in a down market. Trialing six months, only 1.5% (52,000) of the 3,300,000 shares held by insiders were sold. ADS is expected to earn ~ $5.00 per share in 2009 and ~ $6.00 per share in 2010! Estimates are actually higher than they were 90 days ago.

Alliance Data Systems (ADS) is a leading provider of data-driven and transaction-based marketing and customer loyalty solutions. ADS offers a portfolio of integrated outsourced marketing solutions, including customer loyalty programs, database marketing services, marketing strategy consulting, analytics and creative services, permission-based e-mail marketing and private label retail credit card programs. ADS facilitates and manages interactions between its clients and customers through multiple distribution channels. ADS has a client base of more than 800 companies and employee strength of ~ 10,000.

*Here, in the table below is how we did in WP # 1, WP # 2 and WP # 3 with this new service (there was no WP report on March 22). I will be putting out four new short-term trading ideas / recommendations every Sunday, three (or four) times per month. They will be held anywhere from one-to-four weeks. In each report I will give four new ideas **and** advise which ones are being carried over from the prior weeks. Weekly Picks will usually be part of our "buy and hold" portfolio as well, so I advise looking at this report even if you are not a short-term trader. In fact, the first twelve WPs that I put out were all from our list of open 'long' recommendations ... **Update**: FCX was dropped on March 27th from our 'buy and hold' portfolio. It was dropped on March 15th from the Weekly Picks (after one week). WPs are determined based on short-term technicals, beta, which sectors and industries I feel will do well in the coming week and which direction I feel the market is headed. I hope to beat the S&P with at least 5/8 ths (62.5%) of these picks, where the average downside per pick on the ones that under-perform (37.5%) is significantly less than the upside on the 62.5% that were right. So far, we are batting 75% with three posting double-digit gains versus the S&P and none posting double-digit losses.*

Stock	Ticker	1-Mar	8-Mar	15-Mar	22-Mar	29-Mar	Change	S&P start	S&P end	Change	Vs. S&P
Biotech ETF	IBB	63.07				67.08	6.4%	735.09	815.94	9.9%	-3.6%
Bancolombia	CIB	16.60				19.41	16.9%	735.09	815.94	9.9%	7.0%
Terex	TEX	8.92				10.95	22.8%	735.09	815.94	9.9%	**12.8%**
Petrobras	PBR	27.73				32.40	16.8%	735.09	815.94	9.9%	6.9%
Cerner	CERN		36.72	42.56			15.9%	683.38	756.55	9.7%	6.2%
Joy Global	JOYG		17.58	20.46			16.4%	683.38	756.55	9.7%	6.7%
Nvidia	NVDA		8.39	9.80			16.8%	683.38	756.55	9.7%	7.1%
Freeport Copper	FCX		33.88	37.04			9.3%	683.38	756.55	9.7%	-0.3%
Sandisk	SNDK			11.05		13.08	18.4%	756.55	815.94	7.3%	**11.1%**
Zimmer	ZMH			36.48		37.84	3.7%	756.55	815.94	7.3%	-3.6%
Chiquita	CQB			5.39		7.18	33.2%	756.55	815.94	7.3%	**25.9%**
Honeywell	HON			26.93		29.25	8.6%	756.55	815.94	7.3%	1.3%

End of Report

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