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Investment Strategy

Rude Crude

> "Crude is still the near-term key. Although it looks like it peaked, the Mideast is still a wild card that is not going away. Our company surveys have lost momentum, suggesting the US economy is cooling a touch. [A] Significant fiscal drag could lie ahead for the US given last week's Ryan and Obama deficit reduction proposals and the emergence of the Gang of Six in the Senate. Peripheral problems intensified last week with a downgrade for Ireland – Eurozone cooling is likely. Japan supply chain disruptions are hitting auto production. China's nominal GDP in 1Q at +18.1% YoY is still too hot, which means more tightening is coming, and then China cooling is likely. If oil is indeed the key, then cooling in global growth would be positive, if it doesn't rekindle double-dip fears. We're not trying to send out a bearish signal about the economy, unless oil spikes higher."
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> . . . Ed Hyman & Nancy Lazar, *ISI Group*

Oil that is, black gold, Texas Tea; yet, rude crude still "feels" a bit stretched in the short-term given that West Texas Intermediate (WTI) is ~30% above its 200-day moving average (DMA). Indeed, over the past few weeks oil has become almost as extended above its 200-DMA as it was in July 2008, and we all know how that ended. Not that I am predicting a similar collapse in the price of Texas Tea, but rather that a consolidation/pullback period is likely, which could provide the backdrop for another "leg up" in stocks (even the energy stocks).

Speaking of Texas, Bruce Zimmerman, President, CEO, and CIO of the University of Texas' endowment fund, was on CNBC last week. His appearance was prompted by the fund's $1 billion investment in gold bullion. However, while everyone was focused on the gold topic, I was struck by the attendant pie chart of the fund's asset allocation. As he spoke, CNBC displayed said chart that showed only a 21.8% exposure to equities. Perhaps the fund's 30% exposure to hedge funds could qualify as an equity exposure, but I doubt it. Think about that, if Bruce Zimmerman's asset allocation is anywhere close to being representative of other endowment funds, what happens if "they" collectively decide to increase their exposure to equities? To quote Jackie Gleason, "To the moon, Alice, to the moon!"

To be sure I am bullish, and while I didn't think the 7% decline from February into mid-March was "it" at the time, I was indeed buying stocks and conceded two weeks after the March 16th "low" that the intra-day "print" of the S&P 500 (SPX/1337.38) at 1249 was likely "the low." Moreover, for the past few weeks I have suggested all the equity markets were doing was rebuilding their internal energy for another upside "leg" that would break the SPX out above its February intra-day high of 1344. And while last week's action failed to accomplish that, we did see the SPX close above its April "highs," which is obviously a step in the right direction. So what now?

Well, the bad news is that the SPX's 3.2% rally from last Monday's sovereign debt drubbing has used up some of the stock market's short-term energy, implying another pause/pullback may be due. The good news is the market's intermediate and long-term internal energy readings remain almost fully charged and hence any pullback should be contained in the 1315 – 1320 zone. Recall, I scribed similar words about the 1280 – 1300 zone containing any pullback two weeks ago, with the SPX at 1340, right before its six-session slide into last Monday's low of 1294.70.

Speaking to S&P's putting U.S. sovereign debt on "negative" watch, my friend Barry Ritholtz, of Fusion IQ, writes:

> "If ever there was an organization more corrupt, incompetent, and less capable of issuing an intelligent analysis on debt than S&P, I am unaware of them. Why do I write this? A huge part of the reason the US is in its awful financial position is due to the fine work of S&P. Consider what Nobel Laureate Joseph Stiglitz, economics professor at Columbia University observed:
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> 'I view the ratings agencies as one of the key culprits. They were the party that performed that alchemy that converted the securities from F-rated to A-rated. The banks could not have done what they did without the complicity of the ratings agencies.'

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Hence, the 'negative outlook' of US debt has come about because the inability of Standard & Poor's to have performed their jobs rating mortgage backed securities. Ultimately, this enabled the entire crisis, financial collapse, enormous budget deficit and now political (debate) over the debt ceiling. Of course there is a negative future outlook. It's in large part the work product of S&P and Moody's. Why we even have Nationally Recognized Statistical Rating Organizations any longer following their payola driven corruption, their gross incompetency, and their inability to discharge their basic duties is beyond my understanding."

Obviously, the equity markets "listened" to Barry's sage words as following last Monday's initial "sovereign shock" stocks gathered themselves together, lifting the DJIA (INDU/12506.06) 412 points into Thursday's close. So, to borrow a phrase from Adam Smith's book *The Money Game*, "What do we do about it on Monday morning?"

My answer to that question is to keep accumulating stocks with favorable risk versus reward metrics. In past missives I have suggested names like The Williams Companies (WMB/$31.97/Outperform), EV Energy Partners (EVEP/$56.87/Outperform), LINN Energy (LINE/$38.94/Strong Buy), IBERIABANK Corporation (IBKC/$58.25/Strong Buy), Clayton Williams Energy (CWEI/$94.99/Outperform), Hewlett Packard (HPQ/$40.99/Strong Buy), NII Holdings (NIHD/$40.80/Strong Buy), Teekay LNG Partners (TGP/$38.83/Strong Buy), Stanley Furniture (STLY/$5.03/Strong Buy), and Peoples United Financial (PBCT/$13.20/Strong Buy), to name but a few of the companies mentioned in these letters recently. This morning I revisit a name used in my New York City sojourn, namely Hospira (HSP/$57.78/Strong Buy).

On April 20, our fundamental analyst upgraded HSP from Outperform to Strong Buy. His reasoning goes like this.

"We are upgrading HSP to a Strong Buy as various events over the last month and a half have lowered the risk profile on the name. Additionally, a deeper dive into Hospira's pipeline gives us comfort with Hospira's three-year growth goals. With little risk to 1Q11 results, and 2011 guidance, we believe the risk/reward profile is favorable and our new rating reflects increased optimism.

1) De-risking events: With the FDA approval of generic Taxotere and the appointment of Mike Ball as the new CEO, two primary concerns on the stock have been eliminated. Additionally, prescription data suggests that Hospira's production levels are improving and the company is benefitting from a more favorable pricing environment.

2) Taxotere is now a source of upside: With Taxotere approved, we have more confidence that our 2011 Taxotere estimates could prove conservative. Every $20 million of Taxotere upside to our $130 million 2011 estimate equates to ~$0.05 in EPS.

3) Pipeline is vague, but has option value: Hospira's pipeline includes 46 small molecule drugs addressing $13 billion in local market value, 19 of which are currently under regulatory review. We believe the Street is underestimating Hospira's small molecule pipeline and, after adjusting for risk and probability, think it is worth at least $10/share. This analysis gives us more confidence in the intermediate-term growth profile. At these valuations, we believe investors are assigning very little value (if anything) for Hospira's biosimilar franchise (11 proteins with $28 billion local market value).

4) Excess cash and 'shareholder value': Hospira has been more vocal about 'returning value to shareholders.' While there are many ways to create value, we suspect that management is looking at a larger buyback or possibly a dividend. Cash flow suffered in 2010 due to transient causes like quality assurance initiatives and inventory build ahead of new drug launches. We expect Hospira to generate ~$415 million in free cash flow in 2011.

5) Raising estimates, but still below management's 'goals': We raise our 1Q sales and EPS estimates to reflect the Taxotere launch, but maintain our 2011 estimates. We raise our 2012 estimates slightly on a quicker recovery in the Specialty Injectable Pharmaceuticals (SIP) business. At 12% EPS growth in 2012, we are still below management's mid-teens growth goal as is the Street at 13%.

6) We raise our price target to $66 to reflect more confidence in the growth profile. Our target is based on a 15x multiple applied to our 2012 non-GAAP EPS estimate, which is in-line with our EPS growth estimate over the next two years. Hospira's peer group of mid-cap healthcare companies is trading at a 2012 PEG ratio of 1.2x. Structurally, we believe that Hospira is better positioned than most of its peers to cope with a more challenging healthcare environment as its business is tethered to markets that should exhibit less pricing pressure."

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The call for this week: As I said in last Tuesday morning's verbal comments "Buy 'em!" Or, as Jackie Gleason opined, "To the moon, Alice, to the moon," which I think is going to happen by the end of June! For those timid souls afraid to buy stocks, I spent hours with the good folks at Goldman Sachs a week ago and became extremely comfortable with Goldman Sachs' Dynamic Allocation Fund (GDAFX/$11.10). The fund tends to smooth out the stock market's volatility (by about half), yet delivers almost the same returns as its more volatile competitors. I will have more extensive details on this fund in future reports, but for further information in the interim, please contact our Mutual Fund Department.

P.S. – I am traveling again this week, and will be speaking at Raymond James' National Conference next week, so other than this missive, and possibly a strategy report next Monday, these may be the last comments for the next two weeks.

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ANNUAL RETURNS THROUGH 3/31/11	NAV%	POP%		
1 Year Average	11.66	5.52	**Maximum Sales Charge:**	5.50%
Since Inception	8.56	3.69		
			Annual Expense Ratio (Gross):	3.39%

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