[2011 Midyear Roundtable Report Card](http://online.barrons.com/article/SB50001424053111903425204576373910676523034.html?mod=BOL_hpp_highlight_top" \l "articleTabs_panel_article%3D1http://online.barrons.com/article/SB50001424053111903946504576378251082968120.html)

Buy Low, Stay Nimble

**By LAUREN R. RUBLIN |**[**MORE ARTICLES BY AUTHOR**](http://online.barrons.com/public/search/results.html?KEYWORDS=%22LAUREN%20R.%20RUBLIN%22&ARTICLESEARCHQUERY_PARSER=bylineOR)

[2011 Roundtable Report Card](http://s.wsj.net/public/resources/documents/BARRONS_RTSCORECARD_061311.pdf)

[2010 Midyear Roundtable Report Card](http://online.barrons.com/article/SB50001424053111903946504576378251082968120.html)

Rarely has the backdrop been so lousy. The U.S. is printing money to pay its bills. Europe is coughing up change to pay the neighbors' bills. Oil prices are climbing as the Middle East burns, and gold, that reliable barometer of fear, is rising almost by the day. And yet. American companies are flush with cash. Corporate revenue is growing, profit margins are widening, and stocks -- especially big ones with juicy dividends -- are relatively cheap.

That delicious irony hasn't been lost on the members of the Barron's Roundtable, whose opinions we rounded up by telephone in the past week or so. In view of the alternatives, chiefly negligible bond yields, U.S. stocks just might be "the best house in a decent neighborhood," as Oscar Schafer observed.

The Roundtable crew is unanimous in seeing slower economic growth in the year's second half. As a result, these money managers and market savants have turned notably more defensive since our annual get-together in January at the Harvard Club of New York. These days they are far fonder of consumer-staples, health-care and utility stocks than the shares of companies that make things that rust in the rain.

Our panelists have their eye on the near term, when we'll inevitably muddle along, and on the long term, when economic calamity could befall us if the nation doesn't first mend its profligate ways. How to do so is apt to be the subject of increasingly urgent discourse as 2011 rolls into 2012 and the presidential election.

The discussions that follow should help to explain why the best investors worry so much about the big picture, even as they take their dividend checks to the bank. For the whole picture, please read on.

**Felix Zulauf**

Barron's: How's the view from Europe, Felix?

Zulauf: I am in a good mood but I feel sorry for the world. The global economy's structural problems haven't gone away, and the authorities continue to kick the can down the road. They go from one quick fix to the next. Quick fixes have worked well in the past two years, and might work a bit longer. But at some point we will have to face reality, and that will be a very sour moment.

In the medium term, it is much more a trading market than an investment market. Expectations for earnings growth are too optimistic. Professional investors are fully invested because they have no choice. Individuals have come back to the market, but not like in previous cycles. There just isn't much firepower left to push stocks higher, and there have been some important changes in fundamentals.

**Felix Zulauf's Picks**

|  |  |
| --- | --- |
| **Instrument/Ticker**  | **Price 6/8/11**  |
| **Short\***  |  |
| [SPDR S&P Metals and Mining](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=xme) / XME | $65.28 |
| [Industrial Select Sector SPDR](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=xli) / XLI | 35.51 |
| [Technology Select Sector SPDR](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=xlk) / XLK | 25.10 |
| [Financial Select Sector SPDR](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=xlf) / XLF | 14.76 |
| **Buy\***  |  |
| [Consumer Staples Select Sector SPDR](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=xlp) / XLP | 31.10  |
| [Utilities Select Sector SPDR](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=xlu) / XLU | 33.16 |
| \*Short/Buy through November. | Source: Bloomberg  |

Such as?

The biggest challenge has been greater inflation, particularly in emerging economies. These economies are operating at full capacity. With inflation rates rising, the authorities moved away from ultra-expansive policies, and in China they started to tighten credit. That will slow these economies over time, although they are structurally sound.

The problem is in the developed world. In the U.S., quantitative easing is ending due to tremendous criticism. The hurdle for launching QE3 will be very high. Europe is a special situation. The ECB [European Central Bank] is trying to reduce its balance sheet for the third time since the financial crisis of 2009. The first time they tried it triggered the Greek crisis. The second time it triggered the Irish crisis. The third time there could be problems in Italy.

What will happen if Greece defaults on its debt?

Greece is bust but it isn't allowed to default. If it does so you could see a bank run throughout the European and the global banking system. The ECB and Germany are trying to force a Teutonic fiscal program on Europe. They are on a collision course with economic reality. If Greece defaults, the ECB probably will lose 30 billion to 50 billion euros. The bank's equity capital is €10 billion. The Irish and probably Portugal and Spain would default. Germany's Bundesbank owns more than €300 billion of European debt. A default would be worse than the collapse of Lehman Brothers.

If you ran the ECB, how would you deal with Greece?

There is no painless solution. We have to let entities, even governments, default. But we have to make sure first that the banking system can handle its clients' defaults. That is the problem. In the European banking system, equity capital is only 3% of assets. In the U.S. it is 4.5%. Raising banks' equity-capital ratios is the only way to solve the problem in the long run.



Brad Trent

We missed the chance during the financial crisis. I would have handled the whole crisis differently. I would have nationalized the banks and not allowed them to pay any dividends or big bonuses. First they would have to improve their equity-capital positions. This would go hand in hand with extremely low growth.

You would have been very unpopular.

The fiscal authorities have to support the system. But instead of wasting money to boost consumption, they should be spending on investments that will bear fruit long term. By the middle of the decade at the latest, we will have a major crisis, bigger than 2008. Several countries will default, particularly in Europe. Quasi-fixed exchange rates between the U.S. and China will start to unravel, which will force the U.S. dollar down tremendously. It will push bond yields up and stocks down.

What do you see in the near term?

From Asia to Europe to the U.S., all the important economic indicators are rolling over. Some blame the Japanese tragedy; others, the weather. It is more than that. It is the result of policy decisions. Economic growth could slow to a crawl well into early next year. The stock market isn't priced for that. Analysts will cut their earnings estimates. There is 20% downside risk from the market's intraday May high. Once the economic news turns decisively disappointing, the authorities will come to the rescue and try to stimulate again. That is when a trader can move in on the long side for a rally at year end.

Those who have to own stocks should buy pharmaceuticals, health care and consumer staples rather than cyclicals. In the near term, through the summer and fall, I would short the XME [ [SPDR S&P Metals and Mining](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=XME) exchange-traded fund], the XLI [ [Industrial Select Sector SPDR](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=xli)], the XLK [ [Technology Select Sector SPDR](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=xlk)] and the XLF [ [Financial Select Sector SPDR](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=XLF)]. If you have to own something, go with the [Consumer Staples Select Sector SPDR](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=XLP) [XLP] and the [Utilities Select Sector SPDR](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=XLU) [XLU].

What form will stimulation take this time?

The U.S. central bank is doing the opposite of what Paul Volcker did from the late 1970s until the mid-'80s. He tried to break inflation by limiting the money supply. In so doing, he created extremely high real interest rates. It took the bond market about five years to understand it. [Federal Reserve Chairman Ben] Bernanke's monetary policy creates deeply negative real interest rates. It will take the bond market several more years to realize this will lead to inflation. Bonds can't be recommended to long-term investors for the next 10 years. Gold will beat stocks in the next few years, even if gold corrects by more than 10%.

Thanks, Felix.

**SCOTT BLACK**

Barron's: How does the second half look to you, Scott?

Black: Ironically, corporate earnings are good and stocks are reasonably priced. Assuming the Standard & Poor's 500 earns $97.94 this year, the market has a price/earnings multiple of 13.4. Given that nominal interest rates are low, that is a cheap P/E. Also, corporate balance sheets are in better shape than they have been in years. Nonfinancial companies are sitting on $1.9 trillion in cash and equivalents. That's the good news. The bad news is all the problems that beset us.

Hence, the irony.

We can't seem to get congressional legislation that raises the debt ceiling with a proviso to slow meaningfully the growth of the federal deficit. Republicans are afraid to raise taxes, and Democrats won't touch entitlement spending. Both sides want the other to walk the plank first. Meanwhile, the country is slowly going broke. The national debt exceeds $14.3 trillion. It is equal to 96% of nominal GDP [gross domestic product], the highest level since World War II. At least then, we had an excuse. It is disgraceful that both parties aren't doing what is right for America.



What bothers me now is we've spent trillions of dollars but haven't created any jobs. We are pursuing the wrong economic policies. Some 28% of homeowners with mortgages are underwater. Consumer confidence is dropping off the map.

The industrial side of the economy has been the engine of growth. Can it continue?

It is starting to peter out. The ISM [Institute for Supply Management] manufacturing index just fell to 53.5 from 60.4. Capacity utilization in the steel industry is up only 1% year over year. Real GDP was up 1.8% in the first quarter. The expectation was it would reach 3% this quarter, but it isn't even close.

Is another recession in the cards?

No, we'll have slow growth. I don't see a QE3, but Mr. Bernanke is wise enough not to withdraw liquidity. Interest rates will stay very low. In Europe, they haven't solved the crisis in Greece. You have to wonder how much longer the German people will allow [Chancellor] Angela Merkel to subsidize the Continent's weak economies.

**Scott Black's Picks**

|  |  |
| --- | --- |
| **Company/Ticker**  | **Price 6/8/11**  |
| [Helen of Troy](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=hele) / HELE | $30.57 |
| [Alliance Resource Partners](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=arlp) / ARLP | 67.84 |
| Source: Bloomberg  |

I am also worried that too much hot money is chasing consensus earnings estimates. We own [Buckle](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=BKE) [ticker: BKE], an apparel retailer. In its latest quarter, revenue was up 11.8%. Comparable-store sales were up 8.1%. Earnings per share were at an all-time record. But they came in two cents light. The stock was down 6.71 the day they reported. The P/E is under 14. This sort of selloff is utter nonsense. The market is becoming a casino.

Yet, you expect it to rally.

If Congress can deal with the debt ceiling and deficit in a more orderly fashion in coming months, the market could have a nice jump. The Standard & Poor's 500 could trade up to 15 or 16 times earnings, meaning a gain of 7% to 14%.

One stock we like is [Helen of Troy](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=HELE) [HELE]. It has diversified over the years, making judicious acquisitions. It bought Oxo, which makes housewares. In March 2010, it bought Pert and Sure, former [Procter & Gamble](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=PG) [PG] brands. Then it bought Kaz, which sells consumer health-care products like thermometers and humidifiers, paying $272 million in cash for more than $419 million of sales. Housewares accounts for 28% of revenue. Health care is 9% and personal care is 63%.

How much revenue does the company generate?

They did $777 million last year. The core business grows about 5% a year. Add Kaz, and total revenue is around $1.16 billion to $1.18 billion. Operating margins will be 14.1% in 2011. That gets you to $163 million in operating income. The company will earn about $127 million this year, or $4.05 a share. The consensus estimate is closer to $3.50.

The stock is 31, so that puts the P/E at 7.7. The market cap is $972 million. Last year they earned 15% on book value and 12% on total capital. Net debt to equity is 40%. Helen of Troy could generate north of $100 million in free cash this year.

What else looks appealing to you?

[Alliance Resource Partners](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=ARLP) L.P. [ARLP], a coal play based in Tulsa, Okla., has been a spectacular performer in the past 10 years. They have 13 mines, including eight in Illinois, and will sell 32 million to 33 million tons of coal this year, mostly steam coal. Their two biggest customers are the Tennessee Valley Authority and Louisville Gas & Electric. The stock trades for 70, and the market cap is $2.57 billion. They pay a dividend of $3.56 a share, and the stock yields 5.1%.

My model suggests revenue will be about $1.8 billion this year. They will have Ebitda [earnings before interest, taxes, depreciation and amortization] margins of 31.3% on the low end, 31.6% on the high end. Net income will be between $364 million and $385 million. The general partner takes a 22% cut of net income.

Is this a master limited partnership?

No, just a limited partnership. Earnings could range from $7.75 a share to $8.15. Using the midpoint, $7.95, on a $70 stock, you get a P/E of 8.8. Return on equity is staggering. Last year it was more than 80%. This year it will be 61.7%. Net debt to equity is 75%, but the interest-coverage ratio is 15 to 1. Pricing is going the company's way. In the first quarter, the coal price per ton rose 9.6%, to $54.08 from $49.34. They are sold out for the whole year, so earnings are locked in. There are 21 years of reserves still in the ground.

Thank you, Scott.

**BILL GROSS**

Barron's: You have made no secret of your disdain for Treasury bonds at current levels. Yet yields continue to fall while prices rise. Could yields go even lower?

Gross: That is unlikely. The two-year note yields 40 basis points [a basis point is one hundredth of a percent]. The five-year yields 1.6%, and the 10-year is around 3%. These are historically low yields relative to inflation. With headline inflation at 2% to 2.5%, they are close to negative real yields, all the way out to the 10-year. This raises the question of why an investor would buy Treasuries at those yields, especially when the Fed, which wrote a six-month check for $600 billion, is departing the scene. When the Fed stops buying Treasuries, who will buy them? Importantly, QE2 will be replaced by "extended period" language, which means the Fed will keep interest rates low for a long time. I don't see a bear market in Treasuries, but I see a very low-yield, low-return environment.



The saver class -- not just individuals, but banks and fixed-income investors -- is being undercompensated and used by the debtor class. I don't claim it's dirty pool. But investors ought to be aware that this probably will be the policy for the next five to 10 years. They ought to look elsewhere in bonds, and in equities, for more adequate compensation.

Ten years is long time to ignore Treasuries.

There is a fat-tail chance of a dollar or debt-ceiling crisis in the near term, or simply a budget crisis if we solve the debt-ceiling issue. Does the Fed react in order to smooth it out? Probably not. A weaker dollar is part of the plan. If investors come to understand that very little will change in the next few years, their dollars will go elsewhere.

If and when inflation goes higher because of current policies, yields on 10-year Treasuries will rise. Until then, real yields will stay at historically low levels, much like we experienced in the 1940s, '50s and '60s under similar circumstances. Financial repression is occurring not just in the U.S. but in all developed countries with high debt levels. It is the hidden way governments pick the pockets of savers.

Where, then, do you see value?

One area is conservative, high-yielding stocks like a Procter & Gamble, a [Coca-Cola](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=KO) [KO] or a Merck [MRK], or an electric utility. On average, these stocks yield around 4%. That is a real yield. Even a baby boomer has to begin to accept the higher volatility of a Coke versus a Treasury security if it means picking up an additional 4%. That will be critical for their standard of living.

**Bill Gross' Picks**

|  |  |
| --- | --- |
|  | **Price/Yield**  |
| **Investment/Ticker**  | **6/8/11**  |
| [Annaly Capital Management](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=nly) / NLY | $18.48/13.46% |
| [Pimco Corporate Opportunity Fund](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=pty) / PTY | 20.09/10.42 |
| [Pimco Income Strategy Fund](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=pfl) / PFL | 12.45/9.78 |
| Source: Bloomberg  |

If an investor prefers to stay in bonds, we recommend other countries. Yields on government bonds are higher in Canada, Mexico and Germany, and even Brazil. You could buy an emerging-market bond fund that has a higher yield and better prospects than the U.S. in terms of the issuers' growth and balance sheets. Both recommendations come with risk, but as long as the Fed keeps rates low and liquidity ample, barring a crisis you will be rewarded.

How about some specific recommendations?

I recommended Annaly Capital Management [NLY] in January. The price is up a little since then, and the stock yields 14%, so that is about a 6% return for the first six months. [Pimco Corporate Opportunity](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=PTY) Fund [PTY], my other pick, also has done well but still yields about 10%. I would stay with both. You're not going to get your pocket picked with a 10% closed-end fund, and Annaly will continue to do well if interest rates stay low.

A third idea is [Pimco Income Strategy](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=PFL) Fund [PFL]. This is a portfolio of corporate bonds rated Baa, with 20% leverage. The 12-month yield is 9.6%.

Pimco made headlines recently with news it lost $3.4 billion on Lehman Brothers bonds in 2008.

It was old news. We marked the bonds down to 20 or 25 cents on the dollar the day after Lehman collapsed. Even so, Pimco put up its best numbers ever in 2008 relative to competitors. Sure, we could have done even better if we hadn't invested in Lehman. But not every pick is a winner.

Well said. Thanks.

**FRED HICKEY**

Barron's: What is your second-half forecast?

Hickey: QE2 ends in two weeks, and already the global economy is turning down. Whether it is housing, autos or consumer confidence, the numbers are weak. This isn't what the Fed planned. In Europe there are more bailouts for Greece and Portugal, but eventually they will default on their debt. The Middle East is a mess. Japan's economy was sinking before the earthquake, tsunami and nuclear disaster in March, and it is worse now. Even Singapore, which has been strong, recently reported a decline in exports, led by electronics shipments.

Most major technology companies, including [Hewlett-Packard](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=HPQ) [HPQ] and [Dell](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=DELL) [DELL], have had weak revenue. Lower spending by state and local governments and a slower auto market are problems for tech companies. At many major tech companies, inventory is growing far in excess of sales.

Can QE3 be far behind?

Given the criticism of QE1 and QE2, the Fed might have to use other tools to pump up the economy. Bernanke won't sit there and do nothing. He won't allow the U.S. to become Japan II. But the alternative is worse. It could be a collapse in the dollar and severe inflation. Money-printing isn't working, but that doesn't mean it will stop until the rest of the world says "no" to America's bonds and the dollar. We are putting off the inevitable, needed correction. The recession we saw in 2009 will be mild relative to what we ultimately will see.

How will stocks do in the nearer term?

For the first time in a long time, stocks are vulnerable. They were down mildly in May, and not so mildly in June. Earnings won't be so good this quarter, and guidance won't be good. Thereafter the Fed could ride to the rescue again, triggering another liftoff in asset prices. It happened in March 2009 and August 2010. But for the moment, short sellers have an opportunity.

How are you positioned?

My largest position is gold. It has been in a bull market for 11 years. I also own government bonds in New Zealand and Canada. They are a play on natural resources, but mostly on better-run governments. I recently established a short position in some semiconductor names as a result of the build-up in inventories. The stocks are near their highs. I would short the Philadelphia Semiconductor Index, or SOX. You could also short the [iShares PHLX SOX Semiconductor Sector](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=SOXX) exchange-traded fund [SOXX], which is trading around 55.



Gold has risen to $1,534 an ounce from under $300, but it is going higher. The gold stocks have underperformed the metal, so I prefer the stocks. They also lagged in the last bull market for gold, in the 1970s. They didn't get going until the last couple of years of that 10-year bull market, and that could happen again. Gold-mining margins and cash flow are soaring. Earnings are beginning to soar. In the first quarter, the average realized gold price for most miners was $1,380 to $1,390 an ounce. Earnings estimates for these companies haven't been adjusted yet.

Which gold stocks will do best?

[Goldcorp](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=GG) [GG] is a low-cost senior producer with about a dozen mines in good locations, primarily in Canada, the U.S. and Mexico. The company is expected to earn 52 cents in the second quarter, but you could add a nickel based on the rise in gold prices. Production is growing about 10% a year. At many gold companies, rising cash flow is leading to increased dividends. The stock has a P/E of 18.

You have owned Microsoft for a while. Do you agree with money manager David Einhorn that Microsoft CEO Steve Ballmer should go?

No. I have been recommending [Microsoft](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=MSFT) [MSFT] and it hasn't worked. The company has been beating estimates quarter after quarter, but the stock's P/E just shrinks and shrinks. There is this perception that Microsoft is tied to old businesses like Windows and Office and that the personal-computer market is dying. But Microsoft has made some moves that could lead to a change in perception among investors.

One is its partnership with [Nokia](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=NOK) [NOK]. Microsoft's Windows 7 phone was highly rated when it came out, but it didn't have support among the major handset vendors. It now will have that with Nokia. Assuming they can bring out a product on time and that it works well, Nokia and Microsoft are a powerful combination. Some research firms are saying they could jump into second place in the phone business in a few years, ahead of [Apple](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=AAPL) [AAPL]. If that happens, there is no worry about Microsoft being a dead-PC company.

Will it happen?

It could, because the phone is good and telecom operators would like to see Microsoft succeed. Also, Microsoft recently bought Skype for $8.5 billion. It is a big number, but the cash was sitting overseas where it wasn't being utilized. Skype capability could give the whole Windows 7 phone business a big leg up. Microsoft will embed Skype's video conferencing in almost all its products. That solidifies Microsoft's place in the communications market.

**Fred Hickey's Picks**

|  |  |  |
| --- | --- | --- |
| **Company**  | **Ticker**  | **Price 6/8/11**  |
| **Short**  |  |  |
| [iSharesPHLXSOXSemi Sector](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=soxx)  | SOXX | $55.45 |
| **Buy**  |  |  |
| [Goldcorp](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=gg)  | GG | 47.02 |
| Source: Bloomberg  |

Would you buy Microsoft shares now?

With the downturn in tech it will be difficult to win with Microsoft in the next few months. But I'm not selling my position. As Nokia starts rolling out the first of its Windows 7 phones later this year and early next, and as Microsoft starts integrating Skype, investor perceptions could lift and the stock could be a winner. As for Steve Ballmer leaving, the CEO has been more effective than people think.

How serious are the problems at Cisco?

[Cisco Systems](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=CSCO)[CSCO] is under pressure from many different competitors. But some of Cisco's problems are industry -- not company-specific problems. Did the company make mistakes? Yes. But if they right the ship, this could be a good investment in time.

Thanks for the update.

**MERYL WITMER**

Barron's: How does this market look to you, Meryl?

Witmer: Stocks had gotten pretty expensive and people were having a tough time finding opportunities. Sure enough, the market came down and has presented some. There are a lot of OK values and a few good values. We look for cheap stocks and companies with good businesses that generate free cash flow and have real assets. The economy has hit a slow patch, but that is predictable. Gasoline is at $4 a gallon, the middle class is suffering and discretionary spending is down. If gas prices come down, things will pick up. On the employment front, companies we talk to are doing well, so I don't see a lot of layoffs ahead.

Will the market end the year higher?

Yes, because stocks are on the cheap side. We have been buying [Macquarie Infrastructure](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=MIC) [MIC], an infrastructure fund with ownership interests in four businesses: International-Matex Tank Terminals, Atlantic Aviation, the Gas Company and District Energy. International-Matex, or IMTT, is the most exceptional. It is one of the largest bulk-liquid storage-terminal businesses in the U.S. Macquarie owns half.

What makes it so exceptional?

The company can store more than 43 million barrels. They store petroleum, vegetable oil and commodity and specialty chemicals. The main storage facilities are in Bayonne, N.J., and St. Rose, La. Storage contracts last from three to five years, so the business isn't particularly sensitive to the economy. The Bayonne facility is strategically placed on the Kill Van Kull, a tidal strait near New York Harbor. The facility is able to load and unload ships quickly due to the depth of the water in front of its docks. Competitors' docks can't handle large ships; products have to be transferred to barges before docking. That increases costs. IMTT's advantage will increase because the Port Authority of New York and New Jersey is dredging the Kill Van Kull even deeper so New York Harbor can be accessed by larger ships being built to take advantage of the widening of the Panama Canal.



We estimate IMTT will contribute about $1.50 of after-tax free cash flow in 2012 to Macquarie. The division deserves to trade at about 15 times free cash, which makes it worth 22 a share. Macquarie is trading for 24.75.

So you're getting the rest of the company for less than $3?

Correct. The next-largest asset, Atlantic Aviation, operates gas stations and terminals for private planes. It suffered during the financial crisis, but has been cutting costs and the business is improving. Last year it contributed about $1.20 per share of after-tax free cash flow, and could earn about $2 a share if the business returns to earlier levels. We value Atlantic at about $10 to $15 a share.

The Gas Company operates the only private gas utility in Hawaii. District Energy operates the largest district cooling system in the U.S. Together the businesses earn 55 cents a share. Along with some tax assets, they're worth about $7 a share.

**Meryl Witmer's Picks**

|  |  |
| --- | --- |
| **Company/Ticker**  | **Price 6/8/11**  |
| [Macquarie Infrastructure](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=mic) / MIC | $24.66 |
| [Innophos Holdings](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=iphs) / IPHS | 42.56 |
| Source: Bloomberg  |

How will Macquarie unlock this value?

The game plan is to pay out dividends. The company pays 80 cents a share, giving it a 3.2% yield. In a few years they could pay as much as $3 a share, if not more. There is no debt at the holding company. Executive compensation is tied to the stock's outperformance relative to a particular benchmark. For management to receive extra performance fees, the stock needs to reach the mid-30s. Macquarie is worth 40 to 45 a share.

What is your second pick?

[Innophos Holdings](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=IPHS) [IPHS] has 23 million shares and sells for 43. Innophos, along with its main competitor, ICL, are the two main producers of specialty phosphate products in North America. The majority of Innophos' business is specialty ingredients such as minerals fortification, leavening agents in bakery products and excipients in pharmaceutical tablets, which bind the ingredients. The company also makes additives for deli meats and abrasives in toothpaste.

Specialty ingredients usually account for less than 1% of the overall cost of a product. They deliver technical effects that are hard to replicate with substitutes, and it can take months to qualify a specialty phosphate in a product so it generally isn't worth switching suppliers. These attributes allow Innophos to pass through cost inflation in its key input, phosphate rock. It recently restructured its rock sourcing to have multiple suppliers and shorter lag times between price fluctuations. The company buys phosphate rock in Mexico and converts it to an intermediate product. It also buys intermediate product in the U.S. and processes it further into specialty ingredients. Innophos is working to shift some sales in Mexico to higher-value-added products.

How much does Innophos earn?

The company could earn about $4.70 a share of free cash flow in 2011 and about $5 in 2012. Reported earnings are about $1 a share lower. Innophos has a strong balance sheet with little net debt. It is worth about 12 times free cash flow. Our target price is $65.

Thanks, Meryl.

**OSCAR SCHAFER**

Barron's: This market has taken a beating. What happens next?

Schafer: It will end the year higher than it is now. On the macro level there are worries, but on the corporate level companies are doing well. Historically there hasn't been much correlation between GDP growth and stock-market performance. Everyone is talking about GDP stalling but earnings per share are what matter.

U.S. stocks are the best house in a decent neighborhood. When you get major companies selling at single-digit multiples of earnings or cash flow, where the alternatives, especially in fixed income, are poor, common stocks in the U.S. are a good place to be.

Will the economy perk up soon?

The economy will continue to grow slowly, by 2% or 3%. Maybe it will grow a little more, because the second quarter had nonrecurring problems like the crisis in Japan. Unemployment won't come down a



Which big, cheap companies do you like?

[Xerox](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=XRX) [XRX] no longer is a pure play in copy machines. In the past five years, and particularly in the past year under Ursula Burns, it has transformed itself into primarily a technology-services company. At this point, 85% of revenue is from annuity-services businesses.

The transformation was accelerated in February 2010 when Xerox bought ACS, a leader in outsourced service areas such as payment services, customer care and human-resources management. Lots of state and local governments are increasingly outsourcing services such as Medicaid administration, child-support payments and the EZ-Pass toll system. They are all run by ACS. Xerox Services and ACS together account for 50% of Xerox's revenue. ACS raised Xerox's growth rate and shifted its revenue base to something more annuity-like.

How is the traditional business faring?

In the document business there has been a shift from pure commercial copier and ink sales to managed print services. Xerox is the industry leader. It also has become a leader in color, which now accounts for more than 30% of machines in the field. Printing color costs three to four times the price of printing black and white. As a result, Xerox's technology business should grow in the 1% to 3% range. Overall revenue could grow by 3% to 5%. Xerox could generate more than $2 billion in free cash flow annually in the next few years. That's $1.50-plus a share of free cash flow on a $10 stock.

**Oscar Schafer's Picks**

|  |  |
| --- | --- |
| **Company/Ticker**  | **Price 6/8/11**  |
| [Xerox](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=xrx) / XRX | $9.46 |
| [TE Connectivity](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=tel) / TEL | 35.19 |
| [Salix Pharmaceuticals](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=slxp) / SLXP | 36.66 |
| Source: Bloomberg  |

What will management do with that cash?

Once Xerox finishes paying down debt from the ACS deal, likely later this summer, it will start buying back lots of stock. If the company uses only 70% of free cash flow to buy back stock, it conservatively can buy back 50% of the company at these levels in the next five years. There are a lot of cheap large-cap technology stocks out there, but Xerox seems to have fewer issues. It trades for seven times 2012 expected earnings of $1.25 a share, and the stock has at least 50% upside.

We also like [TE Conductivity](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=TEL+) [TEL], the old Tyco Electronics. I am very positive on the global auto industry. Following a severe downturn, we see signs of a recovery. In North America, SAAR [seasonally adjusted annual rate of sales] will surprise on the upside this year and return to 15 million autos from 12 million in 2010. It isn't unreasonable to assume 10% annual growth in car sales in China. Latin American auto demand could grow even faster. Barring a meaningful double dip in the economy, which I don't see, the auto sector will be robust for the next two years.

So TE is a play on auto-industry growth?

It is the largest global supplier of connectors. Electronics content in automobiles is increasing, whether because of new safety standards and energy-efficiency requirements or comfort and infotainment demands. The auto-electronics market will grow 5% to 6% faster than the global auto market.

In January I recommended two beneficiaries of this trend -- [Sensata Technologies](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=st) [ST] and [NXP Semiconductors](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=NXPI) [NXPI]. I still like them. TE Connectivity is another beneficiary. About 35% of revenue is derived from the global auto market. That business should grow by high single digits or even low double digits. TE also supplies connectors to industries such as telecom, industrial aerospace and computers. The business has high barriers to entry. Pricing pressure isn't an issue.

How are the numbers?

Revenue can grow at a low-single-digit rate with some margin expansion. The stock trades for less than 10 times my 2012 earnings estimate, with a 2% yield. Like Xerox, TE has a lot of free cash flow. I expect the company to use almost all its post-dividend cash to buy back stock or consolidate smaller manufacturers. The stock has 40% to 50% upside.

What else are you buying?

[Salix Pharmaceuticals](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=SLXP) [SLXP] has a $2.3 billion market cap. It is a U.S.-based specialty pharmaceutical company focused on gastrointestinal diseases. About a third of its business consists of -- you'll excuse the discussion -- bowel preparations before a colonoscopy and drugs to treat inflammatory bowel disease. The other two-thirds comes from Xifaxan, a rapidly growing oral antibiotic approved to treat travelers' diarrhea and hepatic encephalopathy, a liver-related condition.

Xifaxan is being used without FDA [Food and Drug Administration] approval to treat irritable-bowel syndrome. It is the key growth driver for Salix. When the FDA rejected Salix's new drug application for IBS in February, the stock fell 20%.

Why did the FDA reject it?

They said Salix didn't have tests that went on long enough. Longer-term studies are now under way. Salix could see 30% compound annual growth in revenue and profit from 2011 to 2014. The company could earn $2.50 next year. Using 20 times earnings, versus an industry multiple of 18, the stock is worth at least 50, up from 37 now. The FDA could reconsider its decision not to approve Xifaxan for IBS after a meeting with the company June 20. In that case, the stock could be worth at least 60. Salix is a logical takeout candidate for any pharma company with a GI [gastrointestinal-products] sales force, or one that wants to get into that therapeutic category.

Thank you, Oscar.

**ARCHIE MACALLASTER**

Barron's: Financials -- your specialty -- have been in the doghouse. How long will they remain there?

MacAllaster: Nobody will pay anything for financials, and the news is almost always bad. I see lots and lots of bargains long term. The problem is, define long term. Corporations are doing well. Most have good balance sheets, good earnings and solid book values. Dividends are good. In recent years many companies cut dividends, but now eight or 10 a day are raising their dividends. Politically, however, things are difficult. The Obama administration is anti-business. The president is good on his feet. He speaks well. He has a sense of humor. But he is anti-business because he never grew up with business. Also, the two parties don't get along, which makes things difficult for business. In this environment it is hard to know what stocks will do.

What are you doing?

We've been buying [Visteon](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=VC) [VC]. It sells for about 60. The 12-month range is 76.72 to 49. Visteon is an auto-parts company that formerly was owned by [Ford Motor](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=F) [F]. Visteon exited bankruptcy court last fall. Its first-quarter earnings were better than expected. The company earned about 87 cents a share, while people were expecting 79 cents. It could earn about $4 a share this year and as much as $7 next year. The business is a lot different than it used to be.

How so?

Only 21% of sales are in the Americas. Another 39% are in Europe, and 40% are in Asia. More than 50% of sales are to Ford and Hyundai Motor [005380.Korea]. The company has net cash. U.S. auto sales were down slightly in May. Ford's sales were flat but Hyundai's were up 20.7%. Visteon is a great way to play the worldwide recovery in auto sales. The stock could be 80 by December 2012.

View Full Image



Visteon owns 70% of Halla Climate Control [018880.South Korea], a South Korean company. It has a 50/50 joint venture in China with Yanfeng. Analysts think this investment is worth $25 or $26 per Visteon share. Yanfeng sales in China were up 37% year over year in the first quarter, to $720 million.

**Archie MacAllaster's Picks**

|  |  |
| --- | --- |
| **Company/Ticker**  | **Price 6/8/11**  |
| [Visteon](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=vc) / VC  | $60.47 |
| [Hartford Financial Services](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=hig) / HIG | 24.42 |
| Source: Bloomberg  |  |

What else intrigues you?

[Hartford Financial Services](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=HIG) [HIG] is selling for 25. It pays a 40-cent dividend. The stock's 12-month range is 31.08 to 18.81. The company earned $1.16 in the first quarter, versus estimates of 95 cents. Hartford could earn more than $4 for the full year and at least $4.50 for 2012. The stock is trading for 5.7 times my 2012 estimate. Book value is more than $45 a share. Hartford sells property and casualty and life insurance, and the company is 200 years old. They cut the dividend sharply during the recession but doubled it this year. It wouldn't surprise me to see it double again, to 80 cents a share. The stock yields 1.5%. The company has $320 billion in assets, and there are 445 million shares outstanding. My target price is at least book value, and 75% above the current market value.

You recommended Hartford warrants in January. Now you prefer the common?

Yes. There is no real premium in the warrants right now. Generally, insurance companies will do fine. But the government and the market are beating up the banks. Some are very cheap. They are trading around book value. You've got a good chance to make money in the stocks, but the timing is tough.

Duly noted. Thanks.

**MARC FABER**

Barron's: How does the world look from your perch?

Faber: The global economy is decelerating. After the financial crisis in 2008, it was supported largely by enormous fiscal stimulus and expansionary monetary policies. Now it is losing steam as fiscal stimulus wears out and QE2 comes to an end. There will be many more QEs, but not right away.

An economy is like the human body. There are periods when rest is required. In economic terms, that is a recession. Also, if you lived beyond your means by borrowing, you need a period of deleveraging. That has happened in the U.S. only in the corporate and household sectors. Private borrowing has been replaced by government borrowing, which means the overall level of debt hasn't been reduced. That needs to happen. The U.S. needs to cut entitlement spending meaningfully. It would be best to impose a flat tax and cut government expenditures by 50%. A severe depression ensued when communist countries embraced capitalism. A major readjustment won't happen in America unless there is a devastating crisis.

You're cheery, as always.

The world has a dual economy. In the economy of the super-rich, Bentleys and Rolls Royces and Ferraris and Porsches sit in front of fancy hotels. Quantitative easing has had a huge impact on this economy, as the people who own equities and commodities have done very well. Singapore and Hong Kong are boom towns because of quantitative easing. China has been helped dramatically by artificially low interest rates and a recovery in consumption in the U.S. and elsewhere. At the same time, the economy of the workers and lower middle class is doing very badly. Wage increases don't match cost-of-living increases. One symptom of inflation is a weakening currency.



Has the U.S. market seen its highs for the year?

Some strategists say the S&P 500 will drop to 400. That isn't my view.

That's a relief, unless you see it dropping to 200.

The U.S. stock market measured in Swiss francs, Australian dollars, Japanese yen or gold or silver is already down by 50% to 80% from a 2007 peak. You can adjust values in stock prices or in the currency, and the U.S. has done it in the currency. In foreign-currency terms, the stock market and the property market are rather inexpensive relative to other countries, but they aren't the bargain of the century, as stocks have doubled since March 2009. The stock market could have a correction of 10%, 20%, 30%. It will be important to invest in the right sectors and companies. The inflation theme of three months ago -- buying oil, copper, technology, cyclicals -- is over. Investors will be better off now in consumer staples and health-care stocks.

In January you were bullish on Japan. That was before the tsunami and nuclear crisis. What is your view now?

The Japanese economy contracted following the nuclear disaster, and maybe there is one more disaster to come. But that doesn't change my long-term view that there is good value in Japanese equities.

Is gold still attractive at $1,500 an ounce?

Not to own gold is to trust the value of paper money and the government's integrity. No one in his right mind could trust the U.S. government any more. The government's economic statistics are distorted and there is no consensus on how to solve the budget crisis. So, yes, people should own some gold. It can correct by $100 or $200 an ounce, but you own it as an insurance policy. The world is grossly underweight gold. It is flooded with U.S. dollars. Investors might be bearish about the U.S. dollar, but international dollar reserves exceed $9 trillion. Compared to that, there is very little gold.

**Marc Faber's Picks**

Buy after a stock-market correction of 15% from recent high:\*

|  |  |
| --- | --- |
| **Investment/Ticker**  | **Price 6/8/11**  |
| **THAILAND**  |  |
| **Advance Info Service / ADVANC.Thailand**  | 92.75 baht |
| **AEONThana Sinsap / AEONTS.Thailand**  | 34.00 |
| **DEFENSIVE STOCKS**  |  |
| [Procter&Gamble](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=pg) / PG | $64.85 |
| [Johnson&Johnson](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=jnj) /JNJ | 66.14 |
| [Roche Holdings](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=rhhby) / RHHBY | 42.73 |
| **Nestlé / NESN.Switzerland**  | 53.30 CHF |
| [H.J. Heinz](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=hnz) / HNZ | $53.14 |
| **DEFENSE**  |  |
| [Raytheon](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=rtn) / RTN | 48.15 |
| **SHORT**  |  |
| Australia andNewZealand [Banking](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=anzby) / ANZBY  | 22.49 |
| [iShares iBoxx$High Yield CorpBdFd](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=hyg) / HYG | 90.16 |
| [Salesforce.com](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=crm) / CRM | 140.28 |
| \*S&P 500 closed at 1363.61 on 4/29/11. |
| Source: Bloomberg  |

How about some other picks for the second half?

Stock and commodities markets, including precious metals, will head lower for the next three to six months. Therefore, defer any new buying for now. You can buy again after the S&P 500 has corrected by 15% from its late-April high. In Thailand, you can buy Advance Info Service [ADVANC.Thailand] and AEON Thana Sinsap [AEONTS.Thailand], a consumer-finance company that I recommended in January. I also recommended Chiang Mai Ram Medical [CMR.Thailand], but it has had a big run-up. I am removing it from my list.

Defensive stocks such as Procter & Gamble, [Johnson & Johnson](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=JNJ) [JNJ], [Roche Holdings](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=RHHBY) [RHHBY.Switzerland], Nestlé [NESN.Switzerland] and [H.J. Heinz](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=HNZ) [HNZ] are likely to outperform. Believing the whole Middle East and Pakistan will blow up, I recommend having exposure to defense companies. Therefore, I would buy [Raytheon](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=RTN+) [RTN] on weakness.

Do you recommend shorting anything?

You can short [Australia and New Zealand Bank](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=ANZBY) [ANZBY]. There is excessive leverage in the Australian household sector, and the real-estate market is overvalued. The [iShares iBoxx $ High Yield Corporate Bond](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=HYG) Fund [HYG] is another short. Credit spreads [between Treasuries and high-yield bonds] are likely to blow out [widen] in the second half of 2011. My third short is [Salesforce.com](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=CRM) [CRM]. Competition is likely to increase in the market for the company's software, and the P/E is 78 based on fiscal 2013 earnings.

Thank you, Marc.

**MARIO GABELLI**

Barron's: What lies ahead for the economy and the market?

Gabelli: The president's No. 1 job is to get himself re-elected. To do that he has to make voters feel the country is moving in a more positive direction. Instead, voters are worried about the deficit, American competitiveness and gasoline prices. Also, since January the Middle East is roiled, oil prices have spiked, and Japan's nuclear crisis at Fukushima has created a significant air pocket in industrial production. The auto industry will produce three million cars in the second quarter, not the 3.5 million expected. It means fewer people are employed, and retail sales will appear sluggish.



I talked in January about the Bs. Beijing: Come November, December, January, the Chinese take their foot off the economic break and start tapping on the accelerator. Berlin, as in Europe, is still a work in progress. All points lead to trying to make the Greeks, Irish and Portuguese more competitive. Bernanke is near the end of QE2. The question is what happens next. Barack has to start making the U.S. competitive by realizing we can't over-regulate. At this point a 10% decline in stocks can't be ruled out, but the market's multiple could rise if interest rates stay where they are. Other than a near-term correction, there isn't much reason the market can't be up 5% to 10% for the year.

Do you see a stronger economy by year end?

Yes. The global economy will be helped as Japan revives. The auto industry will start seeing more robust sales . That will show up in retail sales in the fall. But the housing market won't improve until 2012, and I am struggling to find any financial Hail Marys other than time.

Another element that affects the market psychology is deals. When I see the Japanese buying companies, it says they perceive the yen as fully valued. It gives them a competitive advantage in doing deals. The Canadians see the same with regard to their currency. The Swiss are looking to buy American companies because the Swiss currency is so strong and they want to grow. All this activity will be positive but stock-specific.

**Mario Gabelli's Picks**

|  |  |
| --- | --- |
| **Company/Ticker**  | **Price 6/8/11**  |
| [El Paso Electric](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=ee) / EE  | $30.17 |
| [Brink's](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=bco) / BCO | 27.44 |
| [National Fuel Gas](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=nfg) / NFG  | 67.92 |
| [Genuine Parts](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=gpc) / GPC | 50.50 |
| [Schiff Nutrition International](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=wni) / WNI  | 9.31 |
| Source: Bloomberg  |  |

Let's get specific about your stocks.

I still love my January recommendations. I will echo them again, but add some new names. There are three traditional categories of utilities: electric, gas and water companies. The electrics are yielding about 4.5%. They have a 65% payout ratio, which isn't high, and earnings are growing 4% to 5% a year. There have been a lot of deals in the industry. [El Paso Electric](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=EE) [EE] is a proxy for the group. The stock is 30 and there are 42 million shares. They will earn about $2.25 a share this year, growing by 5.5% to 6%. They are using cash flow to buy back stock and have reduced their shares outstanding in the past 10 years to 42 million. This is a great area. Fort Bliss, a military base in El Paso, is growing.

What does the stock yield?

It pays 88 cents a share and yields 2.9%. They just restored the payout, much to my objection. I would rather have them buy back stock so my clients can own more of the company. In El Paso's part of the world, there are three or four other utilities, all of which will figure out how to get some synergies by merging. The two logical parties are Public Service of New Mexico and El Paso Electric. One and one here equals two-and-half or three.

I recommended [Brink's](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=BCO) [BCO] in January. The stock hasn't done much. The company transports gold, cash and valuables. The business of providing secure logistics for pharmaceuticals is starting to gain traction. Brink's could earn about $2.10 a share this year, up from $1.71 last year. It has a decent enough balance sheet and the potential to partner with another large company globally that needs to be in the U.S., just as Brink's needs to be more involved in other parts of the world. The stock is cheap at 13.5 times earnings.

Where else do you see value?

I also recommended [National Fuel Gas](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=NFG) [NFG] in January. I still like it. I still like [Genuine Parts](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=GPC) [GPC], too. Gasoline prices are up sharply but Genuine Parts' auto-repair business is doing OK. The industrial-products business remains very strong, as well. The company will hit its earnings estimates. It has net cash. If inflation picks up, it will enjoy a nominal increase in revenue. Genuine Parts will grow by 10% a year for the next three or four years, with an inflation rate of 2% to 3%. If inflation picks up, the growth rate rises.

Another stock we like is [Schiff Nutrition International](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=WNI) [WNI]. We have owned it for a long time. The company had 30 million shares, and the Weider family owned 15 million. They sold 7.5 million to a unit of Texas Pacific Group for around $6.50 a share. TPG brought in a manager from P&G who will use the company's financial resources to get more active in the health and wellness area. Schiff just bought a probiotics business. The stock sells for nine and the market cap is $270 million. We expect them to do more deals. The company likely earned 55 cents a share in the year ended May 31. It has no debt.

Thanks, Mario.

**ABBY JOSEPH COHEN**

Barron's: What do you make of the market's recent bout of indigestion?

Cohen: It is an unexpected inflection point. The second half of the year might look very different from the first half. We expected the year to start off well, and that happened. What we didn't expect are things that are unforcastable: the earthquake and tsunami in Japan, and the Arab spring. Japan caused a supply-chain disruption, and the problems in the Middle East could mean a potential disruption in energy supplies and a higher energy price.

What does it mean for second-half GDP?

Our economic team has somewhat reduced growth expectations for several reasons. Economic data suggest a deceleration in growth in the past month or two. Higher energy prices act as an impediment to economic activity. Some industries have seen disruptions related to the Japanese tragedy. Lastly, there have been extreme weather events. Also, much of the fiscal stimulus put in place by the Obama administration is, by design, ending.



We expect the economy to grow by 2.5% to 3%, varying by quarter. It means job growth will be slower than many people had hoped, and profit margins might not increase much. Costs are rising, and the focus now will be on enhancing revenue to keep profit growth up.

What is your year-end forecast for the S&P?

David Kostin [Goldman's chief U.S investment strategist] expects the S&P 500 to end the year at 1450. That is unchanged from January. The past several weeks have been disappointing, but that forecast relates not just to the fundamentals of the economy but valuations. The S&P is trading for 14 to 15 times earnings, but we don't base our work on P/E ratios. We look at discounted cash flows and six other valuation models. Our models come up with 1450 as a fair-value estimate for the market.

Where do you see the best values now?

Assets related to economic growth will perform best. That includes equities globally. Commodities and fixed income have done well, but it is hard to make the case that fixed income will continue to generate the kinds of returns it did in the past.

Among equities, our analysts like Johnson & Johnson. Many investors look at J&J as a medical-device company. It is probably the best biotech play in global pharma. They have a very strong new-product pipeline. J&J also has a strong balance sheet, solid cash flow and an above-average dividend yield of 3.4%. Our analysts expect 2012 earnings of $5.50 a share. The consensus is $5.28. The P/E based upon our 2012 estimate is about 12.

**Abby Joseph Cohen's Picks**

|  |  |
| --- | --- |
| **Company/Ticker**  | **Price 6/8/11**  |
| [Johnson & Johnson](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=jnj) / JNJ | $66.14  |
| [Boeing](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=ba) / BA | 73.85 |
| [Ford Motor](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=f) / F | 13.70 |
| Source: Bloomberg  |

Give us another name.

[Boeing](http://online.barrons.com/public/quotes/main.html?type=djn&symbol=BA) [BA] is a revenue-growth and margin-enhancement story primarily tied to expectations that the new 787 soon will start to see new order flow. There is also the possibility of more demand for the 737 and 777 planes. There are some concerns about Boeing. There have been some earnings reductions due to pension costs. The 787 could be further delayed by a quarter or two. The defense market is challenging. We see 2012 revenue growth of about 11%, and earnings growth of about 23%, linked to the margin enhancement. The stock yields 2.3% and trades for 14.5 times 2012 estimates.

Ford, another recommendation, is likely to benefit from continued margin expansion. This will come from volume and pricing. Revenue could grow 15% in 2012. Ford has been good at using global platforms in many markets. About 95% of its production in China is on global platforms. The company's cash-flow picture is improving. This will lead to a further paydown of debt. We expect debt-rating agencies to reinstitute an investment-grade rating. Ultimately Ford could restore its dividend. Goldman is forecasting earnings of $2.14 in 2012, versus the consensus view of $2.02.

Thank you, Abby.