

# BARRON'S

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## Stocks Rally 1.1%, for a Third Weekly Gain

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### Vital Signs

No bad news was good news for U.S. stocks last week. Plus, auto shares look attractive. More split-ups and spinoffs are coming. And activist investors see value in CMGI.

Good news is good and bad news is bad, but a lack of bad news can be good, at least for investors. Stocks rose about 1% last week on improved trading volume, as third-quarter earnings reports—with the exception of Apple's (ticker: AAPL)—came in generally as expected.

There was also a lack of bad European news and "this is a headline-driven market," notes Andre J. Bahkos, director of Market Analytics for Lek Securities. Other than that, it has been a pretty themeless market, he adds.

Last week marked a third consecutive week of gains, as the Dow Jones Industrial Average rose 1.4% to finish at 11,808.79. The Standard & Poor's 500 Index picked up 1.1% to 1238.25. But the Nasdaq Composite bucked the trend, falling 1% to 2637.46.

Many investors intuitively know that stock movements among S&P 500 companies have been highly correlated of late, so much so that fundamental stockpicking seems to have been hijacked by one big macroeconomic worry, that of a European banking crisis.

The other big macro worry, notes Bill Schultz, CIO of McQueen Ball & Associates, has been a potential U.S. recession, but here again, while the macroeconomic news hasn't been great, a lack of bad news has helped investor sentiment. "Can Europe ring-fence the problem banks? Maybe things look better than they did two weeks ago, but we are not out of the woods yet," Schultz says.

Many look to a European summit to be held over the weekend, but already it seems that another meeting Wednesday will be even more important. "I've lost track of how many European meetings there have been," Bahkos says.

Anyone who believes there will be a clean and definitive answer on Europe's sovereign-debt problem is going to be disappointed for many months. For now, at least, it seems like the "risk on" trade is back, but European leaders have had a nasty habit of disappointing markets on Mondays.

The correlation within the equity market has never been higher, according to Bespoke Investment Group. When the S&P 500 advance/decline line (advancing stocks minus decliners)

reaches plus- or minus-400 in a session, Bespoke calls that an all-or-nothing day. Since the end of July there have been 31 all-or-nothing days, more than the total for the 1990s. This year will top 2008 for such volatile trading days, according to Bespoke.

The volatility most likely is due in large part to high-frequency trading and investors' heavy use in recent years of exchange-traded funds, which must rebalance their portfolios every day.

As noted, Apple fell sharply last week on disappointing earnings, but McDonald's (MCD) reported strong third-quarter earnings Friday, which drove the stock to an all-time high of \$92.32. Mickey D's stock has been the best Dow performer by far since hitting lows in 2003.

AUTO STOCKS HAVE BOUNCED UP a bit from their 2011 lows, but the consensus remains that a "double-dip" recession or a full-blown European bank crisis will hurt their profitability.

That's hard to deny. Still, when the stocks' price/earnings ratios reach about five and both General Motors (GM) and Ford (F) are making decent money at industry sales levels that are historically low to begin with, perhaps the share prices already incorporate much of the potential bad news.

Keith Goddard, president of Capital Advisors, which recently began buying GM shares, says the car maker—post bankruptcy—builds cars profitably according to demand, unlike the old GM, which needed a high level of production to be profitable.

It makes a decent dollar, he says, at the current North American seasonally adjusted annual rate, or SAAR, of 12.5 million cars, and can break even at 10.5 million, due to the cost changes effected by the bankruptcy.

Moreover, people have to buy cars even in tough times, and other factors are supportive. The U.S. car-scrappage rate is about 13 million annually, and the average vehicle age is a creaky 10 years. GM also happens to have nice businesses in emerging markets such as Brazil, India and China.

At \$24.35 a share, GM trades at a P/E of about five times analyst consensus estimates of \$4.25 this year. The company has net cash of \$20.7 billion, compared with a market capitalization of \$36 billion. There remain \$32 billion in unfunded pension liabilities, however.

Similarly, Ford seems interesting at \$12.26 a share. Again, at the current rate of car sales, Ford can earn \$6 billion to \$7 billion, notes Jack De Gan, chief investment officer at Harbor Advisory. The company has cut its auto-division debt sharply to \$12 billion from \$30 billion in a short time, and it will probably institute a dividend as early as the first quarter next year, he says.

Ford has improved its car and truck lineup and deserves Street cred for coming through the 2008 financial crisis better than GM, he adds. Ford trades at a P/E of 6.7 times 2012 consensus estimates of \$1.74. Like GM, Ford is a stock with hair on it: \$68 billion of net debt.

Investors need to consider that estimates for 2012 might yet come down. In a recession, these stocks, like many others, will fall some more. But they are a contra-consensus call and appear to be priced close to recessionary levels.

**MERGER AND ACQUISITION ACTIVITY** has been unusually quiescent this year, given the high cash levels at U.S. corporations. But there has been a rise in other types of corporate actions, including breakups and spinoffs.

Last week, for example, Abbott Laboratories (ABT) said it was splitting into drug and medical-products companies (see Follow Up). That follows similar action in the past 12 months from the likes of the former Fortune Brands, ITT (ITT), Marathon Oil (MRO), Sunoco (SUN), Conoco (COP) and Tyco International (TYC), among others.

"These things come in cycles and it is definitely increasing," says Carol Levenson, director of research for Gimme Credit, an independent credit-research outfit that keeps an eye on such moves, because often they can worsen bondholder value. "There isn't much going on in M&A land, so the investment bankers have to pitch something," she quips.

There is, however, some rationale in these deals for the companies and their shareholders. In some, disparate businesses—such as golf, spirits and housing supplies at Fortune Brands—somehow find themselves under one corporate roof and could benefit from being on their own, where the sum of the parts is greater than the whole.

Mark Minichiello, chief investment officer of QCA Capital in Los Angeles, specializes in looking for stocks where, among other attributes, there is potential for a spinoff or split-up that might enhance shareholder value. In uncertain times like these, traditional M&A suffers, so it is no surprise that breakup or spinoff activities pick up, he adds.

While the potential for this alone isn't enough to buy a stock, it can be a good place to start looking. Along such lines, both (NFG) and (HES) are on his radar. The former is partly a natural-gas distributor and an exploration operation, while the latter has refining and marketing assets to go along with its exploration business. Energy is an area where split-up and spinout activity is strong.

Additionally, Minichiello thinks that CVS/Caremark (CVS) might consider—after March 2012, when tax rules will make it easier—undoing the 2007 merger of CVS, a drugstore chain, with Caremark, a pharmacy-benefits manager. The combination hasn't paid off as expected by Wall Street, he says. Such an announcement could drive the stock into the high-\$40s from the current \$35.55, he adds.

ModusLink Global Solutions (MLNK), a small-cap supply-chain-management and logistics company, probably doesn't ring a bell with even the most experienced investors.

But back in the day—that being more than 10 years ago, during the Internet bubble—it was known as CMGI, a highflying and publicly traded venture-capital investor that owned stakes in some of the biggest Internet names of the time, hot properties such as Lycos and GeoCities, among others. CMGI's stock-market capitalization reached about \$40 billion at one point. Then the stock lost 97% of its value when the bubble popped.

CMGI lives on in an afterlife called ModusLink, a loss-making company with a \$166 million market cap and net cash position of about \$111 million, or some \$2.58 a share, for shares trading Friday at about \$4. The stock price is down from a high of \$6 this year.

That cash, the stock drop and some \$2 billion in potential ModusLink net-operating-loss tax benefits lately have attracted the attention of some big activist investors who are agitating for the board to institute changes that they claim will unlock value at the company.

For example, Handy & Harman, Raging Capital Management, Steel Partners, LCV Capital Management and Evermore Global Advisors all have amassed stakes in the company. At least 20% of outstanding shares are in the hands of what might be termed activist investors. LCV and Evermore have recently published letters that they sent to the board calling for the ouster of ModusLink's chairman, president and CEO, Joseph C. Lawler.

What's the beef? The activists insist that the company—which posted revenue of \$877 million in the fiscal year ended July, and earnings before interest, taxes, depreciation and amortization of \$15 million, but net losses of \$49 million, or \$1.13 a share—could be better run to make a profit. They also contend that executives are overpaid, and perhaps most important, that those tax benefits could bring home huge value in the future—but only for a profit-making enterprise.

ModusLink, which declined a request for comment, has said in the past that it is committed to acting in the best interest of the company and all stockholders. It pointed out that it returned some \$96 million to its shareholders since the beginning of fiscal 2008 in the form of buybacks, and a \$40 million special dividend, paid in March 2011.

At CMGI, highflying times are long over. But things could get interesting again fairly soon.