BARRON'S ROUNDTABLE

A Few Good Ideas

By LAUREN R. RUBLIN | MORE ARTICLES BY AUTHOR

Scott Black, Abby Cohen, Marc Faber and Oscar Schafer serve up their investment picks for 2010. The case for energy -- and tech.

IF THE WORLD ENDS TOMORROW, THERE'S good news today: You still have time to do your laundry.

The talk at the 2010 *Barron's* Roundtable, held Jan. 11 in Manhattan, followed a similar logic. As most of our 10 panelists saw it, the U. S. economy and the dollar are headed for ruin, courtesy of runaway federal deficits. Yet the stock market, even amid the biggest rally since the Great Depression, still holds tantalizing opportunities for smart and nimble investors. It's a paradox, all right, and it stems from divergent structural and cyclical forces -- two fancy-pants words that loosely refer to long- and short-term trends.

Brad Trent for Barron's

A Formidable Foursome: Oscar Schafer, Scott Black, Marc Faber and Abby Joseph Cohen share their investment picks for the new year in this week's issue.

In the first part of our annual session, recalled in last week's Roundtable issue, our panelists discussed and debated the long-term challenges facing the country, and the world, in the aftermath of the near-collapse of America's financial system. In this week's installment, they get down to the laundry -- that is, the stocks and other investments that could make you money now.

The pages that follow feature the picks of four of our wise men and women. Oscar Schafer, managing partner of New York's O.S.S. Capital Management, leads off with a shrewd analysis of Yahoo!'s parts and prospects, and a look at a neat oil-shale play. Next, Abby Joseph Cohen, the razor-sharp senior investment strategist and head of Goldman Sachs' Global Markets Institute, explains her firm's bullish calls on technology, energy and lodging, and which stocks in those sectors its analysts favor most.

A math and markets whiz, Scott Black takes the baton thereafter. Founder and president of Delphi Management in Boston, he recommends six companies that have cheap stocks and "the wind at their back," including Cisco and Teva.

Finally, Marc Faber, the globe-trotting head of Hong Kong-based Marc Faber Ltd., makes an impassioned case for investing in emerging markets, whose epic growth spurt, he asserts, has only just begun. Marc likes a passel of Asian stocks, not to mention that "honest" currency, gold.

It wouldn't be like the rest of the Roundtable crew to sit silently by, minding their business and BlackBerries while their colleagues take center stage. They, too, pipe in this week to question, contradict or merely comment upon the views of our key speakers. We hope you enjoy the give and take.

And P.S.: The long term won't look nearly so bad if policymakers read the Roundtable members' prescriptions, put forth in last week's issue, for fixing the mess we're in.

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Barron's: *Oscar, what are you recommending this year?*

Schafer: We are excited about Yahoo! [ticker: YHOO]. The company reaches one out of two Internet users and attracts 146 million unique U.S. visitors per month to its network of sites. Despite changing consumer behavior, Yahoo! consistently has captured 10% to 14% of the time spent online since 2006. In its largest verticals -- sports, mail, finance and entertainment -- it has close to a 40% share. The company generates most of its revenue from Internet advertising display and search. For the past three years Yahoo! has been rightly criticized for a lack of focus on technology. One charge is that it had evolved into an inefficient conglomerate with little structure and redundant personnel. The complaints culminated in a very tumultuous and public takeover attempt by Microsoft [MSFT] in 2008, at $33 a share.

To fix these issues, the board hired Carol Bartz and Tim Morse as CEO and CFO, respectively. Both have strong organizational track records. They are taking measures to unlock tremendous value. Yahoo! is worth $24-$25 a share.

Where is the stock now?

Schafer: It was trading at 16.70 Friday [Jan. 8]. There are three elements to our thesis. First, there are hidden assets. Wall Street has overlooked or severely discounted the value of Yahoo!'s 40% interest in the privately owned Chinese companies Taobao and Alipay. When combined with

Yahoo!'s cash and publicly traded assets -- stakes in **Yahoo! Japan** [4689.Japan] and **Alibaba.com** [1688.Hong Kong] -- nearly $12 to $13 a share is hiding in plain sight on Yahoo!'s balance sheet. Taobao and Alibaba were founded several years ago by Jack Ma. Taobao is the leading e-commerce site in China, with an 80% share of the Chinese consumer-to-consumer e-commerce market and 40% to 50% of business-to-consumer e-commerce. It is a cross between eBay [EBAY] and Amazon.com [AMZN], connecting consumers and merchants, but without taking inventory risk. With nearly 150 million users, it is on the track to facilitate $30 billion in transaction volume in 2009. There is significant growth ahead, as e-commerce represents less than 1% of retail spending in China. We value Taobao at $2.50 to $3 per Yahoo! share.

Alipay is similar to PayPal. It is the dominant online payment processor in China. By the end of 2009, it will have 190 million users and process $58 billion in transaction volume. PayPal did $60 billion in 2008. Ma, the CEO, hasn't monetized the business and doesn't currently charge for its payment services. After scaling the user base, there are tremendous opportunities to charge for processing and value-added services. We value Alipay at $1.50 to $2 per Yahoo! share. We are confident that Jack Ma intends to monetize Taobao and Alipay after he has locked up significant market share. An IPO [initial public offering] of Taobao in late 2010 or '11 could prove a significant catalyst for Yahoo!.

What are the prospects for the core Yahoo! business?

Schafer: Significant costs can be taken out in the next two years, including through outsourcing the search function to Microsoft. Some of these savings will be reinvested. But management is committed to improving margins and growing revenue. A cyclical advertising recovery also should benefit Yahoo! There are signs of a modest recovery, with online media capturing a lot of the benefits of an upturn. Yahoo! has close to a 20% share. A secular shift to the Internet as an advertising medium, together with a cyclical recovery, should enable Yahoo! to return to positive revenue growth in 2010. Recent headline news about share loss in the search market, while disappointing, isn't catastrophic, as the majority of that loss comes from Yahoo!'s exiting of non-profitable partnerships.

After accounting for the value of its Asian assets and the cash on its balance sheet, we're getting Yahoo!'s core global media assets for $3 to $4 a share, or between $4 billion and $6 billion. By comparison, eBay, Amazon and Google [GOOG] have market capitalizations of $30 billion, $56 billion and $188 billion, respectively. Ex its Asian assets, Yahoo! is trading for 4 times our estimate of 2011 free cash flow.

What do you think of Yahoo!, Fred?

Hickey: It could work. Bartz did a good job as head of Autodesk [ADSK] and has done a good job cutting costs. The issue is, what will Yahoo! become? They are trying to become a content provider, and there is a lot of competition in that market. They are losing ground in search. The display-ad business probably will improve if the economy improves. There is a lot of value embedded in the company. It could work out, but the model has yet to be proven.

Schafer: That's true, but you aren't paying anything for it. You have a call option on Bartz's ability to grow the company again.

My next pick is in the oil sector. Most known, easily accessible oil reserves have been nationalized in the past decade. The super-major integrated oil companies increasingly have to re-evaluate their business model of leveraging technical expertise and large project management to produce from hostile places and complicated onshore and deepwater reservoirs. In other words, as finding oil and gas becomes more expensive and more risky geopolitically, North American oil and gas assets will become more valuable. Devon Energy[DVN] is a very cheap North American E&P [exploration and production] company. It sells for 76 a share. It has 25% to 30% upside, which would bring its P/E [price/earnings] multiple in line with its peer group. But the stock could trade at a premium, as oil represents a higher percentage of Devon's hydrocarbon production and it has less leverage than peers.

Where does Devon operate?

Schafer: It has prolific shale-gas plays in the Barnett, Haynesville, Woodford and other fields, and Canadian oil sands. To date, the growth potential of these assets has been obfuscated by the capital intensity of its international and offshore assets, which consume 30% of capital expenditures but contribute only 11% of production. Management recently made a decision to focus all its investment in onshore unconventional gas assets and oil sands. Devon will sell its low-return international and offshore Gulf of Mexico properties. By directing the proceeds of the sales to its onshore assets, it will accelerate its production growth rate. Production-cost and reserve-replacement metrics will improve. We applaud this direction and believe the asset sales will serve as a catalyst for Devon's shares to be revalued.

Devon's attractiveness is highlighted by a sum-of-the-parts analysis. Based on a shale joint-venture between Chesapeake Energy [CHK] and France's Total [TOT] announced earlier this month, Devon's industry-leading position in the Barnett Shale is worth north of $33 a share. Using a long-term oil price of $75 a barrel, the net present value of its oil-sands development in Canada is $13. Applying a peer multiple to the company's midstream and marketing assets gets you $12 a share. Assuming the midpoint of management's guidance, proceeds from the sale of the international assets announced in the fourth quarter of 2009 offset Devon's net debt of about $6.5 billion. Devon's Barnett Shale, oil-sands and midstream assets alone are worth $58 a share, giving investors the remaining 1.4 billion barrels of proven reserves for $5.70 per barrel-equivalent. Looked at differently, the current stock price gives you exposure to the company's remaining 8.6 billion barrels of proved and probable and possible reserves for less than a dollar a barrel. Valuing the remaining reserves at $15 a barrel brings the total to about $105.

This valuation ascribes no value to potential reserve increases from the exploitation of major shale plays in which Devon participates. If Devon's probable and possible reserves are valued the way ExxonMobil[XOM] is valuing XTO Energy's [XTO] in its takeover of that company, they would be worth $25 a share. The XTO deal illustrates the desire of the majors to have more North-American-based assets. It can serve as a catalyst for other majors to buy other U.S. independent E&P companies with vast acreage in unconventional gas plays.

Is Devon is a takeover candidate?

Schafer: In past eras the super-majors have acted in herd-like fashion. BP's [BP] acquisition of Amoco in 1998 led to three other big oil companies making sizable acquisitions in the ensuing 18 months. U.S., European and Chinese majors are looking at Devon's international assets. They could do the valuation and decide to buy the whole company. More and more, the big internationals will look to the U.S. to make acquisitions, and Devon is in their sights.

Abby Joseph Cohen, senior investment strategist and president of Global Markets Institute at Goldman Sachs and Barron's Roundtable member, says corporate profits will do well in 2010 and corporate revenue growth will near 10%.

Black: We used to own Devon and sold it. Last year they had zero growth from the drill bit. Historically they were a 5% or 6% grower. Also, they are selling off one of their greatest assets -- their interest in the Jack Field in the Gulf of Mexico, which is a huge find.

Schafer: Devon has said it can't be all things to all people.

Black: My concern with these shale plays is there is a glut of gas. We've talked to a lot of the independents this past year, and they say they aren't doing as much drilling and exploration because it isn't economic.

Schafer: We also own Aflac [AFL], a supplemental health insurer. It is the type of financial you would want to own coming out of a recession. It has a fantastic core business, but has been beaten up on balance-sheet concerns that should abate. Aflac is the dominant cancer and supplemental medical insurer in the U.S. and Japan. For more than 10 consecutive years Aflac has sustained double-digit earnings growth per share, and a return on equity of more than 20%. Deriving 75% of its earnings from Japan, it has thrived on the country's unique supplemental-insurance market, in which reputation and brand are drivers of differentiation. Aflac has developed considerable market share, best-in-class distribution, scale advantages and franchise value that have all allowed it to outperform its more commoditized life-insurance peers. Recent investor concern is focused more on

the company's investment portfolio, specifically a large $8.5 billion book of bank hybrid securities that Aflac owns.

Issued by which banks, specifically?

Schafer: European banks, such as RBS, Lloyds, Deutsche Bank and HSBC. The market is worried that a combination of investment losses and rating-agency downgrades on these securities could trigger a capital raise for Aflac. We don't think that will be the case. In the long term, Aflac will be made whole on the majority of its hybrids. Government support of large financial institutions gives us comfort that bank issuers won't be going bankrupt any time soon. Further structural features of these hybrids restrict issuers from permanently suspending coupons. In many cases, coupons on the hybrids are cumulative, meaning they must be repaid even if they are temporarily deferred.

We've stress-tested Aflac's hybrids and capital position. An equity raise is extremely unlikely even in an adverse scenario. Aflac has many capital buffers and levers, including more than $2 billion in annual operating earnings, an estimated $410 million of cash and an annual dividend of $540 million. With a dilutive capital raise off the table, it could trade more in line with its historical valuation. Aflac has always been valued at a premium to its peers, trading at an average of more than 15 times earnings.

Oscar's Schafer's Picks

Company	Ticker	1/8/10 Price
Yahoo!	YHOO	$16.70
Devon Energy	DVN	76.12
AFLAC	AFL	49.41
Carter's	CRI	26.64

Source: Bloomberg

Where is the P/E now?

Schafer: The stock is 50, and it trades at about nine times 2010 estimated earnings. With earnings power of more than $5.35 a share this year, Aflac should trade at a minimum of 12 times, which would imply a share price of 65. There could be upside as the multiple expands.

Witmer: What's the yield?

Schafer: The stock yields 2.2%.

Witmer: So if you get cancer in Japan, you need supplemental insurance?

Cohen: Japanese society is less open than the U.S. about cancer diagnoses. Treatment may be delayed, affecting outcomes, and cancer insurance has been a popular product.

Gross: What are they selling in the U.S.?

MacAllaster: About 75% of their business is health insurance.

Gross: How does the health-care reform bill affect them?

Schafer: Our checks indicate supplemental medical insurance is the one line of insurance that should benefit from health-care reform. In Japan Aflac has thrived in a socialized health-care system.

My last stock is Carter's [CRI], a wholesaler and retailer of baby and young children's apparel under the Carter's and OshKosh B'Gosh brand names. It's got 200-year-old brands. The company commands nearly 15% of the $24 billion baby and young children's apparel segment. Sales are split evenly between wholesale and retail channels. The largest wholesale accounts are Kohl's, Wal-Mart Stores and Target. Carter's operates 273 Carter stores and 169 OshKosh stores. We have always viewed this as a high-cash-flow business with significant growth potential. But the stock is attractively priced today because investors sold it when the company delayed its third-quarter filing due to accounting irregularities. Since then Carter's has quantified the issue and hired some

promising new executives. Investors are distracted by the accounting questions and are underestimating the earnings and cash-flow power of the company as the economy improves. They are also missing the defensive nature of the baby segment.

What is the stock price, and your target?

Schafer: Our price target is 35 a share, about 35% higher than today's price. This would represent 16 times consensus 2010 earnings, the multiple it used to sell at. Current consensus expectations are too low. Carter could grow revenue in the high single digits, and earnings per share in the mid-teens. The company generates more than $2 a share of free cash flow, and will be net cash positive by the end of 2010 even after investing in store growth. Carter's will return some of its excess cash flow to shareholders through share repurchases.

Carter's is a defensive business. We view the company as a consumer staple. As such, it could command a premium valuation. Most sales are in basic items purchased on a recurring basis. Some 80% of the products in Carter's retail stores sell for $10 and under. Also, the retail segment will lead to higher shareholder returns over time. There are significant opportunities for Carter's to expand its retail footprint beyond outlet centers.

How many stores does the company have?

Schafer: Carter's has less than 450 stores between the two brands, compared to 950 Children's Place [PLCE] and another 950 Gymboree [GYMB] units. It can grow store footage by 7% to 10% annually for the foreseeable future. This type of growth will generate high returns on invested capital. The retail segment is higher-margin than the wholesale business, and as it becomes larger it will improve the margin profile of the company. Finally, there is a big upside opportunity in turning around OshKosh. Both the company's brands could grow internationally and via e-commerce. The company has a very profitable licensing business overseas.

Carter's bought OshKosh in 2005 and the performance has been terrible. The margins are significantly below Carter's. But recent results are showing signs of improvement. Carter's, with sales of $1.5 billion, is the largest apparel company we can find without a meaningful e-commerce business. Management recognizes the huge potential in this channel and is committed to going after it.

Gross: You are flying straight into a consumer headwind with this company. Why do that?

Schafer: There may be consumer headwinds, but baby clothes aren't exactly postponable. Such concerns are in the price. For 2009 the company could earn $2.10 a share, and this year, $2.35.

Thanks, Oscar. Let's hear from Abby.

Cohen: We think the worst is over in the economy. The rate of economic growth is unsustainably high and will be moving lower, but the recession is over. In 2010 the most rapid rate of earnings growth will come from cyclically oriented sectors such as energy and technology. Our earnings estimates in these areas seem to be above consensus forecasts.

In technology, we see several things happening. No. 1, the global economy is improving. No. 2, there is a refresh cycle for personal computers and servers, and a lot of pent-up demand. During the most difficult portion of the recession and credit crisis, many companies pulled in their horns and didn't invest in upgrading their computer systems. In 2010 they will do so. In a survey of global companies that Goldman Sachs did just a few weeks ago, three-quarters of companies indicated they had pent-up demand for PCs. That was two or three times the number that had indicated as much just six months earlier. Part of this has to do with the fact that PCs, on average, are now more than four or five years old. They need to be replaced, and there have been some well-timed software introductions, such as Microsoft's Windows 7. In another survey, 94% of companies said they planned to move to Windows 7 at some point in the next two to three years.

Hickey: One of the main drivers here is that the Windows Vista operating system was terrible. As a result, most companies are still using Windows XP. There is pent-up demand for a new product that actually works.

Cohen: The hardware is starting to break down at age five and beyond, and the software is eight years old. Thus, one of our recommendations is Dell [DELL]. It has had an uneven record, but at

these levels it is interesting. Global information-technology spending will increase by about 5% in 2010, and the increase in unit sales will be dramatically greater. In the next couple of years, we expect unit growth of 12% to 13%, even though spending growth could be more like 3% to 5% per year. Unlike in the past two to three years, when a lot of the spending on personal computers was focused on personal and family use, spending in the next couple of years will be done mainly by companies. And companies aren't so much Apple-based [AAPL] as PC-based. Dell offers a good product at an attractive price.

What are your estimates for Dell?

Cohen: Our earnings estimate for the coming fiscal year [ending Jan. 30, 2011] is $1.35 a share. That's above the consensus, at $1.24. The company doesn't pay a dividend. The stock trades for about 15 times our 2010 estimate, and 11 times our 2011 estimate. Although it isn't one of my recommendations today, Microsoft is expected to be a big beneficiary of the upgrade cycle. It will see significant demand for Windows 7.

The stock has already moved up a bit.

Cohen: Our analysts believe it can continue to do so.

Hickey: Microsoft isn't done here. It will benefit from earnings expansion.

MacAllaster: The stock's gone from 19 to 30.

Hickey: It was about 15 at the low. But it is selling for only 14 or 15 times earnings, on low estimates. There is going to be significant earnings leverage this year. The stock is going into the 40s. Also, for the first time, Microsoft is cutting costs. They had their first mass layoffs. They blew away their numbers [significantly beat earnings estimates] in the September quarter, and that's without the impact of Windows 7.

Marc Faber, managing director of Marc Faber Ltd and Barron's Roundtable member, anticipates meaningful market correction in 2010. Mining and agriculture will be top performers within commodity sector.

Cohen: My next recommendation is Accenture [ACN]. It is primarily a consultant and outsourcing firm in the IT [information-technology] services area. It will be a beneficiary of companies deciding to upgrade their technology. Accenture typically benefits from a lot of early-stage spending. It also could benefit from companies that don't want to build a full-time staff. The company has a lot of cash, and strong free cash flow. It announced a stock-buyback authorization of about $5 billion. About half could get done in 2010. The company does 55% or 60% of its business in Asia-Pacific and other parts of the world, where economic growth will be faster than in the U.S. and Western Europe.

Black: I talked to the company twice this past year. The problem is, they don't have much top-line growth. Hewlett Packard [HP] and IBM [IBM] have done a better job in that space and are taking share away.

Hickey: Accenture's latest quarter was very difficult. The company said it hadn't seen any improvement yet in its business, while competitors have seen some. But if there is a general lift in IT spending, they aren't going to be left behind.

Cohen: Part of the attraction is the cash flow, and a 3% yield. The stock is trading at about 15 times our 2010 earnings estimate, and 13 times our 2011 estimate, also above consensus. Among broad sectors, we like energy. Petroleum is more interesting at this point than natural gas. There are significant opportunities in energy. We see rapid earnings growth, and Goldman Sachs estimates are 20% to 25% above the consensus. One of our analysts' favorite stocks is Petroleo Brasileiro, or Petrobras, based in Brazil. The ticker is PBR/A. It is a high-beta kind of company. The sector is priced at roughly $75-per-barrel oil. Our forecast is closer to $90 for 2010.

What are you so bullish on energy?

Cohen: We see greater global demand. Many people are focused on demand in the United States, which hasn't been all that robust. It has been hurt by downward pressure on industrial production, greater energy efficiency and so on. Natural gas, which is much more a North American phenomenon, is more afflicted than petroleum in this regard. Petrobras is interesting, as well, because of its exposure to Latin America. It has good resource exposure. It isn't going to run out of oil and have to look for new resources. The stock yields about 2.6%. Based on our 2010 estimates, the P/E is 9.6. The stock has done well in recent months, but our analysts think there is more here.

Abby Joseph Cohen's Picks

Company	Ticker	1/8/10 Price
Dell	DELL	$14.85
Accenture	ACN	42.57
Petroleo Brasileiro	PBR/A	43.50
Occidental Petroleum	OXY	83.72
Polo Ralph Lauren	RL	86.37
Starwood Hotels	HOT	37.62

Source: Bloomberg

Black: Of all the national oil companies, it has the highest growth rate. The company is growing 5% or 6% organically, which is enormous for a company of this size. It operates off the coast of Brazil. As Abby points out, it's not like Petrobras has to invest across the world to enhance its business.

Cohen: My second energy name is Occidental Petroleum [OXY]. Like Petrobras, it has good resource exposure, but it is lower beta. The company has very significant free-cash generation. It is estimated that Occidental's debt declined by about $800 million last year. Occidental has good resource exposure. It has projects under way in the Middle East, Texas and California. The company could increase its dividend significantly and it is engaging in share repurchases. The yield, at 1.6%, isn't so high now, but could rise substantially.

Gabelli: Occidental made a fairly significant discovery last July.

Cohen: That is correct. Our earnings estimates for both companies are notably above the consensus. That doesn't mean they are right, but they are substantially higher. We estimate Occidental will earn $7.85 to $8 a share this year. The consensus is $5.80. This has to do with our energy forecast.

My next stock is a consumer name: Polo Ralph Lauren[RL]. The company has become increasingly international. It has been very successful in Europe as it has done brand extensions. It is now turning its attention to Asia. Polo has long-term prospects for earnings growth on the order of 15%. Again, our forecasts are well above the consensus. We estimate Polo Ralph Lauren will earn $5.20 in the fiscal year ending March 2011, while the consensus estimate is $4.74. Polo did well this past Christmas, not just in the stores but increasingly online, which will be important in the future.

MacAllaster: What is the price on the stock?

Cohen: It closed Friday [Jan. 8] at 86.37. It has a small yield. It is trading near its 52-week high, as are many retail stocks.

My last name is Starwood Hotels [HOT]. We're assuming the economy gets better and business travel picks up. We're beginning to see some signs of that. In the past few weeks, hotel revenue per person has been increasing. There have been improvements in pricing and occupancy rates. Trade shows, while nowhere near the level of two to three years ago, are recovering. In 2010, Starwood's earnings per share will be close to trough levels, but Ebitda [earnings before interest, taxes, depreciation and amortization] is the most important measure for this company. Based on 2009 numbers, the stock is trading for 13 times EV [enterprise value, or market value plus net debt] to Ebitda. Based on our 2010 estimate, which is 20% above consensus, the multiple is about 11.8. Starwood is the dominant player in the industry, which gives it significant benefits. We also see

capital coming out of the hotel industry, as there was a great deal of overbuilding. That's all to the good of a quality operator like Starwood, however.

Thank you. Scott, you're next.

Black: Our theme this year is looking for companies with earnings momentum. If they have been in a downtrend, we try to catch the inflection point. Also, we want to buy stocks that are statistically cheap. My first stock is a consumer issue -- Ross Stores [ROST], operator of Ross Dress For Less. It had record earnings last year. The stock closed Friday at 45.06 a share. There are 124.6 million fully diluted shares, for a market cap of $5.6 billion. The company has $4.62 a share of cash. It sells name brands at 20% to 50% less than department stores such as Macy's. In addition to 955 Ross stores, it operates 53 dd's Discounts. In the latest month, comparable-store sales were up 12% and revenue, 16%. The company consistently earns 30% on book value.

I model my own numbers. For the year just ended, Ross will have had revenue of approximately $7.16 billion, up 10%, and earnings per share of $3.50. If square footage and "comp" sales each grow by 4% this year, you get about $7.8 billion in revenue.

If you model 5% expansion and 6% comps, you get revenue of $7.97 billion, up 11%. Operating margins are about 9.8%. Based on revenue, operating income could range from $748 million to $781 million. Net interest expense is about $7 million, so earnings are in the ballpark of $3.74 to $3.93 a share. Let's say they're $3.80. The P/E is 11.8 times. Free cash flow could be around $460 million in the coming year. The company repurchases about $300 million of stock year in and year out.

Women's wear is 32% of the merchandise; home furnishings, 23%; menswear, 14%. Ross operates in the Sunbelt, and New Jersey and the Carolinas. Its major competitor is TJX [TJX]. Ross does a lot of market research, and has about 360 buyers. It will buy on closeouts and store merchandise until the proper season. It is a consumer company that benefits from a bad environment.

What is your next pick?

Black: Nexen [NXY] is a major operator in the Canadian tar sands. It sells for 24.35 a share, and there are 521 million fully diluted shares, for a market cap of $12.7 billion. From 2000 through 2008, it earned more than 20% on book per year. It earned less last year. Return on equity should be 15.6% this year. The company has 283 million barrels of conventional oil reserves, which I value at $3.396 billion. It has 576 billion cubic feet of gas. The net present value of $2.50 per thousand cubic feet is $1.44 billion. Together, the conventional reserves are worth $4.836 billion. If you add debt and deferred taxes, Nexen's total capitalization is $20.46 billion. Thus, you're paying $15.623 billion for the tar sands, which have six billion barrels of recoverable reserves. Put another way, you're paying $2.60 a barrel for the tar sands, and you're getting a freebie in an enormous shale play they hit in British Columbia, with three trillion to five trillion cubic feet of gas. At $2.50 per Mcf, that adds another $14.40 a share.

Nexen is cheap. In 2009 the company should have had $4.5 billion in revenue and earned close to $1.30. Revenue could rise 31% this year, to $7.08 billion, and earnings could climb to $2.30. Companies like this are valued not only on earnings but discretionary cash flow, which in Nexen's case is about $5.50 per share. The stock sells for 4.4 times discretionary cash flow. Suncor Energy [SU], another tar-sands play, sells for 9.3 times forecast discretionary cash flow. Canadian Natural Resources [CNQ] sells for 6.7 times. Nexen's net-debt-to-equity ratio is 0.72, but the [interest] coverage ratio was 8.15 in the latest quarter.

MacAllaster: How much debt do they have?

Black: Net debt is $5.3 billion, against $7.4 billion in equity. Free cash will approach $400 million this year. Capital spending will be about 2.5 billion Canadian dollars, or $2.425 billion. The company wants to use excess cash to knock down the debt. This year Nexen will produce about 255,000 barrels per day, up about 8% year over year. You are getting a decent company with growing free cash flow from the drill bit. And you're getting the Athabasca tar sands at a ludicrous price per barrel.

Scott Black's Picks

Company Ticker	1/8/10	Price

Ross Stores	ROST	$45.06
Nexen	NXY	24.35
Teva Pharmaceutical	TEVA	59.34
Belden	BDC	25.07
Micron Technology	MU	11.10
Cisco Systems	CSCO	24.66

Source: Bloomberg

MacAllaster: And reserves in the tar sands aren't hard to find.

Black: Finding and development costs are cheap up there, at $10 to $12 per barrel. But a lot of the capital spending is behind them.

My next stock is Teva Pharmaceutical Industries [TEVA]. The company is gaining earnings momentum. The stock is 59.34 and there are 915 million fully diluted shares. The market cap is $54.3 billion, the largest for an Israeli company, though most of its business is in the U.S. North America accounts for 63% of distribution, and Europe, 23%. Revenue could be up 15% for the year, to about $16.05 billion. Operating margins are 28%, and operating income, $4.494 billion. Interest expense is $130 million, and pretax profit is $4.36 billion. Earnings per share should be $4.50. The company trades for 13.2 times expected earnings. Return on equity will be 19.1% this year. The plan from 2009 through 2015 is to grow revenue from $13.9 billion to $31 billion, or by 14.3% compounded annually. Net income could go from $2.97 billion to $6.8 billion, up 14.6%, compounded. Earnings per share will grow only 13.4%, as Teva will probably issue more shares for both compensation and acquisitions. But free cash flow is staggering, at more than $2 billion a year. It will grow about 15.3%, compounded, to roughly $4.7 billion.

What are some of Teva's products?

Black: Roughly 70% of Teva's business is generic drugs, and 30% is branded drugs. They have two big brands. Copaxone, for multiple sclerosis, is a $2 billion drug already, and Azilect, for Parkinson's, is $300 million. Branded drugs have higher gross margins of about 80% to 85%, but the company sees opportunities in generics as drugs like Eli Lilly's [LLY] Zyprexa come off patent. Teva now has 216 filings with the FDA [Food and Drug Administration], representing $114 billion in current sales of branded products.

Schafer: Are they the first generic maker to file?

Black: There is no advantage to filing first any more. The real issue now is getting these drugs into their portfolio and building a sustainable franchise. I asked management if Teva would be hurt by a cut in generic pricing under ObamaCare. They said they would more than make it up in volume. I am not hopeful about health-care reform. I don't want it to pass, though it will in some form.

What is your objection?

Black: There is no cost containment or tort reform built into the bills.

Gross: It would be the biggest entitlement program in our history.

Black: But it will benefit Teva. More scripts [prescriptions] are written for Teva than any other drug company in the world. In the 12 months through last September, their U.S. market share was 16.4%. Mylan [MYL] was second, and Novartis [NVS], third. They have the wind at their back. Teva generates nothing but cash. The stock recently moved up, but it still sells for only 13 times earnings, and the company is a 14% grower.

My next recommendation is an electrical firm, Belden [BDC]. It sells for about 25. There are 46.6 million fully diluted shares, and the market cap is $1.17 billion. Since the bottom fell out of the market in the fourth quarter of 2008, the company has had successive negative quarters. This quarter

could mark the turn. They could earn 31 cents, against 26 cents in the prior year. For this year we modeled $1.5 billion of revenue, up 7%, and earnings per share near $1.60. Peak earnings were $2.87, in 2007. For 2011 we are modeling a 9% increase in revenue, to $1.64 billion, and 15% operating margins. They have taken out a lot of costs. Operating income could be $245 million. Interest expense is about $45 million. Interest income is $3 million. Fully taxed at 30%, you get earnings per share of about $3.05. The stock trades for about eight times expected earnings. Belden generates free cash flow. The ratio of net debt to equity is 50%.

What exactly does Belden do?

Black: It operates in four segments. Basic cable for industrial customers is about a GDP-plus-1% grower. The connector business grows at twice the rate of nominal gross domestic product. The industrial-networking, or Ethernet, switch business grows 12% to 20% a year. The wireless-LAN [local area network] business is small, but it is growing by 25% or more per year. Organic revenue growth, overall, is 7% to 9% a year. With acquisitions, they could grow more. Geographically, there is exposure to emerging markets. North America accounts for 55% of sales. Europe, the Middle East and Africa are 25%, and Asia-Pacific is 16%. They also run a wireless business out of Aruba. This is a mundane business, but if earnings power can return to $3 a share, the stock can go back to 40.

I also like Micron Technology [MU], which had a terrible record for 10 years.

Hickey: It had a terrible record for 20 years.

Black: The prior peak was in 2000, when they earned $2.59 a share and return on equity was 29.3%. The business has changed since then. They formerly made just DRAM memory. Now they make NAND flash-memory products in a joint venture with Intel [INTC]. As Abby said, fundamentals in the tech sector are good. According to Gartner, global DRAM revenue will be $29.1 billion this year, up 25% year over year. Daiwa Securities sees 13% growth in PC units, and a 55% increase in smartphones. DRAM prices are still up in January. Usually there is a seasonal dip. Micron is 11.10 a share.

Scott Black, Delphi Management president and Barron's Roundtable member, says the markets will be up in 2010 and the technology sector will be a top performer.

Hickey: Up from 2. It's over.

Black: I didn't say it was a great company. They have one billion fully diluted shares, and a $11.1 billion market cap. Book is $5.19 a share, so the stock sells for 2.1 times book. The balance sheet is what saved them over the years. They've had more cash than debt. The net-debt-to-equity ratio is 0.23.

Hickey: They burned through cash. What saved them was they always had a partner that came through with additional cash. Intel saved them a couple of times.

Black: We have modeled $7.2 billion in revenue for the fiscal year ending in August. That is up 50% year over year, due both to unit growth and pricing. Gross margins are 27.6%. Operating income is $1.07 billion. Interest expense is about $180 million, and they had $56 million in other income in the fiscal first quarter. Some foreign operations are taxed, but Micron also has tax-loss carryforwards that reduce taxes. We see net income of $900 million, or earnings of 90 cents a share. Stock-based compensation is a cost of doing business, so that's another $20 million a year, or two cents a share, bringing total earnings per share to 88 cents in fiscal 2010. The stock sells for 12.6 times expected earnings. Micron's run could continue for a while. Some of the semiconductor capital-equipment companies have good order-backlog visibility for the first time in a long while. DRAM and NAND prices are up strongly as demand exceeds supply. The company said inventories were lean at the end of 2009.

Hickey: Micron always says inventories are lean. It is something you take with a grain of salt. Once again the industry is going to overbuild. They will have a boom and bust. It has been their history for 20 years.

Black: I don't disagree. It is cyclical. For fiscal 2011 my model has revenue increasing 10%, to $7.92 billion. Margins will increase slightly, to 28.5%. They could earn $1.13 a share, after

subtracting two cents a share for stock-based compensation. In fiscal 2010 Micron could generate $1.46 billion in free cash. They'll use about $650 million to pay down debt.

A couple of things are helping Micron besides pricing. DRAM technology is shifting to a new generation, DDR3 memory, which accounts for 40% of the company's production. They are ahead of the competition on DDR3. Then, there's growing demand. Smart phones are doubling their DRAM usage every nine months. Micron has three major competitors: **Samsung Electronics** [005930.Korea], **Hynix Semiconductor** [000660.Korea], which is subsidized by the Korean government, and **Elpida Memory** [6665.Japan], which is kept in the ballgame by the Japanese. But the stock is cheap, and for the first time in 10 years, things are going Micron's way.

MacAllaster: For how long?

Black: Maybe 12 to 18 months. My last pick is Cisco Systems [CSCO]. Earnings have been down for several quarters, but the turn is finally coming. The stock is 24.66. There are 5.87 billion shares. The market cap is $144.8 billion. For the fiscal year ending July 2010, revenue will be up only 5%, to $37.9 billion. Operating margins are about 26%, and operating income, $9.86 billion. Cisco has $35 billion of cash and equivalents, but that doesn't earn a whole lot. Minus the debt, it's $30 billion. Pretax profits are $9.89 billion, and they are taxed at a 22% rate. The company has an authorization to buy back $10 billion of shares. It has bought back more than $30 billion in the past three years and some $60 billion in the past 10. Cisco could earn $1.25 a share this year, after excluding stock-based compensation. Take $6 a share in cash out of the stock price and you get a price/earnings multiple of 14.9.

In fiscal 2011, revenue could grow 13%, conservatively, to $42.5 billion. With a slight increase in profit margins, the company could earn $1.47 a share. You're paying 12.7 times fiscal '11 estimates. The company generated $8.22 billion of free cash last year. It is a veritable money machine.

Hickey: Cisco has had a great position in its market. But it can't raise margins because its prices are so high.

Black: The service component is increasing, and services have higher margins than products.

Hickey: There are huge changes going on in the business. The computer and telecom worlds are converging. Cisco is treading on computer companies' turf by coming out with LAN computer servers. Computer companies are moving into Cisco's turf. Cisco was competing against the 3Coms of the world, but Hewlett Packard is buying 3Com and making its own huge push into networking.

Black: Cisco has taken $1.5 billion out of its cost structure in the past 18 months. It has a global footprint. The U.S. and Canada account for 53.5% of sales; Europe, 21.3%; emerging markets, 11.1%, and Asia-Pacific, 10.3%. The company is making an acquisition in Norway in the video-conferencing area. Our estimates don't include all the small, bolt-on acquisitions planned. And, they are a beneficiary of the trend toward cloud computing. You are paying relatively little for a powerhouse company.

Thanks, Scott. Let's hear from Marc.

Faber: I am surprised nobody mentioned India today. The world is changing. In the past 10 to 15 years there has been a huge shift in the balance of economic power. The Western world still regards itself as the dominant economic force, but auto sales and oil consumption, for instance, are larger today in emerging economies. India added over a hundred million mobile phones last year. It has a billion people, 70% of whom live in the countryside. I have been going to India since 1973, and not much changed until about 10 years ago. Today, because the economy has become much more market-oriented, you drive through the villages and people have businesses and shops.

The typical international portfolio manager has 60% or 70% of his clients' money in America and 30% or 40% overseas. Maybe 10% or 20% is in emerging markets. That doesn't mean he should sell all his U.S. and European holdings and buy emerging markets, because the U.S. now is relatively inexpensive compared to other markets. But we are living in a new world where emerging

economies no longer are the poor cousins of rich countries, although their per capita income remains much lower.

But this isn't a revelation. Emerging markets did spectacularly well last year.

Faber: Still, many people think of emerging economies as relatively small, when in fact, they are larger than the developed world.

Cohen: It is not just the size, it's the growth rate. In physics, mass times velocity equals momentum. The mass of the BRIC nations [Brazil, Russia, India and China], their GDP, has been increasing. In the past eight to 10 years, the BRICs probably contributed far more to aggregate incremental global GDP growth than the U.S. did.

People said similar things before the Asian financial crisis of 1997-98.

Faber: That crisis was predictable, as Asia's emerging economies had to finance their current-account deficits with foreign money. When the foreigners balked, no more credit flowed in, and whole economies and currencies collapsed. Today we don't have current-account deficits in emerging economies. We have current-account surpluses. Sure, rapidly growing economies have setbacks, but investors should find ways to invest in countries such as India and China.

I am still holding most of the stocks I recommended here last year, but I am probably going to reduce my positions somewhat after last year's gains. One stock I still like is NovaGold Resources [NG]. It has very valuable assets in Canada and Alaska, in a joint venture. The stock is around 6.

What are the assets?

Faber: Gold properties in Galore Creek in Canada and Donlin Creek in Alaska. For the past 20 years there has been practically no new investment in oil exploration and mining. It picked up in 2006 and 2007 as commodity prices rose, but then came 2008 and everything collapsed. The supply response in commodities hasn't really happened. I am on the board of a mining company. From the day you start looking for copper until the day you produce it, it's 12 years, if you're lucky. The mining industry is like the pharmaceutical industry. The big drug companies don't do a lot of research. They let the small companies do it. If the small ones are successful, the big ones take them over. It is much cheaper. The big miners don't have large exploration budgets. They let the exploration companies do the hard work. Once an exploration company finds proven reserves, a big company buys it out. NovaGold is a small explorer.

Black: I met with Rick Van Nieuwenhuyse, chief executive of NovaGold. He is trying to get a partner. No one will buy the company. He doesn't have the balance sheet to do it himself. We owned the stock, but then I saw it was a story, not a business.

Faber: In mining, everybody has a negative story about everybody else. It's like art dealers. They all think the other guy is no good. The people behind NovaGold have deep pockets now.

This morning Mario recommended Griffon [GFF], which makes diaper components. In Thailand there is a diaper company called **DSG International** [DSGT.Thailand]. It sells for seven times earnings and yields more than 4%. Until recently there was no word in Thai for "diaper." It didn't exist. In some emerging economies, diapers are a new thing. The potential for expansion is huge. When you compare the P/E of DSG International to Griffon, which Mario says is more than 20 times earnings, I'd rather own DSG.

Gross: On what exchange do you buy a stock like that?

Faber: You can buy it on the Stock Exchange of Thailand, or through an international broker. The market cap is about $80 million. Mario also recommended money manager Legg Mason [LM]. **ARA Asset Management** [ARA.Singapore] is a fund manager in Singapore that manages real-estate investment trusts, or REITs. In Asia lots of stocks yield 5% or so. The local money-market yield is essentially zero. The bond yield is maybe 2%. These stocks at least pay you to wait. In the long run, property prices will go up in Asia. ARA has a P/E of about 11, and yields 5%.

Gross: I agree that emerging markets now supply capital as opposed to depending on others. But the problem many people have with emerging-market investing is epitomized by the book This Time Is Different, by the economists Ken Rogoff and Carmen Reinhart. It outlines 800 years of financial

crises, but in the past 50 to 100 years most of the defaults have been outside of the G7 [the world's largest industrialized countries] and in South America and Asia. The perception is property rights aren't the same in those places. That may be changing, however, as developed countries, including the U.S., have changed personalities, as in the GM bankruptcy.

Marc Faber's Picks

Company	Ticker	1/8/10 Price
NovaGold Resources	NG	$6.65
DSG International*	DSGT.Thailand	7.25 THB
ARA Asset Management	ARA.Singapore	S$0.87
Thai Beverage	THBEV.Singapore	0.25
Thai Tap Water Supply	TTW.Thailand	4.60 THB
Kingsmen Creatives	KMEN.Singapore	S$0.60
Vietnam Enterprise Investments*	VIETENI.Ireland	$2.87
Stella International	1836.Hong Kong	HK$14.52
Bank of Georgia	BGEO.UK	$9.20
Oslo Bors**	OSLO.Norway	60 NOK
Gold (per ounce/spot price)		$1,138.25
Short the pound against the U.S. dollar		£1=$1.60

*1/7/10 price.
**12/31/09 price.

Source: Bloomberg

Faber: The fact that the Western world hasn't defaulted for a long time doesn't mean that it won't in the future.

In Thailand I like **Thai Beverage** [THBEV.Singapore]. It sells whisky and beer. The stock sells for 13 times earnings and yields 5%. **Thai Tap Water Supply** [TTW.Thailand] is another good company. It sells for 11 times earnings and yields 6%. Emerging economies have world-class companies today, such as **Singapore Airlines** [SIA.Singapore] and Swire Pacific [SWRAY] in Hong Kong. Tourism is exploding in Asia, because one of the first things people do when they have money is travel. The departure rate in countries like China is still very low compared with the developed world, but it will rise. Along with tourism, the convention business is developing. **Kingsmen Creatives** [KMEN.Singapore] designs exhibits for conventions. It also designs the interiors of shops like Burberry and Harry Winston. The company has good growth prospects and sells for eight times earnings. It yields 5%.

What else do you like?

Faber: Agricultural commodities hardly moved last year. Wheat, inflation-adjusted, is at a 200-year low. You play it through purchases of wheat futures, or you buy farmland or potash companies.

Gross: What is the emerging bread basket of the world?

Faber: Ukraine has huge agricultural potential, as do Argentina and Brazil.

Cohen: In the past year or two, the application rate of fertilizer has been dramatically below average, in part because farmers didn't have cash. As a result, potash prices have come down. There could be a significant increase in the use of fertilizer.

Faber: **Potash One** [KCL.Canada], which trades in Toronto, doesn't produce anything yet. It is doing a feasibility study on a big project. If it gets approval to move forward, it is going to be big.

Vietnam has gone down a lot. It is attractive, and some Vietnam funds sell at huge discounts to net asset value. I expect Vietnam to develop very, very quickly. The population is literate and ambitious, like the Chinese. I'm recommending **Vietnam Enterprise Investments** [VIETENI.Ireland], a closed-end fund. Full disclosure: I am a director of the company. It sells at a 35% discount to net asset value. In China, I like **Stella International** [1836.Hong Kong]. They make shoes. Shoe companies originally thought they would design in the U.S. or Italy or wherever, and outsouce manufacturing to China. Now all the designers are in Dongguan, and China has become the footwear center of the world. Stella is developing its own brands, after manufacturing for others. The company has great potential. The P/E is 12 and the yield is 5%.

I own the **Bank of Georgia** [BGEO.U.K.], listed in London. The stock fell from more than 40 to under 2, and is now around 9. It can double from here, although Georgia is dicey politically. **Oslo Bors** [OSLO.Norway] is another interesting situation, though it isn't very liquid. It yields 8%.

Any others?

Faber: No. But I wouldn't be surprised if the market closes down this year. There is a lot of complacency among investors, and geopolitically, the world looks horrible.

Yet this is the first year you haven't had a short recommendation.

Faber: I would short the pound sterling against the U.S. dollar. And, I am still positive on gold.

Thank you, Marc.

E-mail comments to editors@barrons.com

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