

December 2010

Market Commentary

“Opinions Vary?!”



The S&P 500 moved up 12.8% from August month-end through October month-end, and then tacked on another 3.6% gain through November 5 before finally pausing over the past three weeks. Yet even accounting for this recent pullback, the S&P 500 is up 12.5% over the past three months, and is up 7.8% over the past 12 months. Clearly, the markets have surprised most investors during the 4Q10, buoyed by the overall strong 3Q10 earning reports, and the factors we detailed in last month's commentary: 1) The risks of a double-dip recession are relatively low (some think as low as 10%, others as high as 30%); 2) Corporate earnings growth will remain relatively strong, though there is high risk to this expectation given economic sluggishness; 3) The P/E multiple on 2011E EPS remains reasonable on a historic basis; and 4) The amount of dollars in low yielding defensive investments, such as checking and savings accounts, money market funds, and short-term CDs, is at record levels.

The near-term question, of course, is whether the recent 4.3% pullback from the November 5 close is merely the market catching its breath prior to a Santa rally, or has Scrooge shown up in the form of geopolitical concerns (EU debt crisis, aggressive saber rattling on the Korean Peninsula, revelations of the true depth of the global community's concerns about Iran) to tamp down the recent cautious optimism into year-end?

Looking at a chart of the S&P 500 for 2010, we see that we've enjoyed this run once already this year. From February 5 through April 23 the S&P 500 improved 14.2%, only to then embark upon a 16.0% retreat all the way to the low for the year on July 2. Is past prelude in this case, and have we begun to stumble down a slope of unknown length? Well, as we wrote in our Investment Strategy commentary of November 22, "I have learned the hard way it is tough to turn the equity markets down between Thanksgiving and Christmas."

"That jubilant seasonality becomes especially true in mid-term election years, for as the good folks at Bespoke Investment Group note, 'The S&P 500's performance following mid-term elections is quite positive. One year after election day, the S&P 500 averages a gain of 15.8% with positive returns every year (since 1946)!' Bespoke goes on to comment about comparisons between now and the 1994 stock market environment. While many people remember the stock market rallying right after the 1994 mid-term elections, the rally didn't actually begin until mid-December. A more apt comparison might be 1966 when the Democrats lost 48 seats in the House, and three seats in the Senate, leaving the DJIA range-bound between 780 and 824 into year-end before embarking on a rally that would lift the senior index 26.7% from its pre-election low (744.32) in October of 1966 into its September 1967 high (943.08)."

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In that same commentary we go on to detail the myriad of economic data that supports our measured optimism.

“Exports out of Long Beach surged 14.4%, the NAHB’s housing starts were revised upward for July and August (and increased slightly in September), the NFIB Index of Small Business Optimism rose, Manufacturing Industrial Production improved and is growing at an 8.2% annualized rate, the Fed’s Senior Loan Officer Survey indicated banks have eased their lending standards, the U.S. Trade Balance narrowed, retail sales rose 1.2% (and are up 7.7% year-over-year, reinforcing my belief the Christmas ‘selling season’ will be stronger than most expect), and the Philadelphia Fed Index jumped to 22.5 in November versus +1.0 in October. All of this suggests real GDP for 3Q10 is on track to be revised upwardly to approximately 2.7%. While that’s not great, it’s not bad either!”

Employment remains the dark cloud shadowing our expectations, and giving us pause. As we went on to note in that same commentary:

“The ‘bad’ remains employment; and while that looks to be at ‘steady state’ rate, private sector job growth is not strong enough to lower our unemployment rate. Here’s the problem, in my opinion. The first two-thirds of this decade saw production employment decline by approximately 2.4 million jobs. Most of those displaced workers found jobs in the construction industry. However, in 2007 the construction industry’s ‘bubble burst,’ with an attendant loss of those jobs, exposing the structural unemployment problems we are currently experiencing. Unfortunately, the U.S. is ill-equipped to deal with this in the short/intermediate-term. Over the longer-term I am confident ‘creative destruction’ will cause labor, and capital, to move from dying industries to growth industries, thus ameliorating the employment situation. Yet the risk is our politicians won’t wait long enough for this sequence to occur.”

Looking back to the charts, the buying stampede appears to have ended during the first week in November, yet we still believe it is a mistake to become too bearish. Even if we get a correction, we think it will be contained in the 5% to 8% range. The S&P 500’s 200-day moving average currently resides at 1134, while its 50-day moving average hovers around 1178; this benchmark index finished November at 1180.55. We expect any decline to be contained by those parameters. For the week ending November 26, despite the decline in the Dow, the S&P MidCap, S&P SmallCap, NASDAQ, ValueLine, and Russell 2000 all closed higher. Then too, the Supply/Demand metrics, Advance-Decline lines, New High/New Low readings, and Dow Theory all indicate to us that the stock market’s primary trend remains bullish.

We cannot predict what news out of Europe, Korea, the Middle East, or the hallowed halls of the White House and the U.S. Capitol may dampen investor enthusiasm further, but we remind our readers that these risks are likely already priced into the equity market valuation. Indeed, on a trailing 12-month basis stocks are priced at approximately 16x earnings. Yet given the current interest rate environment, they should be priced at more than 20x earnings! However, we are also still awaiting more signs of a sustainable rebound in consumer spending; absent this, we surmise current corporate revenue expectations may have to come down somewhat for 2011. That would put current earnings expectations at risk. Chief Economist Scott Brown writes “The Federal Reserve will keep the overnight lending rate near zero for ‘an extended period,’ likely into late 2011 and possibly into 2012,” which does provide some cover for most investors’ concerns. Overall, we think it wise to look toward the holiday season and year-end with hope, but as always, we urge our readers to heed the timeless wisdom of Benjamin Graham’s quote, “The essence of investment management is the management of RISKS, not the management of RETURNS. Well-managed portfolios start (and end) with this precept.”

Jeffrey D. Saut, Chief Investment Strategist

S&P 500 #	SYM.	SR	11/30/10 Close	12 Mo. Trail. Price Rge		Proj. 12 Mo. Price Target	Current Yr. P/E	2009A	2010E	2011E	Div. Yld.	Bv/ Shr.	Beta	FYE	Mkt. Cap. (Mil)
				High	Low										
	SPX	NA	1180.55	1227.08	1010.91	NA	14.2	56.86	83.39	94.44	1.7%	NA	1.00	DEC	NA

Large Cap (\$5 billion and above)

Alpha Natural Resources (hn,ng,o) Coal	ANR	AG	49.56	55.70	32.00	51.00	19.4	1.71	2.55	3.50	0.0%	21.22	2.07	DEC	6,041
	Alpha Natural Resources is our current favorite coal stock, primarily from the standpoint of valuation and potential upside given its leverage to metallurgical coal and improving thermal coal fundamentals. Alpha trades at a discount to its U.S. coal peers on an EBITDA basis. In addition to its met leverage and attractive valuation, Alpha has an embedded natural gas asset of 330 Bcf currently, with upside via its Marcellus Shale acreage that is worth at least \$5 per share, although not counted in our current 12-month price target.														
Hewlett-Packard (hs,ng,o) IT Hardware and Distribution	HPQ	G	41.93	54.75	37.32	56.00	9.2	3.85	4.58A	5.20	0.8%	17.75	0.90	OCT	96,313
	We recommend Hewlett-Packard given the company's strong market position, consistent execution, financial strength, and inexpensive valuation. HP has stepped up its offense over the past several quarters by acquiring 3Com, Palm, 3PAR, and ArcSight, companies that operate in large markets with above average growth and generally higher margins. We also believe anxiety around the CEO transition has passed and investors have low expectations for the recently appointed CEO.														
NII Holdings, Inc. (m,o,vf) Telecommunications Services	NIHD	AG	38.76	45.26	30.00	60.00	21.1	0.68	1.84	1.55	0.0%	17.13	2.27	DEC	6,561
	We believe NII Holdings will continue to see strong growth in its enterprise-oriented business in Brazil as that country ramps up its infrastructure spending ahead of the 2014 World Cup and 2016 Olympics in Rio de Janeiro. We believe that macroeconomic conditions in Mexico and Argentina are stabilizing and NII has already seen a rebound in net adds in these countries and we expect this trend to continue in the coming quarters.														

Mid Cap (\$1 billion to \$5 billion)

Brinker International (hn,hs,ng,o) Restaurants	EAT	G	20.44	21.12	13.33	23.50	17.3	1.44	1.18A	1.40	2.7%	6.46	1.84	JUN	2,077
	EAT remains the cheapest mid-cap restaurant stock in our universe by far when measured by cash flow. We believe restaurant industry sales are stabilizing after several years of declines. This should allow the flagship Chili's chain to see better comp store sales soon. This, coupled with the so far successful cost efficiency efforts, could create higher EPS estimates and a normalization in valuation over the next three to six months. In the meantime, the stock is supported by the company's significant share repurchases and a 2.7% dividend yield.														
Global Payments Inc. (ng,o) Transaction Processing	GPX	G	41.56	54.52	34.61	54.00	16.4	2.10	2.53A	2.71	0.2%	11.57	0.85	MAY	3,312
	Management has reiterated several positive trends and opportunities that could benefit revenue and profitability over the next several years: 1) a large, fast growing and high margin revenue opportunity in the Asia-Pacific market; 2) the ability to process domestic China Union Pay transactions in mainland China; 3) potential expansion into the Brazilian market; 4) further penetration of the ISO channel in the U.S.; 5) stabilizing macroeconomic trends in Canada by the end of F4Q11; 6) a strong balance sheet and capital structure; 7) potential accretive acquisitions; 8) cost synergies from the G2 data center consolidation; 9) the back-end conversion of eight territories; and 10) potential future share buybacks.														
Hub Group, Inc. (m,ng,o) Transportation Services	HUBG	AG	32.63	34.52	21.53	37.00	27.7	0.93	1.18	1.60	0.0%	9.75	1.22	DEC	1,218
	Ongoing secular trends coupled with recent changes in the intermodal competitive landscape stand to benefit Hub Group's pricing and volume in 2010/11. Hub's 3Q intermodal volumes surged 22% and pricing rose 3%. Two key competitors had favorable/below market rail line haul contracts reset up to a market level cost structure in November 2009 and April 2010, respectively, basically leveling the playing field for Hub and ostensibly enhancing market pricing. Additionally, Hub should continue to benefit from favorable secular trends in its "Local East" operations, where Intermodal is taking share from Truck given its lower cost. Hub's asset "light" model also generates plenty of cash, with our estimate that the company should have nearly \$4 per share in cash vs. no debt by 2011 before considering a buyback.														
Panera Bread Co. (m,ng,o) Restaurants	PNRA	AG	100.24	100.39	62.83	120.00	27.7	2.86	3.62	4.50	0.0%	18.28	0.98	DEC	3,057
	We believe Panera is in the relatively early stages of evolving into a power brand supported by strong product innovation and menu development and increased advertising and promotional activity. Underlying demand for the brand remains strong (as evidenced by its significant comp outperformance through the recession), which should support strong unit growth for years to come, with the chain eventually reaching ~3x its current size. Combined with the company's significant share repurchase power (funded by \$7.50 of cash on the balance sheet at end of 3Q10 and more than \$100 million of annualized free cash flow) and the shortage of high quality consumer unit growth stocks, we expect PNRA to sustain high valuation metrics for some time.														

SYM.	SR	11/30/10 Close	12 Mo. Trail. Price Rge		Proj. 12 Mo. Price Target	Current Yr. P/E	2009A	2010E	2011E	Div. Yld.	Bv/ Shr.	Beta	FYE	Mkt. Cap. (Mil)	
			High	Low											
Regal Entertainment Group (g,hn,o)	RGC	HR	13.50	18.49	11.59	18.00	20.8	0.62	0.65	0.80	5.3%	NM	1.01	DEC	2,084
Entertainment & Leisure	<p>With the industry's move toward digital exhibition likely to result in an acceleration of industry revenue trends over the next five-plus years, we believe Regal's industry-leading market share, best in class ROIC metrics, and strong cash flows should provide attractive returns for equity holders. Additionally, the company's future growth into digital (currently only approximately 25% of screens) will be funded largely by industry-related third parties (e.g., movie studios), which should help drive higher returns and free cash flow for Regal. The company currently remains undervalued relative to its five-year historical forward median EV/EBITDA multiple of 7.7x. Given the forthcoming digital upgrade cycle taking place in the exhibition industry, we believe RGC should trade up toward its historical median multiple.</p>														
Tenet Healthcare Corporation (ng,o)	THC	AG	4.08	6.46	3.92	7.00	16.3	0.15	0.25	0.28	0.0%	1.52	1.33	DEC	2,285
Hospitals	<p>Valuation has become increasingly attractive in recent months as THC shares have remained relatively flat in 2H10 on continued fears of softening utilization. Consequently, THC shares currently trade at 5.6x 2011E EBITDA, well below the group average (6.2x) and the low end of the historical range (6-8x). In mid-June, management raised 2010 EBITDA guidance 5% at the midpoint to reflect improving labor cost management. Still, in our view, guidance remains conservative, especially when considering the various cost initiatives currently being implemented. Plus, with Tenet having the lowest margins among its peers, we believe the company has the most room for operating leverage off improving volume trends (with management becoming more vocal about the 200-400 bp of margin opportunity over the next several years). We believe the combination of an inexpensive relative valuation paired with solid EBITDA growth should lead to share price outperformance over the coming quarters, especially with free cash flow set to grow in 2011 and beyond.</p>														
ValueClick Inc. (ng,o)	VCLK	AG	15.54	16.00	8.60	17.00	17.7	0.91	0.88	0.95	0.0%	5.59	1.40	DEC	1,255
Marketing & Information Services	<p>ValueClick is an undervalued stock with the potential for multiple expansion and positive estimate revisions. The stock is cheap at 7.7x 2011 EBITDA vs. its five-year average multiple of 9.2x and also has an attractive free-cash-flow yield of 6-7%. We expect that multiple expansion will be driven by improving Street sentiment (of the 18 analysts covering the stock, 12 have rated it a hold and one has rated it a sell) as the company performs in-line to ahead of Street achievable estimates. We expect positive estimate revisions to come from (1) secular growth in the underlying Internet advertising market, (2) accretive acquisitions using the company's debt-free balance sheet and about \$2.00 per share in cash, and (3) share repurchases. Insider buying has totaled \$7.7 million since May.</p>														

Small Cap (Less than \$1 billion)

KB Home (g,o)	KBH	HR	11.30	20.13	9.43	16.00	NM	(1.33)	(1.35)	(0.44)	2.2%	7.98	2.08	NOV	869
Housing	<p>In our view, KB Home offers investors a well-positioned entry-level builder poised to capitalize on the recovery in the housing market. We believe the next up-cycle will begin with entry-level buyers, and KB Home is ideally positioned due to its innovative "Open Series" models, which have been a popular choice among first-time buyers. With KBH shares trading at a 15%+ discount to peers under our adjusted book value framework and a 30%+ discount to peers based on our 2012 EPS estimates, we believe KBH shares represent one of the most compelling values in the sector.</p>														
Radiant Systems, Inc. (h,m,ng,o)	RADS	AG	18.05	20.69	9.00	23.00	19.0	0.76	0.95	0.92	0.0%	6.98	1.24	DEC	666
Application Software	<p>We believe the company can sustain momentum in system sales and the hosted solutions/SaaS business will continue to structurally alter the growth and profit picture in a positive way. Almost all of the renewed systems sales growth relates to replacement of aging technology and is not incumbent on restaurant site expansion. It appears that RFP activity remains solid and the company is well-positioned to win additional large pieces of business. On the SaaS front, the company's hosted solutions have grown from \$27 million in revenue in 2009 to an annual run-rate of \$37 million at the end of 2Q10. We estimate the SaaS business can achieve strong 20%-plus growth over an extended period and could allow for multiple expansion. Instead of trading at its typical 15x-20x forward earnings, we believe a case can be made for a higher trading range of 20x-25x forward earnings in the future.</p>														

Summary of Focus List Changes

November additions: HPQ

November deletions: NOV, SNX, VOCS

All Focus List stocks are rated Strong Buy and expected to significantly outperform the market over the next six to twelve months.

Suitability Categories (SR)

Total Return (TR) Lower risk equities possessing dividend yields above that of the S&P 500 and greater stability of principal.

Growth (G) Low to average risk equities with sound financials, more consistent earnings growth, possibly a small dividend, and the potential for long-term price appreciation.

Aggressive Growth (AG) Medium or higher risk equities of companies in fast growing and competitive industries, with less predictable earnings and acceptable, but possibly more leveraged balance sheets.

High Risk (HR) Companies with less predictable earnings (or losses), rapidly changing market dynamics, financial and competitive issues, higher price volatility (beta), and risk of principal.

Venture Risk (VR) Companies with a short or unprofitable operating history, limited or less predictable revenues, very high risk associated with success, and a substantial risk of principal.

Footnote Section: IR - In Registration NR - Not Rated UR - Under Review NA - Not Available. NM - Not Meaningful. # - S&P 500 EPS estimates are bottom up operating estimates from S&P. 12-Month Trailing Price Range values are from Thomson Reuters with up to a 24-hour delay. P/E based on either 2010 estimated or actual earnings per share. g - EPS is GAAP EPS. h - Raymond James & Associates managed/co-managed a public/follow-on offering of these shares or has provided investment banking services within the last three years. hn - Raymond James & Associates received non-securities-related compensation from these stocks within the past 12 months. hs - Raymond James & Associates received non-investment banking securities-related compensation from these stocks within the past 12 months. m - Raymond James & Associates makes a NASDAQ market in shares of these stocks. ng - EPS is Non-GAAP EPS. o - Security is optionable. vf - EPS is Valuation Free Cash Flow/Share.

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SYM.	SR	Stock Price	12 Mo. Trail. Price Rge		Proj. 12 Mo. Price Target	Current Yr. P/E	2009A	2010E	2011E	Div. Yld.	Bv/ Shr.	BETA	FYE	Mkt. Cap. (Mil)
			High	Low										

INTRA-MONTH ADDITIONS: NONE

Large Cap (\$5 billion and above) NONE

Mid Cap (\$1 billion to \$5 billion) NONE

Small Cap (Less than \$1 billion) NONE

INTRA-MONTH DELETIONS: THC

Large Cap (\$5 billion and above) NONE

Mid Cap (\$1 billion to \$5 billion) THC

Tenet Healthcare Corporation (ng,o)	THC	AG	6.54	6.75	3.92	NM	26.2	0.15	0.25	0.28	0.0%	1.52	1.36	DEC	3,662
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Downgraded to Market Perform. Please refer to the December 14, 2010 comment for details.

Hospitals
(Deleted as of 12/14/2010, price as of 12/14/10 11:30 AM)

Small Cap (Less than \$1 billion) NONE

Footnote Section: ng - EPS is Non-GAAP EPS. o - Security is optionable.