Barron's Roundtable: Masters of the Game

Part 1

Our experts predict sluggish economic growth and subdued gains for stocks. Where to find value around the world.

By Lauren R. Rublin

January 17, 2015

Whether you favor tarot cards, tea leaves, or crystal balls, it's hard to predict the future. Just ask anyone who correctly forecast that oil prices would fall more than 50% in the past few months -- and good luck finding anyone who did.

Rising to the challenge of divining economic trends, market moves, and especially the actions of the world's central bankers, the members of the Barron's Roundtable took their usual seats last Monday at the Harvard Club of New York and gamely got down to the annual business of making sense of the world for investors, notwithstanding some good-natured grumbling about the perils of the forecasting trade. Whether these market seers ultimately get it right or wrong, or get some things right and others wrong, they are worth a serious listen.

In a day-long session that covered everything from macroeconomics to their investment picks for 2015, the Roundtable members debated the causes of crude's plunge and its effect on consumers; euronomics and Abenomics; the limits of leverage; and much, much more. On the whole, they expect interest rates to stay unnaturally low, and the U.S. to lead the world in economic growth. Yet, they doubt that will translate into robust gains for the stock market. Scott Black's expectation that the Standard & Poor's 500 will return 10% this year -- an 8% price advance and a 2% dividend yield -- was as rosy as it got. Marc Faber, we feel compelled to warn you, thinks the market already has made its high for 2015.

If you have taken the time to peruse this year's spiffy artwork, you'll note a new face in the crowd, that of David Herro, Harris Associates' chief investment officer, international equities, and manager of the renowned $28 billion Oakmark International fund (ticker: OAKIX), among other Oakmark offerings. David traverses the globe every year to learn about countries and companies, and wasn't the least bit shy in sharing his common-sensical perspective on Europe, Japan, and China and other emerging markets.

The first installment of this year's Roundtable begins with the macro and concludes with the micro: the top investment picks of Bill Gross and Meryl Witmer. Bill has changed homes since last year's confab, dramatically decamping from Pimco, which he co-founded and ran, and taking up residence at the far smaller Janus Capital Group JNS -1.0169491525423728% Janus Capital Group Inc. U.S.: NYSE USD17.52 -0.18 -1.0169491525423728% /Date(1422982510065-0600)/ Volume (Delayed 15m) : 655576 P/E Ratio 21.448569689592208 Market Cap 3292111555.47714 Dividend Yield 1.8161180476730987% Rev. per Employee 796734 More quote details and news » JNS in Your Value Your Change Short position (JNS), where he manages the Janus Unconstrained Global Bond fund (JUCAX). He might have a new business card, but he has the same old smarts and style, displayed to superb effect in his disquisition on the debt supercycle's demise and the bond market's response. He also sang, literally, the praises of four fixed-income funds -- yes, including one of Pimco's -- that will help investors "hang on to what you've got."

Enlarge Image Close

Photo: Brad Trent for Barron's

There is no dislodging Meryl, a partner at Eagle Value Partners, from her home in the fine print of financial filings, where the truth about companies often lurks if you know how to find it. Meryl understands business just as well as finance, which makes her a formidable analyst and investor. Her picks this year involve underpriced makers of packaging, textbooks, and supersoft underwear. For the juicy details, please read on.

Barron's: It should be obvious from recent trading that oil's not right with the markets or the world. Take the plunge in crude, a veritable bolt from the blue, which has rattled companies, governments, and investors around the globe. Felix, you accurately predicted last year that economic growth would be sluggish, the dollar would rise, and commodity prices would fall. So tell us, please, how 2015 will unfold.

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2015 Roundtable Panelists

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Delphi Management
Boston

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Global Markets Institute
Goldman Sachs, New York

Marc Faber
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Zulauf: Mainstream economists forecast normalization last year, which I took to mean a return to economic growth rates before the great financial crisis of 2008. That didn't happen. Today's mainstream forecast calls for a decoupling, or an acceleration of growth in the U.S., with the rest of the world still sluggish but catching up later this year or next. The consensus has it wrong again. Europe is still in crisis, and policy makers are doing everything wrong. They are talking about purchasing 500 billion euros in government bonds, €100 billion in asset-backed securities, and so on, to add liquidity to the financial system and spur economic growth. Feeding the system with cheap money won't solve Europe's problem.

In Asia, China's big investment and credit boom is slowing. You should probably cut the country's official numbers in half to achieve a realistic picture of economic growth. It is more like 3% or 4% than 7% or 8%. Japan devalued its currency by 50% in the past two years against the U.S. dollar, which is hurting competitors in the region. Now, with oil prices falling 50% in six months, the U.S. fracking industry will be hurt. Instead of accelerating, U.S. growth could revert to a postcrisis trend of 2% to 2.5% per annum.

Aren't you ignoring the positive impact of lower energy prices on the U.S. consumer?

Zulauf: The oil-price slump will hurt the economy dramatically in terms of capital spending and employment, and a lot of oilfield jobs are high-paying jobs. Yes, lower oil prices will bring down the cost of energy, which is good for consumers, but the private sector is going to save this money, instead of spending it.

Roundtable Report Cards

2014 Roundtable Report Card

2014 Mid-Year Roundtable Report Card

Most members of the Barron's Roundtable are active money managers who trade their positions and change their investment opinions as market conditions warrant. For those keeping score, here's how our panelists' 2014 picks and pans performed through Dec. 31.

Japan's yen devaluation is negatively affecting the price of all globally traded goods. Inflation is diminishing even in weak-currency countries. In Europe, it is below zero. It could approach zero in the U.S. this year. At some point, this will hurt the stock market. There will be a crisis in the junk-bond market, where spreads [between junk-bond and Treasury yields] are widening. In the past, when Treasury-bond yields went down and the yield curve flattened, a recession usually followed. I'm not forecasting a recession, but I am expecting the world economy and the U.S. economy to be much softer than the consensus view.

Does anyone care to challenge this gloomy forecast?

Cohen: While I agree with Felix in some areas, he might be too pessimistic about the U.S., and the impact of the decline in oil prices. Yes, the U.S. is an oil producer, but it is also an oil importer. On the negative side, there has been a notable decline in the consensus view of 2015 profits for companies in the Standard & Poor's 500 index. The estimated growth rate has fallen to 8% from 12%, mostly because of the drop in energy prices. A lot of capital spending in the U.S. in the past three to five years has been linked to the oilfield, and Goldman Sachs' commodities team expects that to adjust. The impact on energy supply will be gradual, however. It is hard to see how energy prices could rise sharply from here, except on a trading basis.

But there are big benefits to the U.S. from a decline in energy prices. Assuming crude oil stays around $50 a barrel, that equates to a $150 billion tax break for consumers. It is possible, as Felix suggests, that this will be saved, at least in the beginning, as people are skeptical about whether low oil prices will hold. If our team's view that prices will hold between $45 and $50 becomes the conventional wisdom, the consumer could start to spend. We are seeing other positive trends in the U.S. The labor-market news, while not totally rosy, is a lot better than six to 12 months ago. The unemployment rate is down substantially. Lastly, while it is possible that headline inflation could be zero in 2015, due largely to the drop in energy prices, some other measures of inflation could be closer to 1.5%. Core consumer-price-index inflation was probably 1.8% in 2014. It could be 1.6% this year.

At their annual grilling by the editors of Barron's, the Roundtable members predicted modest gains for the S&P 500 index, but saw pockets of opportunity in individual stocks. Photo: Jenna Bascom for Barron's

Zulauf: When the difference is that small, the numbers don't matter. It is the deflationary process that counts.

Cohen: The transportation and utility industries are major consumers of energy, and will benefit from lower oil prices. Energy accounts for 17% to 18% of their total costs. Our U.S. strategy team believes that the decline in energy prices will boost S&P profits in 2015.

Gabelli: What percentage of S&P 500 earnings is tied to energy?

Black: In the third quarter, 12.2%.

Gabelli: Why are the Saudis allowing oil prices to fall? Why aren't they cutting OPEC [Organization of the Petroleum Exporting Countries] production?

Black: The Saudis are holding back for political reasons. They fear both Iran and ISIS [the Islamic State], and this is a way to break Iran's economy. Saudi Arabia has $750 billion of reserves and can tolerate low oil prices for six to nine months. So can the United Arab Emirates and Qatar. While low oil prices hurt our shale business, my sources think there could be tacit consent from the Obama administration.

From left: Marc Faber, Bill Gross, Meryl Witmer, Scott Black, and Felix Zulauf. Says Gross: "Capitalism is being distorted." Photo: Jenna Bascom for Barron's

Rogers: I disagree with Scott. The Saudis are out to send a message to the Russians. Interestingly, a year ago, no one saw the decline in energy prices coming. This gets to the issue of forecasting. The world in general isn't much good at forecasting anything.

In that case, shall we adjourn?

Rogers: It is conceivable that we are just one OPEC meeting away from a rebound in oil prices. The financial system was shocked in the past 12 months by unexpected developments. There is a chance that unexpected things will happen in the next 12 months that will lead to radically different outcomes.

Zulauf: What might have started as a political move also has an economic rationale. In recent years, crude oil, and particularly OPEC oil, has lost market share among energy sources. It is important for the Saudis to ensure that their most precious asset, crude oil, has a good market, long term. Therefore, they have to kick out some of the marginal players to ensure the market share of crude in the energy equation. Natural gas and alternative energy have been gaining share. To be successful, the Saudis will have to keep prices down for at least a year. It has only started. The spot price has fallen, but the effects haven't been felt through the real economy yet. A lot of production has been hedged. Those hedges will run off by summer.

Gabelli: Unlike some in this room, I fill up my own car with gas. The impact of lower spot prices hits right away by giving consumers more cash in their pockets or lower credit-card bills. It was only around Thanksgiving that the price at the pump collapsed. The effect is appearing on credit-card statements now. The consumer accounts for 70% of gross domestic product. His costs are going down. Food will be the next thing that falls in price. This is an extraordinary after-tax saving, and it will start working in the real economy.

Faber: With low oil prices, you would expect discretionary spending to be picking up. Not so. Of the S&P consumer-discretionary companies that offered earnings guidance for the fourth quarter, 89% issued negative guidance. This is the worst reading in the data series going back to 2006.

From left: Abby Joseph Cohen, Brian Rogers, Oscar Schafer, Mario Gabelli, David Herro. “It’s about time” China slowed, Herro says. Photo: Jenna Bascom for Barron's

Gabelli: These are lagging figures, put together by people who don’t go to gas stations. I talk to the guys who are pumping gas, and they say the consumer is buying more beer.

Herro: Lower oil prices also have a positive impact on the emerging world because it is a huge importer of energy. Governments have subsidized it, so either governments are going to save on subsidies, or the consumer will face lower fuel prices. Two major events occurred last year from a global macroeconomic perspective: falling fuel prices and a realignment of currencies. The euro was overvalued for way too long. In fact, oil was overvalued for way too long, as was the yen. We’re finally seeing a realignment that reflects reality and might counter some of the inflationary fears people have.

Gross: When a country devalues, it exports deflation. That is what Japan is doing and what other countries are trying to do, relative to the U.S. They are trying to export deflation and import inflation.

Cohen: Japanese exports are up, and Japanese multinationals that depend on exports have become more competitive. We could see more growth in Japanese corporate profits. This could help with job creation.

Zulauf: If exports aren’t up after you’ve slashed your currency by 50%, something is wrong. But you can’t build a case that that’s why the world economy will do well. Actually, Japan is an exception. Most exports in Asia are down and declining.

Faber: Japanese exports are up in yen terms but down in dollar terms, just to clarify.

Brian, even though you just dissed forecasting, what do you see ahead for the U.S and the global economy?

Rogers: The U.S. has been a true economic engine for five or six years, and has tried to pull other economies up. Our bond and equity markets benefited from a massive flight to quality in 2014. The economy is in a decent place right now. My big worry is: How long can we continue to be the engine, given what is happening elsewhere in the world?

Mario Gabelli, center: “Financial engineering will continue, and activist investors are another spur to specific stocks.” Photo: Jenna Bascom for Barron's

When I talk to many S&P 500 companies about their businesses in Asia and Europe, there aren’t many rays of hope coming from some of those markets. There is a general consensus around 3% GDP growth in the U.S. I wouldn’t be surprised to see downward pressure on that estimate as 2015 unfolds. It just feels like too many things are going to drag on us, including a decline in energy prices. One of my Roundtable stock picks, perhaps not surprisingly, is an oil company. You have to buy when things look really bad. That said, the U.S. could have a tougher year than people expect.

Oscar, what is your view?

Schafer: First, in relation to forecasting, I’d like to paraphrase Woody Allen: I’m astounded by people who want to “know” the macro when it’s hard enough to find your way around Chinatown.

Perhaps we’ll invite him next year.

Schafer: Also, as Seth Klarman [founder of the Baupost Group, an investment firm] put it brilliantly last summer: Is the market nearly triple its spring 2009 low because things are better, or do things feel better because the market has nearly tripled? None of us predicted the oil-price plunge. I expect U.S. economic growth to slow due to the knock-on effects of the energy price decline. A decent percentage of employment growth in the past four or five years came from the oil patch. At the same time, with interest rates so low, central bankers have little powder left to try to help the economy. Even so, there will be pockets of opportunity for investors on both the long and short sides of the market.

Scott Black, left: "Small- and mid-caps did poorly last year, but they are still expensive." Photo: Jenna Bascom

Gabelli: I'm going back to the consumer. His net worth is at an all-time high. Wages are starting to rise in certain industries, but the psychology is fantastic. When the consumer buys gas every week, he feels good.

Schafer: You spend a lot of time at gas stations. How many cars do you have, Mario?

Gabelli: You city guys send someone else to fill up your car. Go talk to the guy who fills it up. You learn a lot by asking. Capital investment accounts for 12% of the economy. The government is going to examine ways to improve infrastructure. The midterm election resulted in a Republican-controlled Congress, which has a clear vision of less regulation and improving the rate of return on investment. Capital spending by the major oil companies and the independents could drop below $600 billion this year from an estimated $725 billion last year, which will be a challenge, but it's not a big deal. The housing recovery has traction, and local-government spending is up. The U.S. economy could grow by 2.75% to 3.25% this year, in real terms.

The U.S. is expected to be 22% of the global economy this year. The European Union is expected to be 25%. But, in relation to the oil surprise, what is [Russian President Vladimir] Putin going to do? Is he going to help the Saudis deal with Iran? A year ago, nobody thought about oil, or Putin invading Crimea, or the spread of Ebola. Nobody thought about the psychological impact of these events, which prompted investors to seek refuge in the U.S. bond market, driving down yields. My bet is that U.S.-centric companies do well this year.

Does anyone think oil is going lower?

Zulauf: Yes. The Saudis have a game plan and want to see their goals achieved before they change policy. This will not happen in three months' time. The next OPEC meeting is in June. Perhaps there will be an emergency meeting before that if the Saudis achieve what they want to achieve. The Russian situation is unclear. Putin was expecting to be hit with sanctions for his invasion of Ukraine and annexation of Crimea, but he wasn't prepared for the oil-price decline. It is creating a difficult situation for him. Also, internally, he might come under pressure from the oligarchs. Russia is a wild card, but Russia won't start a war.

Schafer: In July 2008, oil was $147 a barrel. In December 2008, where was oil?

Faber: At $32.

Schafer: Exactly! In six months, the price fell 78%. I got that from your latest newsletter, Marc.

Faber: Thank you. I go occasionally to Saudi Arabia. It would surprise me if they purposely decided to lower the oil price, given how much lower prices hurt the region. The oil price collapsed because of a lack of demand. Suddenly, Asian demand stopped growing. Asia was taking excess U.S. supply. U.S. oil supplies rose in the past five years to 9.3 million barrels a day from five million barrels. Asian demand, and particularly Chinese demand, has slowed considerably.

Black: The Saudis are keeping the price low for political reasons. There is also oversupply because of fracking activity in the U.S. Plus, Libya and Iraq came back into the oil market last year. If the Saudis wanted to, they could put supply and demand back in sync. I would not bet on that this year.

Let's get Meryl's take on the world.

Witmer: Like Oscar, I am more of a stockpicker than an economist. But I would note that a lot of large capital-spending projects, planned and ongoing, that were predicated on using natural-gas liquids from fracking might be put on hold. They would have been stimulative to the economy. Even in Europe, there were a lot of energy-related projects in the works, and they are likely to get put on hold. There was a lot of job growth from the energy industry. To the extent that capital spending is reined in, the U.S. economy probably will be weaker than people think.

Zulauf: With a much lower oil price, fewer petrodollars have been created -- possibly $1.5 trillion less, on an annualized basis. Petrodollars were reinvested in a variety of things. In the past, they financed other countries' current account deficits. Now that money isn't there. Lower oil prices have implications not just for the fracking industry, but for the financial world.

Marc, a petrodollar for your thoughts.

Faber: I look at the investment world in three parts: the Americas, Europe, and the emerging-market bloc from Turkey to the Far East, and to South Africa. I am used to Americans being optimistic about America, especially with the bull market now more than five years old. The economic expansion also is more than five years old, lengthy by historical standards. Consider this data, however, from the Institute for Supply Management: In December 2014, the purchasing managers' manufacturing index fell one percentage point from the prior year. New orders were minus 7.1 percentage points. Production was minus 2.9 percentage points.

I don't buy that all is well in America. If it were, why are home-ownership rates falling, whereas home prices have been going up? There is an affordability issue. Many young people finish college with huge student-loan debts. The labor-participation rate is also down, and it is low-paying jobs that are being created. The growth of high-paying jobs is anemic. Many people can use Facebook and wait on tables, but there is a lack of skilled labor. For these reasons, I recommended 10-year Treasuries a year ago. I thought the economy would disappoint, and it will disappoint this year. Growth will be about 2%, at best, but there could also be a contraction.

There is no growth in Europe. Plus, there is an unpleasant political climate and an entitlement society. It is hard to see how the European economy will grow much, although some companies will do well. In Asia, there has been a meaningful slowdown, although a transition is occurring. The two best whiskeys in the world now come from Asia. One is Yamazaki, a Japanese brand, and a Taiwanese whiskey has been elected the best single-malt. Unlike Mario, who spends a lot of time in gas stations, I spend time drinking whiskey.

Good for you, but what is your point?

Abby Joseph Cohen: “Assuming crude oil stays around $50 a barrel, that equates to a $150 billion tax break for consumers.“ Photo: Jenna Bascom for Barron's

Faber: Even if Asia doesn’t grow much this year, economic power is shifting to Asia. The Indian economy could grow by 5%-6% in 2015, although the Indians would say I am too pessimistic. Nonetheless, a 5% growth rate is enormous, compared to zero in Europe.

Gabelli: Is growth in China slowing to 5%?

Faber: It is slowing to 4%, maximum. Exports are hardly growing. Imports are down.

Zulauf: Industrial capacity has been built up, based on 10% growth in China. The corporate sector in Asia is unprepared for this slowdown.

Faber: Unlike the optimists, I believe Japan will contract, as well. The population contracted last year by more than 200,000, the largest contraction since 1947. The population won’t increase unless Japan welcomes foreigners, but Japanese culture is unlikely to do that. The currency has weakened significantly. Approximately 50% of food expenditures in Japan are for imported food. Food prices are rising, but wages aren’t, so real income has tumbled in the past three months.

Cohen: One outcome of the recession in Japan is that the government suspended plans to tighten fiscal policy. It suspended a plan to raise the consumption tax.

Herro: Gross domestic product is a function of population growth and productivity growth. If you don't have population growth, the way to get economic growth is through productivity increases. The aim of some of the reform initiatives, which have stalled, is to increase the efficiency and productivity of the Japanese economy. Both Europe and Japan have had slow population growth and have been slow to increase productivity. Companies need to have more freedom to hire and fire workers. Hopefully, this is something Japan will tackle. I don't see Japan bouncing back strongly, but it seems to be looking at the right things.

Zulauf: Abenomics [the economic policies advocated by Japanese Prime Minister Shinzo Abe] is based on three arrows: currency devaluation, fiscal stimulus, and structural reform. The first two have occurred, but the third hasn't, because it is difficult politically. Reform means taking away something from somebody. Europe faces the same problem. Germany is moving backward on reform. Italy and France aren't moving at all. Most European governments can't pass necessary reforms. Introducing the euro, which acts as deflationary straitjacket for at least half the members of the European Union, was the dumbest thing they could do. I see no hope for Europe. It is going the way Japan did.

Rogers: Quantitative easing is the only option left to the European Union. It is a Hail Mary pass.

Zulauf: But QE just takes the pressure off politicians to do what is necessary. Only a major crisis will allow European governments to introduce reforms.

Gabelli: Your conclusion is to bust up the euro because the common currency makes no sense. That's where you're going.

Zulauf: Europe will hold on to it for several more years, but people in some countries eventually will say that's enough. A third of all seats in the European Parliament are held by members opposed to the euro and against the centralization of Europe. And the number is growing.

[Barron's checked in with Felix late last week to get his take on the Swiss National Bank's surprise decision to decouple the Swiss franc from the euro, a move that shocked the currency market and came just ahead of likely quantitative easing by the European Central Bank. Via e-mail, he said, "Full support (for franc/euro parity) would have meant that the SNB must pursue the same monetary policy as the ECB, which is completely unnecessary as the Swiss economy has performed well. More monetary stimulus would have had counterproductive effects and inflated assets such as real estate and equities, creating major risks later on. The removal of the euro cap is beneficial as it will force the Swiss economy to become more productive and move into higher-value-added industries. But first, the Swiss economy will most likely –suffer a recession."]

Cohen: European policy makers are hoping that a combination of quantitative easing plus euro devaluation will spur economic growth. It will help nations like Germany, which export beyond the euro zone. But the implementation of the euro has prevented some weaker countries from devaluing their currencies, as they might have done in the past when their economies suffered. As David intimated, nations either have to bolster their labor productivity, as Ireland has done, or devalue their currency.

Faber: May I finish my remarks? In addition to the slowdown in Asia, people overlook what has happened to global oil outlays. With production and prices rising, the world spent $4.2 trillion on oil in 2007, up from $250 billion in 1999. Outlays have since fallen to $2.5 trillion. In other words, $1.7 trillion went back to the consumer. Also important, sovereign wealth funds rose to $6.8 trillion as of September 2014, from $3.2 trillion in 2007. Of that growth, 59% came from oil, gas, and related revenue. As oil prices fall, what will happen to the growth of sovereign wealth funds, which have been buying financial assets around the world? Their funding is going to evaporate, and they might be forced to sell.

Herro: Norway accounts for a big chunk of that money. It is a small country. There won't be a catastrophe because of falling oil prices.

Faber: Norway has a colossal housing bubble and an overpriced economy.

Herro: That's true, but the country has only five million people.

Faber: So declining assets in sovereign wealth funds have no impact on the world?

Herro: You have to look at the net impact of lower energy prices rippling through the global economy.

Gross: The Saudis, Norway, and other sovereign wealth funds bought not only stocks, but bonds with their oil money. Now there is less to spend. What might be the substitute? Quantitative-easing programs in Euroland and Japan, and continued monetary easing in the U.S.?

Rogers: The money doesn't vanish just because the oil producers don't get it. It goes into consumers' hands.

Faber: My point is, assets in sovereign wealth funds won't double again, as they did since 2007. Therefore, one source of demand for financial assets won't be there.

Zulauf: More central banks will buy bonds this year. You can't just declare your currency lower; you have to print more of it. That money must be invested, and it goes primarily into fixed-income assets. That's why interest rates will stay low, and go even lower this year. There won't be any rate hike in the U.S. That's off the table.

Before we continue this fascinating debate, let's hear David's macro forecast.

Herro: Like Marc, I divide the world into broad geographies. Regarding North America, I am not as bearish as some people here. The impact of lower energy prices, an improving labor market, a better feel-good factor, and perhaps a deal on tax reform will mean acceptable rates of growth in the world's largest economy. The euro zone has many maladies and needs structural reform, including the right to hire and fire. It needs to end the defense of the welfare state. But you can't lump all of Europe together; some economies are doing better than others.

The emerging world is led by the China region and India. China is slowing, which isn't tragic but necessary. It's about time. It needs to stop overinvestment and focus on consumption. Reforms being enacted in China hopefully will mean more-sustainable growth down the road. There's a question about how legitimate the reform is, but China's leaders are thinking about the right things and saying them publicly. India wants to do well, but it is a tough place to do business, even if you're the government. India could be one of the bright spots in the next few years. It has roughly the same population as China, but consumes one-tenth the amount of steel and cement. If India grows, it could pick up some of the slack from China's slowing.

Japan technically is the world's third largest economy. They're trying, but don't know what to do with the third arrow. Japan is aggressively changing the asset allocation in its $1.3 trillion government pension fund, and putting more than 50% in equities from 100% Japanese government bonds. It is using the fund as a battering ram against the corporate sloths of Japan, and trying to increase productivity and profitability. This is a good sign. Abe-san [Shinzo Abe] has been aggressive in putting his people on the pension board to make sure that they use that as a weapon. To sum up, the world isn't booming, but led by the U.S., with a little help from emerging markets, we could make up for what is lacking in Europe.

Gross: You think that's a good sign that the government captured the pension fund?

Herro: They didn't capture it, per se.

Gross: They rolled the monetary, fiscal, and pension authority into one.

Gabelli: Oh, stop. Who runs the Social Security lockbox in the U.S.?

Gross: There is nothing in the lockbox.

Zulauf: Japan is discussing whether to dictate that all private pension funds change the asset allocation. It's not about being right or wrong in terms of allocation, but in relation to government interference.

Gabelli: I would use the word "encouraging."

Gross: Doesn't that smell of desperation?

Herro: It was all bonds. Who wants that?

Gabelli: You're talking to a bond guy!

Herro: Encouraging the pension fund to be properly diversified is how I would put it.

Cohen: One part of Abenomics is womanomics. In a nation where the population isn't growing and the labor force has been shrinking, women are a good potential source of workers. They haven't been encouraged to be in the labor force, and certainly not in a highly professional capacity. Getting more women into the labor force would be helpful in the years ahead.

Gabelli: The Japanese also have robotics and artificial intelligence.

Cohen: The women have natural intelligence.

Bill Gross: "Is a zero percent real rate of interest a fair return on your money? It isn't, but it might be an acceptable rate in a world where there is too much debt." Photo: Jenna Bascom for Barron's

Gross: Human organisms want to grow. The nature of things is to grow. It is interesting to ask, why don't economies grow? Why don't people get hired? Why don't corporations expand? Why don't governments produce real growth? Typically, in the past 30 or 40 years, the answer has always been that inflation got a little too high, central banks raised interest rates to restrict credit, and recessions were produced. Today, it is different because we have no inflation. So why don't we grow?

It is because we are at the end of a debt supercycle. In the past 20 to 30 years, credit has grown to such an extreme globally that debt levels and the ability to service that debt are at risk, relative to the private investment world. Why doesn't the debt supercycle keep expanding? Because there are limits. Interest rates have reached zero, and governments still don't want to borrow for infrastructure investment. Companies still don't want to borrow for private investment. They simply want to buy their own stock at a 15 times earnings because investing in the real economy is too risky. Interest rates are so low and the amount of debt is so high that there are limits to the ability of monetary policy to influence what it has influenced for the past 30 years.

What are the implications of the end of this supercycle?

Gross: The implications are much lower growth, less inflation, lower interest rates, and less profit growth. Barter economies couldn't grow rapidly, but once someone decided to save and invest and extend credit, growth became possible. Well, we overdid it. Now there is a limit not only to lenders' willingness to extend credit, but their willingness to do so at an unacceptably low rate of interest.

I have called this slow-growth, low-inflation environment the new normal. Larry Summers [the Harvard economist and former Treasury Secretary] calls it secular stagnation. It is tied to high debt levels, low population growth almost everywhere in the world, and technology that promotes job destruction. We applaud U.S. growth of 3%, but it is an aberration. Structural growth in the U.S. is really just 1.5% to 2%, and in Euroland and Japan it is zero to 1%. We brought consumption forward and issued one giant credit card for the past 30 years. Now the bill is coming due. Investors need to get used to low returns, and low growth, inflation, and interest rates for a long time.

What is your interest-rate forecast for 2015?

Rogers: There are some glimmers of hope. The U.S. is five years into healing from the 30-year extension of credit you're talking about.

Gross: In the household sector, yes. Corporations are levering up.

Cohen: They are levering up at very low interest rates, often for money they don't need.

Gross: So long as they don't buy back stock.

Rogers: Investment opportunities are limited because global growth is so low. That is why companies are buying back stock. The debt position in the corporate world and the U.S. consumer market is very different from five years ago. But I don't want to trump Bill's rate forecast, which we are all eager to hear.

Gross: The global interest-rate forecast depends critically on what central bankers are now beginning to understand as the natural rate of interest. To forecast where the 10-year Treasury yield belongs, you need to ask where the federal-funds rate [the interbank overnight lending rate on funds maintained at the Fed] will be five years from now. Until now, central bankers have based the policy rate on the so-called Taylor rule, developed by John Taylor, a professor at Stanford University. It posits that the policy rate should be 2%, plus the rate of inflation. Central bankers in the U.S. and elsewhere relied on this rule for more than 20 years, and it worked pretty well. But it doesn't work now because of the structural problems I have outlined.

Enlarge Image Close

Meryl Witmer: At Houghton Mifflin, the sale of digital education products improves profits. Photo: Jenna Bascom for Barron's

A policy rate of 4% nominal growth and 2% real [inflation adjusted] growth is 200 basis points [two percentage points] too high. Once the U.S. economy normalizes, the Fed should be shooting for a policy rate of 2%, not 4%. The real rate should be zero, not 2%. How do I know that? I don't. Goldman doesn't. No one knows it, which is the problem. We are feeling our way, and that is what the Federal Reserve will do this year. It will feel its way in gradually raising rates and seeing how the economy responds. If a 2% nominal rate is about right, the 10-year bond is decently valued at 2%, as well. Is a zero percent real rate of interest a fair return on your money? It isn't, but it might be an acceptable rate in a world where there is too much debt.

Interest rates will be lower than the market thinks. Policy makers at the Fed have indicated that the policy rate will be 3.75% to 4%, longer term. They are dreaming. Money is being stolen from bond holders because of the repressive policies of central banks. That is what happens in a deflationary environment when a debt supercycle ends. The savers pay the price.

Zulauf: In Europe, things are even worse. Institutions have to pay the bank to hold their cash.

Gabelli: That sounds like good, sound banking.

Gross: If the new neutral rate is 2% nominally and zero after inflation, as I am suggesting will be the case for the next five years, it pays to borrow as opposed to lending. You can borrow at 2% in the future (and now even lower at 0.25%) and lever that into a 4% to 5% return.

Cohen: Some of the highest-quality corporations are selling long-maturity bonds. On the consumer side, household balance sheets are in dramatically better shape than five or eight years ago, but some households have big problems. Subprime debt no longer is a problem in the housing market, but is becoming one in the car market, and could have an impact on future auto sales.

Rogers: I'd like to challenge Bill. This is a roundtable, after all. Based on the Taylor rule, if 2% is the nominal yield on the 10-year Treasury, that barely covers the rate of inflation. There is no risk premium. Yet, you ought to be compensated for taking duration risk. Thus, the return can't be zero. Long term, an investor will demand 50 or 100 basis points of return. Maybe the bond won't yield 4%, but it could yield 2.5% or 3%.

Gross: I admit that my premise suggests a distortion of capitalism, but capitalism is being distorted. Money is moving to the financial economy, not the real economy.

Zulauf: The best capital allocator is the free market. In recent years, and probably for a few years to come, central-bank policy has distorted all that. Capitalism won't function as we knew it in the past. We will also see the yield curve flatten as investors move into longer-dated bonds to capture a more attractive return. This is happening throughout the world.

Let's turn to the stock market, which had a good year in 2014, despite all of the problems we've been discussing. Abby, your 2014 forecast was close to accurate. How will the U.S. stock market perform in 2015?

Cohen: I gave a somewhat tongue-in-cheek forecast last year that the S&P 500 would end 2014 at 2088. The index hit 2090 a few days before year end, and then sold off. Goldman's forecast for GDP growth in 2015 is a little above the consensus, partly because we expect the decline in energy prices to provide a boost to the economy. Also, U.S. companies took advantage of a lower dollar in the past few years to become more competitive. The economy isn't as sensitive to a higher dollar as many investors think because U.S. companies sell mostly high-value-added goods and services to non-U.S. markets, not commodity-type products.

We expect S&P 500 revenue to rise 4% this year, and earnings to increase 8%. Our U.S. portfolio strategy team is estimating S&P earnings of $122, below the consensus at $125. For 2016, the team is using $131, and the consensus is $140. Our interest-rate view is somewhat different from Bill's, although I take to heart many of his comments. If the U.S. economy performs better than in the past few quarters, the Federal Reserve will seriously consider raising interest rates in the second half of the year, although not by much. But the Fed is unlikely to move unless it sees that the labor market has gotten better, not just in terms of the unemployment rate but job creation and wage improvement. The Fed might also be encouraged to wait to tighten policy because of energy prices.

Based on these estimates, the house forecast calls for the S&P 500 to end 2015 around 2100, which implies a single-digit percentage gain. However, if 10-year Treasuries don't move much this year, we could get to 2300. To be fair, David Kostin, Goldman's chief U.S. equity strategist, thinks the market could be higher during the year, and then fall. His concern is how the market will respond to the first phase of Fed tightening. The risk to this forecast is that interest-rate increases could be pushed further into the future, which would be much better for equity valuations. Picking a point target simplistically, I could say the market will end the year at 17 times our 2016 earnings forecast, or 2233.

You could, but is it right?

Cohen: If there is a risk to the Goldman forecast, it is that share prices will be higher, not lower, based on an improving economy and quiescent inflation and interest rates. Using a dividend discount model, the S&P could have been at 666 in March 2009 only if profits declined by an average of 8% a year in the next five years. That wasn't correct; the recession ended two months later. Priced into the S&P 500 on Dec. 31, 2014, were five years of flat earnings, which doesn't seem right either. The components of the S&P 500 performed well as companies and securities in 2014. One question now is whether investors will rotate away from S&P 500 companies and toward small-cap stocks.

Rogers: So Goldman is expecting a return of just 3% or 4%.

Cohen: Plus dividends. It also assumes there is no active management. If the Fed doesn't tighten, you could see a more optimistic forecast from Goldman.

Brian, where do you think stocks are headed?

Rogers: I agree with much of what Abby said. It is hard to be precise. If you factor in the loss of some earnings momentum from the energy sector, a gain of 5%, 6%, 7% in corporate earnings seems reasonable. I expect that a move by the Fed to raise rates will be perceived favorably by U.S. investors. It has been well communicated. If the first 25-basis-point increase in the fed-funds rate comes in the spring or summer, it will be viewed by the market as a statement that the Fed sees decent economic activity.

Corporations have a lot of liquidity. Dividend and buyback activity will be strong again this year. The relationship of earnings yields and bond yields is supportive of a good environment for equities, although the market's price/earnings multiple makes me a little queasy. When you look at negligible money-market returns and a 2% yield on the 10-year note, a total return of 5% to 8% on stocks looks good. Investors are unlikely to squeeze another great year out of the Treasury market.

Oscar, do you agree with that?

Schafer: I agree with Brian that multiples are high. But if we agree with Bill that inflation, interest rates, and growth will stay low, we have a TINA market: There is no alternative to stocks. I expect stock multiples to rise. We will see more divergences among equities, as we saw last year with large- and small-caps. In contrast to 2014, this will be a stockpicker's market. The averages won't do much, but within the market, there will be great opportunities on the long and short side.

Marc, what is your market view?

Faber: In the U.S., some stocks were up 10% last year, and some were up 40%. But an equal number were down 10% and down 40%. It has been a mixed bag. A year ago, portfolio managers were universally bearish about bonds. Yet, the 30-year Treasury had a 30% total return. The 10-year had a near-12% total return. Utility shares, which had been shunned, rose 30%, and real estate investment trusts, which no one paid attention to because they were too boring for the Facebook crowd, were up 26%. Active managers underperformed the indexes badly, and hedge funds did exceedingly badly, especially when you consider that they complained about low volatility in the first half of the year. Then, when the euro and yen and oil prices collapsed in the second half and volatility spiked, they did even worse. I don't know what they were drinking.

Schafer: Japanese whiskey.

Faber: In the U.S., people think the market did well. But in dollar terms, the Indian market rose 34%. Pakistan was up 32%-plus; Sri Lanka, 23%; Philippines, 22%; Thailand, 15%; Indonesia, 20%; Vietnam, 20%. Shanghai did poorly until June, and then went ballistic. Don't ask me why. Lots of things are difficult to explain because the free market has been distorted by central-bank actions to stimulate economies, lower currencies, and such. This year, we have already seen the high for the S&P 500. That was also the case in January 1973.

This market is similar to the Nifty 50 market of the early 1970s, in that just a few stocks are driving strong growth in the indexes. International Business Machines IBM 1.2676839518944782% International Business Machines Corp. U.S.: NYSE USD156.6206 1.9606 1.2676839518944782% /Date(1422982526776-0600)/ Volume (Delayed 15m) : 1128780 P/E Ratio 13.029333333333334 Market Cap 151930207580.566 Dividend Yield 2.8141629144494473% Rev. per Employee 215191 More quote details and news » IBM in Your Value Your Change Short position [IBM], Amazon.com amzn -0.8423189837297994% Amazon.com Inc. U.S.: Nasdaq USD361.4 -3.07 -0.8423189837297994% /Date(1422982528616-0600)/ Volume (Delayed 15m) : 2365939 P/E Ratio N/A Market Cap 169254038025.676 Dividend Yield N/A Rev. per Employee 758636 More quote details and news » amzn in Your Value Your Change Short position [AMZN], and General Electric GE 0.6199917389508468% General Electric Co. U.S.: NYSE USD24.3601 0.1501 0.6199917389508468% /Date(1422982527097-0600)/ Volume (Delayed 15m) : 8665450 P/E Ratio 16.65983746500034 Market Cap 243121421108.834 Dividend Yield 3.7712646034023365% Rev. per Employee 481469 More quote details and news » GE in Your Value Your Change Short position [GE] were all down last year, but Apple AAPL -0.34982719379583577% Apple Inc. U.S.: Nasdaq USD118.215 -0.415 -0.34982719379583577% /Date(1422982528684-0600)/ Volume (Delayed 15m) : 15223403 P/E Ratio 15.88888888888889 Market Cap 690989844802.633 Dividend Yield 1.5839582104642345% Rev. per Employee 2153110 More quote details and news » AAPL in Your Value Your Change Short position [AAPL] was up 38% and has the biggest weighting in the S&P 500. Ideally, the S&P will go to 3500 and then collapse 50%. Then, everybody will be right.

Stocks haven't had a correction of more than 11% since October 2011, which is unusual. Yet, the uptrend isn't supported by the real economy. Policy makers have created an environment in which a corporation with a lot of cash isn't going to build a factory or a business. It is going to buy back shares or take over another company. In each takeover, staff is eliminated and there is no capital spending. Mario likes this because he is an activist investor, but the real economy can't rebound because it is easier to make money in trading, financial assets, and real estate.

Meryl, how does the market look to you?

Witmer: It isn't easy to find a lot of undervalued stocks. Usually, when we have trouble finding cheap stocks, the market doesn't go up much. This market is pretty fully valued.

Scott?

Black: Small- and mid-caps did poorly last year, but they are still expensive. The Russell 2000 [a small-cap benchmark] is trading for 22 times expected earnings. The Russell 2500 is trading for 21.1 times. There is better value in the larger names. S&P 500 revenue has grown by 4.9% to 5.5% in the past few quarters, and will continue to grow. There will be more stock buybacks. Earnings could come in around $126 this year, up 8%. Operating profit margins have been at a record high of 10.1%, and some improvement is possible. Based on Friday's close [the S&P 500 closed on Jan. 9 at 2044.81], the market is selling for 16.2 times this year's expected earnings. It is fairly valued. For deep value investors like Meryl and Delphi, it is increasingly difficult to find good stocks.

I agree with Bill that Fed Chair Janet Yellen will be highly accommodative, and that interest rates will remain low. We might get 8% appreciation in the S&P 500 this year, and a total return of 10%, compared with 13.7% in 2014. The problems in Europe and Asia won't derail economic growth here, but it might slow it. I am moderately constructive on the year.

Felix, we have a hunch that doesn't describe you.

Zulauf: In the past 100 years, stocks have been up in the fifth year of the decade with only one exception: 2005. In the third year of the presidential cycle, the market has been up 70% of the time. Combining the two, stocks were up at least 20% in 1915, 1935, 1955, 1975, and 1995. The caveat is that none of those years had a lame-duck president. To find the same combination with a lame-duck president, you would have to go back to 1875, and the market ended down that year.

Forget about 1875. Just tell us about 2015.

Zulauf: The biggest thing going for stocks is paltry bond returns. If I am right that the economy will struggle, equity investors could be disappointed. The major U.S. stock indexes haven't declined by 10% for the past 3½ years. Extreme readings of investor sentiment reflect a lot of complacency, which usually makes a market vulnerable. A lot of multinational growth stocks are extended on the upside, and cyclicals are extended on the downside. Usually, this situation ends in a big correction. I expect a decline of 15% or so moving into the spring. It could be worldwide, and probably triggered by earnings disappointments in the U.S., due to the strong dollar. I assume central-bank monetary policy will get even easier in the face of this decline. Thereafter, markets could rally, perhaps into 2016. There will be a lot of volatility. It will be a trader's dream, but an investor's hell.

Gabelli: I'm looking at the moving parts. The euro is $1.18 today. It was $1.37 a year ago. For S&P 500 companies operating in Europe, the currency will be a drag. Energy earnings will be a big drag. On the other hand, if interest rates go up in the spring, that will help banks' net interest margins. Companies are going to maintain profit margins as best they can. With the Republicans gaining control of the Senate and the House, the rest of the world is saying this socialist president won't gain any more traction. Thus, the U.S. is a good place to put your money. A lot of money is moving into the U.S. market, and it isn't going into small-caps. It is going into large-caps. Foreign investors are sector allocators. Financial engineering will continue, and activist investors are another spur to specific stocks. Putting it all together, the market could rise 2% or 3% this year.

David, how does the year look to you?

Herro: I'm a bottom-up value investor, focusing mostly -- although not exclusively -- on international markets. I see better value outside the U.S., but there are good places to look here, too. Mario talked about the negative effect a strong dollar will have on multinational earnings for American companies. On the flip side, European-based multinationals struggled for a long time with a strong local currency. The pressure is easing on those companies, and they could record higher profits in their home currencies. The macroeconomic problems we have been discussing have hit European equity valuations. No one wants to invest in European companies, even though many generate sales and cash flow all around the world. Therefore, Europe is probably the most fertile market for value, and its stocks could perform best in the next 18 months.

European multinationals have a big presence in the emerging world, which is undergoing more of a cyclical than a structural downturn. Structurally, emerging markets have a long-term growth story, as more and more people from the lower and middle classes move into the middle and upper-middle classes. There are speed bumps; this doesn't happen in a straight line. But India and China will eventually find their footing. It could happen in two or three years. That will be good for the corporate earnings of companies exposed to Asia.

Are you bullish on emerging-market shares?

Herro: Shares of quality companies based in emerging markets are too expensive. State-owned companies in these markets look cheap, but low price alone doesn't determine value. We have very little direct exposure in emerging markets.

In a nutshell, it will tough for the U.S. to keep performing well, as valuations are stretched. Europe has done poorly but will benefit from weaker currencies, lower energy prices, and perhaps a recovery in emerging markets. Investors must be highly selective in emerging markets. The Japanese market has doubled in the past few years. It has benefited from a weaker currency. There isn't much room for growth left.

Gabelli: One more thing: The combination of lower interest rates and new U.S. mortality tables, as people are expected to live longer, will crimp cash flow as companies put more cash into defined-benefit retirement plans.

Bill, you predicted in your latest outlook that there could be minus signs in front of many asset classes this year. Does that include stocks?

Gross: It is possible. Rather than dissecting valuations, let me note that liquidity is decreasing. The Fed has ended its quantitative-easing program. This reduces the liquidity that helped drive price/earnings ratios higher and helped investors get in and out of the market. Liquidity is becoming increasingly at risk for the stock market, and even more so for the bond market. At some point, it could get harder to sell assets, so be careful about getting out at the appropriate time. I would put a bit of a minus sign on stocks this year, if only because the liquidity premium is increasing.

We have talked today about the difficulty of forecasting, and the fact that nearly every market prognosticator missed the swoon in oil last year. That begs the question: What could you be missing this year?

Cohen: The U.S. economy could show sufficient momentum to override the impact of central-bank tightening and a strong dollar. We know from history that when central banks first begin to raise interest rates, equity markets, at least in the U.S., get a new lease on life. A rate hike is a sign that the economy doesn't need that much help anymore. That isn't true of Europe. While valuations are appealing, the European banking system hasn't been fully repaired. While the U.S. could look a lot better, the impact could be mixed around the world.

Zulauf: There is the potential for many black swans when the world economy is growing insufficiently. The risk of conflict goes up. The war cycle is rising. There could be potential conflicts in Eastern Europe, and in the South China Sea. That could scare away investors.

What do you mean by the war cycle?

Zulauf: You measure conflicts over the course of history, and give them ratings according to degree. When you smooth out the numbers, you find a repeating cycle. We are in the rising part of the cycle now.

Gross: A low-probability event but a possible one might be a one-two punch of debt defaults in Ukraine and Greece. That would lead to widening yield spreads on Europe's periphery. Also, there is a small chance that the Chinese might devalue their currency. The renminbi has been appreciating against the dollar for a long time.

Zulauf: A Chinese devaluation would be horrible for the world economy.

Gross: But the Chinese might view it as a form of self-defense.

Schafer: If we knew what we were missing, we wouldn't miss it. That said, everyone seems to believe interest rates are going down. A big spike in rates would be shocking. Likewise, no one is predicting that the economy will fall into a deep recession.

Rogers: I'll be surprised if we have two quarters of 4%-plus growth in the U.S. in the year's first half and the Fed raises short-term rates three times in the second half. I'll be surprised if the yield on the 30-year bond rises to 3.5%.

Won't we all?

Gabelli: Interest rates could rise faster than we anticipate. Also, we are assuming that U.S. banks are in solid shape, despite the sudden drop in oil. What if a bank unexpectedly goes bust in the U.S.? Third, there are natural disasters. There hasn't been a really good hurricane season for a long time, or a big earthquake. Bill, you had your own earthquake about 60 days ago.

Gross: It was one of the biggest, and I survived.

Herro: One surprise could be strong growth from ICI -- India, China, and Indonesia -- in the second half. These countries are home to almost a third of the world's population. My extra-credit answer is that better cooperation between the U.S. president and U.S. Congress brings forth meaningful tax reform.

Faber: By far the biggest hypothetical shock mentioned would be a devaluation of China's currency. If China lets the currency go, prices will plummet and corporate margins will fall apart.

Black: I see two potential surprises. The drop in energy prices could have a deleterious effect on the housing market in states such as Texas and Colorado, which have seen big gains. Outside the U.S., we must consider the destabilizing effect of ISIS. The U.S. is providing air cover for bombing, but doesn't have a dog in this fight. ISIS intends to seize leadership of the Muslim world from Saudi Arabia. It is well organized. Iran is another potentially destabilizing player, and it produces 2.8 million barrels of oil a day. In the event of a wider Mideast conflict, oil prices could run up instantaneously.

Cohen:ISIS is not only well organized but well financed, because it establishes itself as a tax authority in the territory it seizes. It is also active in the kidnapping and ransom business.

Zulauf: A lot of fighters who have joined ISIS from other countries are trying to leave. They have had enough. The group also has a financing problem because of the drop in oil.

Cohen: You talk to people who left ISIS?

Black: My sources have a different view. They say the Europeans joining ISIS might be thugs, but the people running the organization are well educated and intelligent. They have established local and provincial governments, and issued passports. If ISIS' attacks spill over into Saudi Arabia, the United Arab Emirates, and Kuwait, the U.S. will have to act.

Witmer: My surprise is something on my wish list. Even environmentalists now agree that ethanol isn't good for the environment. The government could reduce the amount required to be added to gasoline. If that happens, it might help the oil price, but corn prices could be hurt, leading to lower prices for farmland.

Faber: Many surprises could occur in the next 12 months. The president, for whatever reason, might not finish his term. China's president, Xi Jinping, doesn't speak as much as Obama, but when he speaks, he makes sense. He is a powerful person. In the past 45 years, China has pursued a policy of nonintervention in other countries' domestic affairs. But that might change because of its oil interests in the Sudan. China is the largest supplier of troops to the U.N. peacekeeping forces. Its troops are conveniently placed next to Sudan's oil facilities. China also has a large interest in the Iraqi oilfields. If ISIS moves toward southern Iraq, which it currently can't do, China will protect its interests. The Chinese are becoming more assertive in their geopolitical ambitions. They must ensure a supply of natural resources, such as oil, copper, and iron ore. In their view, the Americans have no interests in Southeast Asia and eventually will have to move out. It is unclear how this will be achieved, or when, but it probably won't happen peacefully.

On that note, let's move on to your investment picks. Bill, since you were kind enough to state in your latest investment essay that you've been reserving your 2015 picks for the Roundtable, you can go first.

Gross: It is possible that the Fed will nudge the fed-funds rate higher in late 2015, as Goldman predicts. While the Fed would like to focus on inflation, it is perhaps more concerned with the potential for inflating financial assets. It would like to normalize interest rates to the extent that it can, which could mean a 25-basis-point increase in the fed-funds rate, or maybe a 50-basis-point increase in the next 12 months. A small increase won't threaten the bond market so long as the Fed uses the right language, which Janet Yellen has tried to do in communicating Fed policy to Wall Street. Mario Draghi [president of the European Central Bank] is the master of verbal manipulation. He has manipulated European interest rates down and into negative territory merely by talking. He deserves an award.

Bill Gross' Picks

Fund/Ticker	Price/Yield 1/9/15
Janus Flexible Bond / JFLEX	$10.62/3.0%
Pimco Municipal Income / PMF	14.41/6.7
BlackRock Build America / BBN	22.40/7.0
SchwabU.S. TIPS / SCHP	54.68/1.0.*

*Estimated

Source: Bloomberg

Given this backdrop, the 10-year Treasury is attractive at a yield a bit below 2%. At some point, there will be a bear market in Treasuries, but not in 2015. Investors are more likely to be threatened this year by credit quality than interest-rate movements. I am going to recommend high-quality investments that could provide a 4%, 5%, 6%, 7%-type return. You can skip the guffaws, but one of my picks is a Janus fund.

We're shocked, shocked.

Gross: It isn't the Janus Global Unconstrained Bond fund, which I run, but the Janus Flexible Bond fund [JFLEX], a total-return fund run by Darrell Watters and Gibson Smith. It has done well in the past few years, and performed well during the credit crisis. The managers focus on credit quality, instead of taking a macro approach, as I do. The fund has $9 billion, and the management fee is only 61 basis points. It typically yields 3% to 3.5%, but the total return is dependent upon credit selection and interest-rate changes.

I like closed-end funds that provide steady income. To prove I am not biased, my next idea is the Pimco Municipal Income PMF -0.31289111389236546% PIMCO Municipal Income Fund U.S.: NYSE 15.93 -0.05 -0.31289111389236546% /Date(1422981582733-0600)/ Volume (Delayed 15m) : 25308 P/E Ratio N/A Market Cap N/A Dividend Yield 6.120527306967985% Rev. per Employee N/A More quote details and news » PMF in Your Value Your Change Short position fund [PMF]. It is a closed-end municipal-bond fund. There are a lot of closed-end municipal funds that sell at surprisingly solid discounts to net asset value and yield 5% to 6%. Some have Puerto Rico bonds, but this one doesn't. I own this fund. Since inception in 2001, Pimco Municipal Income has maintained its dividend rate. You can't find many closed-end funds that have done that.

What does this fund own?

Gross: It holds an assortment of municipal bonds from across the country. None have the poor credit quality of Puerto Rico. The fund currently yields 6%, and it is tax-free. Typically, muni bonds are yielding 2%, 3%. 4%. The fund's yield is higher because like most closed-end funds, Pimco Municipal Income uses leverage. Leverage is dangerous if credit quality falls or interest rates rise. If the fed funds rate jumps to 1% or 2% next year, this wouldn't be an attractive holding, but that is not my bet. The fund sells at an 8% premium to net asset value, as most Pimco closed-ends do.

Next, I like the BlackRock Build America Bond BBN -0.6409052092228864% BlackRock Build America Bond Trust U.S.: NYSE 23.2699 -0.1501 -0.6409052092228864% /Date(1422982403601-0600)/ Volume (Delayed 15m) : 59828 P/E Ratio N/A Market Cap N/A Dividend Yield 6.794514898443138% Rev. per Employee N/A More quote details and news » BBN in Your Value Your Change Short position Trust [BBN], which I have recommended previously. It is a levered closed-end fund that owns Build America bonds, which were issued in 2009 and 2010 to fund construction projects. Build America bonds were an Obama administration initiative. Although the bonds aren't government guaranteed, the government provides 35% of the interest expense.

Witmer: If a project goes under and an issuer defaults, does the investor still get 35% of the interest payment?

Gross: No. You get 50, 60, 70 cents on the dollar. These bonds aren't completely risk-free. The fund typically trades at an 8% discount to net asset value, and the 7% yield is taxable. Build America bonds have provided a fairly consistent dividend stream since they were issued. These are long-term bonds, and you might ask how they compare with 30-year Treasuries. They yield a lot more than a 30-year Treasury. Also, because they are corporate bonds, they don't appreciate as much as Treasuries when rates go down, or fall as much when rates rise.

Black: Have there been any defaults in the fund portfolio?

Gross: Not that I know of, although some marginal Build America bonds have defaulted and are expected to default.

Rogers: How much leverage do these closed-end funds have?

Gross: The Pimco fund has the potential to leverage 35% of the portfolio, as does BlackRock Build America. It really went for the fences, and that is why it yields 7%.

My last pick is a Four Seasons pick. I am not referring to the hotel, but Frankie Valli and the Four Seasons. Remember when they sang [snaps his fingers and sings],

"Let's hang on to what we've got

Don't let go, girl; we've got a lot…"

Gabelli: Can you do that again?

Gross: Go see the play [Jersey Boys]; it's good. You won't be impressed by the potential return of this pick, but there is a twist; it offers a free call option on oil. It is the Schwab U.S. TIPS SCHP -0.4297224709042077% Schwab U.S. TIPs ETF U.S.: NYSE Arca 55.61 -0.24 -0.4297224709042077% /Date(1422981478157-0600)/ Volume (Delayed 15m) : 15288 P/E Ratio N/A Market Cap N/A Dividend Yield N/A Rev. per Employee N/A More quote details and news » SCHP in Your Value Your Change Short position exchange-traded fund [SCHP]. It is a $500 million fund that invests in a potpourri of TIPS [Treasury inflation-protected securities] with typical maturities of five to seven years, although it has some long- and short-term TIPS. The fund charges only seven basis points. A five-year TIPS is yielding only 15 basis points. TIPS are sensitive to inflation. The fund hasn't done well in recent months as the price of oil has come down and the expected inflation rate has fallen to 1.3% or 1.4% from 1.8%.

A five-year TIPS trades at 99 cents on the dollar. The U.S. guarantees that an investor gets back 100 cents on the dollar. That is a nice guarantee. Because of the inflation sensitivity, if oil rises to $60 or $65 a barrel from current levels, the fund will appreciate 2% or 3%. Is that a big deal? No. But the fund does just what Frankie Valli advised: It lets you hang on to what you've got. It yields more than a money-market fund and charges almost nothing.

Thanks, Bill. If these don't work out, you have a future on Broadway. Meryl, you're next.

Witmer: Gildan Activewear GIL 0.16652789342214822% Gildan Activewear Inc. U.S.: NYSE USD60.15 0.1 0.16652789342214822% /Date(1422982449668-0600)/ Volume (Delayed 15m) : 42592 P/E Ratio 18.71182849308239 Market Cap 9245939167.29646 Dividend Yield 0.8659450457951707% Rev. per Employee 59339.7 More quote details and news » GIL in Your Value Your Change Short position [GIL] manufactures basic family apparel, such as T-shirts, underwear, fleece, and socks. Its market capitalization today is $6.7 billion, and it has $100 million of net debt. At a current $55, the stock offers long-term investors an attractive entry point. Gildan has two segments. Print-wear is two-thirds of revenue and has mid-20% operating margins. It is growing by mid-single digits. Gildan supplies distributors who then sell the products to screenprinters, who imprint them with logos.

Meryl Witmer's Picks

	Price
Company/Ticker	1/9/2015
Gildan Activewear / GIL	$55.52
Graphic Packaging /GPK	13.93
Houghton Mifflin Harcourt / HMHC	18.87
Cengage / CNGO	23.00*

*As of 1/8/15

Source: Bloomberg

What is the second segment?

Witmer: It is branded apparel, which Gildan sells under its proprietary Gildan and Gold Toe labels, and under licensed labels such as Mossy Oak, a camouflage brand, and Under Armour. This business is growing by 20% to 30% a year. Because it is in investment mode, operating profit margins are only in the high single digits now. We see the branded business reaching margins north of 20% as it grows and captures the benefits of its investment in cost reduction, lower cotton costs, and the leveraging of SG&A [selling, general, and administrative] expenses. Gildan's key competitive differentiator is its low-cost, vertically integrated manufacturing. By continually investing in manufacturing facilities, it has been able to increase capacity and reduce costs while also improving quality. Its North Carolina ring-spun cotton facilities, which opened last year, will be the largest globally.

What is ring-spun cotton?

Witmer: It is a thin, soft cotton used in many fashion brands. Gildan's Anvil brand will drive the company's penetration in fashion-oriented basics and further differentiate its branded products. Evidence of the strategy's success can be seen in the underwear business, where Gildan has captured 7.8% of the market since November 2013. Its market share could reach 10% this year.

In December, Gildan provided 2015 guidance of $3 to $3.15 a share in earnings, better than 2014's $2.94, but below the Street's estimate of $3.50. The stock traded down more than 10% on the news. Gildan decided to take strategic pricing action to reinforce its leadership and to help it get into segments of the print-wear market it hadn't previously served. The pricing action is costing it around 70 cents a share. While the market reacted negatively, the company's moves have enhanced its long-term prospects. Gildan also announced plans to buy back 1.5 million shares.

Co-founder and CEO Glenn Chamandy is one of the best operators we have encountered. He is concerned with long-term earnings, Gildan's market position, and the success of its customers. In addition, his ownership of six million shares keeps his incentives aligned with ours.

What will Gildan earn in 2016?

Witmer: Gildan can earn $3.85 to $4 a share in 2016 and grow by at least a mid-teens rate from there. This earnings momentum could start to show in the third quarter of this year. Given Gildan's pristine balance sheet and growth outlook, we apply an 18 price/earnings multiple to future earnings to get a target price of $70 a share in one year and $80 in two years, up from $55 now. There is upside potential from acquisitions and the continued deployment of free cash.

Gildan is based in Montreal. It trades on the Toronto Exchange and in New York. Most of its operations are in Honduras, and some are in the southeastern U.S.

Black: Does the company benefit from the depreciation of the Canadian dollar versus the U.S. dollar?

Witmer: No. Only its corporate headquarters is in Canada. But it could benefit from more money in the consumer's pocket and lower energy costs. My next name, Graphic Packaging GPK 1.5883977900552486% Graphic Packaging Holding Co. U.S.: NYSE USD14.71 0.23 1.5883977900552486% /Date(1422982492481-0600)/ Volume (Delayed 15m) : 393044 P/E

Ratio 10.528571428571428 Market Cap 4735452120.80353 Dividend Yield N/A Rev. per Employee 334442 More quote details and news » GPK in Your Value Your Change Short position [GPK], is a vertically integrated paperboard manufacturer. The stock is $14, the market cap is $4.4 billion, and the enterprise value is $6.5 billion. Graphic Packaging makes boxes for cereal, beer, detergent, and other branded consumer goods. While the container itself costs little, the value is in the brand marketing and protection of the contents. Graphic's customers are reluctant to switch suppliers, so there is good stability to the revenue and earnings stream.

Graphic's mills are some of the lowest-cost in the industry. The company has two virgin-paper mills and four recycled-paper mills producing 2.3 million tons of paper annually. It also has more than 40 converting plants located near customers in the U.S. and Europe, where it converts paper produced in its mills into packaging. Graphic is only one of two producers of stronger virgin paper, with a market share of 55%. MeadWestvaco MWV 0.7575757575757576% MeadWestvaco Corp. U.S.: NYSE USD50.54 0.38 0.7575757575757576% /Date(1422982504239-0600)/ Volume (Delayed 15m) : 380654 P/E Ratio 9.966888722456542 Market Cap 8430719413.72025 Dividend Yield 1.9774569903104608% Rev. per Employee 351937 More quote details and news » MWV in Your Value Your Change Short position [MWV] is the other. It's a leader in the recycled-board market, with a 35% share. CEO Dave Scheible is a long-term thinker who has been with the company since 1999. He has been CEO since 2007. He has done a fantastic job of integrating acquisitions, paying down debt, and disposing of noncore businesses.

What do the financials look like?

Witmer: In the past few years, Graphic has transitioned from a highly levered company to one that is appropriately capitalized. The company has nearly $900 million of net operating-loss carryforwards, which could allow it to shield earnings from taxes for the next 2½ years. In our base-case model, Ebitda [earnings before interest, taxes, depreciation, and amortization] can grow 5% a year organically. We assume that the cash simply builds up on the balance sheet. Even though Graphic won't pay much in corporate taxes until 2017, we use a 35% pro forma tax rate to get $1.45 a share in after-tax free cash in 2016. Plus, there is a buildup of $3 a share in excess cash. Using a 12 multiple and adding the excess cash gets us a target price of about $20 a share in two years.

The company will likely redeploy the cash to make opportunistic acquisitions, repurchase shares, and implement a dividend. The CEO seems to have a knack for making $1 worth at least $2. Plus, with the decline in energy prices, the consumer could add a tail wind to our growth assumptions. Our upside two-year target is north of $23 share.

My next picks, Houghton Mifflin Harcourt HMHC 1.8734177215189873% Houghton Mifflin Harcourt Co. U.S.: Nasdaq USD20.12 0.37 1.8734177215189873% /Date(1422982515635-0600)/ Volume (Delayed 15m) : 70708 P/E Ratio N/A Market Cap

2794229915.6189 Dividend Yield N/A Rev. per Employee 425972 More quote details and news » HMHC in Your Value Your Change Short position [HMHC] and Cengage [CNGO], publish textbooks and other educational material. Both have come out of bankruptcy protection.

You have invested successfully in other companies coming out of bankruptcy.

Witmer: It is a good place to look. Houghton is focused on pre-K to 12th grade, and Cengage, on college students. Houghton has a market cap of $2.7 billion and an enterprise value of $2.3 billion, and about $2 a share of excess cash. Cengage has a market cap of $1.8 billion, an enterprise value of $3.6 billion, and some debt. Both companies are benefiting from the conversion of educational materials from print to digital. Given the complexities of GAAP accounting [accounting based on generally accepted accounting principles], this change is being overlooked by the market. Reported earnings are also greatly obscured by noncash amortization charges.

What led to the companies' bankruptcy filings.

Witmer: In the middle of the past decade, private-equity firms purchased and levered up textbook publishers, including Houghton Mifflin and Cengage. The money for textbook purchases comes primarily from state and local tax revenue, and the recession forced a sharp pullback in spending in pre-K-12. The college-textbook market was challenged by the growth in online textbook-rental companies. Given their leverage, both Houghton and Cengage were forced to declare bankruptcy and restructure. It was your classic example of "good business meets bad balance sheet." Houghton came out of bankruptcy protection in 2012 and came public in 2013. Cengage emerged in the middle of 2014.

The K-12 and college markets each have three competitors with most of the market. This is an attractive industry structure. Schools and professors are rapidly accelerating their use of digital materials in the classroom. In Texas, 70% of Houghton's best-selling math program was sold as digital content. At Cengage, digital content was 19% of total sales in 2014. According to professors and research studies, students learn better using digital content. In the college market, many classes have required purchases of digital material for homework and at-home quizzes. The shift improves profitablity as you don't need to print and warehouse books.

How does the GAAP accounting work?

Witmer: When a print textbook is sold, the revenue and costs are recognized in today's income statement. When a digital product is sold, revenue must be deferred over the lifetime of the contract, usually six years, while most of the cost is incurred in the current period. In the first three quarters of 2014, Houghton's GAAP revenue has increased 3%. Billings, which combine reported revenue and deferred revenue, are up 25%. As a significant part of deferred-revenue growth comes from digital-product sales with minimal incremental costs, reported earnings significantly understate true earnings power. The correct adjustment is to add back most of the increase in annual deferred revenue, less estimated costs and taxes.

GAAP also penalizes the reported earnings of these companies with large amortization charges. These are accounting charges and don't involve the outflow of cash. They are tax-deductible. We add back the charges, resulting in a 2014 estimate of $1.60 to $1.80 a share in after-tax free cash flow for Houghton Mifflin. The company has said that it will generate close to $2 share in cash in 2014.

What are reported earnings?

Witmer: They were a negative 20 cents for the first nine months of 2014.

Demand for textbooks in 2014 was higher than industry expectations. But national spending per student in the K-12 market is near historic lows. Spending is about $55 per student, up from a postrecession low of $47, but below a 10-year average of $62. With 55 million students and a market share of 42%, an incremental $5 per student could add 30 cents a share to Houghton's earnings. A $5 increase is reasonable as municipal budgets improve. Houghton is also working to sell supplemental learning materials directly to parents. This could be a big and profitable business. We value Houghton at 14 to 15 times adjusted earnings. Our target price is $26 to $28 a share, up from $18.50.

Cengage's adjusted earnings are about $2.60 per share. The stock is $23. The company recently paid a special dividend of $3.85 a share dividend. We value the business at 12-13 times earnings, or $31 to $34 a share.

Black: Does Houghton still have a trade-book division?

Witmer: Good memory -- they do. This pick is really about the growth of digital revenue, with 20% fewer associated costs, and the drought of spending reversing in pre-K to 12.

Thank you, Meryl.

Barron’s Roundtable: 22 Smart Investment Ideas

Part 2

Felix Zulauf, Abby Joseph Cohen, Brian Rogers, and Scott Black share their best investment bets in this week’s Roundtable installment.

By Lauren R. Rublin

January 24, 2015

If you’re looking for raging bulls or rabid bears, you’ve come to the wrong section of this esteemed publication. But if you’re seeking ways to make sense of perplexing economic times, and money in a market that offers slimmer pickings than in recent years past, stay right where you are.

Clockwise from top left: Scott Black, Brian Rogers, Abby Joseph Cohen, and Felix Zulauf. From Chicago to Singapore, the Roundtable panelists see opportunities to win at the investment game. Photo: Brad Trent for Barron's

The great big picture -- global economics, interest rates, currencies, politics, and markets -- was the focus of last week’s Roundtable issue, the first of three to distill the daylong conversation of the 10 Wall Street seers whom we convened in New York on Jan. 12. In this week’s installment, panelists Felix Zulauf, Abby Joseph Cohen, Brian Rogers, and Scott Black put their mettle to the pedal to drive home the case for specific investment ideas.

None expects a year of robust stock-market gains; indeed, Felix looks for U.S. stocks to correct by 15% or so in the first half of 2015. Hence, the urgency of finding companies likely to outdistance the crowd through savvy management and shareholder-friendly maneuvers.

Felix, who runs money for two Swiss investment firms, is the odd duck in this week's lineup, but we mean that only in the most affectionate way. He's no stockpicker, but rather a tactical trader at home in nearly every asset class, who can explain eloquently not only when to buy gold or short currencies, but why. For the record, he expects long-term U.S. Treasury bond yields to keep heading south, and calls an interest-rate hike "off the table" for 2015.

Abby, head of Goldman Sachs' Global Markets Institute, travels the world, observing and advising. When she returns home, or at least to her Roundtable perch, she comes armed with practical insights about business and economics, and a bevy of stocks favored by Goldman analysts that embody her macro views. This year she's especially bullish on companies that will benefit from cheaper oil and rapidly rising spending on cybersecurity.

Brian captains a big ship known as T. Rowe Price, but remains surprisingly well-informed about the goings-on in other companies' boardrooms and balance sheets. An optimist by nature, he favors concerns that have gone astray in various ways, but could soon get themselves and their beaten-down shares back on track. General Electric GE 0.5989260636100785% General Electric Co. U.S.: NYSE USD24.355 0.145 0.5989260636100785% /Date(1422983363407-0600)/ Volume (Delayed 15m) : 10072567 P/E Ratio 16.649593662500855 Market Cap 243121421108.834 Dividend Yield 3.7735849056603774% Rev. per Employee 481469 More quote details and news » GE in Your Value Your Change Short position [ticker: GE] and Mattel MAT -0.10748835542816194% Mattel Inc. U.S.: Nasdaq USD27.88 -0.03 -0.10748835542816194% /Date(1422983354264-0600)/ Volume (Delayed 15m) : 2300968 P/E Ratio 13.347619047619048 Market Cap 9114446059.10225 Dividend Yield 5.422761327149483% Rev. per Employee 207717 More quote details and news » MAT in Your Value Your Change Short position [MAT] are two that fit the bill.

Scott Black, founder and boss of Boston's Delphi Management, builds his brief for stocks meticulously, by modeling all the relevant financial data. One could learn a lot by listening to his dissection of an income statement. We learned, for instance, why he favors Viacom viab 1.6121602947950253% Viacom Inc. Cl B U.S.: Nasdaq USD66.18 1.05 1.6121602947950253% /Date(1422983346505-0600)/ Volume (Delayed 15m) : 780829 P/E Ratio 11.967509025270758 Market Cap 26443471988.7268 Dividend Yield 1.990950226244344% Rev. per Employee 1407070 More quote details and news » viab in Your Value Your Change Short position [VIAB] and a nifty small bank with big ambitions.

Want to know more? Please read on.

Barron's: Felix, we hope you've brought us some winning ideas today.

Zulauf: I am re-recommending the iShares 20+ Year Treasury Bond TLT -1.483852196683154% iShares 20+ Year Treasury Bond ETF U.S.: NYSE Arca 135.44 -2.04 -1.483852196683154% /Date(1422983358997-0600)/ Volume (Delayed 15m) : 4514868 P/E Ratio N/A Market Cap N/A Dividend Yield 2.469567782858829% Rev. per Employee N/A More quote details and news » TLT in Your Value Your Change Short position exchange-traded fund [TLT], which I recommended last year. The world economy is slowing. The deflationary process is gaining traction, and the commodity cycle remains bearish. The pressure on bond yields is to the downside. The yield on the 30-year Treasury is at 2.53%, near its 30-year low. I expect the 30-year bond to break that low decisively, and yield 2% or even less than 2% when the stock market sells off. The major stock-market indexes are in for a correction of 15%. Large-cap stocks are overvalued.

What will spark a correction?

Zulauf: Earnings estimates will come down. The dollar is strong against foreign currencies, and foreign earnings will be weaker than the market expects. I am looking for a big selloff, probably in the first half of the year. During that selloff, the TLT will rise dramatically and the yield will fall sharply. When that happens, I will sell the ETF. I sold it in mid-October when the stock market fell sharply and bond prices spiked up, and I bought it back shortly thereafter.

The TLT is the biggest position in my portfolio, by far. U.S. bond yields are the highest in the world. Italy's 10-year bond yields 1.9%. Spain's yields 1.7%. France is at 0.8%, and Germany is at 0.49%.

The U.S. bond market is mispriced, and that will change as soon as the market accepts that the U.S. economy is slowing, not accelerating.

Cohen: It is not the U.S. that is mispriced, but rather those other markets.

Zulauf: The others are mispriced, too, but it is a relative world. I don't know what the right price is.

I'm just saying that U.S. bond yields have more to go on the downside.

Gross: If European bonds are mispriced, would you short them?

Zulauf: I wouldn't short them yet, although yields are close to the lows, because the European Central Bank is likely to enter the market soon and buy 500 billion euros of government paper, driving yields down further. I don't want to go against the central bank. [The ECB launched a €1 trillion-plus bond-buying program Thursday.]

If I saw serious fiscal-stimulus programs in European countries, I would short their bonds, but that isn't the case yet.

When do you expect the Federal Reserve to start raising interest rates?

Zulauf: A Fed rate hike is off the table because the U.S. economy will disappoint. The Fed will postpone its plans to raise rates this year. Perhaps it will do so in 2016. I don't see how the Fed can justify hiking rates when economic growth will disappoint, employment growth will fade, and inflation will overshoot on the downside.

My next recommendation is to buy the U.S. dollar. The dollar was strong against every major currency in the world last year. That hasn't happened in at least 25 years.

Mainstream economists are telling us that the dollar is strong because of growth differentials among countries, and an impending interest-rate hike in the U.S. They don't understand the true reasons for the strong dollar.

Enlighten them, and us, please.

Zulauf: The Federal Reserve, under [former chairmen] Alan Greenspan and Ben Bernanke, pursued a monetary policy that kept interest rates too low. It weakened the U.S. currency, which became a funding currency around the world. Corporations issued dollar-denominated debt. According to the Bank of International Settlements, there is $9 trillion of dollar-denominated debt outstanding in the private sector around the world. That is the short position. Whatever the reasons for the recent firming of the dollar, the true firming eventually will occur when all issuers of dollar-denominated debt see their liabilities rise. They will have to hedge their positions and buy dollars, creating demand for the dollar.

Felix Zulauf: “The world economy is slowing...The pressure on bond yields is to the downside.” Photo: Jenna Bascom for Barron's

At the same time, the current account deficit of the U.S., which is the way the U.S. supplies dollars to the rest of the world, has been shrinking in recent years. Therefore, there is a diminishing supply of new dollars. At some point this year, the market will realize that interest-rate hikes in the U.S. are off the table. When that happens, the dollar will have a correction. I expect that correction to start in the first quarter and end before midyear. Then, the dollar will strengthen again, probably into late 2016. I don’t want to buy U.S. dollars at today’s level, but an investor who wants to establish a dollar position should do so in phases as the dollar corrects.

What is the best way to bet on the dollar?

Zulauf: You can do it in different ways. You can buy the U.S. Dollar Index, which is listed as a futures contract. [It measures the value of the dollar against a basket of foreign currencies]. You can also buy the dollar and short individual currencies. I recommend buying the dollar and shorting the Singapore dollar, which is perceived as a sound and strong currency. Within Asia, other economies have been burdened by the devaluation of the Japanese yen, including the Singapore economy, which is closely connected to China through trade. The Singapore banking system is extended; the loan-to-deposit ratio is about 120%.

FELIX ZULAUF’S PICKS

	Price
Investment / Ticker	1/9/2015
iShares 20+ Year Treasury Bond ETF / TLT*	$131.07
U.S. Dollar Index Future (Mar. ’15)**	92.15
Buy U.S. dollar / Short Singapore dollar**	$1=S$1.33
Market Vectors Gold Miners ETF / GDX***	$20.71
Gold (spot, per ounce)***	$1,223.25
Market Vectors Retail ETF / RTH****	$72.05

*Sell after stock-market correction. Zulauf expects the U.S. stock market to correct by about 15% in the first half of the year.

**Buy in phases as the dollar corrects.Zulauf expects the dollar to correct in the first quarter and then rally into late-2016.

***Hold only until the middle of 2015.

****Buy after U.S. stock-market correction.

Source: Bloomberg

Investors bought Singapore dollars because they believed the Singapore monetary authority was pursuing a gradual strengthening of the Singapore dollar. Singapore has a policy of matching its currency to a basket of currencies, although it doesn't disclose which currencies they are. The Singapore government is one of the best in the world.

Now, however, values in Singapore's real-estate market have fallen sharply. Singapore must choose whether to provide more liquidity to the financial system or fix its currency to other currencies. It can't do both at the same time. The world hasn't yet realized that Singapore is changing from a currency to a liquidity target. That means the government will have to weaken the Singapore dollar. The Singapore dollar will lose some of the glamour it had in recent years, and shorting it is a good way to play the strength of the U.S. dollar and the weakening of other currencies.

Where is the Singapore dollar trading?

Zulauf: It traded down from 1.70 Singapore dollars to the U.S. dollar to S$1.20 in the summer of 2011, and has traded sideways since then in a range of S$1.20 to S$1.30. Recently, it broke above that range and moved up to S$1.34. It now trades at S$1.33. If I am right that China will continue to slow and the world economy will weaken further, Singapore, like nearly all other Asian economies, will need to become more expansive in its monetary policy. Singapore will celebrate the 50th anniversary of its statehood in August. It doesn't want to have major real-estate problems then, and will provide the necessary liquidity. Going long the U.S. dollar and short the Singapore dollar is a two-year trade.

Faber: I disagree somewhat about the outlook for the Singapore dollar, although I don't disagree that the government has embarked on a policy of lowering its value. There was a huge speculative bubble in Singapore real estate. The government implemented measures in some areas to cool real-estate prices. They have fallen 30% or 40% from the peak in places like Sentosa Island, but that is after they went up about 20 times.

Real-estate inflation is a problem in Singapore and many countries as a result of increased financial liquidity. Ten or 15 years ago, Hong Kong and Singapore were reasonably priced, or inexpensive. Today, prices are so high that there is social unrest. Ordinary people's salaries aren't going up, but the cost of living has risen greatly.

Enlarge Image Close

2015 Roundtable Panelists

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Abby Joseph Cohen
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Global Markets Institute
Goldman Sachs, New York

Marc Faber
Editor and Publisher
The Gloom, Boom & Doom Report
Hong Kong

Mario Gabelli
Chairman and CEO
Gamco Investors
Rye, N.Y.

Bill Gross
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Janus Capital Group
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David Herro
CIO - International Equities
Harris Associates
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Brian Rogers
Chairman
T. Rowe Price
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Oscar Schafer
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Oscar Schafer
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Rivulet Capital
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Meryl Witmer
General Partner
Eagle Value Partners
New York

Felix Zulauf
President
Zulauf Asset Management
Co-CIO and Partner
Vicenda Asset Management
Zug, Switzerland

The Singapore government has tried to lower the value of the Singapore dollar to make the country more competitive, more attractive to tourism, and so forth. But the economy is still in good shape, and Singapore's banks are some of the strongest in the world. Yes, they have exposure to China. But they also have exposure to Singapore and other Asian countries. I am not that negative about the Singapore dollar. It might go down somewhat from here, but there are other currencies that are much weaker.

The Hong Kong dollar was undervalued, relative to the Chinese renminbi. This created a huge boom in Hong Kong, but with the U.S. dollar strengthening, there is an adjustment process. The Hong Kong dollar won't be devalued against the U.S. dollar unless the Chinese renminbi really goes down against the U.S. dollar.

Roundtable Report Cards

2014 Roundtable Report Card

2014 Mid-Year Roundtable Report Card

Most members of the Barron’s Roundtable are active money managers who trade their positions and change their investment opinions as market conditions warrant. For those keeping score, here’s how our panelists’ 2014 picks and pans performed through Dec. 31.

Zulauf: I don’t disagree with much of what you said. However, Singapore and its banking system are closely tied to China these days, and China is weakening. If the U.S. dollar strengthens, countries like Singapore, with current account surpluses and low interest rates, could be the first to see a weaker currency. Sicker and weaker economies will suffer later.

When the dollar corrects in the first half of the year, there will be a rally in gold, although it won’t last all year. In the past few months, gold has withstood the strengthening of the dollar, and put in a bottom for a good rally. Bullion could rally about 10% into the middle of the year. Then, I will exit gold. You can also invest in the GDX, or Market Vectors Gold Miners GDX -2.89532293986637% Market Vectors Gold Miners ETF U.S.: NYSE Arca 21.8 -0.65 -2.89532293986637% /Date(1422983363451-0600)/ Volume (Delayed 15m) : 12745838 P/E Ratio N/A Market Cap N/A Dividend Yield 0.5540267672767066% Rev. per Employee N/A More quote details and news » GDX in Your Value Your Change Short position ETF. This isn’t the beginning of a sustainable multiyear run in gold; it is a trade into the middle of this year.

Black: Why would gold rally if inflation is close to zero in the euro zone, and 1.4% in the U.S.?

Zulauf: Gold is a protection against extreme deflation, as well as inflation. It is protection against systemic risk.

Schafer: Felix, don’t people also own gold as a hedge against currency risk?

Zulauf: Yes. Gold has been a fantastic currency. Last year, it was the second-strongest currency, after the U.S. dollar. It has risen against all other currencies and has fulfilled its function to protect against currency debasement.

Gross: If real interest rates come down, as you expect, won’t that push the gold price up?

Zulauf: Historically, falling interest rates have been a plus for gold, but that has always been in times of inflation. Now the risk is toward deflation. Gold doesn’t pay any interest, and there is a minimal cost to hold it. It is more attractive to hold gold in a world of zero interest rates than when rates were 4% or 5%. Gold could run to the mid-$1,300s from today’s $1,223.

Once the U.S. stock market corrects, I would also buy the Market Vectors Retail rth 0.4131093362709997% Market Vectors Retail ETF U.S.: NYSE Arca 72.92 0.3 0.4131093362709997% /Date(1422982286588-0600)/ Volume (Delayed 15m) : 11013 P/E Ratio N/A Market Cap N/A Dividend Yield 0.3990674712013165% Rev. per Employee N/A More quote details and news » rth in Your Value Your Change Short position ETF

(RTH). U.S. retailers benefit from a stronger dollar, as it allows them to buy foreign goods at cheaper prices and expand their profit margins. The ETF's three largest positions are Wal-Mart Stores WMT 0.45502275113755686% Wal-Mart Stores Inc. U.S.: NYSE USD86.1 0.39 0.45502275113755686% /Date(1422983362615-0600)/ Volume (Delayed 15m) : 1777260 P/E Ratio 17.6 Market Cap 276259606927.011 Dividend Yield 2.226345083487941% Rev. per Employee 219905 More quote details and news » WMT in Your Value Your Change Short position [WMT], Home Depot HD 0.6703054677774586% Home Depot Inc. U.S.: NYSE USD105.13 0.7 0.6703054677774586% /Date(1422983362615-0600)/ Volume (Delayed 15m) : 1543584 P/E Ratio 23.80766968325792 Market Cap 137620676765.694 Dividend Yield 1.7865644650427301% Rev. per Employee 223863 More quote details and news » HD in Your Value Your Change Short position [HD], and CVS Health CVS 0.1311673897689436% CVS Health Corp. U.S.: NYSE USD99.24 0.13 0.1311673897689436% /Date(1422983353604-0600)/ Volume (Delayed 15m) : 902296 P/E Ratio 25.402307672627728 Market Cap 113618025443.349 Dividend Yield 1.4100110786584752% Rev. per Employee 649490 More quote details and news » CVS in Your Value Your Change Short position [CVS]. Retailing stocks have always been among the best performers when the dollar has strengthened considerably.

Thanks, Felix. Abby, what do you favor this year?

Cohen: From an asset-allocation standpoint, 2015 will be a better year for U.S. equities than bonds. It is possible that the Fed will wait even longer to raise interest rates because of its concerns about the impact of a strong dollar, the deflationary consequences of falling energy prices, and so on. Nevertheless, equities are more attractively valued than fixed-income assets. My suggestions presume that the economy continues to grow.

Many parents in this room might recognize the name Carter's CRI 1.1300822994718094% Carters Inc. U.S.: NYSE USD82.33 0.92 1.1300822994718094% /Date(1422983345109-0600)/ Volume (Delayed 15m) : 43065 P/E Ratio 26.194267515923567 Market Cap 4307077509.65026 Dividend Yield 0.9240121580547113% Rev. per Employee 249002 More quote details and news » CRI in Your Value Your Change Short position [CRI]. The company sells a variety of apparel and other products under the Carter's, OshKosh, and other brands, for children from birth through about age 12. It sells through a variety of channels, including its own stores, a Website, department stores, and discounters. Carter's was founded in 1865. It is a North America-centric company; the U.S. accounts for 89% of sales; Canada, 7%, and the rest of the world, 4%.

Abby Joseph Cohen: “FedEx benefits significantly from online shopping, which is here to stay.” Photo: Jenna Bascom for Barron's

Carter’s could face moderating costs, including the cost of cotton, which represents 15% of its cost of goods sold. Cotton prices have fallen about 30% from their high last spring. The company also is benefiting from a strong dollar, as some of its products are sourced outside the U.S. Carter’s will soon exit a period of heavy investment in its Website and stand-alone stores. Selling, general, and administrative expenses are expected to fall.

Also, U.S. birth trends have improved. We haven’t seen a new baby boom yet, but the baby dearth seems to be ending. Carter’s has a 20% share of the apparel market for children two years and under.

Has the company been growing?

Cohen: Yes. The stock is rated Buy by Goldman’s analyst, who is forecasting annualized sales growth of about 9% in the next couple of years, and a return on equity of 23%-25%.

Carter’s is generating strong free cash flow, and a number of retailers are telling us they are seeing good demand for its products in their stores. Our analyst estimates that the company will earn $5.10 a share this year, notably above the consensus of $4.58. The price/earnings ratio is 16.6, based on Friday’s [Jan. 9] close of $84.81. The shares trade for 22 times last year’s estimated earnings, so earnings growth is an important part of the story.

My next few stocks are beneficiaries of the decline in energy prices. FedEx FDX 0.10102189781021897% FedEx Corp. U.S.: NYSE USD171.423 0.173 0.10102189781021897% /Date(1422983356887-0600)/ Volume (Delayed 15m) : 443334 P/E Ratio 21.630323874469365 Market Cap 48517349243.1641 Dividend Yield 0.46617329992424683% Rev. per Employee 288660 More quote details and news » FDX in Your Value Your Change Short position [FDX] provides transportation and business services, typically in the form of shipping, delivery, and package freight. The company's freight division operates 62,000 ground vehicles, and energy costs are a substantial portion of its cost of goods sold. FedEx executed well during the holidays, its peak shipping season. It benefits significantly from online shopping, which is here to stay, and there has been a shift in its business mix.

How so?

Cohen: For a while, there had been a shift away from so-called priority shipping toward cheaper forms of shipping. Now there is a shift back to more expensive forms of shipping, which is good for profit margins. It could enhance FedEx's margins by three percentage points in the next three to four years. Our analyst estimates that FedEx's earnings CAGR [compound annual growth rate] could be substantial in the next few years. Goldman has a 2015 earnings estimate of $9 a share, versus the consensus estimate of $8.98. The shares sell for 19 times estimated earnings.

ABBY JOSEPH COHEN'S PICKS

	Price
Company / Ticker	1/9/2015
Carter's / CRI	$84.81
FedEx / FDX	172.66
Quest Diagnostics / DGX	68.39
Acuity Brands / AYI	151.5
Siemens / SIE.Germany	€ 93.10
Palo Alto Networks / PANW	$125.82

Source: Bloomberg

On the negative side, the stock has been a strong performer in recent months, and is already owned by a number of big U.S. mutual funds.

Black: FedEx has a pristine balance sheet.

Cohen: My next pick, oddly enough, also benefits from the decline in crude prices. It is Quest Diagnostics DGX -0.05574912891986063% Quest Diagnostics Inc. U.S.: NYSE USD71.71 -0.04 -0.05574912891986063% /Date(1422983356614-0600)/ Volume (Delayed 15m) : 642229 P/E Ratio 18.72972690174741 Market Cap 10370314254.7607 Dividend Yield 1.8435754189944134% Rev. per Employee 181341 More quote details and news » DGX in Your Value Your Change Short position [DGX]. Quest has a 26% share of the independent laboratory market in the U.S. It is the low-cost provider of blood-testing services. It also does work for pharmaceutical companies. Ultimately, the Affordable Care Act will be a net positive for Quest. The company's volumes are rising organically, and it has been active in making acquisitions, leading to a growing market share. In the current and coming health-care environment, it is good to be the low-cost provider with substantial volume growth.

Quest also has several growth initiatives. It offers drug monitoring for pharmaceutical companies. It is also involved in what it calls esoteric testing, including genetic and other specialized testing. This work tends to have higher profit margins.

What is the connection with lower energy prices?

Cohen: Quest operates 2,000 patient locations. It transports fluid samples for testing. It also produces much of the material it uses, including plastic tubes made of oil-based resins. Labs and services has been the worst-performing subsector of the health-care sector in the past year or two. It is possible portfolio managers will look to rotate into it.

In addition, Quest's size makes it easier for the company to absorb some of the regulatory costs that have been imposed on the industry.

Quest is opening a new facility in Massachusetts that will give it more geographic reach. The company has a free-cash-flow yield of about 9%, and might be able to lower its costs further. Our analyst estimates 2015 earnings of $4.68 a share, versus the consensus view of $4.40. The stock yields 1.9%.

My next name is Acuity Brands AYI 0.0395935066649069556% Acuity Brands Inc. U.S.: NYSE USD151.6 0.06 0.0395935066649069556% /Date(1422983191560-0600)/ Volume (Delayed 15m) : 63730 P/E Ratio 36.04857819905213 Market Cap 6572137890.20752 Dividend Yield 0.3418241577649959% Rev. per Employee 352314 More quote details and news » AYI in Your Value Your Change Short position [AYI], a major provider and distributor of LED lighting.

Black: That's the old Lithonia Lighting, which was owned by Erwin Zaban's National Service Industries.

Cohen: That's right. Acuity works primarily through electrical wholesalers. As Scott indicated, it sells a number of lighting brands. We are seeing enormous demand for LED lighting, particularly in new construction and industrial projects. Many individuals and companies are finding LED lights well worth the upfront cost, as they consume electricity far more efficiently than less expensive incandescent lights.

LED bulbs don't need to be replaced as frequently, either, so they offer labor savings. LED lighting is a higher-margin business for Acuity than traditional lighting.

Here are the numbers: Our analyst estimates Acuity will earn $5.49 a share in the fiscal year ending in August. The consensus is $5.36. The price/earnings multiple isn't low at 28 times, but gross profit margins of 42% are impressive.

Acuity's LED lighting sales were up 75% in fiscal 2014. Even though sales of traditional lighting are declining, overall sales rose 13%. LED lighting accounts for 42% of sales.

Siemens [SIE.Germany], my next stock, is a beneficiary of a rising dollar. The company is based in Germany and was founded in 1847, proving that it isn't only companies founded in the past five years that provide interesting things.

Siemens is a conglomerate; it has businesses in electronics and electrical engineering, gas power, electric utilities, wind power and other energy renewables, building technologies, such as fire safety, security, and automation, and more.

Siemens also has financial activities. One attraction is that the company is pruning its portfolio. The stock hasn't performed well. It has underperformed its sector and yields about 4%.

Schafer: In what currency?

Cohen: That's in euros; I was referring to the German shares. Siemens also trades in the U.S. via American depositary receipts [SIEGY].

Our earnings estimates aren't much different than the consensus, but we are interested in how the company will address its diversified portfolio of business activities. Eighteen percent of current contracts are unprofitable. Total sales were flat in 2013 and 2014. We forecast that they will be up just a smidgen in 2015. As Siemens begins to rationalize its operations, the stock could become more attractive. The company will also benefit from the decline in the euro, relative to the dollar.

Zulauf: Siemens has been a disappointment for as long as I can remember. The former CEO was ousted, and the chief financial officer took over. He is trying to slim down the company and increase profitability. It might work; there is enough waste to cut. But it is difficult to cut out the fat in some European countries, due to labor laws.

Herro: Do you have earnings-per-share estimates for Siemens?

Cohen: We estimate that Siemens could earn 7.12 euros in 2015. It could earn €7.69 in 2016. The stock is trading at €93.10.

My last name is in the technology sector, which has performed well. It is Palo Alto Networks PANW -2.2540164655103507% Palo Alto Networks Inc. U.S.: NYSE USD122.29 -2.82 -2.2540164655103507% /Date(1422983334080-0600)/ Volume (Delayed 15m) : 413488 P/E Ratio N/A Market Cap 10077109811.3531 Dividend Yield N/A Rev. per Employee 384637 More quote details and news » PANW in Your Value Your Change Short position [PANW], a specialist in cybersecurity.

How timely. It seems that ISIS has just hacked the Twitter account of the U.S. Central Command.

Cohen: We are all learning the importance of cybersecurity. Palo Alto provides an enterprise-security platform, including firewalls. It also sells subscriptions to software products that protect against malware.

We surveyed hundreds of companies around the world, asking how they plan to spend their 2015 IT [information technology] budgets. Cybersecurity was the No. 1 target by far for accelerated IT spending. Beneficiaries will include some of the big data-management companies, and specialty concerns, such as Palo Alto. The U.S. Department of Justice recently advised that companies need to pay more attention to cybersecurity at the board and chief-financial-officer level. Many companies need to update their firewalls.

Palo Alto's results were above consensus forecasts for the past few quarters. Forecasts have been moving higher. We expect the company to earn 74 cents a share this year. The company's business has been largely domestic, but management is planning to move into other parts of the world. Palo Alto has a new partnership with a company that will give it more distribution flexibility. We see good top-line growth and better operating leverage, although we have some concerns. Everyone knows that cybersecurity is important, so large companies such as Cisco Systems CSCO -0.11181513231457324% Cisco Systems Inc. U.S.: Nasdaq USD26.8 -0.03 -0.11181513231457324% /Date(1422983356980-0600)/ Volume (Delayed 15m) : 9031675 P/E Ratio 17.956375838926174 Market Cap 137197562715.333 Dividend Yield 2.8405905438235846% Rev. per Employee 638854 More quote details and news » CSCO in Your Value Your Change Short position [CSCO] and Juniper Networks JNPR 1.3297872340425532% Juniper Networks Inc. U.S.: NYSE USD22.86 0.3 1.3297872340425532% /Date(1422983357351-0600)/ Volume (Delayed 15m) : 1446728 P/E Ratio N/A Market Cap 9758756414.49104 Dividend Yield 1.7520805957074026% Rev. per Employee 487936 More quote details and news » JNPR in Your Value Your Change Short position [JNPR] are trying to move into the area. Also, the stock has doubled in the past 12 months.

Black: And it trades for 115 times this calendar year's expected earnings.

Cohen: Palo Alto's fiscal year ends July 30. We are not saying that it is a cheap stock, but that there is a possibility that profit margins and revenue growth will continue to outperform.

Black: I recently visited Check Point Software Technologies CHKP 0.6954248366013072% Check Point Software Technologies Ltd. U.S.: Nasdaq USD77.032 0.532 0.6954248366013072% /Date(1422983354754-0600)/ Volume (Delayed 15m) : 435216 P/E Ratio 21.951566951566953 Market Cap 14595434486.3892 Dividend Yield N/A Rev. per Employee 500273 More quote details and news » CHKP in Your Value Your Change Short position [CHKP] in Silicon Valley. It has much greater penetration of big companies and government agencies than Palo Alto. If you back out its $19 a share of cash, Check Point sells for 15 times earnings, well below Palo Alto's multiple.

Cohen: Palo Alto is a cybersecurity pure play.

Rogers: There aren't too many plays in this business.

Gabelli: Palo Alto has built up a sales force and is doing extremely well on new conquests. I don't own any of the stock; it is not my core competency. But it is a good story.

Black: You know the old joke: We're not here to buy stories, we're here to buy businesses. This is an overpriced business.

Rogers: To each his own.

Well said, Brian. Let's get your ideas.

Rogers: I have nothing selling for 115 times earnings. To put my stocks in context, I believe it will be harder to make money in 2015 than in 2014. Relative valuation will be important. Income could be important. The market might well have the correction that Felix talked about, but between now and the end of the year, it could reward companies that perform well fundamentally with reasonable returns. It is going to be a volatile year. I am looking at companies that have had performance issues and therefore are relatively inexpensive. Our bet is one of mean reversion.

Brian Rogers: Boeing's cash flow will exceed earnings for a couple of years. Photo: Jenna Bascom for Barron's

Boeing BA 0.7315739094762751% Boeing Co. U.S.: NYSE USD147.33 1.07 0.7315739094762751% /Date(1422983361823-0600)/ Volume (Delayed 15m) : 1702126 P/E Ratio 19.7022696929239 Market Cap 103638629554.175 Dividend Yield 2.4666260079962052% Rev. per Employee 538967 More quote details and news » BA in Your Value Your Change Short position [BA] is one of the world's best companies. The stock was down 5% last year, but up a lot the year before. The shares are selling for $131, and the company will probably earn $8.75 a share this year. It sells for 15 times earnings. Boeing and its chief competitor, Airbus Group air.fr 0.9494346063580115% Airbus Group N.V. France: Paris EUR47.315 0.445 0.9494346063580115% /Date(1423004060000-0600)/ Volume (Delayed 15m) : 2219770 P/E Ratio 22.10981308411215 Market Cap 36782667055.5139 Dividend Yield 1.585120997569481% Rev. per Employee 415012 More quote details and news » air.fr in Your Value Your Change Short position [AIR.France], are serving a steadily growing marketplace. Even going back to 2001-'02, the commercial airliner business has been flattish to growing slightly. It never had a major downdraft. And Boeing is the industry leader, with good secular growth and a decent valuation. Something interesting is going to happen here regarding cash-flow conversion.

Something positive, we presume.

Rogers: Yes. Boeing capitalized development expenses on the 787 Dreamliner. Now that the company is starting to deliver so many 787s, cash flow will exceed earnings for a couple of years. As deliveries of the 787 continue, cash expenses per unit will be much lower than accounting costs per unit. Once Boeing reaches the tipping point in deliveries, cash flow will really start to grow.

How do we know this is happening? Let's look at Boeing's dividend history. In December 2013, the company surprised investors with a 50% dividend increase. This past December, it blew the market away again with an above-consensus dividend hike of 25%. The company now pays a dividend of $3.64 a share, yielding 2.8%. Boeing has a nine-year backlog on the 787. It is going to be in business for a long time.

The company is aggressive about returning cash to shareholders not only through dividends, but also through stock buybacks. Boeing bought back about $6 billion of stock last year and has a continuing buyback authorization.

There is a lot of debate about whether the drop in oil prices is good or bad for the company.

What could be bad?

Rogers: Bears would say that with the price of oil going down, no one buys new fuel-efficient planes. At the same time, lower oil prices make for a much stronger airline industry.

Abby recommended Siemens today. The American version of Siemens is General Electric. Abby said Siemens is reshuffling its portfolio, and GE is undergoing a similar reshuffle. It took Synchrony Financial SYF -0.1925545571245186% Synchrony Financial U.S.: NYSE USD31.1 -0.06 -0.1925545571245186% /Date(1422983363616-0600)/ Volume (Delayed 15m) : 104331 P/E Ratio 11.634472268552743 Market Cap 25980117729.2229 Dividend Yield N/A Rev. per Employee 1087750 More quote details and news » SYF in Your Value Your Change Short position [SYF] public last year and will spin off the rest of that company toward the end of 2015 in a stock swap. GE yields 3.8%. After the company disposes of the rest of Synchrony, it will own a group of mostly industrial businesses generating 70% or 75% of revenue. These arguably are higher-multiple businesses than financial services.

BRIAN ROGERS' PICKS

	Price
Company / Ticker	1/9/15
Boeing / BA	$131.54
General Electric / GE	24.03
Hess / HES	71.12

Loews / L	40.05
Mattel/MAT	29.1
Vulcan Materials / VMC	68.29

Source: Bloomberg

GE currently trades for $24 a share. The downside is probably $22, plus the dividend. If you put a multiple of 18 times on industrial earnings, which isn't too high for a world-class business, and a multiple of 12 on the remaining financial-services business, you end up with a $29 stock. GE is a way to do reasonably well in what could be an uninspired market.

Cohen: Brian, what is the catalyst for GE?

Rogers: The company is reducing its financial-services exposure. The shares could be re-rated upward, based on the remaining higher-quality, higher-multiple industrial businesses.

What is the outlook for dividend growth?

Rogers: GE increased the dividend in December. It now pays 92 cents a year. At some point in the next 18 months, we will probably see a dividend of a dollar a share, which would support a $30 stock price.

Is currency a head wind for GE?

Rogers: It is a bit of a head wind, but we have built that into our estimate of $1.75 a share in earnings for 2015.

Next, given the selloff in energy stocks, you have to own an energy name. My pick is Hess HES 3.1392694063926943% Hess Corp. U.S.: NYSE USD72.28 2.2 3.1392694063926943% /Date(1422983359617-0600)/ Volume (Delayed 15m) : 1429786 P/E Ratio 9.720630979771249 Market Cap 20951747656.8036 Dividend Yield 1.3831258644536653% Rev. per Employee 878282 More quote details and news » HES in Your Value Your Change Short position [HES]. The stock previously traded above $104 and is now in the low $70s. Hess has undergone a transformation in the past few years, after Elliott Management launched a proxy battle. The board was restructured to include people from Elliott's slate. For a CEO whom investors doubted, all I can say is, John Hess has gotten religion.

The company has been pruning its portfolio. You've got to love a company that sold its Russian business two years ago for $2 billion. Today, it would be worth only $1 billion. Hess has pruned about $8 billion in assets. It has become serious about capital allocation, and has taken the share count down by repurchasing $4.7 billion of a $6.5 billion buyback authorization. The company has raised its dividend by 150%. It is in an interesting resource position. Having sold many of its old businesses, it is now concentrated in the Bakken and

Utica shale formations. It is an energy exploration-and-development pure play. The company has shed its terminal business and its gas stations.

Does it still make Hess toy trucks?

Gabelli: If you want a Hess truck, you'll have to buy it online.

Cohen: That is another plus for FedEx.

Rogers: Hess has cleaned up its balance sheet and took its debt down to $5.7 billion from $8 billion two or three years ago.

Gabelli: I have to say this: That's the good side of investor activism.

Rogers: Mario, you're right. Everyone would have to agree that the company is in a better place today because of the proxy battle. In a sector under tremendous siege, Hess seems like a high-quality, well-managed, financially safe company that has cleaned up its act. Recent estimates have put the company's valuation at $100 to $105 a share, compared with an asset value of $135 last summer. It shows you how quickly things can change.

Black: The Bakken isn't profitable with oil selling at $50 a barrel. I just sold all my Bakken plays. How do companies operating in these areas make any money at current oil prices?

Rogers: I concede that forecasting earnings per share is virtually impossible.

My next idea is Loews L 1.251276813074566% Loews Corp. U.S.: NYSE USD39.65 0.49 1.251276813074566% /Date(1422983361616-0600)/ Volume (Delayed 15m) : 482746 P/E Ratio 83.03384872544923 Market Cap 14651479470.498 Dividend Yield 0.6290890790135883% Rev. per Employee 788281 More quote details and news » L in Your Value Your Change Short position [L] -- not the retailer but the holding company. It has a shareholder-friendly management team and owns lots of interesting assets. Every sector in which Loews operates is under siege, except for the hotel business. Loews offers exposure to CNA Financial CNA 0.9828629032258065% CNA Financial Corp. U.S.: NYSE USD40.07 0.39 0.9828629032258065% /Date(1422983336995-0600)/ Volume (Delayed 15m) : 42860 P/E Ratio 15.238239642166711 Market Cap 10711536644.8816 Dividend Yield 2.487562189054726% Rev. per Employee 1368020 More quote details and news » CNA in Your Value Your Change Short position [CNA], the insurance company, which is a well-run business that trades for a moderate multiple. Loews also owns majority stakes in Diamond Offshore Drilling DO 0.6390748630553865% Diamond Offshore Drilling Inc. U.S.: NYSE USD33.07 0.21 0.6390748630553865% /Date(1422983332714-0600)/ Volume (Delayed 15m) : 793693 P/E Ratio 12.12 Market Cap 4506683199.24804 Dividend Yield N/A Rev. per Employee 521063 More quote details and news » DO in Your Value Your Change Short position [DO] and Boardwalk Pipeline Partners BWP -0.3320610687022901% Boardwalk Pipeline Partners L.P. U.S.: NYSE USD15.6678 -0.0522 -0.3320610687022901% /Date(1422983349998-0600)/ Volume (Delayed 15m) : 103966 P/E Ratio

18.12227074235808 Market Cap 3823481329.59625 Dividend Yield 2.5364616360177554% Rev. per Employee 1034830 More quote details and news » BWP in Your Value Your Change Short position [BWP]. Then there's the Loews hotel chain, and about $5 billion of net cash.

When you work through the numbers, each share reflects two-thirds of a share of CNA, 0.19 of a share of Diamond, 0.35 of a share of Boardwalk, $5 of the hotel business, and about $9 of net cash. That is a $51-a-share pool of assets, for shares selling at $40. The Tisch family owns 21% of the company. Loews has bought back 70% of its shares in the past 40 years. No one will claim that the value of CNA or Diamond Offshore is at peak levels, so there are a few ways to win here. The company could continue to buy back shares. You are making a bet on the capital-allocation decisions of CEO Jim Tisch and his family. Loews, by the way, has lagged the Standard & Poor's 500 index in each of the past five years, so there is the possibility it will revert to the mean and advance.

Hasn't the stock always carried a conglomerate discount?

Schafer: It has always traded at a discount to the underlying asset value, but Jim Tisch has done a great job.

Witmer: I agree, especially when it comes to buying back shares.

Rogers: My next pick was a Murphy's Law stock for us in 2014. Anything that could go wrong did go wrong. Now, it sells at a price that the rest of you can afford. I am talking about Mattel, which fell 35% last year. As a shareholder, I didn't see the trouble coming. Sales are expected to be down 8% but up a bit at the retail level. The company has been liquidating inventory.

Mattel has great product lines, including Barbie, Fisher-Price, Hot Wheels, and American Girl. Earnings are under pressure, and will probably fall from $2.58 a share in 2013 to a $1.80 in 2014. They could rebound to $2.30 in 2015. The stock sells for $29. Mattel has a $9.7 billion market cap. Sentiment on the stock is awful; more than a dozen analysts follow the company and there is only one Buy rating. We see downside to $25. The company pays a $1.52 dividend and yields 5%, which I would assume is 75% safe. If the dividend holds and earnings rebound to $2.30 in 2015, you could see a total return of 30%. Mattel isn't for the faint of heart. But the company is financially strong, so it is unlikely to get into much more trouble than it already has.

What could drive earnings higher?

Rogers: Cost-cutting is a big part of it. The company will probably cut selling, general, and administrative expenses, as a result of a recent acquisition. We hope there will be a restocking of the Barbie line in the next year. Mattel is losing a Disney contract, which will hurt in 2016, but the company has a lot going for it.

Black: Didn't Mattel miss the secular shift among young people from toys to electronic games?

Rogers: To some degree, yes. My last pick is Vulcan Materials vmc -0.181970884658454 65% Vulcan Materials Co. U.S.: NYSE USD71.31 -0.13 -0.18197088465845465% /Date(1422983287456-0600)/ Volume (Delayed 15m) : 292336 P/E Ratio 53.19402985074627 Market Cap 9408862850.83741 Dividend Yield 0.3367003367003367% Rev. per Employee 422977 More quote details and news » vmc in Your Value Your Change Short position [VMC].

Gabelli: I owned that one.

Rogers: We have all owned it from time to time. Vulcan is the largest producer of aggregates in the country. Its business has a south-central and southeastern tilt. Shipments are down roughly 50% from the peak in the mid-2000s. Interestingly, Vulcan has never experienced a price decline in its aggregates business. The company tries to co-locate its rock and aggregates facilities in key markets because it is expensive to ship concrete and gravel and sand. Vulcan is a bet on a continued recovery in the Southeast. It is also a bet on a potential new highway-funding bill, since spending on roads has fallen a lot. The stock sells for $68. It was up 10% last year, the best performer among my current picks. The company doesn't pay much of a dividend; it yields 0.4%.

Vulcan has a lot of upside leverage. We expect the company to earn $2.58 a share in 2015. Earnings could rise to $5.10 in the next few years. The stock sells for about 10 time cash flow.

The company has irreplaceable sites, and thus a big moat around its business, to employ one of Warren Buffett's favorite phrases. Vulcan faced head winds for five years after the financial crisis. It is now positioned to benefit from tail winds. A new management team led by Tom Hill is doing many positive things. Full disclosure: T. Rowe Price owns 13% of the shares.

That's conviction. Thank you, Brian. Let's move on to Scott.

Black: We are moderately constructive on the stock market, although I agree with Meryl that it is increasingly difficult to find a lot of cheap stocks. I have a handful here that might be OK. My first stock, and my only large-cap today, is one that Mario has owned forever. It is Viacom. The company has two divisions. Media networks accounts for 73% of revenue, but contributed 95% of last year's operating income. The filmed-entertainment unit, which includes Paramount Pictures, contributed 27% of revenue last year, but only 5% of operating income.

Scott Black: There aren't many quality media companies selling for Viacom's inexpensive 11.5 times earnings. Photo: Jenna Bascom for Barron's

Viacom's cable-TV networks include MTV, MTV2, VH1, CMT, Nickelodeon, Spike, and so on. Most reach up to 95 million homes. Viacom has 11 of the top 50 cable networks. It has eight of the top 30 that reach the best age demographic -- 18 to 49. Seventy percent of their MSO [multiple-system operator] fees are locked in for the next three years, with built-in escalators.

Explain that, please.

Those are the fees Viacom receives from cable-TV providers and other content distributors. You can't guarantee the theatrical business, but Viacom is trying to cushion results with animated movies. Animation has a big release planned with Monster Trucks. Recent and planned films include Selma, Project Almanac, Mission Impossible V, with Tom Cruise, and Terminator Genesys, in which Arnold Schwarzenegger has a cameo role.

Viacom CEO Philippe Dauman notes that the Nielsen ratings don't capture the new market, or viewership of movies and TV shows on handheld electronic devices. He is right about that, although new services are starting to measure this market, which could help Viacom's ratings.

The shares closed recently at $71.67. Viacom has 422 million fully diluted shares, and a $30 billion market capitalization. It pays a dividend of $1.32, and yields 1.84%. We estimate that network revenue will rise 5% in the year ending in September, to $10.68 billion. Filmed-entertainment revenue could rise 10%, to $4.1 billion. After eliminations, we put total revenue at $14.66 billion, operating income at $4.339 billion, and profit before taxes at $3.75 billion. Add $60 million of equity interests, apply a tax rate of 33%, and you get net income of $2.55 billion.

What is that on a per-share basis?

Black: Viacom has an ongoing stock-buyback program. In the past three years it repurchased $11 billion worth of shares. It still has a $6.24 billion authorization. We estimate that the company will spend $2 billion to buy back 28 million shares this year. That gets us to an average of 408 million shares, and earnings per share of $6.25. Wall Street's estimate is $5.97. The stock is selling for 11.5 times estimated earnings. There aren't many quality media operations selling at that sort of multiple. Based on enterprise value to projected Ebitda [earnings before interest, taxes, depreciation, and amortization], Viacom is selling at a multiple of about nine. Walt Disney DIS 1.392363755031002% Walt Disney Co. U.S.: NYSE USD93.21 1.28 1.392363755031002% /Date(1422983362141-0600)/ Volume (Delayed 15m) : 2445500 P/E Ratio 21.642714617169375 Market Cap 155819050022.881 Dividend Yield 1.2328460196762225% Rev. per Employee 271183 More quote details and news » DIS in Your Value Your Change Short position [DIS] has an EV/Ebitda multiple of 12, and most other media companies are between 11 and 12.

SCOTT BLACK'S PICKS

Company / Ticker	Price 1/9/2015
Viacom / VIAB	$71.67
Microsemi/MSCC	28.02
Customers Bancorp / CUBI	18.25
Ares Capital / ARCC	15.84

Source: Bloomberg

Viacom's free cash flow and earnings are about the same. Return on equity will be 59% this year, and return on capital, just over 14%. The company is levered about 3.1 to 1. The interest coverage ratio [earnings before interest and taxes, divided by interest expense] is 7.8 times. You can't pencil in how Paramount will do, but you don't have to worry that Viacom's buybacks are imperiled.

Witmer: What percentage of revenue does Paramount contribute?

Black: The company doesn't break out those numbers. It is pretty small. I've been conservative in using 5% top-line growth for the media networks. With Viacom's acquisition of Britain's Channel 5, network revenue could rise 6% or 7% this year.

Witmer: The stock is down from the $80s.

Gabelli: The big question is: What will happen to the A shares, the voting shares, when Sumner Redstone [Viacom's founder and controlling shareholder] passes?

National Amusements, which he controls, owns 40.5 million of the 50 million A shares. Redstone is still spirited, even at 91, but what would Dauman do if Redstone's estate or National Amusements were seeking liquidity and wanted to sell Viacom? Speaking for my church, how do you protect the other A-class shareholders if a buyer doesn't give them the same price that it offers National Amusements?

Witmer: Is there protection for minority shareholders? Consider what is happening at Sika sik.vx -0.32102728731942215% Sika AG Switzerland: SWX Europe CHF3105 -10 -0.32102728731942215% /Date(1423004046000-0600)/ Volume (Delayed 15m) : 7114 P/E Ratio 20.73801679963812 Market Cap 7912649544.22986 Dividend Yield 1.8357487922705313% Rev. per Employee 331222 More quote details and news » sik.vx in Your Value Your Change Short position [SIK.Switzerland], the Swiss adhesives company.

Gabelli: Another company [Compagnie de Saint-Gobain sgo.fr 2.8294367693942615% Compagnie de Saint-Gobain S.A. France: Paris EUR38.705 1.065 2.8294367693942615% /Date(1423004030000-0600)/ Volume (Delayed 15m) : 1751500 P/E Ratio 23.090835022901285 Market Cap 21149748629.5462 Dividend Yield 1.6018602247771605% Rev. per Employee 224963 More quote details and news » sgo.fr in Your Value Your Change Short position (SGO.France)] is trying to buy Sika's controlling family's stock at a premium, squeezing the other shareholders.

Black: My next company, Microsemi MSCC 2.109704641350211% Microsemi Corp. U.S.: Nasdaq USD29.04 0.6 2.109704641350211% /Date(1422983337615-0600)/ Volume (Delayed 15m) : 127025 P/E Ratio 66.0909090909091 Market Cap 2704644007.39288 Dividend Yield N/A Rev. per Employee 593103 More quote details and news » MSCC in Your Value Your Change Short position [MSCC], was once looked upon as a semiconductor supplier only to the U.S. Defense Department. The P/E multiple is low because that is still the perception, although it isn't accurate. In 2010 mixed-signal chips contributed 29% of revenue, and discrete components, 71%. The mix has changed dramatically since the purchase of Actel. Mixed-signal now generates 26%; discretes, 32%, and field programmable gate arrays, 24%. Last year, Microsemi bought Symmetricom, a leader in timing for network virtualization, which is now 18% of the business.

Who are Microsemi's other customers?

Telecom companies account for 36% of revenue; defense and security clients, 27%, commercial aerospace outfits, 14%, and the industrial sector, 23%. Geographically, only 14% of revenue is exposed to Europe. U.S. and Asian revenue is dollar-denominated. The stock is $28.02. There are 95 million shares outstanding, and the market cap is $2.66 billion. The company doesn't pay a dividend.

Much of the discussion at this year's Roundtable concerned oil prices, interest rates, currency wars, and the troubled outlook for Europe. The group met Jan. 12 in New York. Photo; Jenna Bascom for Barron's

Minimally, revenue will rise 10% in the fiscal year ending Sept. 30. That's 8% unit growth, and 2% from the Symmetricom acquisition. Profit before taxes could total between $266 million and $281 million. The tax rate is 8%, in part because the company has about $60 million of net operating losses from prior years [NOLs offset a portion of current taxes]. We estimate per-share earnings of $2.65, against last year's $2.19.

Excluding stock-based compensation -- which is the appropriate thing to do -- we get earnings of $2.23 and a P/E of 12.5. Return on equity is 20.3%. Microsemi has a net debt-to-equity ratio of 0.48; its return on capital is 13.7%. The coverage ratio is outstanding at 16.5. We estimate $271 million this year in free cash flow.

The valuation is reasonable, and the stock isn't well-known.

Good attributes, both.

Black: Next, I like Customers Bancorp CUBI 2.6634382566585955% Customers Bancorp Inc. U.S.: NYSE USD21.2 0.55 2.6634382566585955% /Date(1422982249147-0600)/ Volume (Delayed 15m) : 51092 P/E Ratio 13.093694027546167 Market Cap 552072182.261867 Dividend Yield N/A Rev. per Employee 574808 More quote details and news » CUBI in Your Value Your Change Short position [CUBI], based near Philadelphia. Yes, net interest margins are getting killed with interest rates so low, but this is a special situation. Jay Sidhu built a little bank outside Philadelphia into Sovereign Bank. He left in 2006, before the Lehman Brothers debacle. He took control of Customers in 2009, when it had $350 million in assets and $22 million in equity. Now it has $6.5 billion in assets.

Customers is a wholesale bank, with just 5% of revenue from consumers. We are expecting more-controlled asset growth of 10% a year in the future. The bank's total risk-based capital ratio is 11.2, and its capital adequacy ratio is 8%. The net interest margin is around 280 basis points [each equal to 1/100th of a percentage point], but Sidhu hopes to lift that to 300 basis points, long-term. In the next few years, he'd like to achieve a 1% return on assets and an after-tax return of 12% on equity. The bank's efficiency ratio [costs minus interest expense, divided by revenue] is 54% and he'd like to drive it down to the mid-40% range.

How good is loan quality?

Black: We study reserves against nonperforming assets. Customers has reserved $31.1 million against loan losses, but has only $9.9 million in non-accruals. That is a coverage ratio of 3.1. Many of the bank's loans have been made to high-net-worth families, with personal signature guarantees. The company also warehouses loans [extends short-term lines of credit] to mortgage brokers. The mix of loans is 39% for multi-family dwellings, 20% for owner-occupied commercial and industrial construction, 10% for non-owner-occupied commercial real estate, 8% consumer loans, and 23% warehousing.

Customers has a great idea for gathering new funds -- BankMobile, a mobile and tablet banking platform. It has signed up 1.2 million students for the service at 800 colleges around the U.S., and taken in $250 million in balances so far. Sidhu hopes that when these customers graduate, he will convert them to customers of the traditional bank. Customers has only a handful of offices in the Northeast, from Princeton, N.J., to Boston. This isn't branch banking. The bank has hired from places like JPMorgan Chase JPM 1.3340544438435191% JPMorgan Chase & Co. U.S.: NYSE USD56.21 0.74 1.3340544438435191% /Date(1422983361616-0600)/ Volume (Delayed 15m) : 6072449 P/E Ratio 10.352022058823529 Market Cap 207357346443.102 Dividend Yield 2.8411613246914675% Rev. per Employee 406463 More quote details and news » JPM in Your Value Your Change Short position [JPM] and Sovereign.

It sounds intriguing. Give us the numbers.

Black: The bank could have $7.03 billion in average earning assets and $197 million in net interest income this year. We are modeling $6 million a quarter in loan-loss provisions, versus $5 million previously, because the loan portfolio is growing. Net interest income after loan-loss provisions is an estimated $173 million. Non-interest income is only about $6 million a quarter, or $24 million a year, and non-interest expense is $108 million. Thus, profit before taxes is an estimated $89 million. Taxed at 35%, that's $57.85 million.

Divide by 27.8 million shares, and earnings per share would be $2.08. Company guidance is $1.95 to $2. Sidhu doesn't expect to raise funds in the capital markets this year, but that might be necessary in the future to bulk up equity.

Customers is trading for $18.25. It sells at 1.19 times book value and 8.8 times earnings. Most regional banks on the East Coast sell for 12 to 14 times earnings, and many of them are under-reserved.

Could this bank become an acquisition target?

Black: Sidhu is going to build it before he sells it. He took Sovereign from nothing to a huge bank, and eventually sold it to Spain's Banco Santander SAN 4.955621301775148% Banco Santander S.A. ADS U.S.: NYSE USD7.095 0.335 4.955621301775148% /Date(1422983360962-0600)/ Volume (Delayed 15m) : 4107794 P/E Ratio 11.388129322824513 Market Cap 92893254575.9487 Dividend Yield 9.337401129943503% Rev. per Employee 299385 More quote details and news » SAN in Your Value Your Change Short position [SAN].

Rogers: Where does he find so many students with money to deposit?

Black: They direct-deposit their student loans into their online bank accounts. Ultimately, they have to pay out the money, but there are transactional balances.

My last pick, Ares Capital ARCC -0.05991611743559017% Ares Capital Corp. U.S.: Nasdaq USD16.68 -0.01 -0.05991611743559017% /Date(1422983357314-0600)/ Volume (Delayed 15m) : 839241 P/E Ratio 8.732984293193716 Market Cap 5242462716.27472 Dividend Yield 9.112709832134293% Rev. per Employee N/A More quote details and news » ARCC in Your Value Your Change Short position [ARCC], is a yield play. It is a business-development company. The shares are trading for $15.84. Ares pays a $1.52-a-share dividend and yields 9.6%. BDCs can leverage up 2-to-1 to make small-business loans. Ares stays under 0.85 to 1. Its sweet spot in loan size is $10 million to $20 million.

How big is the loan portfolio?

Black: Ares currently has a loan portfolio of $8.78 billion, and has lent funds to 205 companies. Only one of its companies, Lonestar Prospects, is tied to the energy industry; it sells sand for fracking [hydraulic fracturing of oil and gas wells].

About 38% of Ares' loan book is unitranche debt [a hybrid of senior and subordinated debt, with a blended interest rate]. The company has a unitranche joint venture with GE. Another

23.2% is loans to the health-care industry; 17.9% is to services providers, and 11.5% is for business services. The average Ebitda margin of the companies in Ares' portfolio is greater than 20%.

Ares grades its loans at the end of every quarter. The No. 1 category, or worst-performing loans, totaled $15.7 million, or 0.4% of the loan book, at the end of the third quarter. The second category encompassed $90.3 million, or 2.2% of loans. The company will have $1.1 billion of total investment income this year. Pretax profit could total $511 million this year. Subtract a 5% excise tax -- the company pays no income tax -- and you get $485 million.

Ares harvests capital gains from time to time, which is hard to model. It realized $40 million of capital gains in the first three quarters of 2014. Being conservative, I gave them $50 million for all of this year, taking income back up to $535 million. Divide by 314 million fully diluted shares and you get $1.70 a share. Last year, the company likely earned $1.46. The Street forecast for 2015 is $1.60. The P/E is 9.3. Book value is $16.71.

Can you explain the tax structure in more detail?

Black: Business-development companies have a pass-through tax structure. They must distribute at least 90% of their taxable income as dividends to investors. That's why the yield is so high. They don't buy back shares.

Ares' portfolio looks bulletproof, and the company seems to be smart in negotiating credit lines. It pays a commitment fee of three-eighths of a percent and borrows from a consortium of more than 12 banks. Plus, you get paid while you wait for growth.

Thank you, Scott.

| SATURDAY, JANUARY 31, 2015

Barron's Roundtable: 33 Savvy Picks

By LAUREN R. RUBLIN |

Part 3

Final 2015 Roundtable issue with Marc Faber, David Herro, Oscar Schafer, and Mario Gabelli discussing their approach to investing.

Variety is not merely the spice of life, but the very essence of the annual Barron's Roundtable. While the 10 market seers on our panel are united in seeking to profit from mispriced assets -- and help you do the same -- each approaches the challenge from an idiosyncratic angle. That is nowhere more apparent than in this week's third and final installment from our memorable daylong confab, held on Jan. 12 in New York.

Part 3 features the 2015 investment picks, pans, and musings of Marc Faber, David Herro, Oscar Schafer, and Mario Gabelli -- four pros who have spent years on the Street, each taking a different path to success. A fearless big-picture thinker with an emerging-markets perspective, Marc is betting against the ability of the world's central banks to put global growth back on a sustainable path. That means a vote for gold and its precious cousins, as well as long-dated U.S. bonds, whose yields he reckons are destined to stay superlow. Marc is no bear on Asia, however, and that includes the Russian bear, as you'll see from his forthright comments and eclectic recommendations.

Mark Faber says the biotech sector, as well as social media and chip stocks, are due for a plunge. He also thinks investors will lose confidence in central banks.

David, Harris Associates' go-to guy for international investing, and manager of the Oakmark International fund, is a value investor who searches for blue-chip companies with temporarily tarnished shares. They are harder to find these days than questionable outfits with nosebleed valuations, but in his first Roundtable appearance, David makes the case nicely for an even four. Underlying his bottom-up analysis is a keen understanding of social, political, and economic trends around the world, whether in China, where the authorities have cracked down on extravagant gift-giving, or in Japan, where the moribund corporate sector could use a deafening wake-up call.

A veteran hedge fund manager, Oscar cares little for the macro outlook. You're far more likely to find him in the trenches, digging through the financials of lesser-known companies with promising prospects, savvy managers, in-demand technologies, and underappreciated shares. He, too, has been known to comb the world for value. But this year, he finds it closer to home, in companies such as Canada's Maple Leaf Foods (ticker: MFI.Canada), which could soon enjoy the fruits of a strategic transformation.

In his Roundtable debut, David Herro makes the case for the parent company of Mercedes Benz and two cheap banks.

Mario, head of Gamco Investors, famously goes where the action is; he favors companies like Graham Holdings (GHC), the former Washington Post, that own a multitude of disparate assets that can be merged, purged, or otherwise rearranged in a value-enhancing and tax-efficient manner. The practice is known as financial engineering, and few do it better than billionaire media investor John Malone, whose praises Mario sings to the skies, and in whose companies he seeks to invest.

To learn why, please read on.

Barron's: Where in the world should we invest this year, Marc?

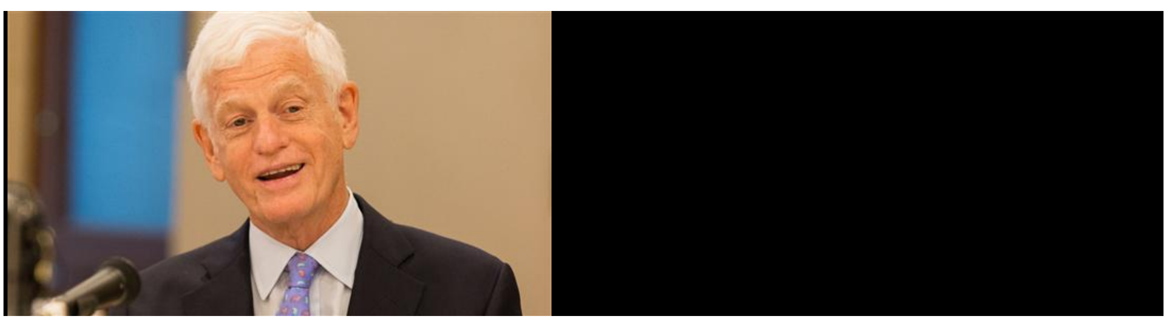
Faber: If I could find a way to short central banks, that is what I would do. This is the year that people will lose confidence in central banks, mostly because of the failure of Abenomics in Japan. [Abenomics, the economic policies advocated by Japanese Prime Minister Shinzo Abe to reignite Japan's economy, encompass monetary easing, fiscal stimulus, and structural reforms.] One way to short central banks is to go long gold. I recommend buying physical gold, silver, and platinum. If you are looking for bigger gains, I suggest either mining-company stocks or the Market Vectors Junior Gold Miners [GDXJ] exchange-traded fund. In last year's first half, when gold rebounded by 15%, the Junior Gold Miners ETF rallied by more than 40%.

Barron's Roundtable veteran Schafer says 2015 and 2016 will be big years for 3D movies, and RealD will profit handsomely.

Secondly, the U.S. market is expensive. Yet, the whole world seems to think it is the only game in town. That suggests it may be vulnerable to a selloff. I hate to short individual stocks because an activist could step in and send a stock soaring. Instead, I would short the SOX, or Philadelphia Semiconductor Index, through the iShares PHLX Semiconductor ETF [SOXX]. I would also short the Global X Social Media ETF [SOCL] and the iShares Nasdaq Biotechnology ETF [IBB].

While people think U.S. stocks are the only game in town, U.S. bonds are still attractive. Can someone on this panel explain to me why investors are bullish on the dollar, yet buy low-yielding European bonds instead of U.S. bonds? The market doesn't believe the dollar will stay strong.

Zulauf: European banks are buying European government bonds, financed by free money from the European Central Bank.



Gabelli serves up an eclectic Roundtable portfolio: Graham Holdings, Post Holdings, and a John Malone enterprise: Cable & Wireless Communications.

Couldn't they buy U.S. Treasuries with that money?

Zulauf: If they buy Treasuries, they have currency exposure. If they hedge the currency exposure, that deducts from the interest-rate advantage.

Faber: Nevertheless, it is a puzzle to me. Japanese government bonds now yield 0.27%. Japan's government debt exceeds 200% of gross domestic product. Compared to these dynamics, U.S. Treasuries are cheap. Last year, I recommended the 10-year Treasury note. This year, I recommend buying 30-year U.S. government bonds.

Photo: Brad Trent for Barron's

Clockwise from top left: David Herro, Marc Faber,Oscar Schafer, Mario Gabelli.

Zulauf: The Japanese central bank already owns about 40% of all outstanding Japanese government bonds. Eventually, it will own a lot more, as the Bank of Japan is buying 70% to 80% of all new issues.

Faber: Yes, that is why I want to short central banks. Eventually, they will go bust massively. I have always diversified among gold, bonds, equities, and real estate. On the equity side, I have recommended some Singapore real estate investment trusts in the past. They remain attractive as an asset class, but I would shift from the office-REIT market to hospitality trusts, which own hotels, and to health-care trusts. While office REITs will come under pressure in 2017 because of supply coming on-stream, I am a believer in the growth of tourism in the area. Also, hospital medical expenses are tiny there, in relation to the rest of the world.

In Singapore, I like CDL Hospitality Trusts [CDREIT.Singapore] and Far East Hospitality Trust [FEHT.Singapore]. Health-care trusts own hospitals that are leased to hospital operators. In that market, I like Religare Health Trust [RHT.Singapore], Parkway Life REIT [PREIT.Singapore], and also aFirst REIT [FIRT.Singapore].

Moving on to currencies, the U.S. dollar was in a bull market between 1981 and 1985 that exceeded expectations. If that happens again, which seems possible, I would short the Australian dollar. Australia -- and Canada, too -- have overvalued currencies. Mining expenditures for minerals, oil, and gas accounted for 3% of Australian gross domestic product in the 1980s and '90s. Today such expenditures are more than 7% of GDP.

There is a colossal housing bubble in Australia, fed mostly by rich Chinese. Also, bank loans for real estate are 60% of total loans, the highest ratio in the world, followed by Norway. At the moment, the bullish consensus on the U.S. dollar is at a record, and bearish sentiment on the Aussie dollar is high. Many small speculators are short the Aussie dollar. It is possible the situation will reverse in the near term, and the Aussie dollar will rise 3%-5%. That is when I would short the Aussie dollar.

The Chinese stock market has been on a tear. What do you see ahead for Chinese stocks?

Faber: I predicted in October that the Chinese economy would weaken but the stock market would go up. The Chinese stock market is in a similar position to the U.S. market in 1982. At that time, the U.S. market hadn't done much for a while, and investors were bearish and underweight stocks. Then the market suddenly took off. There has been huge trading volume in Chinese stocks, and many people are opening investment accounts. The real estate market is done in China; it isn't going to rise substantially in the near future, so speculators are moving into stocks. The market has shot up about 50% in the past three months. It will correct a bit, and then go higher.

Photo: Jenna Bascom for Barron's

Marc Faber: "The real estate market is done in China; it isn't going to rise substantially in the near future, so speculators are moving into stocks. The stock market has shot up about 50% in the past three months."

Bank stocks, especially, can move up from here. The sector is widely hated and has huge problems, but Chinese banks also have a big customer base. Gaming and lodging companies tied to Macau were hit hard in the past 12 months and are also worth a look. In December, gaming revenue was down 30%, year on year. The stocks have corrected by 40% to 50%. In the next six months, there will be buying opportunities in the industry. You are paid to wait, because many of these stocks yield about 5%.

Roundtable Report Cards

2014 Roundtable Report Card

2014 Mid-Year Roundtable Report Card

Most members of the Barron's Roundtable are active money managers who trade their positions and change their investment opinions as market conditions warrant. For those keeping score, here's how our panelists' 2014 picks and pans performed through Dec. 31.

Are the yields safe?

Faber: Most gaming companies will be able to maintain their dividends. Only 1% of Chinese have been to Macau. About 10% of Americans have been to Las Vegas at least once. If 10% of China's residents go to Macau, that is huge volume. More facilities will be built. Macau is going to be a huge success. In the next six months, I would accumulate some Macau-related gambling shares.

Do you have any favorite bank or gambling stocks?

Faber: I would buy Bank of China [3988.Hong Kong]. It is a play on China and Macau.

Marc Faber's Picks

Company/ Ticker	Price 1/9/15
BUY	
Gold (spot, per ounce)	$1,223.25
Silver (spot, per ounce)	16.51
Platinum (spot, per ounce)	1,233.31
MarketVectors JuniorGoldMiners ETF / GDXJ	27.48
30-Year U.S. Treasurybonds	2.53%
Bankof China / 3988.Hong Kong	HKD4.44
WynnMacau/ 1128.Hong Kong	20.55
SJMHoldings / 880.Hong Kong	11.62
MarketVectors Russia / RSX	$15.21
SINGAPOREREITs	
CDLHospitality Trusts / CDREIT.Singapore	S$1.76
Far East Hospitality Trust / FEHT.Singapore	0.83
Religare Health Trust / RHT.Singapore	1
ParkwayLife REIT / PREIT.Singapore	2.35
First REIT /	1.28

FIRT.Singapore

SHORT	
iSharesPHLXSemiconductor ETF /SOXX	$92.63
GlobalXSocialMediaETF / SOCL	18.16
iSharesNasdaqBiotechnology ETF / IBB	313.32
Australian dollar*	1AUD=$0.82

*Short after Australian dollar rises by 3%.

Herro: To Marc's point, the Chinese government has held Macau demand back. It has held back visas and transit permits. Even if they opened things up just a little, all the supply that has been added in Macau would be filled. And, there is limited space for more casinos. You are on good ground recommending Macau.

Zulauf: What is the best way to play Macau?

Faber: Wynn Macau [1128.Hong Kong] is a good bet. So is SJM Holdings [880.Hong Kong], which is controlled by Macau tycoon Stanley Ho.

Russia will not do well, but will survive. There is very low leverage in both the household and government sectors. The Russians know how to tighten their belts.

Witmer: The Russians feel that good times are an anomaly, right?

Faber: That is a good point. The Market Vectors Russia ETF [RSX] is moving into buying range. The Europeans will break from the U.S. and ease sanctions against Russia. A deal will be done in the next six months. Americans don't realize that Europe has a lot of trading relationships with Russia. A lot of capital flows between them. An embargo on Russia won't work.

Those are my recommendations.

In that case, thank you. Let's move on to David.

Herro: We are long-term value investors looking for low-priced, quality businesses. In some cases, a macroeconomic issue allows you to buy a stock at a low price. In others, there is a temporary industry setback. Some blue-chip European stocks are going to be able to take advantage of the drop in the euro's value. After many years of currency head winds, the currency will act as a tail wind. Also, some other factors have negatively impacted two of my stocks. China's slowing economy and a crackdown in China on graft and gift-giving have hurt Cie. Financiére Richemont [CFR.Switzerland].

Richemont is a Swiss luxury-goods company best known for the Cartier brand. About 40% of its profit comes from outside the developed West. I would much rather buy established companies with good exposure to the emerging world, especially companies whose brands are extremely hard to compete against. Cartier is a unique brand and generates a lot of cash flow.

What are some of Richemont's other brands?

Herro: The company has quite a few brands, including IWC, a watch brand, and Montblanc. Richemont's growth recently has slowed, but we view the slowdown as temporary and tied to a cyclical slowdown in the emerging world. The Rupert family controls the company through supervoting shares. Richemont is worth 15 or 16 times Ebita [earnings before interest, taxes, and amortization], as opposed to its current multiple in the low double digits. Management is proactive with the balance sheet, using it to expand stores where it makes sense to do so, and buying back stock. To me, Richemont is the perfect example of a quality business hurt because of its location in Europe and exposure to the corruption crackdown in China, but helped by its hard-to-replicate brands.

Photo: Jenna Bascom for Barron's

David Herro: "It is important to try to get big Japanese companies to behave like profit maximizers. Toyota has started to do that, even without government pressure."

Diageo [DEO] presents a similar situation. It is the world's leading spirits company. The number of people who consume beer has been falling, while sales of spirits and wine have been going up. Diageo has done a good job of building its portfolio. Marc probably doesn't like the company's Scotch because it is too bottom shelf. Diageo sells Johnnie Walker, as well as various vodka and tequila brands, and Captain Morgan rum. The company is good at holding down costs and allocating capital, and has seen good profit-margin progression over time. It is selectively buying more brands to layer into its monster distribution system.

How exposed to emerging markets is Diageo?

Herro: It has gone into the emerging world in a big way. The company bought up local brands in India and China, and really knows how to market liquor. The demographic trend is in its favor, as well. But, like Richemont, Diageo has been affected by the crackdown on gift-giving in China. The company has 30%-plus operating profit margins, and ought to be growing in the mid-single digits. But the situation in China and the recent strength of the euro have hurt it. In the next year things could revert to a more positive trend. We value Diageo at 15 times Ebita, versus its normalized 11 times today.

Black: We sold the stock last year. Top-line growth has been terrible in the past few years. Guinness has been a big problem for Diageo in the U.K.

Herro: But Guinness accounts for only 8% or 9% of Ebita. The only beer companies growing today are craft brewers and beer companies exposed to emerging markets.

Black: How do you get to 11 times Ebita?

Herro: You have to normalize emerging-market currencies and the U.S. dollar [adjust for exchange rates, tax rates, and sales levels]. When you do that, you'll see a much greater lift in revenue and profit.

Faber: David, I agree with you that Richemont has a lot of good brands, but I see two problems. First, the company is catering to the economy of the superrich, and that economy could be vulnerable, especially if asset markets no longer rise in value. No. 2, many luxury chains have to pay very high prices for stores in the best locations, whether it is in Hong Kong or Zurich, or at the airports. Airport shops cost a fortune. Luxury-goods companies have high fixed costs, and they have to sell a lot of merchandise to cover them.

Some luxury manufacturers, such as Prada [1913.Hong Kong], have had disastrous results of late. I agree that luxury-goods companies are attractive investments long term, as people will buy Cartier and other brands. But I would be relatively careful about these brands and companies in the near term. Tiffany [TIF] just reported that fourth-quarter sales were disappointing, and its shares are off sharply today. [Tiffany fell 14% on Jan. 12.] There could be some disappointments among luxury-goods manufacturers.

Herro: There have been disappointments. The things you are talking about have happened. That's where the value is.

Moving on, Toyota Motor [TM] is tied to the global consumer. Although the company is based in Japan, more than 30% of its output is exported. It has good exposure to emerging markets. Toyota has increased its dividend. It is sitting on a huge pile of cash and is the world leader in low-cost automotive production. Sales of its luxury brand, Lexus, are rising again after sinking for a while. Toyota added some pizazz to its Lexus models. The brand is hugely profitable, by the way. Assuming a normalized operating margin on industrial operations of 8.5% and no change in the value of the yen, the stock could have 45%-50% upside. It could trade at 8.5 to nine times enterprise value to Ebita, although enterprise value gets reduced by that pot of cash.

What will Toyota do with its cash?

Herro: We want the company to use the cash to create shareholder value. Japanese management teams have been atrocious capital allocators. Cash accounts for 30%, 40%, 50% of the market capitalization of many Japanese blue chips, and it is earning only 15 or 20 basis points [hundredths of a percentage point]. Companies don't look at that money as the stockholders', but things are slowly starting to change.

Rightly or wrongly, there has been a lot of pressure put on Japanese companies to earn a better than 10% return on equity. ROE would increase if Japanese companies deployed cash more efficiently, by buying back stock, paying more dividends, and engaging in smart mergers and acquisitions. When Japanese companies' ROE is 6% to 7%, aiming for 10% is a good idea. But I fear that the Japanese are doing it for the wrong reason. They are quintessential box checkers. They should hit a 10% ROE target not just to check the box, but because it creates value for the owners -- the shareholders.

David Herro's Picks

Company/ Ticker	**Price 1/9/15**
Cie. FinanciéreRichemont/	
CFR.Switzerland	CHF 90.05
Diageo/DEO	$110.89
ToyotaMotor/TM	126.08

BNPParibas / BNP.France	€ 44.94

Source: Bloomberg

Getting Japan's moribund corporate sector to wake up starts on the micro side. It is important to try to get big Japanese companies to behave like profit maximizers. Toyota has started to do that, even without government pressure, as a result of the quality crisis it had a few years ago, and the Japanese earthquake.

To sum up, Toyota is the world leader in efficiency; it has good exposure to emerging markets, and it appeals not just to rich people, although the Lexus line is doing well. It seems a good place to put your money, long term, especially if you don't think the yen is going to rally any time soon.

Cohen: Several years ago, Toyota got a lot of credit for repositioning its production facilities. For example, most of the cars it was selling in North America were produced in North America. It was producing in dollars and selling in dollars. Is that still the situation, and if so, how does the company benefit from the yen's weakening?

Herro: In the past 25 years, Toyota has done more to align costs and revenue. But it still has a huge manufacturing footprint in Japan. It tries to keep intellectual property and research and development in Japan. Many expenses are still allocated to Japan, and the company is still an exporter. It exports a million-plus vehicles a year, although that number used to be around two million.

With my last stock, I am throwing some controversy into the conversation. BNP Paribas [BNP.France], France's biggest bank, has been hurt by regulatory actions. It was fined nearly $9 billion by the U.S. for doing business with Sudan and Iran. Yet, even after paying this fine, the bank will have a Tier I capital ratio of more than 10%. It hasn't cut the dividend. The bank has well-diversified businesses, each of which it runs quite well. It bought the Belgian bank Fortis during the financial crisis at a fire-sale price. Fortis accounts for roughly 20% of profit, and corporate banking in France, 15% to 20%. BNP Paribas also has an investment bank that does well, and some exposure in the U.S. Loan losses haven't grown materially and costs continue to fall. This is a well-run financial institution.

What is the stock price?

Herro: The stock trades for 44.94 euros, or 8.5 times next year's expected earnings, and below book value. The bank should be able to achieve a return on equity of 13% to 15%. If you apply a multiple of 1.5 or 1.6 times book value, there is decent upside in the shares, and a dividend yield of 3.5%. The bank hasn't lifted its payout because of the fine. Hopefully, there won't be any more fines, and the dividend will start rising.

Is BNP Paribas well reserved against nonperforming assets?

Herro: It hasn't had a big problem. Residential real estate loans in France and Italy have a loan-to-value ratio of 15%, 20%, 25%. People own their own homes, or have inherited them. Real estate assets aren't highly leveraged, and the savings rate is relatively high. As a result, the nonperforming portfolio is somewhat stagnant. BNP Paribas owns Bank of the West, which isn't seen as a core asset. Some Japanese banks have been sniffing around and might want to make a bid for it. In a sale, it might go for as much as two times book.

Gabelli: Great ideas, David. Welcome to the panel.

Hey, that's our line. Thanks, David. Now let's hear from Oscar.

Schafer: I'm ready. My first pick, Cogent Communications Holdings [CCOI], is a company with a long history of growth, run by a fantastic owner-operator. Cogent is an Internet service provider that operates one of the largest Tier 1 fiber networks in the world. The stock was down 12% in 2014, although we believe the company's issues are temporary and that the stock could double in the next few years.

Cogent has two product lines, both focused on selling a single broadband product. In its corporate segment, the company provides 100-megabit Internet connections to midsize corporations in high-rise office buildings. Its 'Net-centric business offers data-transport services to telecom carriers, media companies, and other large users of Internet bandwidth. Cogent meets these customers in any one of the 720 carrier-neutral data centers on its network, and offers transport on its 85,000 miles of metro and intracity fiber. Cogent is led by Dave Schaeffer, who founded the company in 1999. Schaeffer has a long history of creating value for shareholders.


Photo: Jenna Bascom for Barron's

Oscar Schafer: "In the Roundtable I recommended Maple Leaf Foods. The situation is even more interesting today, as the business will complete a five-year-plus transition this year, boosting...free cash flow."

Witmer: Is he your brother?

Schafer: No relation. He created the company by assembling a network on the cheap, after the Internet bubble bust. He spent $60 million on 13 acquisitions that had collectively raised $14 billion and already deployed $4 billion into property, plant, and equipment. Schaeffer continues to be opportunistic. He repurchased Cogent's convertible bonds at 50 cents on the dollar during the financial crisis.

Cogent is unique in the telecom world in that it has always operated on the principle that broadband is a commodity. Whereas most telecom companies live in fear of becoming a "dumb pipe," Cogent has embraced this destiny as a business model. As optical-switching equipment has improved, Cogent has been able to carry more bits at lower prices. The company has aggressively passed these savings on to its customers, typically guaranteeing a price 50% lower than the competition. The company has effectively driven down the price of bandwidth by 24% annually for a decade and a half. Yes, that is a cumulative price decline of 98%. Furthermore, the company's focus on selling a single product has allowed it to minimize subscriber-acquisition costs. Cogent employs a call-center-based sales force that is significantly more efficient than its competitors.

So why is the stock depressed?

Schafer: The financial results of Schaeffer's strategies have been impressive. The company has grown revenue by an average of 16% a year in the past 10 years, and Ebitda [earnings before interest, taxes, depreciation, and amortization] margins have expanded by about 200 basis points [two percentage points] annually, into the mid-30% range.

There are two key investor concerns that drove the share price lower in 2014. First, as a bandwidth provider to Netflix [NFLX] and other large content-distribution companies, Cogent has been caught up in the past year in a high-profile dispute between Netflix and several large carriers about Internet peering, or demands that Netflix pay certain Internet service providers directly for carrying its data-heavy content. Based on our research, we expect the issue will be resolved favorably from Cogent's perspective, and that these carriers eventually will upgrade their peering ports to allow for a return to the previous status quo, or so-called neutral peering. Meanwhile, the issue has impacted only 5% of Cogent's revenue.

Secondly, Cogent's top-line growth rate has slowed in the past three years from the high teens to around 10% annually. The company has taken appropriate steps to address the issue, hiring a new head of sales and significantly expanding the sales force. The CEO has also tied his compensation over the next three years to targets of 15% revenue growth and 20% Ebitda growth. As growth reaccelerates and capital spending on fiber deployment slows, management is committed to returning a substantial amount of capital to shareholders. The company has increased its dividend in each of the past nine quarters.

What is the current dividend?

Schafer: Cogent pays $1.24 a share, and yields 3.2%. Between regular and special dividends and share buybacks, Cogent plans to return $450 million to shareholders in the next nine quarters, representing nearly 30% of the current market cap. By 2017, the company will be generating $3 a share of free cash flow. We expect the shares to trade north of $60, compared with $34 today.

My second stock is NICE Systems [NICE]. It offers investors at least 50% upside as a result of recent management changes. NICE is a $3 billion market-cap software company based in Israel. It is comparable to Verint Systems [VRNT], which I have discussed here in the past, and whose stock has nearly doubled in the past 18 months. NICE's biggest business is call-center monitoring software. This is a mature but stable market. It could grow as higher-priced analytical software allows companies to utilize big data. Currently, mid-single-digit revenue growth is being driven by NICE's financial-fraud and compliance products, as well as video-surveillance analytic software.

By any metric, NICE is a cheap stock. It is trading for $50 a share. Excluding cash, it trades for only 13 times estimated 2015 free cash flow of $3 per share, and five times recurring maintenance revenue, which is about 45% of total revenue. That is a valuation more typical of a legacy enterprise-software company that is declining than a company that is growing.

What is happening in the management suite?

Schafer: The business has been undermanaged for years. NICE's new CEO, Barak Eilam, offers a catalyst for significant value creation by focusing on the company's bloated expense structure and over-capitalized balance sheet. In the past five years, NICE doubled revenue with minimal improvement in operating profit margins. Operating margins are 18%, compared with Verint's 23%. As far as the balance sheet goes, $8 per share, or 20% of the company's value, is in cash. NICE could add at least $1.50 a share of cash flow from Eilam's initiatives, which could result in a potential gain of 50% in the stock.

In the midyear Roundtable ["Picking Up the Pieces," June 16, 2014], I recommended Maple Leaf Foods. The situation is even more interesting today, as the business will complete a five-year-plus transition this calendar year, boosting operating margins and free cash flow. Putting a typical industry multiple on the new margins could drive the stock up between 50% and 75%.

Where is the stock trading now?

Schafer: Maple Leaf is based in Canada. Shares are trading for 19.40 Canadian dollars [US$16.35] and the company has a C$2.7 billion market cap. It controls the No. 1 and No. 2 retail pork brands in Canada, with a combined market share of nearly 50%. Maple Leaf produces branded ham, hot dogs, sausages, and poultry, and it has a small hog-raising business. Despite strong revenue and a dominant market share, profit margins historically languished below U.S. peers', as the company's manufacturing and distribution systems had never really been modernized. Ebitda margins in the meat business were 4% to 6%, versus 10% at Hormel Foods [HRL], ConAgra Foods [CAG], and Hillshire Brands. But in 2009, Maple Leaf announced a plan to spend nearly C$800 million to modernize the meat business. This involved a 12% workforce reduction companywide, the implementation of SAP [SAP] software, five new manufacturing plants, and the consolidation of 17 distribution centers into two.

Oscar Schafer's Picks

Company/ Ticker	Price 1/9/15
CogentCommunications	
Holdings / CCOI	$33.99
NICESystems/	50.06

NICE	
MapleLeafFoods/	
MFI.Canada	C$19.40
RealD / RLD	$11.07
Source: Bloomberg	

How did things work out?

Schafer: The transition will be complete by the third quarter of this year. When that happens, margins immediately could climb to about 10%, and the business could achieve a run rate of at least C$300 million in Ebitda. With US$500 million of idle cash on the balance sheet and the ability to add two to three times that in leverage, Maple Leaf has the balance-sheet capacity to repurchase about 50% of the company. Valuing the company's new earnings stream at more than 11 times Ebitda and 20 times earnings per share -- multiples comparable to peers -- yields a stock price in the mid-C$30s. If Maple Leaf were to be acquired at the recent industry-takeover multiple of 17 times Ebitda, there would be significant upside from here.

Gabelli: Michael McCain, who controls Maple Leaf, is unlikely to sell. But he could be open to a tax-inversion strategy.

Schafer: RealD [RLD] is another stock I talked about in the midyear Roundtable. The stock is down a little since then, but there have been several positive developments at the company, and the shares are even more interesting now. It was a down year for Hollywood, and the summer box office was particularly bad. RealD, which licenses 3-D-film-related technologies, takes a percentage of ticket sales for 3-D movies. The 3-D market has stabilized after several years of decline. Also, the company recently announced cost cuts above and beyond initial reductions that were announced at the end of 2013.

In October, Starboard Value, an activist investor that owns 10% of the stock, made an offer to acquire the rest of RealD for $12 a share. The board rejected the offer, as the company disclosed in its most recent conference call. We agree with the company's decision to reject the bid and believe the shares are worth materially more. But we also think the presence of an activist investor with a stalking-horse bid is motivating the management team to act quickly to create value for the shareholders.

What more can management do?

Schafer: Substantial research-and-development spending has been allocated to products that don't contribute to revenue. The company has announced that it has hired advisors to explore strategic alternatives for this product portfolio. Within the next year, management will either cut the remainder of the expense or demonstrate a clear route to commercialization of the products. Most important, the company likely will announce a large share buyback in the near term. RealD has net cash on its balance sheet and is trading at an attractive valuation ahead of a strong wave of 3-D films.

The 2015 slate of 3-D films looks to be the best in years, with sequels to Avengers, Jurassic Park, and Star Wars hitting theaters. The following year looks just as strong, with the much-anticipated sequel to Avatar, the most successful 3-D movie of all time, set for release. [Release of the Avatar sequel has been delayed to 2017.] Of the top 20 highest-grossing films of all time, half have 3-D sequels scheduled to come out in 2015 and 2016. With no share buyback, RealD is trading for eight times estimated free cash flow for the year ending in March 2016, excluding the monetization of R&D assets. If the company buys back $150 million of stock, or 35% of its shares outstanding, the multiple drops to seven times. Again, that is before additional cost cuts or the benefits of monetizing R&D assets.

RealD continues to make theatrical installations in China and Russia, where 3-D viewership rates are high in local-language films. We think the shares will rise 50% in the next 12 to 18 months, from a current $11.07.

Thanks, Oscar. Mario, you're last but by no means least. And you're immensely patient.

Gabelli: Oscar's ideas are splendid. Thanks for recommending Maple Leaf. There is a lot going on there.

Schafer: You own it.

Gabelli: My clients do. My first idea today is Graham Holdings, which used to be the Washington Post. There are 5.8 million shares, including a million A shares, which have 10 votes apiece and elect 70% of the directors. The B shares have one vote and elect 30% of the board. The company is controlled by the Graham family, which sold the Washington Post to Jeffrey Bezos in 2013. Last year, in a so-called cash-rich spinoff, Graham swapped its ownership in a Miami television station, and cash, for Graham stock owned by Warren Buffett's Berkshire Hathaway [BRKA]. Graham also sold some other assets separately.


Photo: Jenna Bascom for Barron's

Mario Gabelli: “Kaplan’s non-U.S.-college business has done OK. Based on deals done for comparable companies, Kaplan could be worth as much as $800 a share.”

Today, the company holds cash, cable-TV assets, television stations, the Kaplan education business, a marketing company called Social Code, some real estate, and other assets. Graham has $120 a share in cash. The TV stations are worth about $250 a share. Cable ONE, its cable business, is worth $500 a share. Altogether, that’s $870 a share in assets. Graham has announced a spinoff of Cable ONE, which will occur sometime this year. If Cable ONE is bought by another company after the spinoff, shareholders avoid a double tax.

Enlarge Image


2015 Roundtable Panelists

Scott Black
Founder and President
Delphi Management
Boston

Abby Joseph Cohen
Senior Investment Strategist
and President
Global Markets Institute
Goldman Sachs, New York

Marc Faber
Editor and Publisher
The Gloom, Boom & Doom
Report
Hong Kong

Mario Gabelli
Chairman and CEO
Gamco Investors
Rye, N.Y.

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Janus Capital Group
Newport Beach, Calif.

David Herro
CIO - International Equities
Harris Associates
Chicago

Brian Rogers
Chairman
T. Rowe Price
Baltimore

Oscar Schafer
Chairman
Rivulet Capital
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Meryl Witmer
General Partner
Eagle Value Partners
New York

Felix Zulauf
President
Zulauf Asset Management
Co-CIO and Partner
Vicenda Asset Management
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Close

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Schafer: How does that work, exactly?

Gabelli: If Graham sold the cable business, it would pay a tax on the proceeds, and shareholders would pay a tax on the gain. If the business is spun off and then sold, there is only a tax at the shareholder level. A cash-rich spinoff is a terrific tax benefit, too. John Malone [chairman of Liberty Media (LMCA)] and Buffett have done well with cash-rich spinoffs. Graham has an overfunded pension fund, so it has assets to buy other businesses.

Graham is trading for $870 a share. Shareholders are getting the Kaplan business for free. In addition, the cable asset is going to be monetized. Broadcasting Ebitda was about $190 million for 2014. That will drop to $160 million this year because of a decline in election-related advertising spending. Next year, however, there will be a tsunami of spending on political advertising. Graham's TV stations are in markets such as Houston, Detroit, Orlando, San Antonio, and Jacksonville. They could also get a benefit from spectrum auctions.

The cable business has about $300 million in Ebitda. It will be spun off with about $450 million of debt.

How much is Kaplan worth?

Gabelli: Kaplan is the wild card. It runs a for-profit college. In the U.S., the for-profit education industry is facing challenges. Kaplan also has a test-preparation division, which has about $30 million in Ebitda. Kaplan's non-U.S.-college business has done OK. Based on deals done for comparable companies, Kaplan could be worth as much as $800 a share.

Next, I was looking for a company with a database of Christian contemporary and country and western songs. I found Gaylord Entertainment in Nashville. After selling a lot of assets and acquiring new management, the company changed its name to Ryman Hospitality Properties [RHP]. It converted to a REIT on Jan. 1, 2013. Our clients got $6.84 a share in cash and stock on the conversion. We have been one of the largest shareholders for a while.

Thanks for sharing that.

Gabelli: Ryman has 50 million shares outstanding. The stock is selling for $54, and the market cap is $2.5 billion. The company has two businesses -- Hospitality and Opry and Attractions, which includes two entertainment venues and some other assets. The hospitality business includes hotels and convention centers operated by Marriott International [MAR] near Dallas, Orlando, Nashville, and Maryland, outside Washington, D.C. MGM Resorts International [MGM] has a license to build a casino megaplex in that area. Ryman generated about $200 million in funds from operations in 2014. It pays an annual distribution of $2.20 a share and yields 3.9%. Apply an appropriate capitalization rate [rate of return, achieved by dividing yearly income by total value] to the REIT, and you get a value of $55 a share.

Ryman also owns WSM, a radio station in Nashville famous for country music. Ryman is likely to engage in financial engineering and spin off the entertainment assets. In the right hands, the entertainment assets could be worth as much as $15 a share. Ryman shareholders could benefit from rising occupancy and room rates, and financial engineering. We value the company at $70 per share.

Next, why would you give your money to Steve Schwarzman or Henry Kravis, or David Rubenstein? [All three run private-equity companies.]

You mean, instead of giving it to Gabelli?

Gabelli: I mean, why would you pay 2-and-20 [management fees equal to 2% of assets and 20% of profits] and tie your money up for 10 years? When I buy what John Malone controls, I am buying at a discount. I am not paying 2-and-20, and I have liquidity. Malone has his fingerprints on $115 billion of equity value, with investments in companies that include, among others, Liberty Media, Liberty Broadband [LBRDA], Discovery Communications [DISCA], and DirecTV [DTV]. His personal net worth in these companies is about $8 billion, marked to market. I like following Malone, and have been doing so for 35 years. He is now getting involved in an old-line British company that I started following in the early 1990s because I wanted exposure to Hong Kong. I am talking about Cable & Wireless Communications [CWC.UK], which owned Hong Kong Telecom, which it has since sold.

Cable & Wireless is selling for about 49 pence. The stock trades in London, but the company has relocated its headquarters to the Miami area, as it provides telecom and video service in the English-speaking Caribbean, including Barbados and Jamaica. There are 2.75 billion shares outstanding, and the market cap is about $2 billion. Cable & Wireless has about $200 million of debt.

Mario Gabelli's Picks

Company/ Ticker	Price 1/9/15
GrahamHoldings /GHC	$870.47
RymanHospitality Properties / RHP	54.33
Cable&WirelessComm./CWC.UK	49 pence
Chemtura/CHMT	$23.20
Post Holdings / POST	41.33
Kinnevik / KINVA.Sweden	SEK 247.90
Patterson Cos. /PDCO	$50.43

Source: Bloomberg

What is the company's connection with Malone?

Gabelli: A transformative transaction is in process. Cable & Wireless is buying privately held Columbus International, in which Malone is a large shareholder. Columbus provides voice, video, data, and everything that you heard Oscar talk about with regard to Cogent Communications.

Columbus gives Cable & Wireless an expanded footprint in the region. When the deal is done, Cable & Wireless will issue 1.5 billion of new shares and have $1.7 billion of added debt. Pro forma, Cable & Wireless will have 4.3 billion shares outstanding, and an enterprise value of about $5.6 billion. Columbus adds $600 million of revenue to Cable & Wireless for the year ending March 31, 2016. Cable & Wireless is becoming an interesting Caribbean play.

In exchange for his Columbus shares, Malone will acquire Cable & Wireless shares with a put. Tax structure is fundamental to everything he does. Scale and consolidation and deal structure are in Malone's DNA. Malone will own 13% of Cable & Wireless after the deal closes; he will have a $250 million stake in the company, which isn't a big piece of his net worth, but he isn't going to ignore it. He loves these sorts of dynamics. John Risley, one of the founders of Columbus, will own 20% of the combined company. The company could have significant growth in the next three or four years. You could double your money, or do even better than that.

It's good to have John Malone on your side.

Gabelli: Now I am revisiting Chemtura [CHMT], which I recommended last year. It came out of bankruptcy protection in 2010. The CEO, Craig Rogerson, said that Chemtura would sell its AgroSolutions unit. It did so, for $950 million, and has used the proceeds to reduce debt and buy back shares. Following a Dutch auction, Chemtura had 72.7 million shares outstanding, and $50 million of debt. The company is buying back $200 million of stock, and by the time we see the next published share count, it will have about 67 million shares. Chemtura has two remaining businesses: an oil-lubricants business and a bromine business that generate about $2 billion of annual revenue.

Schafer: That is the old Great Lakes Chemical.

Gabelli: That's right. There is overcapacity in the bromine business, which is causing a short-term hiccup for the company. Chemtura could generate $400 million of Ebitda three years out. Chemtura still has $650 million of NOLs [net operating losses from prior years that can be used to offset future taxes]. It will be able to shelter [from taxes] about $80 million a year of earnings.

The balance sheet is wonderful. The CEO is doing good things with the company. Notwithstanding the current air pocket, he is committed to growing Ebitda, getting a high stock market value for it, and buying back a significant amount of stock.

Next, I have talked about Post Holdings [POST] in years past. It was spun out of Ralcorp three years ago. Post is in the cereal business, which has lost some pricing power in the short term. Cereal as a breakfast option has been replaced by protein. The company has increased its market share to 11% of the cereal industry. There has been some talk of consolidation in this market. I have called Bill Stiritz, the chairman, a "cereal acquirer." In the past two years, he has bought 12 companies for $4.4 billion. Most recently, he acquired Michael Foods, which sells egg whites, among other food products. Post could benefit from buying something in the organic area.

What are the numbers for Post?

Gabelli: Post has about 62 million fully diluted shares. The company posted revenue of $2.4 billion for the fiscal year ended last September. Helped by acquisitions and organic growth, revenue could climb to $4.5 billion in the current fiscal year. Ebitda this year will be about $575 million, growing nicely in the next three or four years due to synergies and consolidation. Post is rolling up food companies with a management team that understands financial engineering. Earnings will march higher in the next few years, helped by lower interest expense. Post could earn $2.10 a share for fiscal 2017. The company could have some near-term challenges, but it has good longer-term prospects.

Black: From an operating standpoint, didn't Post have disappointing revenue and operating earnings in the past few years?

Gabelli: Stiritz has been buying companies in the private-label food business that fit into Post's distribution network. He has also been buying branded products and companies in the nutritional-foods business. When you buy 11 or 12 companies in a short amount of time, you will have some short-term challenges. This is true in any roll-up business. It is worth looking two or three years down the road.

In the midyear Roundtable, I recommended Kinnevik [KINVA.Sweden]. The company is based in Stockholm and run by Cristina Stenbeck, a granddaughter of one of the founders. There are 42 million supervoting A shares, of which the controlling family owns 34 million. There are 235 million B shares that have one vote apiece. The stock is selling for 248 Swedish kronor [$29.98]. When a company in Sweden owns more than 10% of another company and sells its stake, it doesn't have to pay a tax on the profits. That isn't the case in the U.S., where you would have to engage in all sorts of financial engineering to avoid the tax.

Kinnevik owns other companies, and has a marked-to-market portfolio worth about SEK300 a share. One of its biggest holdings is a stake in Millicom International Cellular [MIICF], a wireless telecom company serving Africa and Latin America. It could be an attractive asset as the industry consolidates.

Remind us what else Kinnevik owns.

Gabelli: Kinnevik has been investing in Rocket, an e-commerce business incubator. Rocket is an investor in many e-commerce companies. Rocket went public three months ago. Kinnevik is selling at a significant discount to its holdings. It is constantly juggling its assets.

Last, but not least, I want to talk about pet care [puts on a baseball cap that says "WOOF"]. VCA [VCA] handed out these hats when it went public. There are 96 million companion cats and 83 million dogs in the U.S. Spending per animal is rising. You don't have to worry about the Affordable Care Act when you take care of your dog or cat. AmerisourceBergen [ABC] announced today [Jan. 12] that it is tendering for MWI Veterinary Supply [MWIV] at $190 a share, or close to 20 times Ebitda. In the past, I recommended Patterson Dental, now called Patterson [PDCO], which distributes dental and veterinary supplies. There are 104 million shares, and the stock is around $50. The market cap is $5 billion.

On the dental side, Patterson is the exclusive distributor in the U.S. for Cerec, Sirona Dental Systems ’ [SIRO] industry-leading dental CAD/CAM system. Patterson’s exclusive relationship with Sirona and Cerec could end as early as 2017. In addition, lumpiness for dental-equipment buying patterns has caused lumpiness in reported revenue and earnings.

Patterson could earn $2.30 per share in the year ending April. Earnings could top $3 in the next three or four years. Based on those earnings and Ebitda assumptions, Patterson could command a price of more than $80 per share. The MWI acquisition price puts a focus and a valuation baseline on Patterson.

Thank you, Mario, and everyone.