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Here's What's Cooking for 2013

By LAUREN R. RUBLIN | MORE ARTICLES BY AUTHOR

The members of the Barron's Roundtable see a year of modest gains for U.S. stocks, trouble for bonds, and good news for gold. Also featured this week: the best investment bets of Felix Zulauf and Mario Gabelli. How to play deal stocks, and Japan.

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Barron's **Roundtable -- Part II (Jan.28)**
Barron's **Roundtable -- Part III (Feb. 4)**

Tables: 2012 Roundtable Report Card
2012 Midyear Roundtable Report Card

"Baloney!" The accusation zoomed like a missile at *Barron's* 2013 Roundtable, the most amusingly argumentative gabfest this magazine has convened in some years. Stick nine supremely intelligent, colossally opinionated, and verbally gifted investment experts in one room from morning 'til sundown -- as we did last week at the Harvard Club of New York -- and they are apt to kid each other politely, at least for the first 15 minutes. Then introduce such lighthearted topics as the U.S.' runaway entitlement spending, Europe's questionable allegiance to a common currency, and central banks' seemingly incurable addiction to money-printing, and, well, watch the "baloneys" fly.

In other words, our Roundtable members didn't agree on much of anything this year about the economic or investment outlook in the U.S. and abroad, and they weren't afraid to say so in the course of a far-ranging, freewheeling, wisecracking, and occasionally combative conversation. Best we can summarize it, they fell into two distinct camps -- those who foresee an improving economy, quiescent inflation, rising corporate earnings, and decent gains for stocks, and those who expect the interest-rate-suppressing policies of the Federal Reserve and 37 similar institutions to end in recession, depression, and "national confrontation," otherwise known as war. The only question pertaining to the more dismal forecast is, as Fred Hickey put it, "when this thing is going to blow." And that, we're somewhat relieved to report, might not happen for a number of years.

Our Panelists

SCOTT BLACK Founder and President, Delphi Management, Boston	**BILL GROSS** Founder and Co-chief Investment Officer, Pimco, Newport Beach, Calif.	**OSCAR SCHAFER** Managing Partner, O.S.S. Capital Management, Chairman, Rivulet Capital, New York City
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MARIO GABELLI Chairman and CEO, Gamco Investors, Rye, N.Y.	**BRIAN ROGERS** Chairman and Chief Investment Officer, T. Rowe Price, Baltimore	**FELIX ZULAUF** President, Zulauf Asset Management, Zug, Switzerland

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Thus, there should be ample time to digest our panelists' big-picture views and benefit from their best investment bets for 2013. In the current issue, you'll find their opinions on everything from consumer spending to the natural-gas boom to the French economy, while their particular picks and pans will be showcased over three weeks, beginning with presentations by Roundtable veterans Felix Zulauf and Mario Gabelli.

Felix -- suave, serious, and Swiss -- takes a dim view of Europe's currency experiment and is just as dour about Japan's attempt to reboot its economy by devaluing the yen. He thinks emerging markets could be an interesting wager in the year's first half, however, and sees good things ahead for that eternal hedge against disaster, gold.

Mario has an eye for value, a nose for deals, and a predilection for investing at the intersection of both. He has an even 10 picks for 2013, most of which could rise in value as a result of mergers, acquisitions, spinoffs, split-ups, and other financial derring-do. He also shares a history of the sausage (that's bologna, not baloney), and an update on gluten-free dining.

Marc Faber, editor of the Gloom, Boom & Doom Report, couldn't make it to this year's Roundtable, but we're keeping his seat warm for 2014. We have a good hunch there will be even more to talk about then.

Barron's: *The stock market is coming off a good year, which some of you even predicted. What do you think of stocks now? Mario, start us off.*

Gabelli: Investors have been withdrawing money from the stock market. We have seen a negative flow of funds. But let's look at China and Japan, which account for 20% of the $75 trillion global economy. They have a pretty good shot at starting their engines and reaccelerating. Europe is about 20% of the world economy, and is still a work in progress. The U.S. is 21%. The U.S. consumer's net worth is at an all-time high. He is reducing debt. This owes to a combination of Bernanke, Bernanke, Bernanke -- in other words, the Federal Reserve [under Chairman Ben Bernanke] has been printing money, which has geared to drive financial assets and real-estate prices higher.

Jack Otter and Sam Mamudi discuss stocks that are climbing after favorable mentions in Barron's.

Get to the point. Are you bullish or bearish?

Gabelli: I'm getting there. Corporate earnings will be OK in 2013, and 2014 looks even better. Interest rates are going to rise, but the market has discounted that. Given the negative flow of funds and the market's relatively low price/earnings multiple, you have to be positive. The stock market will face a lot of potholes in the near term, and on balance, I don't expect the market to rise more than 5% this year. But I have never been more excited about specific stocks. This year, you will be able to make a lot of money as a result of financial engineering -- companies engaging in deals, takeovers, split-ups, spinoffs, and such. It is a phenomenal time to make money in the market. You get stocks like **SodaStream International** (ticker: SODA), which I'm not recommending, rising to $48 from $36. It will be a fantastic year to pick individual stocks.

Why, then, will the broader indexes see only modest gains?

Gabelli: Our financial system has structural problems, and at some point the Fed will have to start withdrawing all the money it has poured into the system.

Gross: Whenever somebody says, "I've never been more excited," I run the other way.

Gabelli: Well, I'm also excited about being short bonds.

Zulauf: This year could turn out to be the opposite of 2012. Last year, we had a potential calamity in Europe that could have led to the breakup of the euro zone, but the European Central Bank stepped in with money to buy up massive amounts of government bonds and prevented a crisis. Many cyclical markets, including emerging markets and commodities, fell in 2011 and the first half of 2012, until the ECB came to the rescue.

Now those markets are rallying, as are the U.S. and Germany, which didn't correct. But the rally is mature. It is late in the cycle. The rally will end sometime between the second and third quarters, and the markets will go down. The problems we have discussed here in recent years are unresolved, and will be back on the table.

Hickey: Spain has to fund a record amount of debt. Will problems doing that trigger the next crisis in Europe?

Zulauf: There are several issues in Europe. A monetary union of nations with different economic structures is a strange setup that leads to all sorts of stress. There are huge differences in competitiveness among euro-zone economies. Some observers say Europe's current-account balance is improving, and Europe could have a spectacular recovery, much as Asian countries did in the late 1990s. This is complete baloney.

Asia had a financial crisis in the 1990s, and countries let their currencies drop by 50%, which led to a boom in exports. That is not the case in Europe. Countries on the Continent's periphery don't have an export boom. They have an import contraction. You can't create growth under such circumstances. That is why any hope of Europe's periphery coming out of the doldrums is completely misplaced, and there is a good chance France will be the next problem.

Jennifer Altman for Barron's

Roundtable members are at odds this year over the likely growth rate of the U.S. economy and S&P 500 earnings, although they agree that a better housing market and a domestic oil and gas boom are good for both.

Why is that?

Zulauf: Unit labor costs have risen to such a degree that the French economy has become noncompetitive. It is beginning to unravel. The French can't sell their cars anymore. The government isn't reforming the country; it is marching in the wrong direction, toward more socialism. You will see big disappointments in France this year, including rising current-account and budget deficits.

Europe's high priests of economic policy have put preservation of the euro above everything else. By doing that, they have destroyed millions of jobs and consigned millions of people to poverty. At some point this will backfire. You can't glue the European Union together forever with central-bank money. Financial markets can't force the issue because the ECB will go against them. It has immense ammunition; it can print money. Eventually, it will be the man in the street who revolts. You can send people into poverty for a while, but there is a limit.

Gabelli: How can Europe solve its problems?

Zulauf: Countries could give up national sovereignty and create a federal organization of European states, but that is unlikely and unrealistic. Alternately, some countries could break out of the euro and devalue their currencies. That is the more likely option long-term. Throughout Europe, liabilities are moving from the private sector to the public sector. I don't see the European recovery others are talking about.

Mario Gabelli lays out his stock-picking recipe for Barron's Online and explains why Hillshire Farms (HSH) is on the menu.

They aren't making it up out of thin air. Bond markets in Europe are doing better.

Zulauf: Bond markets in Spain and Italy and Greece were priced for calamity. The ECB stepped in and removed that threat. That made bond markets rally and interest rates fall. The decline in interest rates is just about over. Yields in those countries will trade sideways for a few months and then start rising again.

Hickey: Felix, is it possible Europe could suppress rates even further, just as the U.S. did, by printing a trillion dollars?

Zulauf: In theory that is possible. The European Central Bank could lower interest rates by a few more basis points before they hit zero. At the moment, the ECB isn't buying large quantities of debt. But if it starts buying in huge quantities, the German public wouldn't greet the move well, as it doesn't want to be on the hook for its less-disciplined neighbors. German Chancellor Angela Merkel is up for re-election in the fall. Debt mutualization [under which creditor countries take on financial responsibility for the debtor countries] ahead of the election is a no-go.

It is difficult to time such things, but around the middle of the year, the markets will start to reverse. I don't know whether they will end the year slightly up or slightly down. I expect the first half of 2013 to be friendly to equity markets, and the second half to be unfriendly, with risk rising.

Abby, what do you see this year?

Cohen: The U.S. economy is showing some dynamism. Exports have been robust. Only one sector of the economy isn't growing: government spending. That is the sector losing jobs. The corporate sector is doing well. Profit margins didn't come under pressure in 2012, as many people had expected. In fact, they stayed above average levels due to careful management, especially of labor costs. Germany has become much more productive and competitive on labor than the other nations of Europe. Since 2009, the U.S. and Germany have seen similar productivity gains.

Corporate balance sheets in the U.S. are in phenomenal condition. Rarely, if ever, have companies had so much net cash [cash minus debt]. Debt levels have come down at some companies, but others are taking advantage of cheap money to borrow. Much of this money will be used to fund capital spending, but a good deal of it will be returned directly to investors in the form of share repurchases and dividends, as well as merger-and-acquisition activity. People expected M&A to pick up dramatically last year, which didn't happen. But the pieces are in place for transactions to occur now.

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Like many on Wall Street, the Roundtable panelists are excited by the prospect of American energy independence as a result of massive shale-gas discoveries, mostly in the Midwest. Says Meryl Witmer (far right): "A lot of jobs are being created, and they will lead to other jobs. The natural-gas boom is a huge deal for the U.S."

Which pieces are you referring to?

Cohen: First, equity valuations are appealing. Second, market volatility is down. The volatility of the Standard & Poor's 500 is below the six-year average. That makes corporate managers and investors more comfortable.

Now, let's look more closely at some standard valuation models. Despite some of the grouchiness we often hear at this table, U.S. stock prices have risen for the past four years. Stocks are near previous records, but valuations are lower because earnings have risen. If we run the Fed model [a comparison of the stock market's earnings yield with the yield on long-term Treasury bonds] on the back of an envelope, it suggests fair value at year-end 2013 for the Standard & Poor's 500 would be 1750, compared with about 1470 now. If we use a dividend-discount model or a discounted-cash-flow model, we get a somewhat lower fair-value estimate. But keep in mind that return on equity in the U.S. is running around 14% for S&P companies, significantly higher than anywhere else in the world. ROE is under 10% for large companies in Europe, and it is just 5% for the companies in Japan's Topix index. Equity valuations in the U.S. don't reflect fully the improvement in the economy and corporate finances.

What is your S&P 500 earnings estimate for 2013?

Cohen: Consensus estimates for earnings growth are on the order of 12% to 13% this year and next. Corporate performance has diverged from the economy's performance for many years, and that could continue. Companies in the S&P 500 are increasing their exposure to other parts of the world, not just for production purposes, but more important, in terms of end demand.

Rogers: Abby, that's an incredibly bullish earnings forecast, especially if we are talking about gross domestic product of 1% or 2% in Europe, and 2% or 3% in the U.S. I hope you are right, but when I look at the data, it is tough to connect the math dots. I have trouble getting to a low-teens rate of earnings growth.

Gabelli: What do you get to?

Rogers: I get to 5%, 6%, 7% for this year.

Gross: Time out, people. Let's try to analyze why earnings have done so well in recent years. Corporate profits have come at the expense of labor. Wages as a percentage of GDP have declined to 54% from 59% in the past 10 years. That trend would have to continue for earnings to keep going up. Also, 30% to 35% of earnings growth in the past five years has come from lower interest expense. Most of you probably would agree that is coming to an end, as well. Corporations have to sell their products to somebody. They can't benefit when that somebody has depressed wages and high leverage. At some point the game begins to change. A forecast of 12%-to-13% earnings growth under such circumstances is not only extreme but almost farcical.

Cohen: I gave you bottom-up estimates [industry analysts' estimates]. Our top-down number [market strategists' estimates] is lower, but still in the mid- to high single digits. That is much better than many people, Goldman Sachs included, felt 12 months ago.

Black: You are overly ebullient. Last year at this time, people expected the S&P 500 to earn more than $110. Earnings are likely to come in at $98 to $99 for 2012. In the third quarter, corporate earnings were down 5%. In the quarter that just ended, they will be up about 6%. The original earnings estimates don't hold water. Also, operating profit margins for the S&P 500 peaked in the third quarter of 2011, at 9.51%. There are no more economies of scale to be gleaned. If you think nominal GDP growth is going to be around 4%, there is no way you are going to get 12% or 13% earnings growth.

Zulauf: There is huge room for disappointment in the equity market.

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Brian Rogers (second from right): "A combination of decent economic performance, reasonable valuations, and decent dividend activity suggests stocks could do well this year. Stocks are attractive relative to fixed income."

Cohen: We see 2.5% growth in GDP this year and about 3% by the end of next year. There will be substantial fiscal drag [restraint on economic expansion caused by higher taxation] on the order of $200 billion, starting now.

Gross: Can I get a more realistic view of the world, please? The U.S. continues to have a "new normal" economy, with annual growth of 2% or less. Growth rates in the rest of the developed world are even lower. There are several reasons for this. There is too much debt, and the ongoing delevering process creates the fiscal drag we just talked about. There is also a demographic issue: The population is getting older. The baby boomers are receiving more Social Security payments. Japan is way ahead of us in aging, but it is a trend throughout the developed world. Third, de-globalization contributes to slowing growth. Nations are taking care of themselves. They are setting up trade barriers and engaging in currency wars and other practices that are destructive to growth.

In the credit markets, when money yields close to zero, it is destructive, not constructive. Net interest margins at financial institutions come under threat. What does **Morgan Stanley** [MS] do? The company recently said it would lay off 1,600 people and close branches. Companies pull in. Delevering starts with the financial complex and expands to the real economy. This is not the old economy, where leverage could produce 10% to 15% earnings growth every year. We have to adjust to a new world in which returns have been driven down to perhaps 3%, 4%, and 5%, as opposed to 10% to 15%.

Zulauf: On top of that, the U.S. has more fiscal drag this year than other countries around the world. GDP could grow by 1.5% to 2%. With 70% of GDP dependent on the consumer, whose real disposal income is growing by 1% a year, and whose savings rate isn't going any lower, it is difficult to put together an outlook for 2.5% to 3% economic growth.

Cohen: On the positive side, capital spending is likely to grow by 6% in 2013. A housing recovery also is under way.

Gabelli: That is extraordinarily positive, but it doesn't have a big impact on GDP. Also, on the positive side, the consumer's wealth is at a record and consumer debt is falling.

Zulauf: But the wealth is unevenly split. That is the problem.

Gabelli: No question, the guy making $50,000 a year has a payroll shock this quarter when higher taxes go into effect. Then the shock wears off.

Hickey: No, it doesn't. Every week, every month, people have less money to spend.

Cohen: Monthly debt payments relative to income are at the lowest level since the 1990s. Some of this reflects debt repayments, and some, lower interest rates. As Mario suggested, there has been a dramatic improvement in the average consumer's balance sheet.

Hickey: Yet, consumer confidence plunged at the end of the year. Spending at Christmas was terrible. Electronics sales were down 7%, whether we're talking about personal computers or mobile phones.

Gabelli: But home sales are rising. Auto sales are up.

Hickey: Housing is up from depressed levels, but sales still aren't great. Strength in auto sales reflects pent-up demand.

Gabelli: Baloney!

There is a lot of baloney here today.

Gabelli: The car companies are marketing, and that is inducing demand.

Rogers: Abby, back to your earnings-growth estimates. We would all agree that 12% to 13% growth seems very high. The question is, what is 5%, 6%, 7%, or 8% growth relative to? If you add a dividend yield and compare equity valuations to fixed-income, maybe it is enough. I guess that is my theme for this year. It is going to be enough. One thing we haven't talked about is the great rotation: money coming out of Bill Gross's portfolio and going into the equity market.

Gross: Sorry, that hasn't happened.

Rogers: It hasn't happened, yet. It will be a factor in boosting equity returns this year, unless investor sentiment turns very negative, which could be a risk next month as the debt-ceiling fight gets under way. That is going to be a mess, and February probably will be the worst month for stocks. But a combination of decent economic performance, reasonable valuations, and decent dividend activity suggests stocks could do well this year. Dividend growth substantially outpaced earnings growth last year, and there were a number of special dividends toward year end before tax rates were slated to rise. Right, Mario?

Gabelli: Common sense prevailed. [The board of **Gamco Investors** (GBL), Gabelli's investment firm, declared a special dividend of $2.20 a share in November.]

Rogers: You will see more of that this year. The ingredients are in place for stocks to rise. The question is the order of magnitude of the potential return. In any case, stocks are attractive relative to fixed income.

Oscar, what do you have to say?

Schafer: I have to disagree with all the people who are trying to relate growth and GDP to the stock market, because historically there has been little relationship. For example, the Greek stock market was up 33% last year, and yet the Greek economy is in shambles. I'm pretty optimistic about U.S. GDP and earnings growth this year. From a psychological point of view, nobody is talking about common stocks at cocktail parties today, the way they used to do 10 years ago. Everybody is talking about bonds. Last year, investors put $248 billion into bond mutual funds and exchange-traded funds, and redeemed $22 billion from equity funds. This year equities will do much better than bonds. All those great pension funds that have hidden in bonds and think they are getting riskless returns could be surprised. I am extremely optimistic about stocks.

Also, the resurgence of domestic energy demand is a big plus. By the end of the year, the U.S. is going to be exporting more energy than it imports. That will have an enormous effect on the manufacturing sector's balance of payments, and on U.S. growth in general.

Zulauf: I don't deny it is a benefit, but becoming a net importer will account for only a $2 billion improvement in a monthly trade deficit of $40 billion.

Hickey: The domestic oil boom has been going on for six years.

Gabelli: And it is accelerating.

Gross: Fracking [hydraulic fracturing, used in oil and gas production] and housing are two positives for the economy. Whether they can offset fiscal drag and structural problems is another question.

Gabelli: If we are reducing government labor and adding labor in manufacturing, isn't the quality of GDP and corporate earnings much higher?

Witmer: Yes.

Gross: You can't tell me the U.S. is adding a lot of manufacturing jobs. I won't accept that.

Gabelli: The energy industry has hired a lot of people in the Midwest to build plants and pipelines to process and transport oil and gas.

Witmer: There is a huge capital-spending boom coming in the petrochemicals industry because of the discovery of cheap natural gas and natural-gas liquids. You are actually starting to see some wage inflation. **KBR** [KBR], the engineering and construction company, said on a conference call last week that it had to reduce earnings guidance because it had some fixed-price contracts in the Texas area and costs were rising. A lot of jobs are being created, and they will lead to other jobs. There is a multiplier effect. A lot of pipelines -- not just the big ones but other lines -- are being built. The natural-gas boom is a huge deal for the U.S.

Zulauf: Because U.S. energy costs are half those in the rest of the industrialized world, the U.S. is the only country building new energy and chemicals plants. That is a positive.

Hickey: One problem is, we don't know if the government will allow all that oil to be transported. That could affect the benefit we're going to get from it. The government blocked construction of the Keystone XL pipeline extension. There is a lot of oil stuck in the U.S. right now. It can't be moved out. That explains the big difference in price between Brent crude [oil from the North Sea] and West Texas Intermediate [the U.S. oil benchmark; on Jan. 14, Brent was priced at $111.88 a barrel, and WTI at $94.14 a barrel].

Witmer: The industry is finding ways around such limitations.

Gabelli: Order backlogs have gone through the roof for rail-car makers such as **Trinity Industries** [TRN] and **Greenbrier** [GBX]. Bakken oil will be shipped by rail.

Witmer: It will also get moved by river. The problem with Keystone is that it required federal approval.

Schafer: The manufacturing sector accounted for 15% of GDP in 1990. It has fallen to 9% now. It will start growing toward 20% again.

Cohen: The U.S. has devoted substantial capital spending to the energy sector, which helps explain our competitive advantage. Natural-gas costs only a third as much here as it does on a global level. The U.S. invested $138 billion in the energy industry in 2011. Russia and Saudi Arabia have roughly the same amount of annual liquid-energy production, but Russia invested only $10 billion in 2011, and Saudi Arabia, $5 billion. Using technology to keep energy costs down is a multiyear story in the U.S.

So, Brian, are you still looking for only 5% earnings growth?

Rogers: The earnings recovery since 2009 has been quite strong. At some point, you just can't squeeze blood from a stone. I see limited ability to squeeze great profit gains out of U.S. companies this year. Margins are at historically high levels, and demand will be positive but sluggish. I see positive but sluggish growth on a global basis.

Witmer: Health-care costs are going up, too.

Rogers: And consumer demand might be impacted by higher tax rates. It is tough to paint a really bullish outlook for earnings. But, again, earnings growth of 5%, 6%, 7%, and maybe 8% in an extreme case, is enough relative to returns on fixed-income and money-market assets.

The big story is going to be in the fixed-income markets. Bill can lead us through a lesson in duration math, which most investors don't understand. The high-yield market is about as well exploited as it can get, with yields cracking through 6% on the downside.

Schafer: High-yield-bond yields are lower than the S&P's earning yield for the first time ever.

Rogers: I have a positive outlook generally, but stock prices advanced much further than earnings last year. To me, the great mystery of 2012 was Europe. It looked like a basket case on a fundamental basis, but stock prices, depending on the market, were up 10%, 15%, 25%, or almost 30%. Spain was the only market that had very disappointing performance. The Greek stock market had a great year, so that tells you something about the risk-on trade in 2012.

Zulauf: Greece was down 90% previously.

Rogers: I realize that, but I'm taking it one year at a time. This year, the big story could be that we freak out a bit over the debt-ceiling debate.

Witmer: It might not be so bad. All the worry last time was for naught.

Rogers: The president is playing a game of chicken with the Republican leadership of the House. The fight could go right down to the deadline, and perhaps it will all be forgotten six months later. But there is going to be a lot of rhetoric in the first couple of months of the year that could be somewhat poisonous for the markets.

What is your outlook for inflation? Everyone talks about inflation, but we haven't seen much, except in food prices.

Rogers: We don't have a negative view on inflation this year. We're looking for 2% to 2.5% price increases. At some point, the distant economics student in me looks back and says, when you try to monetize everything and create as much liquidity in the system as we have done for the past five years, inflationary pressures will arise. That's the classic economics view. It hasn't happened yet, but at some point there will be upward inflation pressure.

Hickey: The Fed has done a wonderful job to date of keeping inflation expectations contained. Every time they print money, they say, "We're thinking about not printing." They have done that for four rounds of quantitative easing over multiple years.

Rogers: You have to love the rhetoric and word choices. There was some discussion of the Fed slowing asset purchases as unemployment fell toward 6.5%. Then people thought it was "to" 6.5%. They mean different things. It is clear, however, that the Fed is going to buy fewer securities in the future.

At some point, the Fed has to take the training wheels off this economy.

Hickey: It has to, but it won't until some crisis occurs.

Black: We expect S&P earnings to rise about 5% this year, to $104. That puts the index at 14.2 times 2013 estimated earnings. On that basis, the market is cheap. If you look at risk classes within U.S. equities, large-cap stocks are much cheaper than small- and mid-caps. The Russell 2000 [a small-cap benchmark] trades for 17.5 times 2013 estimated earnings. That doesn't mean you can't find individual mid- or small-cap stocks that are cheap, but large-caps are systematically underpriced. Mario expects the market to rise by single digits. In the past 21 years, there have been only five up years in which the market posted single-digit total returns.

Your point?

Black: It is unusual to see a market that is up just 3% or 5% for the year. If earnings come through and the market is cheap, it will go up by more. The one hindrance I see is the debt-ceiling situation. From a July 7, 2011, market peak until an Oct. 3, 2011, trough, a period encompassing the prior debt-ceiling fight, the S&P 500 fell 18.8%. You can't rule out the possibility of something similar happening this year.

The U.S. needs to slow the growth in entitlement spending by $2 trillion to come close to our budget goals. Social Security and Medicare account for 36% of federal-government expenditures. That's where the money is going. Cutting at the edges of some other government programs isn't the answer. Nor is gutting the Defense Department. I'm a Democrat from the old school. Unfortunately, President Obama hasn't led. He let his legislation be written by Representative Nancy Pelosi and Senator Harry Reid. It is time he put his own political capital on the line and said, "For better or worse, we have to slow the growth in entitlement spending."

Public debt is 104.8% of GDP, the highest level since the end of World War II. The U.S. is on an unsustainable path. The Social Security system will run out of money by 2033 under current proposals, and Medicare will run out in 2024. If both parties can come to a reasonable agreement on slowing entitlement spending that doesn't go down to the wire or cause the rating agencies to question the solvency of America, the market could explode to the upside.

Hickey: Why would you expect anything like that to happen? Pelosi is already on record saying she won't touch entitlement spending.

Black: The president is no longer running for re-election. At this point, he has to know that we are on an unsustainable course.

Hickey: He should have known that for the past four years. He did nothing about it.

Black: I expect some kind of deal. The Republicans will hold firm and refuse to lift the debt ceiling unless some action is taken to rein in spending.

Gross: If we continue to run deficits, our debt-to-GDP ratio will begin to resemble some countries' in southern Europe. That will precipitate debt-rating downgrades and higher interest rates.

Bill, what is your inflation outlook?

Gross: To mimic economists, inflation will be relatively benign in 2013. I'm always amazed that they come up with such soothing adjectives. We're expecting 2% inflation. At the moment, money-printing by the Fed and other central banks isn't generating inflation. The problem could come in later years -- 2014, '15, and '16 -- but it depends whether you're talking good inflation, such as wage inflation, which increases consumers' spending power, or bad inflation, such as commodities inflation. We see more bad inflation than good inflation in the future. The Fed recently said it would be satisfied with 2.5% inflation for a year or two. So, all central banks, including our own, are basically accepting greater and greater inflation. The Bank of Japan, which had a zero-inflation target, now wants 2% inflation, and quickly. Almost all central banks are in a reflationary mode.

Zulauf: At some point this year, I expect to see the consumer-price index rise by more than 3%. In the first half of the year, oil prices could have upside of $10 to $20 a barrel. Food prices could rise by 15% to 20%. That would hurt consumers.

Cohen: Why would energy prices go up so much?

Zulauf: The forecast for demand is stable to slightly down in the developed world. But demand is rising elsewhere. Even if China's economy grows only 3% or 4%, the country's energy bill is going up as more motor vehicles are added to the national fleet. That is going to make a difference in the price of oil.

Almost every country is trying to devalue its currency. The world economy isn't growing enough to keep structural problems under control, much less fix them. Therefore, nations are trying to grab more of the pie by devaluing their currencies. The U.S. started this nonsense, and the Fed's money-printing has made the dollar a weak currency.

Gross: This is a replay of the 1930s, when competitive devaluations were perceived to be the solution to the problem. Ultimately, they weren't.

Zulauf: This will end in national confrontations. It is a very dangerous game. The Japanese have entered the game, and the Europeans will be next. Just because earnings might be up by 5% or whatever doesn't mean the financial system isn't fragile. We could have a shock at any time, and possibly this year. If you want to fix the situation, you can't expect to have a high level of economic growth. The outlook for growth is less and less attractive. That is why a decline in the stock market's valuation would be justified.

Schafer: Economic growth and the stock market have nothing to do with each other.

Black: If we get some sort of agreement in Washington on roughly $2 trillion of spending cuts, they can't be front-end loaded. GDP growth could decline by 0.7% this year just from the recision of the 2% payroll-tax cut. We want to be careful not to push the economy back into a recession in the short term.

At the same time, it must appear to the financial markets that the U.S. is taking tangible steps to remedy the problem. If Washington keeps kicking the can down the road, it doesn't bode well for our long-term economic growth or the stock market.

Also, somebody talked today about real disposable income going up. In the U.S., it is actually going down. The consumer has been losing out, and when that happens, the savings rate falls. Installment credit is rising again. A huge consumer-led economic recovery is not in the cards this year.

Witmer: If unemployment falls, that would help.

Gabelli: More people will be employed if housing picks up.

Black: All this said, the stock market is cheap. Nominal interest rates are low, and assuming cooler heads prevail in Washington, it wouldn't surprise me to see the market up 10% to 12% this year, including reinvested dividends.

Rogers: I'm not holding my breath, although to Scott's point, Medicare fixes combined with a resolution of fiscal-cliff tax issues would be huge. The market doesn't need a permanent solution. It needs a directional agreement. There is some chance that could happen after the you-know-what hits the fan over raising the debt ceiling. It could happen later this spring. At some point the president is going to stop just sitting there and try to lead a little. He may be willing to make some changes.

Gross: Can I introduce some evidence from the Office of Management and Budget, the Congressional Budget Office, the International Monetary Fund, and the Bank for International Settlements? Four out of four, using different sets of numbers, basically say the U.S. is one of the world's most grievous offenders in not reducing the level of its deficit relative to GDP. They are talking about a structural deficit that takes into account future payments for Medicare, Medicaid, and Social Security.

Their numbers suggest this structural deficit continues at 8% a year. The structural deficit needs to be reduced by a trillion dollars a year, not a trillion dollars over 10 years. This country is in deep doo-doo. These numbers aren't mine or Pimco's, but those of government and international authorities. Yet, we continue to deny what is going on.

Zulauf: Switzerland had a similar problem on a much smaller scale. About 10 years ago we introduced a debt-limit law that prevents the government from spending more in any given year than it spent in the previous year. It has worked, but it takes political will. We have had balanced budgets for the past 10 years. We have even run surpluses.

Rogers: Our debt ceiling is like Swiss cheese.

Gross: On the other hand, Switzerland has taken on enormous risk in trying to peg the Swiss franc to the euro [to reduce the franc's value and protect exports]. The Swiss aren't right about everything.

Zulauf: The Swiss National Bank is playing a dangerous game and knows it. When the next euro crisis hits and the market is flooded with euros, it won't be able to continue to protect the franc. The next step could be capital-control measures that prevent foreigners from buying unlimited quantities of Swiss francs.

Hickey: Since Marc isn't here today, I'll say what I know he would: We are all doomed. I just don't know if a date has been set. We are living in a dream state. To have every developed country printing money at the same time is unprecedented.

Zulauf: Thirty-eight countries are pursuing a zero- or negative-real-interest-rate policy. I have never seen anything like it.

Isn't that a comment on globalization?

Zulauf: No. It is a comment on irresponsible central bankers and irresponsible political leadership.

Hickey: Japan is printing a trillion dollars. Everything looks fine, and the Japanese stock market is going up. But everything isn't fine, and Japan will have another recession. When the Fed printed money, our stock market doubled.

Does that mean you are long stocks?

Hickey: I own a lot of gold stocks. I am not short anything. I don't know when this thing is going to blow. The European Central Bank promised to print unlimited amounts of money, and it suddenly looked like Europe's problems were solved. They aren't. The Bank of England is on QE6 [a sixth round of quantitative easing], and England is heading back into recession. Money-printing doesn't work. It has been tried for 2,000 years and hasn't worked. It always ends in tears.

Fred, gold wasn't such a great investment last year.

Hickey: It has been great for 12 years, but it doesn't always go up. In the last great gold bull market, gold rose from $100 an ounce in 1970 to $800 in 1980. But it fell 46% in 1975-76. Anyone who left the market then missed the best part of the rally -- a subsequent rise of 600%. In the latest 12-year period, there have been five corrections in the gold price, ranging between 15% and 30%. The latest correction was 19%, and gold has bounced off its recent lows already.

You have to be in gold. You have to be in real estate. Semiconductor sales have been poor, yet semiconductor stocks are rising. That is a result of money-printing. That is why the performance of stocks isn't related to the performance of the economy. Stocks could go up again this year. All assets could go up in price. But you'd better protect yourself. At some point, stocks will underperform and inflation will run higher. That is the history of all monetary inflations.

Stocks will hold some but not all of their value. If you were an investor in Weimar Germany, your stocks lost 90% of their value. The best places to be were in other currencies and gold. But this time around, there is no alternative currency to the dollar.

Gross: There are a few countries with positive real interest rates, decent balance sheets, and good growth prospects. Mexico is one, and Brazil is another, despite its recent problems.

The Mexican peso and the Brazilian real aren't major currencies, although both countries have seen 3%, 4%, 5% economic growth in recent years, and their balance sheets are much healthier than ours.

Hickey: The central banks of both countries, and Korea, are buying large quantities of gold. They know that all the developed-market currencies are on a path to destruction.

Witmer: If a currency is losing its value, wouldn't you want to own a great company in that market? Things might implode for a time, but then they get better and the company holds its value over time.

Zulauf: Actually, things get worse, spurring social debates about whether to tax people who made smart investment decisions and take away the benefits of their intelligence.

The hedge fund manager explains to Barron's Online why he expects Japanese stocks to climb - and why investors need to tread carefully to avoid getting tripped up by currency devaluation.

Witmer: Here's my two cents. The stock market looks like it is trading around intrinsic value. It might not move much this year one way or the other. The U.S. economy is doing pretty well. People could experience a paycheck shock early in the year when taxes go up, and then they will adjust. They will save less and keep spending. More people will be employed, and there could be some wage inflation in the Midwest and Texas. You'll basically collect your dividend and maybe make a percent or two in addition.

That isn't too exciting.

Gross: I am returning to Brian's comment about duration, which is the amount of price risk in a bond relative to 100 basis points [one percentage point] of change in interest rates. The 30-year Treasury bond has a duration of about 20. The five-year has a duration of about five. Stocks have a technical duration of one divided by the dividend yield. If dividend yields are 2%, the duration of a stock is about 50. If you are content to just clip your coupon in terms of dividend payments, without any prospect for growth, you are taking on enormous risk in terms of duration and price volatility.

Witmer: Companies grow over time. The dividend yield isn't the right measure. You should probably use the earnings yield.

Rogers: Bill, you are assuming a static dividend yield.

Gross: OK, let's assume the company grows some. We'll use 3%. So let's give stocks a duration of 33 as opposed to the long bond's 20.

Rogers: I raised the duration issue because I am not sure individual investors know that if interest rates rise by one percentage point and they own a 10-year bond, they could lose 9% of the principal.

They know now.

Gross: All assets are artificially "bubbled." The trick is to figure out which are less bubbled, because, as Brian explains, you could lose your year's income from bonds almost overnight if interest rates rise. Similarly, you could lose your 2% dividend yield almost overnight if stocks fall 2%. We have priced assets -- stocks, bonds, and other financial assets -- to a point where even a minor price movement on a daily basis could eliminate income on an annual basis.

Schafer: Speaking of bubbles, Lee Cooperman [chairman of Omega Advisors] pointed out the other day that **Cisco Systems** [CSCO] sold for 100 times earnings in 2000, and paid no dividends. The 10-year bond was yielding 6.5% at the time. Today Cisco sells for 10 times earnings, or less if you subtract its cash, and yields 3%. The 10-year yields 1.9%. Where is the bubble? It isn't in the stock market. It is in the bond market.

Jennifer Altman for Barron's

Felix Zulauf: "I don't trust Russia. Putin blew it. He had the chance to democratize Russia and create free-market structures. Instead, he went the other way and helped the oligarchs. This is bad for Russia, and its demographics are awful."

We haven't solved anything this morning, and we probably won't. So let's move on to your investment picks. Felix, you're first.

Zulauf: We have talked today about structural problems in the global economy and financial system. Policy makers dreamed a dream that they could take volatility out of the economy. They tried to fine-tune it, and instead have led us into a miserable situation. People believe the risk in the market is low, because volatility indexes are low. Perceived risk in March 2009 was very high, but market risk was low. Right now, it is just the opposite, and that mismatch could persist. But we should be aware that we are operating in a high-risk environment.

We are well aware.

Zulauf: I made two recommendations at *Barron's* Art of Successful Investing conference in New York in October. One was to buy the U.S. dollar versus the Japanese yen. At that time, the exchange rate was 79 yen to the dollar. Now a dollar buys ¥89. Within two years, the exchange rate could go to ¥120. The Japanese government is in a difficult position, with the country's debt running at 230% of GDP. Japan is in a recession. The budget deficit exceeds 8% of GDP, and could top 10% this year and next. The deficit was easy to finance as long as Japan was running a structural current-account surplus and the domestic pool of savings was large enough to do so. In recent times the country's external accounts have deteriorated, and that could continue.

Felix Zulauf's Picks

Investment/Ticker	1/11/13Price
U.S. dollar vs. Japanese yen	$1=¥89.18
USD/JPYCall Option Strike95Exp.12/31/2014	¥89.48
WisdomTree Japan Hedged Equity Fund/DXJ	$38.53

Japanese institutions have always been the largest and steadiest buyers of Japanese government bonds, or JGBs. They recently announced they lack the funding sources to keep buying on the same scale. Japan Post Bank is an example. It formerly was a government institution in which

2013-03-05

iSharesMSCIBrazil Index Fund/EWZ	56.41
iShares FTSE China25Index Fund/FXI	41.09
iSharesMSCIEmergMkts Index Fund/EEM	44.47
Gold (spot price, per ounce)	1,662.98

Source: Bloomberg

individuals held savings of more than $2 trillion. It was a big buyer of government debt, as were pension funds and life insurers. All said recently they can't keep buying. The moment has arrived where the Bank of Japan needs to bridge the gap and buy more JGBs with newly printed yen. In other words, the supply of yen will increase dramatically. Japanese inflation will be pushed from slightly below zero to 2%, and the yen will be weakened. This is a major change for Japan, because the yen has been one of the world's strongest currencies for a long time, right behind the Swiss franc.

There is definitely a trend here.

Zulauf: Japan's big life insurers are pension-fund-style entities for the Japanese public. They are big investors overseas, and because of the yen's strength, have hedged part of their exposure to the currency. What would happen if they unwound 10% of their hedges? The four largest life insurers would have to buy $25 billion worth of dollars and sell yen. Many pension funds and industrial companies are in a similar position. The potential purchase of dollars and sale of yen is gigantic. Of course, Japanese bond yields would rise under this scenario, which is another problem, as Japanese banks have 900% of their Tier 1 equity capital in JGBs. To prevent the bond yield from rising, the Bank of Japan will have to buy even more bonds, and print more yen. They will keep things under control for a while, but eventually this plan will fail.

The dollar/yen trade could have a mild correction, dropping back to the €86 area. I would buy on that correction. Professional investors could employ an options strategy, buying $1 million of yen futures with a strike price of ¥95 at the end of 2014, for $35,000. Break-even would be ¥98.30. At ¥120, you quintuple your money.

Gross: The critical question for all central banks is, can they generate real economic growth and solve a debt crisis at the same time? Japan is attempting to devalue the most to get a head start on growing at the expense of other countries. Can they do it?

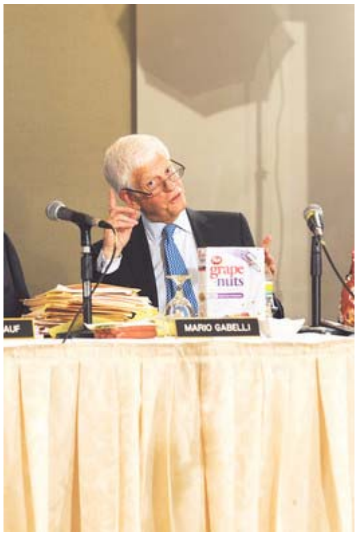
Zulauf: They will be partially successful for a few years. But can they push the dollar/yen to ¥160 to help things further? That is probably unrealistic.

Does a lower yen benefit Japanese stocks?

Zulauf: If the yen weakens as I expect, I would feel sorry for German exporters of cars, machinery, and such, and South Korean car manufacturers. But this is bullish for Japanese stocks. I'm not saying the Japanese economy will heal, but reflation is bullish for equities. The last time I discussed Japanese stocks was at the 1990 Roundtable, when Paul Tudor Jones and I recommended selling the Nikkei at 40,000. We said it would be cut in half. The Nikkei hit a low of 7,000 in 2009 and since then has traded in a range of 7,000 to 11,000. Japan has one of the cheapest equity markets in the world, as it has disappointed for years. The market trades for 20 times earnings, but the price/earnings multiple isn't relevant because earnings are so depressed. Price-to-book is one. Seventy percent of all Japanese stocks trade below book. Price-to-sales is 0.5, compared to 1.5 times in the U.S. Fiscal and monetary stimulus are the keys to change.

Gross: Can the Japanese government generate nominal GDP? Can it produce inflation of a positive sort that will generate corporate profits?

Zulauf: GDP has been stagnant in nominal [noninflation-adjusted] terms for 20 years. The price for generating growth is higher indebtedness. In the past 22 years, the market capitalization of Japanese stocks has fallen by 75%. The capitalization of the bond market has risen by four times. A major reallocation from bonds to stocks is beginning. I would be surprised if the Japanese stock market didn't rally 50% in the next two years. The best instrument to play this trend is a



Jennifer Altman for Barron's

Mario Gabelli: "I'm recommending cereal-maker Post Holdings. With product innovation, marketing attention, a focus on cash flow, and a brand with longevity, you don't have to worry about the next Twitter."

currency-hedged exchange-traded fund listed in the U.S. It is the **WisdomTree Japan Hedged Equity** fund, or DXJ. It trades for $38.53.

Emerging-market equities will have the wind at their backs in the year's first half. The U.S. dollar is weakening because of the Fed's moves. But emerging markets don't want their currencies to rise because they need more trade and growth. They will try to lean against the Fed with some monetary stimulation of their own. Whether this will help their economies is a question, but it will help their stock markets, which will do well in the first half of the year. I would buy Brazil because it is a commodity producer, and commodities traded in dollars will benefit. I would buy the EWZ, or **iShares MSCI Brazil** Index ETF, which is trading at $56. I would also buy the **iShares FTSE China 25** Index, or FXI, which I recommended at the October conference. China's market has been disappointing and could probably rally a little longer. The Chinese market is trading where it did in 2001. It is not a market for widows and orphans. The **iShares MSCI Emerging Markets** Index, or EEM, is another pick, as the whole emerging-markets complex will outperform the U.S. I reserve the right to take all these trading recommendations off the table at the midyear Roundtable in June.

You're allowed.

Black: Felix, the Brazilian government is pursuing a socialist path. This has stymied the economy's growth rate. What gives you confidence in Brazil?

Zulauf: That is why it is only a trade, and not an investment.

Oil prices could rise. What do you think about Russia?

Zulauf: Russia is part of the emerging-markets complex, and it is a beneficiary of higher oil prices. I expect oil prices to rise in dollar terms in the year's first half but retreat in the second half, because the world economy won't revive to the extent the optimists believe. They are using recently positive data out of China to justify a more optimistic view of the world. I don't see it. Nor do I trust Russia as a country. Putin [Russian President Vladimir Putin] blew it. He had the chance to democratize Russia and create free-market structures. Instead he went the other way and helped the oligarchs. This is bad for Russia, and the country's demographics are awful.

We are living in a world of money-printing. Almost 40 countries are pursuing a policy of zero or negative real interest rates to spur more economic growth. We have never seen anything like this in modern history. The people will try to protect themselves against this monetary baloney. It is accelerating the debasement of paper currencies around the world. That is why I have to recommend gold again. Gold's fundamentals are strong; although some technical indicators of sentiment and momentum turned down in the summer of 2011, gold is at the very end of a cyclical correction and the gold price will be up and running again soon. Once gold surpasses $1,800 an ounce, it will run to the low- to mid-$2,000s.

Thank you, Felix. Mario, what did you bring us today?

Gabelli: If you had been sitting here 12 years ago, you wouldn't have heard of Twitter or **Facebook** [FB] or **Google** [GOOG]. If you were here 15 years ago, you were focused on Cisco and a bunch of tech companies. I am going to talk about something that has been around much, much longer. Homer's *Odyssey* mentioned one of the oldest forms of processed food: sausages. The city of Frankfurt, in Germany, honored the creation of the hot dog at its 500th anniversary. Sausages will be around for the next couple of hundred years, too.

Abby and I have discussed how you will be able to make money this year from spinoffs, split-ups, and old-fashioned mergers and acquisitions. She suggested M&A activity will pick up because companies want to grow. So, how do you combine sausages and spinoffs?

We haven't a clue.

Gabelli: Hillshire Brands [HSH] makes sausages and hot dogs. It was spun out of Sara Lee, which I recommended in the past. Hillshire has 122 million shares outstanding. Investors got one share for every five shares of Sara Lee. Hillshire had $694 million of net debt as of Sept 29. It will generate $4.1 billion of revenue in the fiscal year ending June 30. Earnings will be $1.60 to $1.65 a share. Three or four companies were looking to buy Hillshire from Sara Lee before it was spun off.

The sausage market is growing by about 5% a year in the U.S. Breakfast sausages are a $4.6 billion annual business. Lunch meats are $4.8 billion. The lowly hot dog is about a $2.5 billion market. Hillshire is a leader in all three categories. It could earn about $2.40 a share in fiscal 2017. Debt is falling substantially. The stock trades for $29 and change, and could be $35 to $50 a share two years out.

Mario Gabelli's Picks

Company/Ticker	1/11/13 Price
Hillshire Brands /HSH	$29.58
Post Holdings / POST	35.27
Viacom / VIA	60.08
Xylem / XYL	27.18
Graco /GGG	53.48
Patterson Cos. /PDCO	35.49
Weatherford International /WFT	11.53
National Fuel Gas /NFG	49.1
Boulder Brands /BDBD	12.32
Fisher Communications /FSCI	33.26

Source: Bloomberg

Is Hillshire still an acquisition target?

Gabelli: It will be bought by someone. Meanwhile, management is doing a terrific job of getting back to basics. I must say a kind word about another sausage company whose stock is too small to recommend. This company was founded in Coney Island in 1916. It sells Nathan's hot dogs [holds aloft a plastic package of Nathan's franks]. One of the dynamics behind **Nathan's Famous** [NATH] is a capitalization shrink. The company has reduced its share count to 4.2 million from 6.2 million. The shares are $35, and the company has a $140 million market capitalization. It cut a deal with **Smithfield Foods** [SFD], which will market its products starting in March 2014. As a result, earnings will explode upward to about $3 a share in 2015 from an estimated $1.20 this year. The market soon will start discounting that.

Grape Nuts [holds up cereal box] was founded in 1897. **Ralcorp Holdings** [RAH], which owned the brand, was approached about two years ago by **ConAgra Foods** [CAG], which wanted to buy it. Management decided not to sell. It then spun off the cereal business as **Post Holdings** [POST]. ConAgra is buying Ralcorp for $90 per share, but I'm recommending Post. Bill Stiritz, who runs Post, is a proven money maker, like Dr. John Malone of **Liberty Media** [LMCAD]. Stiritz sold Ralston Purina to **Nestlé** [NESN.Switzerland]. He has done other deals. We have been talking today about how to preserve wealth if inflation accelerates. You want to buy cash-generating companies with pricing power that have had some sort of short-term hiccup. They must be run by CEOs who understand how to create value. The sun, moon, and stars are aligned at Post.

How big is the cereal market?

Gabelli: Cereal is a $28 billion market worldwide, and a $10 billion market in the U.S. Cereal is consumed not only by young folks but also by older folks at an increasing rate. **Kellogg** [K] is the industry's big kahuna, with a 34% market share. **General Mills** [GIS] has 33%, and Post has 10.5%. Post came out of the box, so to speak, in February 2012. It was spun off with 34.5 million shares, and bought back 1.7 million. The stock is trading for $35. Net debt is about $890 million. The company will earn about $1.50 a share in the current year, ending Sept. 30, which can grow to $3 in the next three or four years. Stiritz stared out in the business by filling shelves. With product innovation, marketing attention, a focus on cash flow, and a brand with longevity, you don't have to worry about the next Twitter. I have a large number of Twitter followers. You can become my second one.

We figured as much.

Gabelli: Let's talk about using cash flow to buy back stock. **Viacom** [VIA] has been doing this. I have been a Viacom investor for 25 years. Viacom and **CBS** [CBS] split on Dec. 31,

2005. CBS is doing well under Les Moonves, and Viacom is doing extraordinarily well under Philippe Dauman and Tom Dooley. Viacom had 755 million shares at the time of the split. They are now down to 507 million. In the next three or four years, share count will fall to about 355 million. Viacom reported $13.9 billion of revenue for the fiscal year ended Sept. 30. That could increase to $18 billion in the next several years. The company generates revenue from two sources: advertising and subscription fees. It also owns Paramount Pictures, which at some point may be merged with either Malone or Columbia Pictures.

Viacom earned $4.36 a share in fiscal 2012, and could earn $9 by 2016, as earnings grow slowly and shares outstanding shrink. Founder and Chairman Sumner Redstone controls the company. The A stock is fully exchangeable into the B. The A shares sell for $60, two dollars more than the nonvoting B shares. I want to own the A shares. Net debt is $7.3 billion, and capital spending is de minimis at $100 million a year. The company generates $4.3 billion a year of earnings before interest, taxes, depreciation, and amortization, or Ebitda. The question is, what is Redstone's exit strategy? He is a young 90-plus.

Black: Nickelodeon lost a lot of market share last year.

Gabelli: You don't have to buy it. I recommended the stock at $30 a share several years ago. I said it would double in four years. It doubled in three years. You will get $100 a share in three years.

Xylem [XYL] was spun out of **ITT** [ITT] in October 2011. It is assembling one of the best packages of water-infrastructure and water-treatment companies in the world. When I talked about it here last year, I was worried about a slowdown in state and local spending. Business in southern Europe is slow. Short term, earnings are lackluster. The stock rose about 10% in the past year, to $28. There are 186 million shares. The company had $788 million of net debt as of the end of September, the latest published number. Revenue last year was an estimated $3.8 billion, which could rise to $4.6 billion by 2016. Ebitda could rise to $800 million from $625 million. Capital spending is about $130 million a year. Per-share earnings could go from $1.80 to $2.50. This is a yummy for a large corporation that wants to have distribution and products in water industry. Europe accounts for a third of the business; the U.S. is a third, and Asia-Pacific is 11%. They are accelerating their involvement in acquaculture [fish farming].

What is your target price?

Gabelli: The company could be bought at a 50% premium to its current stock price within two years.

Graco [GGG] was founded in 1926. The stock is $53. There are 60.7 million shares outstanding. Net debt is $570 million. The company makes equipment to apply foam on drilling rigs, and products for painters. It uses a razor and razor-blade model [applications are sold separately from applicators] and is a great cash generator. Graco tried to acquire a company from **Illinois Tool Works** [ITW] for $650 million, but the Federal Trade Commission gave it a hard time. So it had to sell a part of the ITW acquisition. Revenue is tied to the housing market, which has a long runway. There are a lot of ways to make money from housing. This is a side-door play. Pat McHale, who runs Graco, is terrific. The company could earn $2.20 a share for 2012, down from $2.32. Earnings could double in three or four years.

Schafer: How so?

Gabelli: Through a combination of growth in the housing market and the absorption of some costs tied to the Illinois Tool Works acquisition. Also, Graco buys back stock from time to time, and introduces product innovations.

Patterson Cos. [PDCO], formerly Patterson Dental, is in one of my favorite industries. As you age, you spend more per tooth. There are approximately 185,000 dentists in the U.S., including 5,000 orthodontists. Three or four companies sell products to the dental market. Ebitda has been flat at about $400 million a year for the past four years, but is starting to ramp up. Capital spending is only $25 million a year, so the company generates a lot of cash. Local practitioners are buying more products such as dental-imaging systems, which they sell. The company competes with **Henry Schein** [HSIC], which is more cutting-edge. Patterson also has a veterinary-supply business. There are 170 million companion pets in this country.

How big is the veterinary-products market?

Gabelli: It is about $3 billion a year, and three companies are important. MWI, out of Boise, does the best job, as far as I can tell. Patterson trades for $35 a share and there are 108 million shares. Net debt is $275 million. The company's cash is held in Canada, but its debt is in the U.S. It could pay off the debt but would incur a tax hit to bring home the cash to do so. Patterson will earn $2.30 in the year ending in April 2013, marching up to $3 in the next three or four year. This is a takeover or split-up candidate.

Domestic energy also has a long runway. I am recommending two companies. **Weatherford International** [WFT] is a turnaround story. It was put together through acquisitions and had some issues with accounting, taxes, and foreign corrupt practices.

Zulauf: The company moved its headquarters from Texas to Switzerland.

Gabelli: More money is being spent on drilling, particularly in the Bakken shale and other fields in the U.S. Weatherford has a pre-eminent position in the artificial-lift market. Artificial lifts are mechanical devices inserted in wells that increase the flow of crude. Weatherford has a disproportionate share of the rod-lift market. Once the company gets some accounting, tax, and management issues settled, it will do well.

Give us some numbers, please.

Gabelli: The stock trades for $11.53, and there are 767 million shares. Debt has been reduced but at glacier-like speed. There is about $8.5 billion of net debt, so enterprise value is $17.5 billion. This isn't a small company, but it could be a good acquisition for a major capital-equipment company that wants to be in all segments of oil service. Earnings are a little hard to figure out. Weatherford earned maybe 60 cents a share in 2012, but in three or four years it could earn about $2.40. It could be acquired in the next two years at somewhere between $18 and $24 a share. Management is motivated to sell.

National Fuel Gas [NFG] has been a disappointment. Shares haven't moved much, because the price of natural gas has fallen to $3 per Mcf [thousand cubic feet] from $5. There are 83 million shares, and the stock trades for $49. Net debt is $1.5 billion. The company owns large acreage in the Marcellus shale. It also operates the gas utility in Buffalo. The third part of the business is a midstream pipeline in the Marcellus area that they can monetize by creating a master limited partnership. There is no reason this company can't be split up. It pays a nice dividend. If natural gas were to rise to about $4.50 per Mcf, you would have a $100 stock. At current gas prices, the stock is worth about $85. The MLP could be worth $20 to $25 a share.

You're exhausting us. Is that it?

Gabelli: No. Let's talk about Glutino. Three million people in the U.S. and many around the world suffer from celiac disease. Consumers are looking for gluten-free foods, which are taking up more shelf space in supermarkets. My next company owns the Glutino brand. [Displays bag of Glutino gluten-free pretzels and passes it around.]

Rogers: Should we try this and see if it is any good?

Gabelli: It is. The company changed its name from Smart Balance to **Boulder Brands** [BDBD]. It is run by Steve Hughes. Shareholders profited when he sold Celestial Seasonings to Hain. About two years ago, the company bought Glutino, which was based in Canada. It bought another company, Udi's, in Colorado. It now has more brands, and its products are gaining traction.

Boulder has about 60 million shares. The stock is $12.30. The company will generate $370 million of revenue for 2012. It has $238 million of net debt. Earnings growth has lagged revenue growth due to spending on advertising, and start-up expenses. You'll see 15 cents in earnings for 2012, but earnings go straight up thereafter. A large company might want to buy this for its brands. Boulder is a small-cap stock.

My last pick is **Fisher Communications** [FSCI]. The company announced it is for sale. It has 8.9 million shares outstanding, and no debt. It operates ABC-affiliate television stations in Seattle and Portland, Ore. The stock is selling for $33 a share, and the company could be worth between $40 and $45.

Thanks, Mario.

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High Hopes for Whiting Petroleum

BMO Capital, which upgraded shares to Outperform, sees upside of about 20%.

Airline Shares Could Fly Higher

Barclays says the potential merger between American Airlines and US Airways could boost other airline stocks as well.

BARRON'S ROUNDTABLE | SATURDAY, JANUARY 26, 2013

It's Gonna Be Delicious

By LAUREN R. RUBLIN | MORE ARTICLES BY AUTHOR

Want a get-rich recipe? Start with our experts' mouthwatering investment bargains in energy, retailing, banking, and more. Up this week: Abby Joseph Cohen, Brian Rogers, Oscar Schafer, and Scott Black.

Barron's **2013 Roundtable -- Part I (Jan. 21)**
Barron's **2013 Roundtable -- Part III (Feb. 4)**

Tables: 2012 Roundtable Report Card
2012 Midyear Roundtable Report Card

If you're dining on stocks this year (we hear the bonds are a bit overcooked), better stick to the à la carte menu.

Such was the considered advice of the members of our 2013 Roundtable, when the editors of *Barron's* gathered the whole thoughtful crew in New York on Jan. 14 to extract their latest forecasts for the economy and financial markets. As should have been evident in last week's issue, which featured the first part of the daylong conversation, these investment pros don't expect all that much from the stock-market averages in the months ahead. The big action, they predict, will be in well-chosen individual issues, which could run rings 'round the Dow and its lethargic cousins.

In this week's Roundtable feature, the second of three, it's à la carte all the way, as three superlative stock pickers -- Brian Rogers, Oscar Schafer, and Scott Black -- and one seasoned strategist, Abby Joseph Cohen, make the case for 22 stocks whose performance could shine, and then some, in 2013. Most of these shares have been unfairly dissed by investors, and many offer the potential for dividend growth as well as substantial capital appreciation. They range from plays on oil and gas and agriculture to surf-wear and Korean tires, and our experts share all the juicy details with precision and verve.

Our Panelists

SCOTT BLACK
Founder and President,
Delphi Management,
Boston

ABBY JOSEPH COHEN
Senior Investment
Strategist and President,
Global Markets Institute,
Goldman Sachs, N.Y.C.

MARIO GABELLI
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Chairman, Rivulet Capital,
New York City

MERYL WITMER
General Partner
Eagle Capital Partners,
New York City

FELIX ZULAUF
President,
Zulauf Asset Management,
Zug, Switzerland

Enlarge Image

Happy reading. Or should we say, *bon appétit*?

Barron's: *Abby, tell us about your investment picks for 2013.*

Cohen: I'm happy to do so, but let me begin with a quick recap of our general expectations for the market. Our sense at Goldman is that the market will get off to a slower start this year, and then get better. There are a number of things to be concerned about at the beginning of the year, including higher taxes in the U.S., and whether the Chinese economic recovery is for real. By the end of the year, however, we expect U.S. gross domestic product to be growing on the order of 2.5%, and we are forecasting 3% GDP growth in 2014. With regard to asset categories, equities are the best place to be.

More Barron's Roundtable

February 02
Meryl Witmer

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Fred Hickey

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Barron's 2013 Roundtable Part Three -- Stirring Things Up

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Video

Meet the All-Star Stocks of the Dow Rally 3:40

What Do New Market Highs Say About the Economy? 4:11

Dow Sets Record: What's the Big Deal? 3:16

There may be some trading opportunities in high-quality corporate bonds. Global GDP will be on the order of 3.3% in 2013, even with weak conditions in Europe,

Zulauf: Is that a lower growth rate than in 2012?

Cohen: It is a little higher. China will be somewhat better, but we are waiting to make sure that the numbers we saw at the end of the year are for real. Our 2013 forecast for Standard & Poor's 500 earnings is $107. Our 2014 forecast is $114. The consensus forecast for this year is $113, and for next year it is $126. We don't agree with those numbers, although we expect companies to show profit gains because profit margins will be stable. U.S. companies are benefiting from keeping labor costs under control. Wages aren't moving up much, and companies are seeing productivity gains. Energy costs also are under control. Our official price forecast for the S&P 500 is 1575, but there are many valuation models one could use. If you use the Fed model [which compares the market's earnings yield to the yield on long-term Treasury bonds], you come up with a number that is more like 1700 or 1750.

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Brad Trent for Barron's

(From left) Abby Joseph Cohen, Scott Black, Oscar Schafer and Brian Rogers

The stocks I have selected today take advantage of a few factors. These include the dramatic decline in correlation and volatility in almost every market. Market volatilities are at the lowest levels we have seen in years. The biggest decline in volatility has been in the emerging markets. Several years ago, volatilities in emerging markets were two or three times as high as in developed markets. Now they are roughly in the same ballpark. To say that correlations [between markets] are down dramatically is just an arithmetic way of saying that stock selection is going to matter. The stocks I have chosen are all rated Buy by Goldman Sachs analysts. My first stock is a pharmaceutical company, **Bristol-Myers Squibb** [ticker: BMY].

What's to like about Bristol-Myers?

Cohen: The company has a few things going for it. Patent-cliff issues [drug-patent expirations], not only for Bristol but a number of pharma companies, probably are coming to an end. Earnings bottomed in 2012, or will bottom in 2013. Our real focus is on earnings growth in the next two to four years, when Bristol will look much better. We recently lowered our earnings estimate for 2013, but made no change in our long-term view. The longer term is driven by a number of promising-looking new products. One, Eliquis, has already been launched in the European Union. It is a drug used to reduce stroke risk in patients with atrial fibrillation. It has been approved by the Food and Drug Administration and is set to launch this year. Bristol-Myers also is working on PD-1, a monoclonal antibody that has shown positive results against skin cancer and renal cancer in early-stage clinical trials.

How will these drugs affect earnings?

Cohen: Longer term, earnings could grow by at least 10%. The stock has a 4% yield, so investors can collect something while they wait for higher earnings to come through. Our analysts estimate 2013 earnings of $1.80 a share.

My second recommendation, **Mosaic Company** [MOS], refers to itself as a crop-nutrition company. In other words, it produces fertilizer. Mosaic was formed in 2004. Cargill, which owned a majority of the company, spun off its stake in 2011 in a $24 billion transaction. Mosaic is a significant supplier of both phosphate and potash base nutrients. It is No. 2 in fertilizer ingredients after **Potash Corp. of Saskatchewan** [POT]. Two things are interesting about Mosaic. It has significant distribution operations in places such as Brazil, China, India, and other parts of Latin America, all areas where the middle class is growing and demand for food is rising. In addition, some charitable trusts and family foundations associated with Cargill have lockup agreements on Mosaic shares that begin to expire in May 2013 [the shares can't be sold before then]. The presumption is that, after the lockups expire and the shares are sold, the company will be able to consider capital-allocation strategies, such as dividend increases and share repurchases later in 2013.

Apart from this, how is Mosaic doing?

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I'm a boomer that will be eligible for Social Security in about 7 1/2 years. I'd gladly forfeit that benefit if I could draw on my investments tax free instead.

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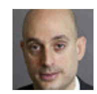

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Abby Joseph Cohen's Picks

Company/Ticker	1/11/13 Price
Bristol-Myers Squibb/BMY	$34.13
Mosaic Company/MOS	59.74
Expeditors International of Washington/EXPD	42.70
Hankook Tire Worldwide/000240.Korea	18,850 won
Noble Energy/NBL	$105.57

Source: Bloomberg

Cohen: The company reported fiscal-second-quarter earnings on Jan. 4. Revenue was down a little because fertilizer prices were a bit lower. In addition, international shipments were hurt because the company, and the industry, were engaged in contract negotiations with India and China. There has been an agreement with China, so now things are moving in the right direction. However, business was strong in North America. On a longer-term basis, my Goldman Sachs colleagues like the fundamentals for crop demand and pricing, which is favorable for both potash and phosphate prices. Inventories are low, and a recovery is likely within a year or two. Mosaic offers both earnings growth and return of cash. The company has $2.5 billion of net cash on its balance sheet.

Goldman's senior investment strategist puts an optimistic spin on the federal budget deficit, explains why stocks are cheap, and makes the case for investing in Bristol Myers.

Zulauf: Is there a reason you prefer Mosaic to Potash? Potash is the lowest-cost producer.

Cohen: Our team prefers Mosaic because of valuation and the catalyst it sees. Mosaic trades for about 13.5 times fiscal 2013 earnings and 10 times fiscal 2014 earnings [the fiscal year ends in May]. It yields 1.7%.

My next company, **Expeditors International of Washington** [EXPD], is based in Seattle, not Washington, D.C. It has significant exposure to global trade, especially trans-Pacific trade, and therefore, trade with China. Freight growth appears to be picking up at the airports in Hong Kong and Shanghai, and we are seeing a reversal of very tough trends at seaports in the Pacific in 2012. If investors want exposure to China without buying Chinese stocks, this is a good way to get it and participate in an inflection in the Chinese economy.

Expeditors describes itself as a global logistics company. Basically, it expedites trade. It has about 250 locations around the world in cities such as São Paulo, Beirut, and Shanghai. The company helps customers get merchandise in and out of countries. It works with customs agents. It has about 13,000 employees around the world.

Enlarge Image

Jennifer Altman for Barron's

Abby Joseph Cohen: "Our teams in Asia and the U.S. are seeing a pick-up in demand for automobiles, including Korean vehicles sold in the U.S. and elsewhere."

Gross: How do you expedite trade?

Cohen: You smooth the process by working with a lot of customs officials. This is important for small- and mid-cap companies that might not have such expertise themselves.

Black: Expeditors used to sell at a high price/earnings multiple. Does it still?

Cohen: Yes. It sells for 26 times last year's expected earnings, falling to 21 times this year. It yields 1.2%. The stock disappointed last year. One of the risks for Expeditors, as seen in 2012, is that their business has become more cyclical.

Keeping with the Asia theme, Korea looks interesting. It has a number of large companies that are engaged in international trade. **Hankook Tire Worldwide** [000240.Korea] trades in Korea. This stock, too, has performed poorly in recent months. There have been concerns about protectionism, weakening demand, and such. Our teams in Asia and the U.S. are seeing a pickup in demand for automobiles, including Korean vehicles sold in the U.S. and elsewhere. Korean auto manufacturers, including **Kia Motors** [000270.Korea], are having discussions about building manufacturing facilities in the U.S., which could bode well for Hankook.

Zulauf: You aren't concerned that if my forecast for a strong dollar and weak yen [detailed in last week's Roundtable issue] comes true, the Koreans will be hurt? They are the major competitors to Japanese automotive companies.

Cohen: Our currency team doesn't share your view, although one could argue that if there is some weakening in the yen, it would hurt the Korean won.

My final pick is in the energy area. As we discussed this morning, investors are focusing on the technological and competitive advantage that many U.S. energy companies have, and just how much they are laying out in capital expenditures. Until now, investors haven't been enthusiastic about energy. The sector is significantly underweight among hedge funds and others. **Noble Energy** [NBL] could benefit from increased interest in the sector. Noble has undervalued reserves and high-impact exploration, or what some would call shale with scale, linked to its technological advances. You can have shale [oil and gas trapped in shale rock], but if you don't have it in scale, it is a problem. Noble has an interesting mix of exploration properties. It has exposure to West Africa, in the Alen project, where there is higher-value crude oil. It also has exposure in the Mediterranean to Israeli natural gas, which sells for far more than U.S. gas. It is working in the Tamar field off the coast of Israel, which is generating good revenue, and in the Leviathan, a natural-gas-liquids project that is in an earlier stage of development. We assume Noble will earn $4.73 for last year, picking up to $6.70 this year. The stock sells for $105.57, or 16 times this year's estimated earnings. It has a modest yield of 0.8% and spends a lot on research and development.

Thanks, Abby. Let's hear from Brian.

Rogers: To frame the discussion, we have modest expectation for earnings growth this year, in the 5%, 6%, 7% range. We have a much more positive outlook for dividend growth in 2013, following a strong dividend picture in 2012. The housing and auto sectors look great. Deleveraging continues, except in the federal government. Corporate finances are outstanding. We'll get somewhere with Washington's debt-ceiling discussions, and maybe a Simpson-Bowles-lite agreement [on taxes and spending]. Jobs continue to be the big issue, and unemployment is sticky on the downside. The unemployment rate will continue to tick down slowly.

We talked today about supply and demand for equities. Supply will be constrained, and demand will be strong, coming from corporate buyers and individual and institutional investors, who will begin to reallocate funds toward the equity market and out of bonds. There will be a great migration or great rotation, or whatever you want to call it. It will intensify as the year continues. Valuations are OK, depending on your earnings assumptions. The S&P 500 is trading at 13.5 times 2013 earnings estimates. That isn't dirt cheap, but it isn't expensive relative to interest rates and fixed-income alternatives. Again, it will be a year in which investment confidence is shaped by what takes place in Washington.

The common theme among my stock selections is companies that have struggled, although my last pick will be an exception. Some stocks did really well last year, and some of decent quality struggled. I have tried to identify strugglers that can get their mojo back. **PNC Financial Services Group** [PNC], the old Pittsburgh National Bank, is one. Most other financial stocks were strong performers last year. PNC, on a total-return basis, was up about 4%.

What was the problem?

Rogers: PNC bought **Royal Bank of Canada**'s [RY] operations in the southeastern U.S. last year, and that held them back a bit. I always go back to 2008 and 2009 when looking at banks to try to figure out how they held together during that time. Did they get through the crisis OK? PNC earned $2.10 a share in 2008 and $4.26 in 2009, so it was profitable all the way through. The bank has completed some interesting deals, buying Mercantile Bank of Baltimore and National City. It is well run.

Gross: The stock is $60 a share.

Gabelli: PNC owns a big piece of **BlackRock** [BLK].

Rogers: It owns 21% of BlackRock. Eliminate BlackRock, and PNC trades for eight times expected earnings. Most banks are trading for 10, 11, 12 times earnings.

Brian Rogers' Picks

Company/Ticker	1/11/13 Price
PNCFinancial Services Group/PNC	$60.05
Kohl's/KSS	42.02
Apache/APA	80.57
Avon Products/AVP	15.22
LeggMason/LM	26.52
General Electric/GE	21.13

Source: Bloomberg

Gabelli: If PNC sold its BlackRock stake, wouldn't it have a tax liability?

Rogers: Yes, but it wouldn't be that big. The bank's capital position is really strong. After the financial industry's latest stress-test results come out in the spring, PNC will be able to raise its dividend again. The current dividend is $1.60 a share, and it could probably rise to $1.80, giving you a 3% yield. If every other bank is selling for between 10 and 12 times earnings, and PNC, BlackRock-adjusted, is selling for eight times earnings, our view is that is the investor's opportunity.

Witmer: If PNC were to trade at 11 times earnings, what would be your target price?

Rogers: It would be $70 to $75 a share.

Gabelli: Brian, shares of **JPMorgan Chase** [JPM] went up sharply last year. **M&T Bank** [MTB] was up sharply. Isn't something else overhanging PNC?

Rogers: The market is a bit concerned, Mario, about the RBC acquisition. To me, the company is always buying banks. You have to go with management in a situation like this, and Jim Rohr is a good CEO. He has proven himself through many cycles.

Enlarge Image

Jennifer Altman for Barron's

Brian Rogers: "It is hard to find anyone who would admit to owning Kohl's, aside from me."

My second pick is **Kohl's** [KSS]. This is the second- or third-largest department-store company in the U.S. The stock is trading for $42. Kohl's has a $10 billion market value, after falling about 15% last year. Many other retailers did a bit better. Kohl's had some fashion-merchandising issues, which I am not qualified to comment on personally, because I wouldn't be a good fashion gauge. The company pays a $1.28-a-share dividend, and yields 3%. In the past three years it has bought back at today's price 25% of its shares, so there is a continued recapitalization theme here. Kohl's has voted with its feet.

That is for sure. What do earnings look like?

Rogers: For the fiscal 12 months ending this month, the company probably earned $4.20 a share. For the year ending January 2014, they could earn $4.80. The stock trades for a multiple of about nine times earnings. The company will probably increase its dividend again in the next six to eight weeks, so its yield will be rising. Kohl's has been a fairly steady dividend grower since it started paying dividends about two years ago. The management team has been around for a long time. The CEO, Kevin Mansell, has been there since 1982. If they miss a fashion cycle, we aren't too worried. We are willing to bet on a seasoned executive with that much experience.

The Chairman of T. Rowe Price thinks investors might finally be moving from bonds to stocks - and he's got two to recommend.

Witmer: Does Kohl's have a lot of debt?

Rogers: Debt is pretty much under control at $2.5 billion, against an equity value of $10 billion. The company generates free cash flow, which it has used to buy back stock and pay dividends at a rate of about $1 billion a year. Kohl's has lost a bit of its luster, but in our view, this isn't **J.C. Penney** [JCP]. Kohl's owns a lot of its stores and tends to be in fairly good strip malls. Historically, it has had operating profit margins of between 9% and 12%. Margins last year were a little shy of 10%. The company has good management that can respond to adversity. Expectations are low right now. It is hard to find anyone who would admit to owning Kohl's, aside from me.

Black: Sales have been doing poorly.

Rogers: Same-store sales have been a big issue for the past six or eight months, but this is the first time in years that the company has had a problem. It brought in some new merchandising folks from **Macy's** [M], and I am making a bet that they can get the train back on the tracks.

Black: What kind of square footage does Kohl's have, and is it opening new stores?

Rogers: Kohl's operates 1,146 stores and is expanding its square footage by a couple of percentage points a year. On that basis, it is adding a dozen or so stores a year. It will continue to add space, but this isn't a huge square-foot-expansion story. In a year when so many stocks were up a lot, it has already paid the piper in terms of performance.

What is your view of J.C. Penney?

Rogers: We don't own the stock. I guess that's a view. There are a lot of smart investors with big positions in Penney. I'm not one of them.

Moving on to energy, who recommended **Apache** *[APA] here last year?*

Black: I did. It was the only loser on my list.

Rogers: This year it is going to be one of our winners. Apache was down about 15% last year. Energy was the second-weakest sector in the Standard & Poor's 500 after utilities. Among energy companies, Apache historically has produced a great return on capital. The company is thoughtful in what it buys and sells, and it makes pro-shareholder investment decisions. It has a strong balance sheet, and is run conservatively. They aren't gunslingers. By the way, 20% of their production is in Egypt.

Black: Gas production?

Rogers: Yes. Egypt is a bit of a question, but Apache's operations in Egypt haven't been affected thus far. Egypt needs the currency, so our best guess is the properties there will continue to produce and do just fine. Forecasting earnings in the energy sector is precarious, but we expect that Apache earned $9.50 a share in 2012, and will earn between $9 and $10 in 2013. We aren't forecasting huge growth, but again, this is a good company, with a good management team, good profitability, and an attractive price relative to the broader energy sector. Apache is selling at a discount based on any type of valuation metric. Its net asset value is about $130 a share. The stock is selling around $80 a share. There are 390 million shares outstanding, and the company has a $31 billion market value. It pays a small dividend of 68 cents a share.

If you like controversy, you will love my next set of comments, about **Avon Products** [AVP].

Everyone: Oh, no!

Rogers: Let's talk about Avon's history. The stock trades for $15 a share and has a $6.5 billion market value. Many of us remember when Avon sold for $40 or $50 a share four or five years ago.

Black: I remember when it sold for $150 a share.

Schafer: I remember when it was one of the Nifty 50, in the 1960s.

Rogers: Now, guys, don't show your age. I don't remember that. There are two keys to this story. First, Coty tried to acquire Avon last year, and the Avon board rebuffed its advances.

Gabelli: Coty made an offer in the low-$20s per share.

Rogers: Avon probably could have gotten an offer of up to $25 or $26 a share in a friendly transaction. It is hard to know.

Schafer: Has Avon cut its dividend yet?

Rogers: They have cut the dividend to 24 cents a year from 92 cents. The stock yields 1.6%. I am not sure the earnings matter this year or next, but it is likely they earned 70 cents a share in 2012 and will do 90 cents in 2013. The other key is that Avon has a new CEO, Sheri McCoy, who spent 30 years at **Johnson & Johnson** [JNJ]. She didn't get the top job there a year ago when the company picked a new CEO, and she was looking for a

CEO position when this came along. She is a highly capable executive who ran a significant portion of Johnson & Johnson for a long period of time. So, we are making a bet on management.

Avon has had a number of problems. It had balance-sheet issues, and she renegotiated some debt covenants to give the company time to work things out. She has also launched a big cost-cutting program. You could argue that Avon had a bloated cost structure, and she is going to take a meat cleaver to it. The company had a lingering issue over violations of the Foreign Corrupt Practices Act, and she is moving aggressively to settle it. This will be resolved sometime in 2013. Then the question becomes, what can they do with the business? We think Avon has potential. If the company can get profit margins back to historical levels, it could earn $1.50 to $1.75 a share in the next two to four years. Again, this is a $15 stock. If you put a consumer-products multiple on $1.50 or $1.75 of earnings, you might get a $25 stock in the next couple of years.

Schafer: Why is Avon in its current predicament?

Rogers: There were a series of self-inflicted wounds in some key markets. They are breaking even in the U.S., where they should be making money. They have struggled in Venezuela and other Latin American markets. There is a question as to whether the model is altogether broken. We believe it is fixable. I look at **Tupperware Brands**' [TUP] problems a few years ago. That model seemed like it was broken; a new management team came in and fixed it, and the stock reacted accordingly. If you don't think Avon has a durable business structure, you don't want to touch it. Our sense is there is pretty good upside in the next couple of years.

Gabelli: It is a great brand, even if they tweak their distribution channel. Was Coty interested in the distribution channel or some other dynamic?

Rogers: Coty liked Avon's distribution abilities, and viewed it as an inexpensive company with decent product R&D [research and development].

Next, we like **Legg Mason** [LM]. I can remember back to the days six years ago when Legg Mason was a $140 stock. Everything that could possibly go wrong at Legg has gone wrong in the past few years. The company had performance problems in key mutual funds. It had disgruntled affiliates. Now a management transition is under way. The stock has descended to $26, and the market value is $3.5 billion. There is another $1.1 billion of debt, for a cash-adjusted enterprise value of roughly $3.7 billion.

Gabelli: But there is cash offsetting the debt.

Rogers: There is probably $900 million of cash offsetting the debt. Legg will earn between $1.25 and $1.50 a share in the fiscal year ending in March. It could earn $2 a share at some point, but it is virtually impossible to understand the earnings potential right now. Assets under management are $650 billion. The company owns a number of money-management firms, including Western Asset Management, ClearBridge Advisors, Royce & Associates, Brandywine Global Investment Management, and Batterymarch Financial Management.

The key here is 1% of assets under management. It gives you an estimated $6.5 billion value relative to today's estimated value. That is the number to keep in mind. It gets you hypothetically to $40 a share in private-market value. I am not saying Legg will trade up to $40, but it is inexpensive at a current $26 relative to the value of these businesses. We own about 10% of the company, roughly the same amount as Nelson Peltz [of Trian Fund Management]. We see little downside and significant upside, and we are eagerly awaiting the naming of a new CEO. There have been rumors that a private-equity firm would try to buy Legg Mason. I am not sure such rumors are true, but where there is smoke, there is fire. A highly activist investor owns 10% of the company, and a prudent long-term investor owns another 10%.

Gabelli: Which one are you?

Rogers: The stock yields 1.7%. The company cut its dividend a few years ago. It has been buying back stock and is in the middle of a $1 billion buyback program now. It has the cash flow to do this. Everything might fall into place at Legg Mason.

Gabelli: I have owned the stock for a long time. They have $1 billion in net operating-loss carryforwards [a deferred tax asset]. This is a powerful shelter for the cash they are generating.

Gross: Isn't the business subject to margin pressure? Exchange-traded funds are eroding the ability of any active money-management firm to earn what it historically earned.

Gabelli: I disagree. There are $125 trillion of investable funds on a global basis. The biggest challenge is the shrinkage of the equity portion. Within that portion, ETFs aren't the issue. We run 45% profit margins. You're running 80% margins.

Gross: I'm talking about fees as a percentage of assets. I'm not talking about your operating margins.

Rogers: Take it outside, guys.

Gross: No. I refuse.

Zulauf: It isn't a secret, Mario, that fees in the money-management business are under pressure.

Gabelli: Not so. Fees are rising because of the amount of money going into hedge funds.

Rogers: Bill, in some parts of the business there is some margin pressure. In the S&P 500 ETF business, there is margin pressure. In the index-fund business, there is margin pressure, and in the active-management equity business there has been margin pressure for my entire 30-year career. But, it has been gentle.

Gross: Well, stand by.

Rogers: Fair enough.

Gabelli: If you want to preach in favor of mindless investing, we don't have to stand by.

Gross: It is about what investors are willing to pay for.

Gabelli: No, it is about what their intermediaries -- their gatekeepers -- are willing to pay for.

Gross: If you are in the business 20 years from now, Mario, and you are right, I'll buy you a steak dinner.

Rogers: Can I mention one more name, please?

You can do anything to end this discussion.

Rogers: After talking about Kohl's, Apache, Avon, Legg Mason, and PNC, I need some ballast on my list. **General Electric** [GE] isn't heroic, but it is a simple story. For the first time in as long as I can remember, virtually every one of the company's businesses has the wind at its back in terms of top-line growth or profit-margin expansion. I haven't seen this happen at GE in more than a decade.

Hickey: Except that Jeffrey Immelt [GE's CEO] came out in December and said the wind was in their face. He made some negative comments about macroeconomic conditions.

Rogers: Jeff has made a lot of public comments about the fiscal situation in Washington. You don't see any pressure in the numbers laid out at an investor meeting in December.

Gabelli: So, GE has 10.5 billion shares outstanding. The stock is $21 and rose nicely last year.

Rogers: And the company has raised its dividend five times since it was cut during the financial crisis. GE yields 3.5%, and the dividend will rise further. Recently, for the first time in a long while, the company talked about reducing its share count, to below 10 billion shares. Given these tail winds, you have an opportunity to invest in a pretty interesting total-return vehicle. GE is a safe, high-quality company.

Witmer: What is it earning?

Rogers: GE could earn $1.70 a share in 2013.

Zulauf: What percentage of earnings comes from the company's financial division?

Rogers: The financial business has accounted for as much as 50% of earnings in the past five years, but it is headed to 30% to 35% now.

Gabelli: If you put a 20 multiple on $1.70 of industrial earnings, in two years you have a $34 stock. Then throw in the book value of the financial subsidiary. There is always a possibility that Immelt splits the company into separate industrial and financial companies.

Rogers: I'm not sure I would count on that.

Gabelli: Suppose Immelt announced that GE is keeping only enough of the credit subsidiary to support the industrial business. He has already been shrinking finance dramatically, and the real-estate portion of the finance portfolio is now manageable. How would a split-up help the multiple?

Rogers: Even during the toughest part of the financial crisis, GE Capital was profitable, and it still is. Returns are up, and the unit is sending capital upstream to the parent company. The credit tail winds are likely to continue, which means the business is an asset to the company. A few years ago, it was a liability. GE's stock could rise to $25 or $26. Maybe you get a 3.5% dividend yield on top of that, to generate an attractive total return. Compared to some of my other names, GE is an anchor to windward.

Black: I see two issues at GE. What are the residual values in the leasing portfolio? I'm talking about aircraft leases, and all leases. They don't discuss how they get their numbers. Secondly, we're going to have cutbacks in the U.S. defense budget. They make the GE404 aircraft engine that goes into the F-18 plane, and the F-18 is vulnerable to cutbacks. Also, GE makes the engine for **Boeing**'s [BA] 787 Dreamliner, which is in trouble. [All Dreamliner aircraft have been grounded owing to concerns about electrical problems.]

Schafer: All these things are important, but they are minor given the totality of GE. Some very smart people shorted GE's stock four or five years ago because of concerns about the company's real-estate exposure. The crisis never really came to pass.

Rogers: If you told me the 787 was going to be banned, that would be very painful. [In follow-up comments e-mailed to *Barron's* last week, Rogers wrote, "The Boeing 787 issue won't make very much difference to GE in the near term. This view is dependent on Boeing being able to deal with the defective battery issue, a problem we believe a technically proficient market leader like Boeing should be able to solve. GE continues to ship aircraft engines to Boeing, and Boeing continues to manufacture the 787. In a year, we believe this will be a distant investor memory as far as GE is concerned."]

Thank you, Brian. Oscar, do you want to take it from here?

Schafer: Sure. Following up on Brian's Legg Mason idea, my first pick comes from an industry undergoing even more dramatic change. It is the rental-car industry, and I am recommending **Hertz Global Holdings** [HTZ]. Both industry and company changes are allowing us to buy Hertz at a 50% to 70% discount to our view of intrinsic value. We have followed the rental-car industry for a while, having owned both **Avis Budget Group** [CAR] and Hertz at various times, and having discussed them both at the Roundtable.

The key to generating strong returns for a car-rental company is a mix of stable pricing, strong asset utilization, and expense management. At times, the industry has lacked one or more of these characteristics. As recently as 10 years ago, the eight major North American car-rental brands were separate companies. Some were even owned by auto makers. During that period, driven by excess production capacity among auto manufacturers, the rental industry became a dumping ground for extra cars. This led to persistent over-fleeting, low asset utilization, aggressive pricing, and low returns. In the past four years, however, these dynamics have changed.

Hedge fund manager Oscar Schaefer explains that GDP growth doesn't always correlate with stock returns. And he tells us why Hertz shares will zoom higher.

How so?

Schafer: First, the industry has consolidated into three major rental companies, with no auto-industry ownership. Second, meaningful capacity reductions and a focus on profitability among car manufacturers have mitigated the risk of fleet-dumping and underutilization. Third, a focus on returns by owners and managers of the remaining car-rental companies has led to strong profitability that hasn't been fully recognized in their valuations. At both Avis and Hertz, pretax operating margins have doubled since 2006. Hertz is on the cusp of a significant rise in long-term earnings power and free-cash-flow generation. The predominant factor behind the expected acceleration is the November 2012 acquisition of Dollar Thrifty. Through the acquisition, Hertz has become the largest player in the industry, with a 35% market share.

There are many synergies in this acquisition. At Hertz, which is predominantly a business brand, 82% of cars are utilized on weekdays, and 72% on weekends. Dollar Thrifty, largely a leisure brand, has nearly the opposite profile. By combining these companies, Hertz can use its business cars for Dollar customers on weekends, eliminating the need for some of Dollar's cars. Running the company at the same revenue level but with 6% fewer cars would add nearly $100 million to Ebitda [earnings before interest, taxes, depreciation, and amortization].

We calculate that the combined company could earn north of $2.50 a share in 2014, significantly above Wall Street estimates and almost double 2012 estimated earnings. At a current price of $17.54 a share, Hertz trades at seven times our earnings estimate. The stock could trade up to at least 10 times earnings, giving us about 50% upside.

Gabelli: Shrinking the number of competitors should firm rental rates.

Schafer: My next pick comes from an industry that Brian likes, too. Few industries were more impacted by the 2008-09 recession than investment banking. The model has been severely curtailed by the increased government regulation and legal scrutiny that characterizes postcrisis Wall Street. This has changed the competitive landscape, and in this context, shares of **Lazard** [LAZ] are undervalued. Lazard generates $2 billion in annual revenue from two distinct businesses; 55% of revenue comes from the advisory business, which most people associate with Lazard, and 45% comes from a large and growing asset-management franchise. Importantly, at this time in the mergers-and-acquisitions cycle, the asset-management division generates nearly all the profits. Rather than thinking of Lazard as an investment bank with an asset-management business on the side, the situation today is closer to the reverse.

How much money does Lazard manage?

Schafer: Lazard has $160 billion under management, with about 70% dedicated to international equities. The assets are 90% institutional, and have been growing at a 7% compounded annual rate for the past five years. The firm's emerging-markets exposure is particularly attractive, as we expect emerging markets will continue to attract funds for the foreseeable future. Asset management is also very profitable, with 26% pretax margins.

Gabelli: Give us some numbers. Where is the stock?

Schafer: The stock trades for $33.89. I'll get to more numbers shortly. Lazard's investment bank is the largest independent advisory firm. It is nearly twice the size of its nearest competitors, **Greenhill** [GHL] and **Evercore Partners** [EVR]. The firm consistently ranks high in the industry's league tables [for size and volume of deals done], alongside much larger banks, despite the fact that Lazard doesn't use its balance sheet to win engagements. Business is 100% fee-based, driven largely by M&A advisory work and, to a lesser extent, restructuring work and sovereign mandates [assignments from governments].

A number of powerful trends have positioned Lazard as a long-term share gainer. First, recent court rulings have made independent-banking advice a priority for company boards, to minimize the conflicts created when a large bank offers both advice and capital. Second, the bulge-bracket firms are losing key personnel due to tarnished brands and regulatory distractions. Third, public outrage over banker compensation at bulge-bracket firms has lowered the cost of talent. I was initially suspicious of an industry where most of the profits flowed to the bankers, as opposed to shareholders, having worked at a few investment banks myself. What caught my eye at Lazard was a rather extraordinary letter the company issued on April 27, 2012.

What did the letter say?

Schafer: In this letter, management outlined the firm's long-term goals with refreshing detail and candor. Two aspects of the letter stood out from the usual guidance issued by most public-company executives. First, while the goals were ambitious, the tone of the letter was factual and honest. Management acknowledged the mistakes of the past and likely challenges the company will face in the future. Second, management issued detailed plans for margin improvement, shareholder-friendly asset allocation, and improved governance and transparency. But the analysts who cover the stock overwhelmingly ignored the guidance in their financial models. Given the history of the industry in general, and Lazard's specifically, there was a healthy degree of skepticism about publicly traded investment banks. Putting all this together, Lazard's stock looks undervalued.

Shares have fallen from $45 within the past two years. Based on the current share price, we are paying a fair price of only eight times Ebitda for the asset-management business, and one times revenue for the advisory division. Said differently, after expected expense cuts, we are paying 15 times earnings at current revenue levels. But this assumes no improvement in M&A, no growth in asset management, and no impact on the capital structure through either share buybacks or debt refinancing.

In a sense, Lazard shares are an inexpensive call option on three things: management's ability to continue to grow asset management; a recovery in the corporate M&A business, which is down almost 50% from 2007 levels; and the ability to gain market share from bulge-bracket firms. We believe Lazard could trade closer to $50 a share, which would imply a midteens price multiple on more than $3 a share of earnings power.

Gabelli: Goldman Sachs shares have gone from $90 to $140. This stock has done nothing.

Schafer: That's why I like it.

Gabelli: I agree.

Schafer: Also, the same activists involved in Legg Mason are involved here. Nelson Peltz and Peter May of Trian Fund Management published an excellent white paper last June, laying out what they thought Lazard ought to do to enhance value.

Black: Oscar, what is the compensation ratio?

Schafer: It is much too high. The company is going to reduce compensation levels. Investment banks are all cutting back, so employees don't have the leverage to demand higher pay. Also, Lazard has a lot of small offices in other countries, and can cut them back.

Gabelli: The guys who run the asset-management business are first-rate.

Enlarge Image

Jennifer Altman for Barron's

Oscar Schafer: "What caught my eye at Lazard was a rather extraordinary letter the company issued on April 27, 2012."

Schafer: Another stock I like is **Western Union** [WU]. In this case, the market overreacted to negative news. When the company announced aggressive pricing actions and lowered earnings guidance on a recent conference call, the stock fell more than 30%, from $18 to $12. Even after rebounding to $13.80, shares trade for only nine times 2013 estimated earnings. Western Union is the largest player in the global money-transfer business. The company has signed 500,000 partners around the globe to act as sending or receiving agents, enabling individuals to send money to practically anywhere on the planet. Local agents offer Western Union money transfers as a way to generate extra income and customer traffic to their stores. For a small percentage of each transfer, Western Union provides a brand name, technology, regulatory-compliance services, and access to its global network of agents. It is a scalable and capital-efficient business model.

Who is the typical Western Union customer?

Schafer: Western Union's growth is driven by global migration trends. The typical customer for a money transfer might be a migrant worker, usually unbanked or underbanked, who is sending money back to his family in his home country. Fees on a typical $350 transaction are 4% to 5%. Western Union shares about half the fee with the sending and receiving agents, and makes another 1% on the foreign exchange.

Oscar Schafer's Picks

Company/Ticker	1/11/13 Price
Hertz Global Holdings/HTZ	$17.54
Lazard/LAZ	33.89
Western Union/WU	13.80
Owens Corning/OC	39.45
Quiksilver/ZQK	5.58
Verint Systems/VRNT	31.50

Source: Bloomberg

A small, fixed expense base and a largely variable cost structure make Western Union a cash-flow machine. In the past five years, the company has generated just over $1 billion in net cash flow annually. Western Union has a market capitalization of $8 billion, and $2 billion in net debt. The recent share-price collapse was due to a decision to slash pricing in certain money-transfer corridors. Investors worry that this is a sign of serious competitive pressures from online money-transfer providers, banks, and regional remittance networks. Wall Street is worried that this is the beginning of a long, slow decline in what had been a great business.

We take it you don't agree.

Schafer: Wez believe the reality is less dire than the share price would suggest. First, competition has always been intense, and the recent price actions aren't an anomaly. Looking back 10 years, Western Union has cut prices annually by 5%, and grown volume by 13% and revenue by 8%. Also, while online money transfers are innovating and growing, the market is expanding beyond the traditional unbanked customer. Finally, while regulatory-compliance costs are increasing, this will be more than offset over time, as industry regulation will push customers toward official remittance players. Most of the business still is done in the gray market. In fact, it accounts for 75% of money transfers around the world.

Western Union shares are a tremendous value, with limited downside. The company pays a 4% dividend, and is using excess cash flow to buy back stock. Even assuming 2% revenue growth, it will be generating more than $2 a share of free cash flow in 2015. A multiple of nine times earnings would get you a stock price of $18, or 30% upside. If Western Union were to increase its leverage to buy back stock, which it should, the share price could rise well into the $20s, giving you 80% upside.

Rogers: Oscar, what do you mean by gray-market money transfers?

Schafer: Examples would be taking money across the border in your pocket, or sending cash through the mail.

Gabelli: We own **Millicom International Cellular** [MIICF], which operates wireless telephone networks in Latin America and Africa. They are starting to offer bank-by-phone services.

Schafer: We have looked at that threat, but banking by phone is only 3% or 4% of the money-transfer business right now, and both parties in such transactions have to be bank customers.

The value manager and Barron's Roundtable member predicts how the deficit battle will affect the market, and he shares one of his top stock picks.

Gabelli: What will Western Union do as that business grows in the next five years?

Schafer: It is opening in new markets. For example, it just opened in Myanmar.

One bright spot for the U.S. economy in 2012 was housing. Home builders' shares have risen to new highs, in some cases justified, and in others, not. One housing-related play, **Owens Corning** [OC], has lagged significantly. Investors have experienced a game of Whack-A-Mole with Owens Corning. The company has three separate but related businesses in insulation, roofing, and composites, with one or more always underperforming. As a result, the stock has been stuck in the $20-to-$40 range for the past two years, while other housing-related stocks have soared. Now, for the first time, there is a clear path to all three businesses performing well in 2013, setting the stock up for a potential double.

Owens Corning is the leading provider of fiberglass insulation in North America. It makes the pink fiberglass insulation you often see. After losing money for the past four years, the insulation segment broke even in the latest quarter and is poised to recover dramatically, with incremental 50% margins as housing continues to improve.

What is happening in roofing and composites?

Schafer: The roofing segment is a completely different story. Demand in this business is stable, driven mainly by the repair and replacement market, with some variability from housing starts and storms. It is a great business, but last year the market leader decided to cut prices in an attempt to regain market share. As a result, distributors loaded up on cheap inventory during the critical winter buying season, and profitability was hurt for the entire year. We believe this competitor has learned its lesson, as it didn't achieve share gains, and our checks indicate a much more rational pricing environment this year. This could result in up to 500 basis points [five percentage points] of margin improvement this year.

Enlarge Image

Jennifer Altman for Barron's

Scott Black: "Medical Properties Trust is a REIT. It is for people who want some yield without chasing bad businesses."

Finally, the composite business is poised to recover, as well, although it is harder to predict, due to a heavy correlation with industrial production. We like the glass-fiber industry. In the past 30 years, it has grown at 1.6 times global industrial production, as glass fibers are taking share from more traditional materials, such as steel. Owens Corning has just completed the restructuring of its European operation, moving higher-cost capacity to lower-cost regions such as Russia and Mexico. That should contribute 300 basis points of margin improvement.

A combination of macro, industry, and company-specific changes makes Owens Corning poised to outperform in 2013. Not to mention, management has indicated a willingness to use excess free cash flow to buy back stock, which could further drive earnings. The business has the potential to earn $7 in 2015. At 12 times earnings, the stock could trade for $80, providing 100% upside.

Black: Are there any legacy legal issues?

Schafer: The company's asbestos business is long gone.

In the global apparel market, authentic brands with a rich heritage are extremely rare and valuable. Well-managed companies such as **Nike** [NKE], **VF** Corp. [VFC], and **Under Armour** [UA] have demonstrated that they can grow large brands by expanding into emerging markets and improve profitability with global sourcing. One apparel company I really love is **Quicksilver** [ZQK]. It owns the three most iconic brands in outdoor and action sports -- Quicksilver, in men's surfing; Roxy, in women's surfing; and DC, in the skate business. The business is at an inflection point, and the stock could triple in the next few years. I'm not predicting fashion trends. Rather, the next few years at Quicksilver will be about improving margins until they are in line with global apparel peers.

The catalyst for this change is new management. The new CEO came from Disney and Nike. The CFO worked at Oakley. Quicksilver generates $2 billion of revenue a year, with 50% gross profit margins. The problem is, it spends 45% on SG&A [selling, general, and administrative expenses], resulting in a meager 5% operating profit margin.

Why are expenses so high?

Schafer: The cost structure is a legacy of the company's history. Initially, Quicksilver was operated by three separate licensees in Australia, Europe, and the U.S. While these businesses were eventually consolidated, they were managed independently, with each region doing its own design, sourcing, marketing, and such. As a result, there was a significant overlap of expenses. By consolidating some basic functions, the company can improve operating margins by 1,000 basis points, effectively tripling profits on the same revenue base. Even then, margins will still be below peer companies. A few things make me optimistic that margins will improve.

First, the board just brought in a new CEO and a CFO with a mandate to improve operations. Co-founder Bob McKnight has done a tremendous job with this company for 37 years, and he will remain as executive chairman. Second, top management's interests are well aligned with shareholders'. Executives have all received a significant amount of restricted stock that vests only if the stock trades to $12.50, or the company is acquired for at least $9.28. The restricted shares expire worthless if neither happens by November 2016. Finally, there is a large private-equity owner on the board who is watching out for our interests. This investment isn't for the faint of heart.

What do you mean?

Schafer: Quicksilver is levered at more than four times Ebitda, due to a terrible acquisition it made nearly a decade ago. That said, the opportunity for margin improvement is enticing. Analysts expect the company to generate $175 million of Ebitda this year, and management is committed to growing Ebitda to $400 million by 2015. They don't need to do anything heroic to get there. Nearly all the improvement comes from cost controls and better sourcing, leading to higher margins. Quicksilver trades for less than nine times 2012 Ebitda. Assuming management can hit its 2015 Ebitda target, my price target is $15, based on a modest seven- times Ebitda multiple. Similar branded-apparel companies have been purchased recently at multiples of 10 to 15 times Ebitda.

What are the chances that Quicksilver could be acquired?

Schafer: That could happen after the company has turned itself around. That is what the incentives suggest.

Now, a short update on **Verint Systems** [VRNT], one of my 2012 picks. The stock, at $31.50, is up only 15% from where it was last year, and I am even more excited about it today. This is a software company with a $1.5 billion market cap. The software enables the recording and analytics of unstructured data -- linguistic, visual, and auditory -- across multiple applications such as call centers and wiretapping. The stock trades for slightly more than 10 times this year's estimated earnings, and the business is growing in the high single digits.

Separating Verint from its troubled parent, **Comverse** [CNSI], has taken a long time, but we have finally arrived at the moment where Verint will emerge as a standalone public company. A shareholder vote on the separation is scheduled for Feb. 4. As liquidity improves and the association with Comverse fades, Verint could trade in line with other software and big-data companies. It could also merge with its largest competitor, **NICE Systems** [NICE], in a deal that would create significant value for customers and shareholders. The stock could rally into the $50s, for between 50% to 100% upside.

Thanks for the update. Scott, you're on.

Black: I'm ready. To reiterate our outlook, although it doesn't affect our stock picking, we're from the Warren Buffett school of thought that says the U.S. economy somehow grows over time. You can't time the market, and you want to own good businesses, which we define as having high returns on equity, low P/Es, strong balance sheets, and strong free-cash-flow generation.

U.S. equities are reasonably priced at this point, although I am not as bullish on corporate earnings as analysts are. I expect S&P 500 earnings to rise to $104 this year from an estimated $98.99 in 2012. Based on my 2013 forecast, the market is trading at 14.2 times earnings. This is especially reasonable as bonds are way overpriced. People have been so hungry for yield that Treasuries, high-yield bonds, and corporate bonds are priced ridiculously relative to risk.

So you are bullish on the stock market?

Black: Barring a disastrous fight between the Democrats and Republicans over raising the debt ceiling and cutting spending, I expect the market will be up this year. You'll get some multiple expansion and the dividend yield, and a total return of approximately 10%. I have a potpourri of stocks to recommend, whose common theme is good unit growth. One thing that bothers me about S&P companies is sluggish revenue growth. Revenue was up only 1.1% in the third quarter, and 3.6% in the fourth quarter. It is hard to grow earnings through financial engineering. It is much better to let top-line growth drive earnings.

My first pick is a large-cap technology stock, **Qualcomm** [QCOM], which closed Friday [Jan. 11] at $64.90. There are 1.7 billion fully diluted shares, giving you a $110 billion market capitalization. The company pays a dividend of a dollar, for a yield of 1.5%. Qualcomm makes radio-frequency chips and supplies chip sets for mobile phones. It has more content on **Samsung** [005930.Korea] phones than on **Apple** [AAPL] phones, but it dominates the 3G and 4G space. The company says there were 1.9 billion 3G and 4G phones at the end of December, and that is going to grow to about four billion by 2016. Qualcomm is one of the few large technology companies that could legitimately see 20% revenue growth.

Walk us through the numbers, please.

Black: Because demand for chip sets is growing rapidly through licensing, we see Qualcomm generating revenue of about $23 billion this year. Our estimate on the high end is $26.6 billion. Margins are falling not because the company is inefficient, but because its mix of businesses is changing. Chip sets have lower profit margins than licensing revenue. The chip-set business is about two-thirds of revenue, and licensing is one third. But operating margins in chip sets are 19%, and in licensing, 88%. Pretax profit margins, modeled, are between 41% and 41.5% of revenue. Taxed at 19% on the high end and 18.5% on the low end, you get between $4.38 and $4.58 in earnings per share. My estimates are higher than the Street consensus of $4.31. We are modeling $7.8 billion of net income this year, and $7.4 billion of free cash flow.

Qualcomm has a 21.8% return on both equity and total capital because of its staggering pile of cash. The company has $26.8 billion of cash and equivalents, including $17 billion offshore. All told, that is $15.42 a share of net cash. Strip the cash from the stock price and use the midpoint of my earnings estimates, and the stock has an 11 P/E. We are purists at Delphi and like to eliminate the cost of stock-based compensation from earnings. Backing out 53 cents a share in stock-based compensation from this year's estimated earnings would get you earnings of $3.95 and a 12.5 P/E. Qualcomm is a great company. It has proprietary technology, enforceable patents, and inexpensive shares, and mobility is the future.

Hickey: There is one big risk. Qualcomm gets hit whenever there are rumors that Samsung is going to develop its own chips. And it is. That development could be accelerated now that Samsung is locked in a battle with Apple. As Apple moves away from Samsung, it is leaving the company with a lot of semiconductor-manufacturing capacity. If nothing happens this year, Qualcomm could be a great play.

Witmer: By how much would Qualcomm's earnings be hit if Samsung starts making its own chips?

Black: Qualcomm won't divulge what it charges per chip set. Apple won't divulge how much content from Qualcomm is in its phones. It is hard to get a definitive answer.

Hickey: Samsung is the largest smartphone maker in the world, far larger than Apple.

Black: My second pick is **McKesson** [MCK], the largest distributor of surgical products and pharmaceuticals in the U.S. It is bigger than **Cardinal Health** [CAH] and **AmerisourceBergen** [ABC]. The stock is trading at $101. There are 240 million fully diluted shares, for a $24.2 billion market cap. They pay an 80-cent dividend, and the yield is under 1%.

Revenue isn't growing quickly, but the key is gross-margin dollars. As generic drugs are substituted for patented products, they generate less revenue per script but have higher gross-margin dollars. We confirmed with **CVS Caremark** [CVS], whose stock we own, that they get more in gross-margin dollars on a $20 generic-drug prescription than on an $80 branded drug.

McKesson's fiscal year ends in March. It will generate revenue of $123 billion in the current fiscal year and earn $7.30 a share against $6.38 last year. Modeling the future conservatively, we've taken revenue up 2.5%. Optimistically, it could rise by 3%. Drug distribution is 97% of the business. The company also has an information-technology business, installing systems for hospitals and medical centers that tie together the pharmacy, billings, the whole works. Distribution historically has been a low-margin business, with about 190 basis points of operating margins. The company's goal is to boost that to 200 to 250 basis points. The tech-solutions business has substantially higher margins of about 11.4%, which it aims to raise to 14% to 16% in the next few years. Using conservative estimates, McKesson will have $126.2 billion of revenue in fiscal 2014, ending March, and operating profit of $2.8 billion. Taxed at 29.5% and fully diluted, they'll do about $7.95 a share in earnings.

And if you're more optimistic?

Black: Operating profits will be $2.9 billion, or $8.19 a share. Using the midpoint of these estimates, we get $1.97 billion of free cash. Return on equity comes out to 20.8%. The stock is selling for 12.5 times earnings. In the current fiscal year, earnings will be up 14.4%. Next year, they will rise 10.5%, so this is a double-digit grower. The company doesn't provide clarity about its spending priorities, but it could use its cash for acquisitions, share buybacks, and bumping up the dividend. The balance sheet is bulletproof, with a net debt-to-equity ratio of 0.10. The [interest] coverage ratio is sensational. In the latest quarter, they generated $762 million in Ebitda, and had $55 million in interest expense. That is a 14-to-1 coverage ratio.

Gabelli: Is McKesson still buying **PSS World Medical** [PSSI]?

Black: Yes. They think the deal will be accretive.

Witmer: What isn't accretive at 2% interest rates?

Black: They base their analysis on a funding hurdle rate. They expect the purchase to return 15% after taxes. PSS won't be a big contributor to revenue growth, but it gives McKesson a new distribution channel. PSS distributes medical products through doctors' offices and medical facilities.

My third company is in the energy business. **Ensco** [ESV] is a global offshore driller with the youngest deepwater fleet in the business. The company is still run from Houston, but is domiciled in London for tax purposes. Management operates in both places. The stock is trading for $60.88, and the company has a $14.1 billion market cap. It pays a dividend of $1.50, and yields 2.4%. Using the latest quarter's revenue run rate of $4.5 billion and about $1.50 in earnings per share, I performed an analysis of incremental growth that took into account day rates, utilization rates, and new rigs coming on line. Ensco has a utilization rate of 91% in deepwater drill ships. Day rates are expected to increase by 10%, and utilization could increase by 2% on the existing fleet. That gives you $307 million in incremental revenue. A new deepwater drill ship coming on in the second half and rented at about a $450,000 day rate over 180 days would result in $82 million of revenue. Assuming an 83% utilization rate in premium jack-up rigs, a 9% jump in day rates, and a 4% utilization increase adds $204 million in revenue.

Continue this exercise across the fleet, subtract expenses, depreciation, and amortization, and you get $473 million in incremental profit before taxes. Taxed at 12.5%, that leads to $414 million in net profit. Divide by 230 million shares, and you get an additional $1.80 a share in earnings, or total earnings of $7.20 next year.

Ensco had negative free cash flow for several years because it was building up its offshore fleet of deepwater drill ships and jack-ups. Cash flow was minus $400 million last year. This year could be the inflection point. Net income will be $1.66 billion. Depreciation is $570 million. The company will spend $1.15 billion on property, plant, and equipment. So, free cash flow will be $1.1 billion. Ensco owns 76 rigs.

Gabelli: Carl Icahn has put his arms around **Transocean** [RIG]. [Icahn announced recently that he has bought 1.6% of Transocean.] I'm trying to figure out what that means for deepwater-drilling entities. Ensco has sometimes been mentioned as a candidate for a sale.

Black: Transocean had its own issues. Ensco has spent a lot of money in recent years relative to its size, and is the second-largest deepwater driller behind Transocean. Ensco is well balanced geographically, with rigs in the Gulf of Mexico, off the coast of Brazil, in the Mediterranean, off the coast of Africa, and in the Asia/Pacific region. At eight times 2013 earnings estimates, 1.2 times stated book value, and 1.6 times tangible book value, it is a cheap stock. Net-debt-to-equity is 0.40, and the company has an investment-grade, triple-B credit rating. The coverage ratio is outstanding at 18-to-1, Ebitda to interest expense.

My next stock, **Medical Properties Trust** [MPW], is a real-estate investment trust, or REIT. It is for people who want some yield without chasing bad businesses. Medical Properties is based in Birmingham, Ala. It runs 75 facilities, including 32 acute-care hospitals, 26 long-term acute-care facilities, and 17 in-patient rehab hospitals. The stock is a $12.66 stock. There are 134.8 million fully diluted shares, for a market cap of $1.7 billion. Net debt was $989 million at the end of the latest quarter, for a total capitalization of $2.7 billion. The REIT pays an 80-cent dividend and yields 6.3%. We don't really look at FFO [funds from operations]. A million years ago, when I studied real estate in business school and we had guest lecturers such as Sam LeFrak and Mortimer Zuckerman, they always emphasized that you should look at cash on cash returns. I'm dating myself, aren't I?

Scott Black's Picks

Company/Ticker	1/11/13 Price
Qualcomm/QCOM	$64.90
McKesson/MCK	101.08
Ensco/ESV	60.88
Medical Properties Trust/MPW	12.66
Titan International/TWI	23.48

Source: Bloomberg

Don't worry about it.

Black: Medical Properties ended last year with annualized total lease and interest income of about $215 million. They get escalators [rent increases] of 2% a year that will add $4 million, and they are going to bring on about $300 million of new properties. Cash on cash returns are about 10%, or $30 million, which will bring gross rent to $249 million. Direct operating expenses are only $2 million, so net operating income is $247 million. The cap rate [capitalization rate, or net operating income over total capitalization] is 7.9%. Pro forma, assuming total capitalization rises to $3 billion, the cap rate is 8.2%. Compare that to some other REITs with cap rates of 4.5% to 5%, and you have a nicely growing business with a higher cap rate and fat yield. The company has strict guidelines on acquisitions, to maintain its 10% return.

Medical Properties has $325 million in available funds. That provides a cushion for its acquisition program. The dividend is well protected. The REIT is paying out about 75% of funds from operations so it has a wide margin of safety.

Good to know.

Black: My last pick is a small manufacturing company, **Titan International** [TWI]. This is a surrogate play on the agricultural cycle and the off-road construction business. Last year I used **Deere** [DE]. Titan manufactures big wheels for mining vehicles, and for construction and farm vehicles. It makes the wheels, rims, and tires. The stock is trading for $23.48. There are 58.9 million fully diluted shares, and the market cap is $1.38 billion. The company pays a nominal dividend of two cents a share, for a yield of 0.1%.

We expect that Titan's revenue will rise to $2.55 billion this year from $1.89 billion in 2012. In part, the increase reflects acquisitions made last year. They bought Goodyear Latin America, their European affiliate, and a small manufacturing company in Perth that supports the mining industry, to gain a mining foothold in western Australia. We assume $37 million in interest expense and $49 million in DD&A [depletion, depreciation, and amortization], yielding profit before tax of $274 million. Taxed at 40%, that is $164 million in net income, or $2.80 in earnings per share. Pro forma return on equity is 20.7%. Cash flow is $228 million: That's net income plus DD&A plus $15 million of deferred taxes. After accounting for funding sources and expenditures, free cash is a slight $24 million. The stock is cheap at 8.4 times earnings. Operating margins are 12.2%, but Titan's goal is to lift margins above 15%.

Will the company continue to make acquisitions?

Black: Yes. It hopes to reach $4 billion to $4.5 billion in revenue through internal growth and acquisitions by 2015. By segment, agriculture accounts for 61% of revenue; earth-moving and construction equipment is 26%; and consumer products, such as rims and tires for all-terrain vehicles, are a nominal part of the business. Profit margins are 21% in agriculture and 20% in earth-moving and construction equipment. Customers include Deere, **Caterpillar** [CAT], **AGCO** [AGCO], Case New Holland, **Kubota** [KUB] -- a *Who's Who* of the industry. Titan has $150 million in undrawn bank lines of credit. It has some opportunities to lower interest costs. It inherited expensive debt when it bought its European affiliate, and will be able to refinance at a lower rate. Return on total capital is 13.5%, and return on equity, 20.7%.

Witmer: Does Titan have competitors?

Black: Yes. Competitors include **Bridgestone** [5108.Japan] in North America, **Pirelli** [PC.Italy] in South America, and **Trelleborg** [TRELB.Sweden] and **Michelin** [ML.France] in Europe. But Titan is the only company with global distribution and manufacturing capability, so it can service customers around the world. It manufactures in the U.S., and has plants in Mexico, India, China, and Taiwan. There hasn't been a lot of price-cutting in the industry, and commodity costs -- primarily steel and rubber -- haven't been a problem.

That's it. I couldn't find six great bargains, only five.

Five is enough. Thanks, Scott.

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Buying Companies Before Someone Else Does
Chuck McQuaid's Columbia Acorn fund has beaten the market by owning shares in "takeover bait."

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Imperial Capital cites reduced uncertainty for American Airlines' spending.

BARRON'S ROUNDTABLE | SATURDAY, FEBRUARY 2, 2013

Stirring Things Up

By LAUREN R. RUBLIN | MORE ARTICLES BY AUTHOR

Bond-fund chief Bill Gross likes gold. Investor Meryl Witmer's picks include Tribune, fresh out of bankruptcy. And tech expert Fred Hickey is wary of most technology stocks, except EMC.

Barron's **2013 Roundtable -- Part I (Jan. 21)**
Barron's **2013 Roundtable -- Part II (Jan. 28)**

Tables: 2012 Roundtable Report Card
2012 Midyear Roundtable Report Card

What does it say about the markets and the times when the world's top bond-fund manager names gold his No. 1 investment pick of 2013? We kid you not, though everyone at this year's *Barron's* Roundtable thought Bill Gross surely was joking -- until he delivered an impassioned and thoroughly convincing case for owning hard assets in an age when central banks are busily manipulating financial ones.

If you read Parts 1 and 2 of this year's Roundtable, you know that macro issues, including central bankers' unprecedented attempts to drive down interest rates to juice economic growth, weigh heavy on the minds of our nine market sages, who gathered in New York on Jan. 14 to give us their 2013 investment views. Extraordinary circumstances provoke colorful, controversial, and sometimes bracing commentary, and there is no dearth of all of the above in this year's final Roundtable issue.


Our Panelists

SCOTT BLACK Founder and President, Delphi Management, Boston	**BILL GROSS** Founder and Co-chief Investment Officer, Pimco, Newport Beach, Calif.	**OSCAR SCHAFER** Managing Partner, O.S.S. Capital Management, Chairman, Rivulet Capital, New York City
ABBY JOSEPH COHEN Senior Investment Strategist and President, Global Markets Institute, Goldman Sachs, N.Y.C.	**FRED HICKEY** Editor The High-Tech Strategist, Nashua, N.H.	**MERYL WITMER** General Partner Eagle Capital Partners, New York City
MARIO GABELLI Chairman and CEO, Gamco Investors, Rye, N.Y.	**BRIAN ROGERS** Chairman and Chief Investment Officer, T. Rowe Price, Baltimore	**FELIX ZULAUF** President, Zulauf Asset Management, Zug, Switzerland

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Bill, founder and co-chief investment officer of bond behemoth Pimco, gets the ball rolling this week by explaining the currently lousy economics of bonds, compared with which, he argues, the underside of the mattress might make a better repository for your money. That said, he's recommending a handful of fixed-income funds that yield more than Treasuries without much risk, along with a play on gold.

Meryl Witmer, a general partner at New York's Eagle Capital, usually manages to ignore the economic and political scenery by burying herself in books -- typically, the books of companies with cheap shares, rich prospects, savvy managements, and copious cash flow. This year, she has found three names that make for excellent reading, including Tribune, fresh out of bankruptcy court.

Fred Hickey, editor of the High-Tech Strategist, wraps up the issue, and the Roundtable, with his typically astute take

More Barron's Roundtable

February 02
Meryl Witmer

February 02
Fred Hickey

February 02
Barron's 2013 Roundtable Part Three -- Stirring Things Up

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Video

Meet the All-Star Stocks of the Dow Rally 3:40

What Do New Market Highs Say About the Economy? 4:11

Dow Sets Record: What's the Big Deal? 3:16

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Brad Trent for Barron's

Bill Gross (left), Meryl Witmer (center) and Fred Hickey (right)

on the tech sector's haves and have-nothings. He espies one bargain in the information-technology bin, plus some promising junior gold stocks, and an emerging-market play that picks up where China left off. For the details, please read on.

Barron's: *Bill, what looks good this year?*

Gross: At Pimco, we don't see a bear market for stocks or bonds in 2013. Stocks will do better than bonds, but neither will return what they have in the past. We're looking at maybe 5% returns from stocks and 3% from bonds, because we're in a 'new normal' economy that isn't growing at the 3% to 4% rate to which investors historically were accustomed. Low yields are also due to the artificial pricing of financial assets by central banks, which have been buying up bonds to drive down interest rates. How long do central-bank purchases of bonds continue?

That's our question.

Gross: Most of us would agree that if the Federal Reserve put an end to quantitative easing and allowed interest rates to rise, financial-asset values would be at risk. To reframe the question, how long will central banks continue to be the buyers of first and last resort? Fed officials have indicated they will continue buying assets until the economy is normalized. That objective might be unattainable, but it is likely the Fed and other central banks will continue to raise prices and lower yields artificially for at least several years, and maybe longer.

The Fed is buying 80% of the Treasury market today. It is remarkable to think that when the Treasury issues debt in the trillion-dollar-plus category, the Fed ends up buying most of it. The Treasury sells it to the banks and primary dealers, who sell it back to the Fed at a higher bid. This is a very different financial system from the free-market capitalism we've come to know. And it will continue until inflation exceeds the upper end of the central bank's target of 2.5% or, by some miracle, we get real economic growth.

What is an investor to do under these circumstances?

Gross: With yields so minimal, an investor is obliged to ask whether investing is worth the risk, given the possibility that the central bank misjudges the situation. Five-year Treasuries yield 78 basis points [a basis point is one-hundredth of a percentage point] now, and will yield 78 basis points a year from now. Ten-year Treasuries yield 1.9%, and will yield close to 1.9% a year from now. Investing with yields at these levels makes sense only if you think the Fed and other central banks will be on the same course a year from now. A good bond manager can probably get returns of 3% to 4% from investment-grade corporate bonds, but it is almost impossible to squeeze more juice from this orange. As Felix suggested this morning, when all this money-printing by central banks ends, it won't be pretty. But it probably won't end in 2013.

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Jennifer Altman for Barron's

Bill Gross: "Bonds are artificially priced, but aside from long-term bonds, there don't appear to be the elements necessary to pop the bubble."

Is a bubble forming in junk bonds?

Gross: All bonds have a bubbly aspect to them. If the economy grows by 2%, plus or minus, this year won't be Armageddon for junk bonds because there won't be a lot of defaults.

Hickey: In order to have a bubble, you usually need euphoria, and we don't have that. Instead, people feel forced into buying bonds at these levels. They aren't enthusiastic about it, but they need the yield, and that produces the same effect.

Zulauf: As Bill just explained, the Treasury yield is mispriced. Therefore, all other fixed-income assets are also mispriced. We are seeing tremendous fund flows into emerging-market bond funds. Although emerging markets have better fundamentals than developed markets, when markets get flooded by too much money, misallocation occurs, and problems begin. Emerging-market bond funds are 10 times as large as they were 10 years ago. At some point, this build-up is going to be a problem.

Gross: The public doesn't realize that when yields come down, prices go up, and when yields go up, prices go down.

Witmer: Do you really think they don't get it?

Gross: Yes. They don't understand this aspect of the bond market.

Cohen: There is another level of complexity to what Bill is talking about, which involves buying bonds through bond mutual funds. If someone owns an individual bond with a rising yield and a falling price and holds it to maturity, there is an opportunity cost, but they don't lose their capital. In a bond mutual fund, however, if someone sells when prices are down, the capital loss is locked in for the remaining mutual-fund shareholders.

Bill Gross' Picks

Fund/Ticker	1/11/2013 Price/Yield
SPDRGold Trust / GLD	$161.06
Pimco Total Return / BOND	109.25 / 2.5%
BlackRock Build America Bond Trust / BBN	22.98 / 7.2
Pimco Corporate&Income Opportunity / PTY	20.22 / 12.5

Source: Bloomberg

Some bubbles are just more recognizable than others.

Gross: At a certain level, a bubble is easy to spot in the bond market. Recently, yields on one-to-two-year German and Swiss bonds went negative because investors considered them havens. U.S. Treasuries have come close to having negative yields. When this happens, it is safer to put your money in a mattress than in a bond.

Zulauf: People don't understand what a terrific bull market we have had in bonds. Many institutional investors missed a great part of it because, from a certain level downward, they stopped participating. They didn't have the historical experience to believe that yields could go as low as they did. In Switzerland, when the 10-year government-bond yield fell to 3.5%, the whole pension-fund industry stopped buying bonds. Then yields fell over several years to 50 basis points. I stayed in the market, but sold all my bonds last summer.

Gross: Let me be clear. Bonds are artificially priced, but aside from long-term bonds, there don't appear to be the elements necessary to pop the bubble. That's because central banks are buying the majority of bonds, and the cash flow from the existing stock of bonds, when reinvested, as most is, is more than the supply of bonds. A supply/demand squeeze at near-zero interest rates is nearly inconceivable. Yet that is close to where we are now.

The manager of the world's largest bond fund explains to Barron's Online Editor Jack Otter why he likes inflation-protected securities as well as bonds from two nations south of the border.

Zulauf: And the Ponzi scheme continues until inflation becomes a problem.

Gross: That's right. Ultimately, that is what will cause investors at the margin to desert bonds. They will sell long-term bonds, but keep five-year Treasuries.

Bubbles burst when it becomes evident to people that they aren't making money, or something is wrong. It is a sentiment thing.

Hickey: It *is* psychological. No one can point to anything that occurred in March 2000 to pop the dot-com bubble. The psychology just turned overnight. One day -- we don't know what day or year -- the psychology changes. Investing in bonds now is like playing Russian roulette. The bullet is going to go off. It could be sooner than we think.

Gross: Actually, the public is down on the list of vigilantes.

There are no vigilantes. They all retired.

Gross: The two big holders of bonds are central banks and sovereign-excess-reserve countries. The Chinese and Japanese authorities, who have huge Treasury-bond holdings, might at some point become disenchanted with inflation, or the dollar, or U.S. fiscal or monetary policies. As bondholders, mom and pop and Goldman Sachs and Pimco have some influence, but are really at the behest of the big buyers. The big risk is that the

Chinese would rather own something else. Investors can choose between artificially priced financial assets or real assets like oil and gold or, to be really safe, cash. The real risk to the financial markets is the marginal proclivity of investors to put their money in real assets, or under the mattress. Thus, my first recommendation is GLD -- the **SPDR Gold Trust** exchange-traded fund. It has a fee, but it is an easy way for investors to buy a real asset.

Lots of things go into pricing gold, but real interest rates [adjusted for inflation] and expected inflation are two dominant considerations. Gold probably won't move much from current levels unless real rates decline more or inflationary expectations rise from the current 2.5% to 3%, or higher. That's what gets gold off the dime. It is a decent hedge. It doesn't earn anything, but not much else earns anything either.

Hickey: The GLD is great for larger investors, but the fee is 40 basis points. Smaller investors can choose the IAU [**iShares Gold Trust**], which charges only 25 basis points. If you don't need huge liquidity, the IAU is a better play.

Gross: I'll defer to you, but I'm on record recommending the GLD.

Zulauf: It's a special sign of our times that the head of the leading bond fund picks gold as his first recommendation.

Gross: All central banks are trying to reflate their economies. If they are successful, gold is an inflationary hedge and bonds, at least long-term bonds, aren't.

Next, I'm recommending three bond exchange-traded funds to be used as bond substitutes. Future returns will be only 3% to 4% in my first recommendation, but that is better than cash, and will help you escape a potential bear market. My first pick is **Pimco Total Return** [BOND], our new ETF. It trounced the competition by 800 basis points in its first 10 months. I manage it on a daily basis. BOND is a $4 billion ETF launched last February. It has been a huge success story, matched only by the launch of the QQQ [**PowerShares QQQ**] and the SPY [**SPDR S&P 500**]. It is a way for investors to earn a 3% to 4% return at a low fee.

BOND earned 10% in the past 10 months, although I can't promise that in the future. It invests in investment-grade bonds and doesn't take a lot of risk. The Securities and Exchange Commission had prohibited actively managed ETFs from using derivatives -- namely, options, swaps, and futures -- and the ban was just lifted in December. Competitors would say Pimco's returns are due to the use of derivatives, and I challenge them to match the performance of BOND without the use of derivatives for the past 12 months.

Witmer: How do you do it? Good credit selection?

Gross: We moved away from Treasuries and into municipals at the appropriate time, buying non-agency mortgages at low levels that will improve in quality as the housing market improves. We bought TIPS [Treasury inflation-protected securities]. There are lots of ways to skin a cat by doing things index funds can't do.

Zulauf: Can you be flexible in the market?

Gross: It was easier 10 months ago. With $4 billion under management, it is harder, but that's what active management can do, when done well.

Gabelli: What are your declining fees on that?

Gross: The *non-declining* fees are 55 basis points, and worth every penny. [Last week's Roundtable issue featured a heated debate about money-management fees between Gross, who predicted fees will fall, and Gabelli, who insisted they won't.]

Gabelli: Actually, it is a bargain.

Gross: My next pick, the **BlackRock Build America Bond Trust** [BBN], is riskier. It has a market capitalization of about $1 billion, and was launched a few years ago when Build America bonds were issued. The beauty and the risk is that it is invested in long-term bonds. I just talked about how they will be the first to get clipped. Also, the fund uses leverage, like most closed-ends. It borrows at 25 basis points and invests at 4% or 5%. It yields 7%, but these aren't junk bonds. This is a levered, high-quality, taxable municipal-bond fund, with bonds issued by California, New York State, the Port Authority of New York and New Jersey, and so on. They are A-rated and AA-rated. For an investor who needs a 7% yield and can take some risk in maturity and leverage, this is a decent vehicle.

Gabelli: Does it sell at a discount or premium to net asset value?

Gross: It sells at a 2% discount. My last pick, which I have recommended before, is **Pimco Corporate & Income Opportunity** [PTY]. I challenge any of you, without researching it, to tell me about another fund or stock that has paid more in dividends in the past five years than you could have bought it for five years ago, and, at the same time, has doubled its book value or net asset value. In the past five years, this fund has paid $12 in dividends. It sold for about $12 in December 2007. Now it trades around $20.

Witmer: That is excellent, but I can think of a lot of stocks that are up that much or more from their 2009 bottom.

Gross: PTY had a 12% yield last year, including regular and special dividends. It will yield about 8% in the future, and probably more if the board authorizes more special dividends. I recommend the fund as a yield substitute, with a greater degree of safety than BlackRock Build America.

Brian Rogers: And the management fee?

Gross: It is 80 to 90 basis points.

Gabelli: You could help shareholders reinvest at an efficient cost by doing a rights offering, and you would probably raise another billion dollars.

Gross: Thank you for the idea.

Thank you, Bill. Let's move on to Meryl.

Witmer: My first stock is **Spectrum Brands** [SPB]. It has 53 million shares. It trades for $48.11 and has an equity capitalization of $2.5 billion. Spectrum is a diversified seller of branded consumer products. Its brands include Rayovac and Varta batteries; it is No. 3 in the business in North America, and No. 1 in Latin America. It also sells Remington electric razors and personal-care products, and is No. 2 in the category in North America, the U.K., and Australia. In small kitchen appliances, with brands such as Farberware, Black & Decker, George Foreman, and Russell Hobbs, it is No. 2 in the U.S. and No. 1 in the U.K. Spectrum also is active in pet supplies; its brands include Tetra, FURminator, Nature's Miracle, and Dingo. It is No. 1 in fish supplies, No. 2 in global pet supplies. In the home-and-garden segment, it sells insect repellants, and is No. 2 in the U.S.

A key consideration for us in any investment is the quality of the management team, and its focus on allocating capital wisely. Spectrum recently completed an acquisition that may turn out to be brilliant. It bought a division of **Stanley Black & Decker** [SWK], whose brands include Kwikset, Weiser, and Baldwin doorknobs and locks. It is No. 1 in locks in the U.S. and Canada, and No. 1 in luxury hardware in the U.S. Other brands include Stanley hardware, No. 1 with residential builders in the U.S., and Pfister faucets, No. 4 in the U.S. The benefits from this acquisition are twofold. Spectrum has a fantastic global distribution system and, over time, can introduce the Stanley Black & Decker products worldwide. Also, it will gain increased scale with customers.

What is the financial impact?

Witmer: If the only benefit of the merger is the $10 million in cost savings that management outlined, and there is no growth, reported earnings per share would climb from an estimated $3.64 in 2013 to $4.20 in 2015, mainly from paying down debt. To square GAAP accounting [accounting according to generally accepted accounting principles] with real life, we add back incremental cash flow of 80 cents a share from NOLs [net operating-loss carryforwards, a deferred-tax asset]. That brings us to $5 a share in after-tax free cash. The excess of depreciation and amortization over capital spending adds another $2 in cash. In all, after-tax free cash flow grows from an estimated $6.44 a share in 2013 to $7 in 2015. The stock is a real bargain at seven times after-tax free cash.

A few things could happen to boost earnings. Spectrum could continue to grow at a 4% annual rate, which would add another 80 cents to earnings over two years. In 2014, it could refinance some expensive debt on which it is paying 9.5%

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Jennifer Altman for Barron's

Meryl Witmer: "Our excitement [about Tribune] begins with the Food Network."

at, say, 6%, which would save another 65 cents a share. Add it up and you get $8.45 a share. Plus, the company has NOLs of more than $1 billion. And these numbers don't include the benefits of broader distribution of the Stanley Black & Decker brands, or a significant increase in homes built in the U.S., which we expect.

How high could the stock go?

Witmer: Our two-year price target is $75 to $100. Spectrum emerged from bankruptcy protection in 2009. It is 57.7%-owned by **Harbinger Group** [HRG], which is controlled by Harbinger Holdings, a private investment firm run by Phil Falcone. Spectrum represents the majority of the value of Harbinger Group. Falcone is controversial, and Harbinger's ownership stake could explain why Spectrum is a good value. Harbinger might have to sell its Spectrum shares at some point. If a forced sale were to occur, it might remove the taint from Spectrum, and bring it more attention.

CB&I, or **Chicago Bridge & Iron** [CBI], trades around $47. It is an engineering and construction company that builds some of the largest energy and petrochemical-infrastructure projects globally. It also licenses process technology in the petrochemical, gas-processing, and refining fields. There will be significant infrastructure and manufacturing capacity built to take advantage of oil and gas shale production in the U.S. and natural-gas finds elsewhere. CB&I and **Shaw Group** [SHAW], which it plans to acquire, could be huge beneficiaries. After the deal is completed, there will be 110 million shares outstanding and $1.2 billion of net debt.

The crown jewel of CB&I is its Lummus Technology division, which licenses proprietary technology and garners an annuity-type stream of earnings. Lummus licenses the most widely used ethylene technology, and has about a 40% market share. It also licenses technology for other petrochemicals. CB&I's ability to provide both engineering and construction expertise and process technology is a competitive advantage.

Who are some of its customers?

Witmer: **Westlake Chemical** [WLK] and **Williams Partners** [WPZ] have announced plans to expand, and both have chosen Lummus. **Dow Chemical** [DOW], **ConocoPhillips** [COP], and **ExxonMobil** [XOM] are all planning major greenfield expansions later in the decade. Lummus is enjoying terrific growth. CB&I has guided analysts to expect operating income from Lummus of $225 million in 2013, up from $120 million last year and $96 million in 2011. This division alone may be worth $2.5 billion, or about half the equity capitalization of the entire company. In addition to petrochemical expansions, LNG [liquefied natural gas] export terminals and large-scale natural-gas processing plants are fertile ground for CB&I. The company is working on major LNG projects in Australia and western Africa.

With the tremendous amount of business coming up for bid, contract terms are improving across the industry. A dearth of fixed-price bids and an increase in less risky cost-plus contracts is a great development for companies such as CB&I, Bechtel, and **Fluor** [FLR]. To determine a run rate of near-term earnings potential, we calculated the pro-forma trailing 12-month earnings of CB&I and Shaw combined, and added some savings from synergies and the increase in Lummus earnings. That leads to $4.60 a share in after-tax free cash flow, supporting a price for CB&I at least 25% higher than the current one. If the stock were to trade at 13 times our earnings estimate, it would be about $60 a share. If you add CB&I's earnings projections, and Shaw's, all listed in the merger proxy filing, you get $8 a share of forecast earnings in 2016. We see the stock trading at about $100 at the end of 2015.

Meryl Witmer's Picks

Company/Ticker	1/11/2013 Price
Spectrum Brands Holdings / SPB	$48.11
Chicago Bridge&Iron / CBI	47.22
TribuneCompany/ TRBAA	49.25

Source: Bloomberg

Hickey: How big a piece of CB&I will Shaw be? Shaw is struggling with two major nuclear power plants, which are experiencing delays.

Witmer: Shaw has an issue in Georgia. If it lost on every issue involving that plant, we estimate it would have a negative effect of $3 a share, versus what it would otherwise earn on the project. But it has a cost-sharing arrangement with Westinghouse on that plant, so things look OK. Shaw has already disclosed some information on its liability. Shaw is well regarded as a servicer of nuclear-power plants, and has a 40% market share, which has grown dramatically. Also, there is a labor shortage among sophisticated engineers.

Hickey: Shaw has cut back on hiring and hours among engineers, so things might not be as tight as you think.

Witmer: They should move to Houston. They could get a job easily. My last pick is **Tribune** [TRBAA], which emerged from bankruptcy protection at the end of 2012 with an attractive portfolio of media assets and a new leadership team. It took four years to work out the bankruptcy process. The stock trades at $49.25 a share, and there are about 100 million shares. The company now has net debt of about $1 billion. Its assets include a broadcast segment with 23 local TV stations in 19 markets, including New York, Chicago, Houston, and Los Angeles. Tribune also owns WGN America, a cable network seen in 76 million homes. It has a publishing segment with a total circulation of 1.8 million, including the Los Angeles Times and the Chicago Tribune. Other assets include its 31% ownership of the Food Network, and 32% of CareerBuilder, a jobs Website.

The hedge fund investor believes engineering firm CB&I is poised to benefit from the shale oil and gas rush.

Our excitement begins with the Food Network, one of the most attractive cable networks in the world. It is seen in nearly 100 million homes in the U.S., and is believed to generate among the highest operating profits in the industry. Revenue has compounded in the low teens in the past five years, and profits have grown even faster. The business will report more than $900 million in revenue and an estimated $500 million in operating profit for 2012. **Scripps Network** [SNI] owns 68% of the Food Network and does a superb job running the business. Tribune gets paid a portion of the profits as a dividend. Some big Tribune holders are looking to sell its minority stake back to Scripps. We would loathe a sale at anything but a very dear price.

What price would make you happy?

Witmer: Tribune's stake in the Food Network is worth at least $20 a share. The company's broadcast segment consists of 13 CW, seven FOX, one ABC, and two independent stations. In the next two years, two-thirds of the subscriber base will be negotiating retransmission revenue with cable providers. Right now the cable channels are getting programming for free, and Tribune wants to be paid. In the past year, the company successfully negotiated meaningful retransmission fees with **DirecTV** [DTV] and **Cablevision** [CVC].

Within broadcast, WGN has great upside. Its subscriber base is a valuable launch pad from which the new management can create value. The team, led by CEO Peter Liguori, has a track record of building and developing great content. Peter built the FX Network from a channel that showed reruns into one featuring original content and netting $600 million in annual revenue.

The publishing assets include eight major properties. It is likely they will be sold, and the proceeds used to pay down debt.

What happens to Tribune if the cable industry moves to à la carte pricing?

Gabelli: The strong will get stronger and the weak will disappear. It isn't a very complicated formula. Isn't everybody going to cut the cord on cable anyway? That is the more interesting question.

Black: Meryl, give us the numbers. I want to see whether, ex-political advertising, broadcast revenue at Tribune has grown in the past year.

Witmer: Broadcast revenue went from $1.1 billion in 2011 to $1.124 billion in the 12 months ended September. Ebitda [earnings before interest, taxes, depreciation, and amortization] went from $384 million to $410 million in the same period.

Liguori is going to do a lot with WGN. That is where he can add a lot of value. We

Enlarge

Jennifer Altman for Barron's

Hickey: "VMware is one of the most exciting tech companies around."

estimate Tribune will have about $6 a share of free cash flow in 2013, of which 40 cents is excess depreciation and amortization over capital spending. The Food Network and other assets contribute $2 of the $6. The publishing and broadcast segments earn $4 of free cash flow, and we value them at nine times after-tax cash flow, or $36 a share. That is a conservative number. The split is about one-third publishing and two-thirds broadcasting. Then we add $20 to $25 for the Food Network and another $7 to $8 for CareerBuilder and some other online assets and real estate. We deduct a couple of dollars for pension liabilities, and get a low-end target price of $60 a share.

The retransmission payments that Tribune might garner from negotiations with cable providers could add a dollar to earnings over time, which would add $10 or more to the value of the stock. The turnaround at WGN is difficult to value, but given management's track record, it could be worth at least $10 a share. Add it all up, and we get a range of $60 to $80 a share, plus free cash generated in the interim, which adds another $6 a share per year. We see the stock at $90 in three years.

Your forecasts for publishing and cable may be too optimistic.

Witmer: Tribune has a lot of cost-cutting still to do, so although revenue might go down, they can cut a lot on the cost side.

Gabelli: The Tampa Tribune was worth about $400 million some time ago. It is a pre-eminent paper in a growing state. It was recently sold for less than $10 million.

Don't depress us, Mario. Fred has been patient. It is finally his turn to speak.

Hickey: First, a few words about technology stocks. It is difficult right now to find tech stocks that are reasonably priced or have a reasonable growth rate. The end markets are bad. The personal-computer market fell 8% in units sold in the third quarter, and 6% in the fourth quarter. This is the worst environment for PC companies in a decade or more. The mobile-phone market fell 2%. Smartphones are growing, but even that growth rate has slipped. Enterprise-IT [information technology] spending started declining last year, and by the third quarter computer-server sales were down 2%, year over year. NPD, a research firm, reported that holiday sales of electronics were down 7%.

Fred Hickey's Picks

Company/Ticker	1/11/2013 Price
EMC/ EMC	$24.15
Gold (spot, per ounce)	1662.98
AuRico Gold / AUQ	8.08
NewGold / NGD	10.95
Market Vectors Vietnam / VNM	19.8

Source: Bloomberg

This is bad enough, but now we have concerns about government spending cuts, and the government is the largest buyer of enterprise IT products. I don't see things improving much. End markets in Europe are in recession. Even Germany has started to slip. There were winners in tech last year, but they were all concept stocks -- companies without earnings, or with minimal earnings. Cloud companies, big-data companies, and 3D-printing stocks went crazy, but they sell at triple-digit P/Es. I can't buy those.

Could you buy **Apple** *[AAPL]?*

Hickey: I'll get to that. **Salesforce.com** [CRM] sells for $170 a share. If you consider stock-option-based compensation a cost, as I do, the company lost money last year.

Black: Much of the reported earnings were wiped out, even at conventional companies like **Cypress Semiconductor** [CY] and **LSI** [LSI].

Hickey: Semiconductor sales are declining, yet semiconductor stocks have risen. It makes no sense. Some parts of the market are acting almost like it's 1999. And other parts, including computers and PCs and the Hewlett-Packards and Intels of the world, are all down and don't seem to want to get up. I'm recommending only one tech stock today. You can't short anything in this market because of the amount of money-printing.

EMC [EMC] is the largest data-storage company in the world, and is still growing by about 6% a year. That is down from its prior growth rate. Both sales and earnings grew by double-digits for 10 consecutive quarters prior to the latest quarter, when the company missed estimates slightly, although it still grew. EMC gained market share against the major storage competitors such as **IBM** [IBM], **Hewlett-Packard** [HPQ], and **Oracle** [ORCL]. There are concerns that EMC will miss fourth-quarter estimates when it reports at the end of January, which is why the stock is at the low end of its 52-week trading range. [EMC reported results Jan. 29. It earned 54 cents for the quarter, two cents above analysts' expectations.] It is trading for $24, and the range has been $22 to $30. The company has a market cap of about $50 billion, and a price/earnings ratio of 12.6 times this year's expected earnings of $1.91 a share. [Earnings estimates have since fallen to $1.87.] That is well below its average P/E of about 16 in recent years.

Black: If you back out EMC's $3.11 a share of cash and equivalents [at the end of the third quarter], the stock is a lot cheaper.

Hickey: EMC owns 79% of VMware [VMW]. Buying EMC is a way to buy VMware cheaply. VMware has a $41 billion market capitalization, and accounts for $30 billion of the market cap of EMC. That means you're getting the rest of EMC for $19 billion. VMware provides virtualization and cloud infrastructure technology, and one fear is that it will start to cannibalize EMC's storage business. VMware is one of the most exciting tech companies around. It has few competitors, **Microsoft** [MSFT] being most important. In addition to its stake in VMware, EMC has strong positions in other fast-growing segments, such as security software and storage software. The stock can bounce back to around $30 if the economy is decent. If it doesn't, you're not going to lose a lot. It's a relatively safe pick in a market where there are few safe picks.

Gabelli: VMware is selling for around $100 a share. Why won't EMC spin it off or do a share exchange?

Hickey: EMC wants to control it. It is a threat to EMC's business.

Gabelli: Does VMware's stock go to $150 before it goes to $40?

Hickey: The stock might not go much higher because you're already paying a high multiple. Sales could continue to grow at a double-digit rate, but the P/E could contract. Black: We own EMC, as well. Growth in the traditional storage business has slowed. Revenue is growing by 6% to 8% a year. The consensus earnings estimate has come down in the past few months. But VMware still is a legitimate 20% top-line grower.

Gabelli: Let's talk about Apple.

Hickey: Apple has dropped from $700 and change to $500. [It now trades around $450.] Apple is under pressure for good reasons. The stock is down today [Jan. 14] because suppliers for iPhone screens say their orders are getting cut by 50%. This isn't the first time we've heard about suppliers getting orders cut. There is too much smoke here. The fourth quarter will probably be good because Apple introduced many new products then, including the iPad mini. The company lowered its earnings estimates sharply, and will probably make its revised number. [Apple met expectations when it reported quarterly earnings of $13.81 a share on Jan. 23, but the stock fell sharply on disappointment with the company's slowing growth rate.] But the market is looking forward; the order cutbacks suggest a big dropoff in growth in the first quarter.

Another problem is that **Samsung** [005930.Korea] is gaining share. The Android market is gaining share. Mobile-phone carriers have an incentive to push non-Apple products, on which they make a lot more money. They don't have to subsidize Android phones as heavily. If customers are willing to buy non-Apple products, this can feed on itself. Also, Steve Jobs is no longer there, and Apple had some hiccups with some of its product introductions. The stock is risky here. It could fall another $100. The company has $130 a share in cash, so it probably won't drop more, but it might not be able to get going again. Eventually, the types of products Apple sells get commoditized. If there is real competition, as appears to be the case, prices decline. A lot of players are moving into the Android market at very low prices. It will be difficult for Apple to maintain its margins in the future.

Gabelli: Fred, you're a CEO with all that cash and $50 a share in earnings. You're

The editor of the High Tech Strategist newsletter believes money printing by governments around the world will lead to no good, and sees gold as a good place to hide. Apple, not so much.

not just going to sit there. What are you going to buy? **Google** [GOOG], Microsoft and Oracle all bought other companies.

Hickey: There is talk that Apple is trying to get into the TV business, but that could be a problem. Margins are very low in television, and TV turnover is usually 10 years. They have to go against tough competitors who will have the advantage of a low yen, if Felix's prediction of a weaker yen is right. The question is, can Apple come up with something else? Can they continue to come up with great products that will allow them to sustain their margins? It could be hard.

Gabelli: So, you think of this as a margin play rather than an opportunity to use cash to find new avenues of growth?

Hickey: Apple should increase its dividend. It currently yields 2.4%. It trades for 10 times earnings -- even less, if you back out the cash.

Black: A lot of the company's cash is overseas. They can't bring it back without taking a tax hit.

Hickey: The downside risk in Apple isn't that great because the P/E is so low and the company pays a dividend. But the stock could be dead money for a long time, stagnating like many other tech stocks have been doing for years.

Dell *[DELL] isn't stagnating. It is up sharply on rumors it might go private.*

Hickey: I am wary of the rumors. Dell has been moving away from the low-margin PC business and concentrating on enterprise computing, networking, software, and services. It is trying to make itself into a mini-IBM, and it might be successful. But that is a long-term story.

So you aren't a buyer?

Hickey: I'm not a buyer here, but I am watching the company because there is a chance they could succeed in other areas.

Black: Let's go back to your investment picks.

Hickey: I am recommending gold, as I have done for many years. I will continue to do so until the gold price hits the blow-off stage, which is nowhere in sight. I am excited about gold because sentiment is so negative. Gold could have a sharp rally at any time. The Hulbert Gold Newsletter Sentiment Index went deeply negative last week, indicating that gold-newsletter writers are recommending net short positions. When that happens, gold almost always rallies. The daily sentiment index for gold is at a 12-year low. Short positions by large speculators have doubled in the past few months. Sales of American Eagle coins hit a five-year low in 2012. Yet, the environment for gold couldn't be better. We talked today about massive money-printing by all the major central banks. Real interest rates are negative. These are the best possible conditions for a gold rally.

Felix said gold could rally to the $1,800-an-ounce level, and I agree. If it breaks that, it will go to $2,000 or more. As long as we have unlimited quantitative easing, we have the potential for unlimited gains in the gold price. Gold could go to $5,000 or even $10,000. You can buy gold through the GLD or IAU, as we discussed. This year I recommend physical gold. You can buy American Eagle coins, or gold bars. Everyone should have some physical gold, and almost no one in the U.S. does.

Do you also like gold-mining stocks?

Hickey: I like two mid-tier miners. Gold was up 7% last year. It had been averaging 15% annual gains previously. Gold-mining shares dropped 16% in 2011 and 10% in 2012. The junior miners are down 50%, on average, since their 2011 highs. There are good reasons for the bear market. It has been difficult to find gold. Grades produced have been lower. Production costs are rising. Miners face the threats of nationalization and higher royalty payments and tax rates. There are labor issues in South Africa, a big supplier of gold. Investors should stay away from South Africa and Russia and places like Venezuela. The

U.S., Canada, Mexico, and Chile are still safe. Gold mines in these countries won't be nationalized or your profits taxed away.

Which stocks do you like?

Hickey: **AuRico Gold** [AUQ] trades for $8 a share on the New York Stock Exchange. It has a market capitalization of $2.2 billion. It changed its name in 2011 from Gammon Gold, divested assets and brought in new management. Yet, there is still the sour taste of past difficulties and earnings misses. AuRico is one of the cheapest gold stocks you can find. It sells at book value.

The company has two main mines. El Chanate, is an open-pit mine in Mexico. Underground mines are much more difficult to operate. Management has cast off all the high-cost mines and retained lower-cost mines. This mine has had steady production for several years, and that will continue. The other mine, Young-Davidson, is where the growth is. It is mostly underground. It has a high level of gold grams per ton. It is hard to find mega mines with such good grades of gold. Young-Davidson started producing in 2012, and everything seems to be going well. AuRico also has some development assets in Mexico and Canada. It has sold off assets for about $1 billion.

What will it do with that cash?

Hickey: It will pay off debt, which is just under $300 million. Also, it is holding a Dutch auction to buy in $300 million of stock between $8.30 to $9.30 a share. AuRico thinks its stock is significantly undervalued. It plans to buy back 13%. [The company announced on Jan. 29 that it had completed the Dutch auction, buying in 12.8% of its stock at $8.30 a share.]

AuRico will produce about 200,000 ounces of gold this year. That could grow to 310,000 ounces by 2015, a 55% increase. It is hard to find gold miners with increasing production. Cash costs are expected to fall steadily from about $600 an ounce in 2012 to under $500 an ounce. If the gold price is at $2,000, their cash margin would be $1,500 an ounce. AuRico could earn 39 cents a share for 2012 and 52 cents in 2013. [On Jan. 18 AuRico announced a timing-related accounting change that reduced 2012 estimates to 37 cents and 2013 estimates to 40 cents.]

Black: What is the reserve life of the mines?

Hickey: Young-Davidson has a reserve life of 21 years. El Chanate's reserve life is seven years. But there is upside at both, and another potentially major project in British Columbia.

Gabelli: AuRico doesn't hedge the gold price?

Hickey: That's right. Almost no one is hedging in this business anymore, because they all expect gold to rise. My second stock is **New Gold** [NGD], another Canadian miner. It sells for $10.95 a share and has a market cap of $5 billion. It has four major mines, located in Canada, the U.S., Australia, and Mexico. It also has a joint venture with **Goldcorp** [GG] in Chile called El Morro. New Gold sells for two times book value and 20 times 2012 expected earnings, but earnings are expected to rise by almost 70% this year, to 74 cents a share, putting the P/E at 14.8. Most of this growth will come from the New Afton mine in British Columbia, where commercial production began last July, ahead of schedule.

New Gold is well managed, and has been able to achieve production and cost targets for three consecutive years. It expects to double its gold production by 2017 from 400,000 ounces to 800,000 ounces a year. There is no growth elsewhere in the industry, and some forecasters expect mining production to fall in 2013. Many mining companies are canceling or delaying projects. New Gold has a world-class project called Blackwater in Canada, which could come online around 2017. It has at least 10 million ounces of gold and 65.2 million ounces of silver, and a 15-year life. Margin per ounce has been growing yearly, and rose from $297 in 2008 to $1,014 in 2011. Also, the company currently has the highest cash balance in its history. New Gold deserves a significant premium to other gold miners.

Do you have any other recommendations?

Hickey: It is important for U.S. investors to diversify beyond heavily indebted, mature money-printing countries. A lot of money has been pouring into emerging-market bonds, but people should consider emerging-country stocks. **Market Vectors Vietnam** [VNM] is an exchange-traded fund trading for $19.80. The average P/E of its 32 companies is 11. The yield is 2.2%. Vietnam has been in a multiyear bear market, like China. The ETF sold for $32 in October 2009. It fell to $14 in early 2012, but it looks like the bear market has ended.

Vietnam's economy has been growing ever since the country initiated political and economic reforms in 1989. For a while, the economy grew by a too-rapid 8% a year, and inflation hit a high of 23%. The central bank raised interest rates six times to ratchet back lending. The government has announced reform measures to try to privatize state-owned businesses. All of this is leading to a return of optimism among investors.

Witmer: It is a vibrant young country.

Hickey: The average age is 28. Tech production is moving to Vietnam from China because the labor force is younger and costs are lower. Samsung has moved 40% of its mobile-phone production to Vietnam. The Vietnamese economy could grow by 5% or 6% a year. Felix thinks China is a good play, and Vietnam could be even better, although with more risk.

Rogers: Vietnam had a credit bubble that dwarfed ours.

Hickey: But they tightened up lending.

Let's debate this over dinner. Thanks, Fred, and everyone.

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Buying Companies Before Someone Else Does
Chuck McQuaid's Columbia Acorn fund has beaten the market by owning shares in "takeover bait."

AMR-US Airways Deal Fires Up Aftermarket
Imperial Capital cites reduced uncertainty for American Airlines' spending.