

Dow Jones Reprints: This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool on any article or visit www.djreprints.com

[See a sample reprint in PDF format](#)
[Order a reprint of this article now](#)

FEATURE | SATURDAY, JANUARY 21, 2012

Smart Choices For Tough Times

By **LAUREN R. RUBLIN**

The second installment of the 2012 Barron's Roundtable features investment ideas from Mario Gabelli, Bill Gross, Meryl Witmer and Felix Zulauf. What to buy, and what to short.

Barron's 2012 Roundtable Part 1

The fat years are over, as if you couldn't tell. The lean years -- the emaciated years -- have arrived with a vengeance, as some kind of cosmic payback for the heady days when the economy boomed, real-estate prices soared and you could throw a dart at the stock tables and hit a bull's-eye every time. Such is the consequence of roughly 20 years of falling interest rates, massive credit creation, madcap borrowing and reckless spending. Comes the day -- in fact, it came a few years ago -- when the music stops and other people's money must be repaid. Or else.

The sagacious and perspicacious members of the *Barron's* Roundtable have been discussing the great deleveraging and its painful consequences for some time now, and to hear Pimco's Bill Gross tell it, they will be discussing it 10 years hence, as the unwinding of a great debt binge is no overnight procedure. Fortunately, when our team of investment experts met Jan. 9 in New York with the editors of *Barron's*, they also held forth, and cracked wise, on a few other juicy topics, prominently including the best values in equities, fixed income and commodities in the year ahead.

In this week's issue, Bill shares his 2012 investment picks, as do Mario Gabelli, Meryl Witmer and Felix Zulauf. Mario, the head of Gamco Investors in suburban New York, has a gourmand's taste for financial engineering -- the buying, selling, spinning off and rearranging of corporate assets to unlock shareholder value. This year he is recommending a passel of companies and stocks that have benefited, or might, from such rejiggering, and a few names that hark back to his first love on Wall Street, cars.

Tables:

[2011 Roundtable Report Card](#)

[2011 Mid-Year Roundtable Report Card](#)

Bill, founder of Pimco, the world's biggest bond-fund manager, is up next, with some scary talk about financial repression, an affliction visited on savers when central banks push interest rates below inflation -- way

below, in the U.S. -- to benefit borrowers and spenders. Bill confesses he would have done things a bit differently had he been running the Federal Reserve, but his day job, and his

Roundtable job, instead compel him to find relatively safe fixed-income investments with relatively decent yields. Closed-end funds that enhance returns by borrowing just a little are one way to do it, he explains.

To Meryl, general partner of New York's Eagle Capital Partners, hard assets are everything, especially when paper ones can lose their value in an instant (see Zimbabwe, if you must). That's why she favors companies that dig up things from the ground, whose properties and applications she can describe with impressive expertise. Meryl also likes companies whose bosses know when, where and how to invest hard-earned cash, or return it to grateful shareholders.

Our Panelists

SCOTT BLACK
Founder and President,
Delphi Management,
Boston

ABBY JOSEPH COHEN
Senior Investment
Strategist and President,
Global Markets Institute,
Goldman Sachs, New York

MARC FABER
Editor and Publisher,
The Gloom, Boom & Doom

FRED HICKEY
Editor,
The High-Tech Strategist,
Nashua, N.H.

BRIAN ROGERS
Chairman and
Chief Investment Officer,
T. Rowe Price,
Baltimore

MERYL WITMER
General Partner,
Eagle Capital Partners,
New York

Enlarge Image

Felix, whose Swiss perch has given him a full frontal view of the euro zone's crisis, deals mostly with the "or else." That includes not only the possible dissolution of the euro but also a coming slowdown in China and the ripple effects of both. Given his bearish views, it's no wonder Felix, head of Zulauf Asset Management, has found a couple of currencies to short, as well as something to buy -- that

cold, hard, bright security blanket known as gold.

You'll find the rest of the Roundtable crew listed in the table nearby, and their comments sprinkled throughout.

***Barron's:* Mario, what looks good to you this year?**

Gabelli: Last year the Standard & Poor's 500 ended unchanged, but there was a lot of volatility. We expect the same this year. As for industries, let's start with autos. On a global basis, about 74 million cars will be sold in 2012, including 13.8 million in the U.S., reflecting a significant cyclical recovery. There are approximately a billion cars on the road around the world, including 240 million in the U.S. But the big growth will come from China, which had eight million car sales in 2007 and will have 20 million in 2013. How can I make money on this?

Good question. We're glad you asked.

Gabelli: The infrastructure is aging, whether it's cars, trucks or airplanes. In total, 2.2 million Class A trucks were sold in the past 10 years. The average age of trucks on the road has risen to 6.7 years. Also, the widening of the Panama Canal will require the use of different types of trucks. I still like **Genuine Parts** [ticker: GPC], which I recommended last year. It makes replacement auto parts. The company went public in 1948 and has increased its dividend every year since. It has no debt. Earnings are terrific. There are 155 million shares, and the stock closed at \$61.78 last Friday [Jan. 6].

In the next five years, revenue could grow by 6% a year. With some slight margin expansion and stock buybacks, you could get 10% earnings growth. The company pays out about 50% of earnings in dividends; the dividend is \$1.80 a share. Earnings are \$3.60 a share for 2011, going to \$4 in 2012. Revenue will rise from \$12.5 billion to \$13 billion.


[Enlarge Image](#)

Brad Trent for Barron's

From left: Bill Gross, Felix Zulauf, Mario Gabelli, Meryl Witmer

Next, **Navistar International** [NAV]. Carl Icahn owns about 10% of the stock. Navistar has 70.3 million shares and sells for \$39 a share. It will earn \$6 a share in the fiscal year ending in October. Shares sell for 6.5 times this year's fully taxed earnings. Navistar has significant opportunities to grow. It sells buses and medium- and heavy-duty trucks. It has no exposure to Europe, and operates joint ventures in Latin America and Asia. Navistar has 17% to 18% of the market for Class A trucks. Earnings will rise from \$6 to \$9 a share in the

next couple of years. Orders in December were good. That is what is going on in industrial America. It is a robust environment.

Owl Creek Asset Management, a hedge fund, has owned Navistar for a long time. In addition there is a convertible bond that converts into common stock at about \$50 a share. A conversion would increase shares outstanding to 80 million. I am intrigued and buying the stock.

Mario Gabelli's Picks

Company/Ticker	Price 1/6/2012
Genuine Parts/GPC	\$61.78
Navistar Int'l/NAV	39.13
Dana Holding/DAN	13.16
Beam/BEAM	50.58
Fortune Brands Home & Security/FBHS	17.65
Xylem/XYL	25.17
Internap Network Svcs/INAP	5.79
Cincinnati Bell/CBB	3.16
Snyder's-Lance/LNCE	22.51
Gaylord Ent/GET	25.52

Source: Bloomberg

What else are you buying?

Gabelli: **Dana Holding** [DAN] came out of bankruptcy protection five years ago. It is also an auto-parts supplier. It sells to original-equipment manufacturers. There are 147 million shares, and the stock is \$13.10. Cash and debt are equal. They have a convertible preferred issue, equal in price to the common. The convert is held by some hedge funds that get a 4% coupon. So far they haven't looked at converting. These are mostly private-equity investors who owned the debt before the bankruptcy filing.

Dana gets 25% of its revenue from Europe, which could see lower car sales in 2012 followed by a pickup in 2013. The company makes sealing products and thermal solutions and driveline equipment. This year they will generate \$8.2 billion in revenue -- 40% from passenger cars and trucks, 38% from commercial vehicles and the rest from off-highway vehicles such as farm and construction equipment. Chrysler accounts for 7% of revenue. **Ford** [F] is 10%, and auto manufacturers around the world account for the rest. Ebitda [earnings before interest, taxes, depreciation and amortization] will be about \$880 million this year, and earnings per share, \$1.95. Earnings could rise to \$2.50 and then to \$3. Dana trades for about seven times earnings, and is perceived to be hit by European head winds. The price/earnings multiple doesn't account for other parts of the business that are doing well.

Black: Are earnings taxed or untaxed?

Gabelli: The company has NOLs [net-operating-loss carryforwards] of \$845 million. Because of bankruptcy laws, they can only use \$86 million of that per year. [Due to prior-year losses, Dana isn't taxed on \$86 million of earnings per year.]

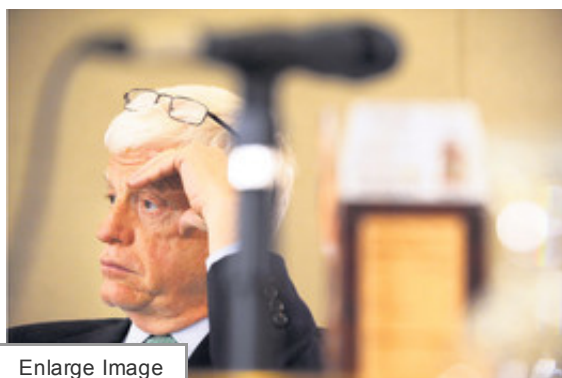
Witmer: Do they have any legacy pension obligations?

Gabelli: They paid \$30 million into the plan in 2011. Corporate profits will be good this year, but at many companies cash flow won't, because the discount rate [used to discount future pension liabilities] has decreased sharply. This means unfunded pension costs will rise dramatically. Even though Dana previously froze its plan, contributions will go from \$30 million to \$60 million this year. [The company disclosed subsequent to the Roundtable that it will make a special one-time \$150 million pension contribution this year.] If interest rates go up, pension liabilities will go down. Dana has funded 77% of its pension plan using a new, lower discount rate.

Next, I am interested in financial engineering, including spinoffs. **Beam** [BEAM] has 155 million shares outstanding. The company was called Fortune Brands. It spun off **Fortune Brands Home & Security** [FBHS] Oct. 3 and renamed itself Beam, as in Jim Beam bourbon. Beam will do about \$2.8 billion in revenue this year and \$2-plus in earnings per share. Earnings will rise in the next five years to \$3.50 a share. The company has \$1.7 billion of net debt, which is coming down. Beam could be taken over.

What does Beam sell, other than Jim Beam?

Gabelli: The alcohol business, on a global basis, was \$465 billion last year. The growth rate is 5% or 6% a year. Bourbon is a \$5 billion to \$6 billion category catered to by companies including Beam and **Brown-Forman** [BF-B]. Beam's hottest new product is Skinnygirl cocktails. The company also sells Teachers' Scotch, No. 1 in India and No. 2 in Brazil. It has some interesting vodkas. But the play is that someone will want to buy the bourbon business -- Bacardi, perhaps, or **Diageo** [DEO].



Enlarge Image

Jennifer Altman for Barron's

Mario Gabelli: "We've done a lot of work on shale, which got us to thinking about water."

to two bucks, with significant leverage in every business when housing starts improve. They do about \$280 million a year in Ebitda.

Rogers: Where does the stock sell?

Gabelli: It is \$17 a share. Unfortunately it has moved up a bit in recent weeks on the

I also like Fortune Brands Home & Security. It is a surrogate for housing. If you can find companies that have held their own despite the cliff in new housing starts, and have cash flow and will benefit when the housing industry recovers, you should focus on them. Fortune Brands Home has made money at the bottom of the cycle in the lock business and in faucets; Moen is their brand. The cyclical part of the business is cabinets, which are deferrable, and other components in the home. The company could earn 60 cents a share for 2011, going up

perception that housing is bottoming.

We have done a lot of work on the shale industry, which got us to thinking about water, as it is the Achilles' heel of shale production. There are many ways to play water, one of which is a spinoff from **ITT** [ITT] called **Xylem** [XYL]. The stock is \$25. The company has 185 million shares. Debt is about \$1 billion. Ebitda was \$525 million for 2011. Maintenance capex [capital spending] is \$120 million.

Water is a \$500 billion business globally. Xylem has significant scale and should be attractive to a larger company. It has \$3.7 billion of revenue and will generate \$1.80 to \$1.85 a share in earnings this year. There are some challenges in Europe and the domestic market.

Black: The business has organic growth of only 6%. Unless they make acquisitions, they can't grow the top line substantially.

Witmer: But the return on capital is huge.

Gabelli: Xylem is like many companies I invest in. They have slow growth and great cash generation. The issue is, how will management use the cash?

Black: Xylem sells for 13.5 times this year's earnings. It is fairly expensive.

Gabelli: Now I want to take you to the clouds -- cloud computing. Think of it as buying time shares on someone else's computers. **Amazon.com** [AMZN] rents processing time on its supercomputers. **Verizon Communications** [VZ] just bought Terremark, a data-center company. **Time Warner Cable** [TWC] bought NaviSite and **CenturyLink** [CTL] bought Savvis. The companies I'm recommending provide co-location services, allowing you to place your computer in their facility. They have managed hosting and cloud hosting. **Internap Network Services** [INAP], based in Atlanta, sells for \$5.80, and there are 52 million shares. Pro forma, after adjusting for a recent acquisition, they have \$50 million of debt. This year they will do \$280 million in revenue and have \$50 million of Ebitda.



Enlarge Image

Jennifer Altman for Barron's

Abby Cohen (right): "There is a demographic time bomb as baby boomers start retiring."

You will probably recognize my next name: **Cincinnati Bell** [CBB]. There are 200 million shares outstanding and the stock trades at \$3.18. They have \$2.5 billion of debt. Cincinnati Bell was an old wire-line telephone company. They started investing in the data-center business about 10 years ago, and it is growing exponentially. That business will have close to \$220 million of revenue this year and \$120 million of Ebitda. The stock could be a three-bagger in the next three or four years. If the market doesn't recognize the value of the

business, management should split the company to surface value.

Hickey: Everybody and their brother has been in Web-hosting for years. There's **IBM** [IBM], **Microsoft** [MSFT] and **Google** [GOOG], and the companies you mentioned.

Gabelli: OK, snacks. [Hands out bags of chips, pretzels and crackers.] They are a global

business. **Kraft Foods** [KFT] is spinning off its snack-foods business. **PepsiCo** [PEP] potentially is looking at a spinoff. The global sweet and savory snack-foods business is \$106 billion a year. In December 2010 Lance, a potato-chip company, merged with Snyder's, a pretzel company, to form **Snyder's-Lance** [LNCE]. The combined company has 67 million shares. It is consolidating its DSD, or direct-store-delivery business. One company owned trucks and the other had independent drivers. The company is going to the driver model. In the next three or four years, earnings will go from last year's 70 cents a share to about \$2 a share.

And the stock price?

Gabelli: Snyder's-Lance sells for \$22.50 a share. Eventually Kraft will want to own chips and pretzels, and Lance is a logical takeover candidate. Kraft could pay \$30 or \$40 a share, depending when they do a deal.

My final recommendation is **Gaylord Entertainment** [GET]. The company is based in Nashville and runs the Gaylord Opryland Resort and Convention Center, as well as some other good hotel and convention properties in Florida, Texas and metro Washington, D.C. In all they have 8,000 hotel rooms, and the economy has hurt them. Now, however, cash flow and Ebitda are recovering nicely. Ebitda could rise from \$240 million in 2012 to \$300 million three or four years out.

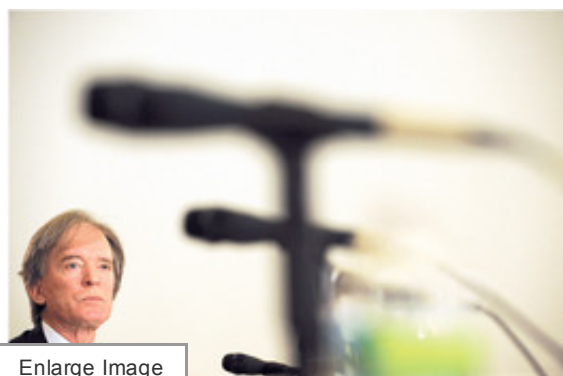
Robert Rowling, who owns the Omni Hotels, owns about 22% of Gaylord through TRT Holdings, and may be interested in acquiring the company. Gaylord has a poison pill [rules that make a takeover difficult or impossible to execute] and another shareholder I know has proposed eliminating the poison pill. Gaylord appears to have no choice this time around but to do some kind of transaction to monetize the value of its properties. If it converts to a REIT [real-estate investment trust] it could trade anywhere from \$30 to \$40 a share, up from \$25.50 now.

Faber: But Gaylord is selling for 89 times earnings.

Gabelli: At least. But the real estate is a bargain. The cap rate [capitalization rate, or income dividend by value] is 10%.

Thank you, Mario. Let's hear what Bill has to say.

Gross: All investors need to recognize two primary forces. One is the delevering process now occurring globally. Countries, companies and households are attempting to reduce debt, and economic growth will be affected. Delevering will be with us for five, 10, 15 years.



Enlarge Image

Jennifer Altman for Barron's

About two years ago I heard Barton Biggs [head of Traxis Partners and former chief global strategist at Morgan Stanley] say on the radio, "I'm a child of the bull market." Children of the bull market knew that whenever stocks went down, they always went back up. When children grow up, however, to extend this metaphor, they recognize that credit can't be extended in an adolescent-like way forever.

Bill Gross: "A titanic struggle is occurring between delevering and reflating by central banks."

That is what we are seeing now. Countries can't issue debt at attractive yields, and in many

cases households and companies are shut out of the credit market. Central banks then respond with policies designed to prevent credit destruction, such as QE2 and Operation Twist.

[Quantitative easing refers to the Federal Reserve's purchase of Treasuries to drive down interest rates. Under Operation Twist, the Fed bought long-term bonds and sold short-term bonds.]

A titanic struggle is occurring between delevering and reflating on the part of the central banks. Reflation has been successful, but in some ways the Fed has gone too far. The central bank's role is to promote liquidity and preserve credit extension throughout the economy, but they have allowed too much risky credit to be created in the process.

What would you have done if you were running the Fed?

Gross: I would have stopped cutting interest rates at 1% before we got to zero-percent money and the destruction of financial and business models. In a reserve banking system, there is the potential for abuse, and there has been abuse in moving beyond 10-to-1 leverage [the ability to borrow 10 times the value of an asset] and into a shadow banking system, rehypothecation [repledging of bank customers' collateral] and such. The ability to expand credit, which prior to central banks was a function of local and state entities and the private market, has blossomed into a monster beyond control. The credit can't be backed up with money, which is what depositors want when there is a substantial perceived risk.

What would you do now, Bill? How would you reverse this credit creation?

Gross: I would try to slow credit creation gradually but not reverse it, because it is the reversal that creates economic destruction. I would implement additional regulatory measures limiting the ability of banks, investment banks, hedge funds and, yes, Pimco, to use credit. Investors have run amok in inventing new ways to bet on the horse race. Credit-default swaps are extensions of gambling.

Zulauf: Credit growth is slowing in the private sector because the private sector is overextended and risk averse. It is public-sector credit creation that doesn't slow. If you slowed it, the economy would weaken.

Gross: Right. So you disproportionately favor government over the private sector, and debtors as opposed to savers, with low interest rates.

Zulauf: That is where I am concerned about Europe. If they keep subsidizing the noncompetitive countries they crowd out the good banks and the good guys in the private sector. At the end of the day they will have more government and less efficiency. They will have a socialist system like the former East Germany. In that situation, Europe won't be able to compete. What they are doing is completely wrong from a structural point of view.

Gabelli: You just solved the euro problem. What would you do to fix the U.S.?

Zulauf: There is nothing you can do that is without pain. You have to cut government in steps. Politicians need to tell constituents there will be seven years of hardship.

Cohen: In the U.S. we have two deficits. There is the short-term deficit, which has been worsened by slow growth and weak employment, and the impact that has on tax revenue. And there are the unfunded entitlements, primarily Medicare. Slowing the economy and firing people in government doesn't provide the funding for Medicare. There is a demographic time bomb as the baby boomers start retiring in much larger numbers. The peak of the baby boom was 1957. Add 65 years, and that peak will be retiring in 2022. The rise in Medicare payments starts a little before that, but intensifies thereafter.

Gross: The present value of our Medicare liability is \$30 trillion. That compares with \$15 trillion of existing Treasury debt.

Zulauf: In Europe, we have the same problems with our welfare system. Step by step, countries are moving the retirement age up. Eventually it will be 70, up from 65, and in some countries, 62.

Black: Bill, don't you think we are out of monetary bullets? Ben Bernanke [chairman of the Federal Reserve] has done about as much as he can to spur growth.

Gross: We are out of monetary bullets from the standpoint of zero-based interest rates. The quantitative easing and twists are more of a fiscal policy.

Hickey: And there is no sense of an understanding that it won't work. They are still patting themselves on the back about how successful these plans have been. They are plotting QE3 [a third round of quantitative easing] here and in England.

We haven't solved anything here, so given your subdued view of the world, Bill, where do you recommend investing?

Gross: The result of what we have been discussing is financial repression, which means central banks keep interest rates far below inflation. Typically the fed-funds rate was close to nominal GDP [gross domestic product.] Now it is three or four percentage points below it, which means savers are getting robbed of the 2%, 3% or 4% yield they used to think was destined for their pockets. If the economy is threatened by delevering, which could lead to inflation or deflation, we are going to experience financial repression for the next five to 15 years. It is a necessary condition. To escape financial repression, an investor should borrow at 25 basis points [a fourth of a percentage point] and lend safely at 4%, 5% or 6%. Safety is always relative, but the way to do it is through a select group of closed-end funds. Many closed-ends borrow at 25 basis points and are levered, although most cap leverage at 50% of assets. This isn't risky like a hedge fund, but it is a way to borrow money and invest it in higher-yielding assets and make a decent spread. It is, by the way, the only legal way to borrow and invest in municipal bonds without being taxed.

We talked about the healthy yields on utility stocks this morning, and the sector might be a little overbought now. But utility stocks could continue to provide 4% to 5% dividend yields. I like the **Reaves Utility Income Fund** [UTG], a closed-end that I also recommended two years ago. It borrows up to 40% of assets. It invests in stocks such as **AT&T**, Verizon, **Southern Co.** [SO], CenturyLink and **PPL** [PPL], and yields 7%. I don't know the management. I know the concept.

Good enough.

Gross: Next, in a world of financial repression where 10-year Treasury bonds yield 2% and 30-years, 3%, certain state bonds and utilities yielding 5% and 6% are decent relative values. It doesn't mean that they are without risk, and certain states have huge liabilities. I might even live in one. But a number of levered funds own relatively safe A-rated and double-A-rated municipal bonds and yield 7%, plus or minus. One is the **Pimco Municipal Income Fund II** [PML]. It is a \$700 million fund and trades at a 5% premium to net asset value. It provides a 7% tax-free yield by investing in 5% municipal bonds and borrowing at 25 basis points.

Invesco Van Kampen Municipal Opportunity Trust [VMO] also is 40% levered. It buys A-rated and double-A-rated municipal bonds and levers a 4% to 5% return up to 6% or 7%. Munis have done well in the past few months. But 7% tax-free sounds pretty good, and I'll take it for 2012.

Bill Gross' Picks

Fund/Ticker	Price/Yield 1/6/2012
Reaves Utility Income/UTG	\$25.18 / 7.0%
Pimco Muni Income II/PML	11.58 / 6.6
Invesco Van Kampen Municipal Opportunity Trust/VMO	14.61 / 7.1

Sources: Bloomberg; Pimco

In past years you recommended mortgage REITs such as **Annaly Capital Management** [NLY]. Do you still like them?

Gross: Annaly levers six to seven times, which doesn't sound too risky relative to an investment bank that levers 10 to 15 times. Annaly buys almost exclusively government-agency-backed mortgages, so we'll call it credit-risk free. The real risk is the cost of money, and

prepayments on their holdings. Annaly and companies like it are sort of modern-day banks without any infrastructure. Like banks, they aggregate deposits and make a spread. Annaly isn't on my list this year, but conceptually, a 14% yield from a six-times-levered agency-backed investment portfolio is better than a 2% yield from a bank stock when the bank has borrowed 10 to 15 times its assets and has a cumbersome infrastructure.

Thanks for that analysis. Meryl, you're up.

Witmer: We like companies that have a strong management team that understands how to allocate capital. Little is more upsetting than when they overpay for an acquisition or squander cash by repurchasing shares at too high a price. We also like companies that generate free cash flow and will pay some of it out in the near future in dividends or share buybacks if the stock is undervalued. And we want companies whose balance sheets give them staying power in a crisis.

Last year I recommended **Tronox** [TROX] at \$94 a share. Now it is \$125. Tronox manufactures titanium dioxide and is one of five companies with the technology to produce it via the chloride method, which is cost-efficient and environmentally friendly. Tronox recently announced a merger with a division of **Exxaro Resources** [EXX.South Africa], a South African company that mines titanium dioxide feedstock. This will make Tronox vertically integrated. The acquired business has a 1.5-million-ton stockpile of ilmenite, the feedstock, which is in tight supply.

Tronox hit a high of \$165 last year. Shares have backed off due to market turmoil, mixed

feelings about the acquisition and uncertainty regarding the economy. Most important, sales of titanium dioxide were slow in the fourth quarter. Investors didn't understand this was a seasonally weak period. Insiders have been buying shares at **Kronos Worldwide** [KRO], a Tronox competitor, which adds credence to our theory.

Schafer: Tronox came out of bankruptcy court last year. Why did the company go broke?

Witmer: It was spun out of Kerr-McGee with a lot of environmental liabilities and debt. Then the financial crisis hit. But there have been positive surprises since I recommended it last year. Tronox has tax-loss carryforwards that are worth about \$30 a share. And the company has incredible earnings power, in the range of \$20 to \$30 a share. I had guessed it was around \$12 a share. Some think it is overearning because of the tight supply situation, but even using an 11 multiple of my prior estimate and adding the tax assets and the next 12 months' free cash flow gets you a target price of more than \$190 a share. If earnings continue to grow at the current rate, they might be sustainably closer to \$20, which gives you a \$250 stock.



Enlarge Image

Jennifer Altman for Barron's

Meryl Witmer: "I have a \$100 trillion Zimbabwe note on my desk that keeps me focused. It makes me buy stocks in companies with tangible value."

Next, we like **Rockwood Holdings** [ROC], managed by an exceptional CEO, Seifi Ghasemi.

Schafer: Didn't you recommend it last year?

Witmer: I did, and it went from \$40 to \$62 to \$40. Yet it has blown through earnings expectations. People are just jittery about Europe and other things. Rockwood produces high-value-added specialty chemicals including lithium, titanium dioxide, ceramics and clay. It is the low-cost global producer of lithium. It

pumps a brine from under the Atacama Desert in Chile, which is condensed in evaporation pools and then converted to lithium carbonate, which accounts for 25% of lithium revenue. The rest is from products that typically have only one competitor, **FMC** [FMC].

Rockwood also makes high-performance ceramics used in applications from artificial hip joints to microelectronics. The clay products go into paints, consumer-care products and drilling mud used in fracking [to extract shale oil and gas]. Color pigments has been a laggard but should turn around with the pick-up in the U.S. economy.

Last year I thought Rockwood would earn \$2.40 a share and have free cash flow of \$4.10. Instead they earned \$3.10 for the first nine months, and will have full-year earnings of around \$4 and free cash flow of more than \$5.50. The company will start paying a dividend after it pays down a chunk of high-cost debt, maybe in the second half. That will serve as a catalyst to reach our target price in the mid-60s.

Packaging Corp. of America [PKG] trades for \$25.77. It is the lowest-cost producer of containerboard in the U.S., and converts 80% into boxes used primarily for shipping. The company was spun out of Pactiv and then taken private in a leveraged buyout in 1999. It came public again in 2000, and has paid down more than \$1 billion in debt, proving it makes cash, not just cardboard. That's a joke in the business. Do you want to make money or paper?

Hilarious. Do you have another?

Witmer: I only have one. These kinds of businesses have staying power. They have some secular growth and great assets. We have to worry about wealth preservation. Who knows what a dollar will be worth? I have a \$100 trillion Zimbabwe note on my desk that keeps me focused. It makes me buy stocks in companies with tangible value. Maybe they will earn less for a few years, but at the end of the day they will make money, generate free cash and pay out dividends, and you will have something more than a pile of paper.

Anyway, the containerboard industry has improved because there have been some acquisitions and rationalizing of capacity. Packaging Corp.'s reported earnings for 2011 should be about \$1.58 a share. This year the company could have some cost savings that will add another 30 cents a share. Then there is 85 cents a share of excess depreciation and amortization. Add it up and you get about \$2.75 a share. The company probably will do better because some input costs are coming down. Our estimated range for after-tax free cash flow is \$2.75 to \$3 a share. We love the management. We love that the company is going to gush cash now that a big capital-spending project is over. Management announced a \$150 million stock-repurchase plan and might well increase the dividend.

What is the current dividend?

Witmer: It is 80 cents a share, and the yield is 3%. Our target price is in the mid-\$30s in the next year or so.

Meryl Witmer's Picks

Company/Ticker	Price 1/6/2012
Tronox/TROX	\$125.14
Rockwood Holdings/ROC	41.06
Packaging Corp. of America/PKG	25.77
Globe Specialty Metals/GSM	12.71
Genworth MI Canada/MIC.Canada	C\$21.91

Source: Bloomberg

I was going to recommend **Delphi Automotive** [DLPH], but a sell-side analyst came out with a 50-page report and Buy recommendation. That is usually a red flag.

Rogers: It is probably from the underwriter.

Witmer: Perhaps this will be the exception. The fourth quarter in Europe was slow for autos and the shares might fall below \$20. That would be value.

Instead, I'll talk about **Globe Specialty Metals** [GSM], which manufactures silicon metals and alloys. Silicon metal is used in many consumer products, such as shampoo and toothpaste. It is used in cast aluminum to improve the strength and durability. It is also used to produce semiconductors and solar panels. Globe has four of the lowest-cost plants in the world. The stock is \$12.71.

Schafer: Wow! That's down from the mid-\$20s.

Witmer: It went from \$10 to \$25.67 and back. Silicon metal is made by smelting quartz with a special grade of coal called Blue Gem. Globe is vertically integrated; it owns its own quartz and coal supply. It is the leading supplier of Blue Gem coal, and supplies other silicon-metal producers through a recent acquisition.

The competitor sounds like a short.

Witmer: One of them just declared bankruptcy. The current spot-market price for silicon metal is about \$1.40 a pound, up from \$1.10 during the financial crisis but down from \$1.70 in March. The slowdown in Europe and inventory adjustments made in the solar-panel market account for the drop. Demand grows about 3% a year, driven by demand in emerging markets and the increased use of aluminum in cars. Near-term factors weighing on the price could clear, leading to a recovery in 2012 or 2013.

Pricing needs to be closer to \$2 a pound for any major capacity expansions to occur. Although Globe might earn only 90 cents or a dollar this calendar year, its earnings power could be about \$3 a share at some point. The company stayed profitable during the financial crisis, as its costs are variable. A focused management team has a history of making smart acquisitions. The current environment might shake out some quality assets to buy. The balance sheet is squeaky clean, so they have the resources to act. The chairman of Globe owns about \$150 million in stock and is focused on the business. Globe should be trading around \$15 today, but if things play out, could be a double or a triple.

As a tribute to Archie [veteran Roundtable member Archie MacAllaster, who passed away last year], I am recommending one financial stock, **Genworth MI Canada** [MIC.Canada]. It is trading at \$22 a share, and I have recommended it in the past. When our stocks go up we sell some. When they come back down, we buy some. Genworth insures mortgages in Canada, and has been tarred by the same brush as Fannie Mae and Freddie Mac, although there are important differences. One is that Genworth gets its premiums up front. It underwrites the mortgages that it insures, and doesn't purchase mortgages. It has a strong balance sheet. Most important, it earns money and returns it to shareholders through dividends and share repurchases.

Genworth hit a rough patch in loan originations during the financial crisis.

What happened?

Witmer: It lost market share due to capital-requirement differences versus its government-owned competitor. Also, the market slowed. The company has since regained share, and the home-sale market in Canada is healthy. The accounting for this business has significant deferral of revenue, which serves to smooth out reported earnings, but isn't indicative of how its business is doing at a particular moment in time. We prefer to use look-through accounting rather than accrual accounting to see how the business is doing today.

Genworth shares have come down from \$30. The company is being punished because management has indicated that the large books of business written in 2007 and '08 will soon pass peak earnings and the 2009 book is comparatively small. The look-through earnings are between \$3 and \$3.50 a share. Our target price is \$30 a share and there is a healthy yield of more than 5%.

Schafer: If you don't pay your mortgage in Canada, they come after you.

Witmer: Right. You can't walk away from it. Also, the culture is such that people want to pay down their mortgages, especially as the interest isn't tax-deductible.

Gross: It isn't just the assets they are insuring that one has to consider. To the extent that

insurance companies and even pension funds can't invest at real rates of return relative to historic models, their models become at risk. We are all in the same boat in the financial industry.

Witmer: That is why I have a range of earnings. They are earning a little under 4% on their investment portfolio, but I stress-tested the return down to 2% in developing my earnings estimates.

Thank you, Meryl. Felix, you're next.

Zulauf: I assume the world economy is decelerating. China's economy will slow more than expected, but the Chinese government won't do anything dramatic to stimulate it. China will ease somewhat, but in piecemeal fashion. That is why those looking for China to get us out of the doldrums are wrong.

Cohen: What growth rate do you assume for China's economy?

Zulauf: Last year China's GDP grew by 9.1%. This year they will publish something like 7.2%, but the slowdown in reality will be more pronounced, and it will affect those who depend on China. The U.S. economy could grow by 1% or 1.5%. In Europe, I expect the next stage of the crisis -- the ratification of a fiscal agreement -- to be critical. I can't believe all the countries in the euro will ratify it, because it would lock them into a depression for five years. There will be exceptions, and that will trigger the next crisis.

Felix Zulauf's Picks

Investment/Ticker

Cash

LONG

	Yield 1/6/12
10-Year U.S. Treasury*	1.96%
Australian 3-Year Bond Future**	3.16

Price 1/6/12

Gold (spot price, per ounce)***	\$1,617.95
---------------------------------	------------

Short

Australian Dollar v. U.S. Dollar	1AUD=\$1.02
Turkish Lira v. U.S. Dollar	\$1=1.88 lira
iShares MSCI Emerging Markets Index FD / EEM	\$38.23

* Sell when yield falls to 1.20%. ** March 2012 contract. *** Buy when prices fall below \$1,520 probably some time this summer.

Source: Bloomberg

We remain in a deleveraging world, and the deflationary process is intensifying. In the stock market, valuation compression has been at work since 2000. Occasionally we have had bull-market rallies when stimulus has been applied in major quantities. The last fiscal stimulus was in 2009, because all governments have realized they have too much debt. Fiscal stimulus is the only thing that works in this economy, and that will come later. We have to fall into a crisis that triggers a policy response. Equity markets around the world will top out during this quarter and then enter the next down leg in the cyclical bear market that started last spring.

And when will that end?

Zulauf: It could end in the second half of 2012 or in early 2013. The market could drop 20% from the first quarter's high. Therefore we will

need ammunition later this year or early next year to buy. My first recommendation is capital preservation, or cash. It doesn't return anything but you'll need it to buy when asset prices become cheap.

Schafer: What's the symbol? [Laughter around the room.]

Zulauf: You figure it out. The U.S. dollar will strengthen against other currencies temporarily, until the policy response comes. We are at the very end of the secular decline in bond yields. Yields on less-safe bonds, such as those issued by Greece and Italy, have already bottomed. Bonds perceived as top-quality will see a low in yields later this year. Ten-year U.S. Treasury yields will hit 1% to 1.20% before ticking up to 2.10% or 2.20%. There will be a horrendous move down triggered by intensifying deflationary pressures as money looks for so-called safe havens. I recommend 10-year Treasuries as a trade. When the yield reaches 1.20%, sell.

Investors should own some gold. But gold also will be subject to deflationary pressure and have a cyclical correction. The first part of the correction was the \$400 drop to \$1,520 an ounce from \$1,920. Gold is now bottoming and could retrace half its losses. Then it could decline again in the second quarter, and you could buy it again in the summer. The low will be lower than \$1,520. Then gold will rally in the next two years to a new high.

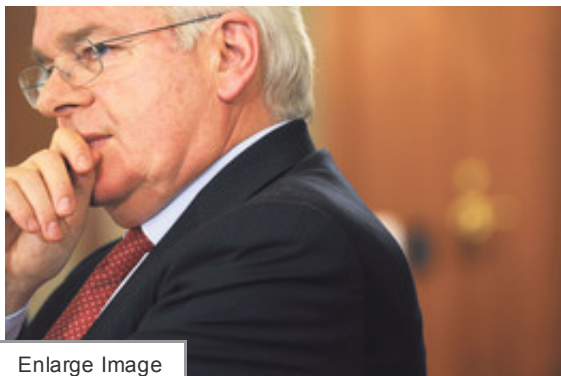
In what form would you buy gold?

Zulauf: I own physical gold, although you can buy the GLD [[SPDR Gold Trust](#)] exchange-traded fund. I hedge my position by selling futures contracts against it, but I closed my hedges recently because a temporary retracement is coming.

Gross: You have more of an emphasis on deflation and I have more of an emphasis on inflation two or three years out. If the 10-year bond yield fell to 1.25% and headline inflation was 2% to 3%, wouldn't that be bullish for gold?

Zulauf: Yes, but some aggressive players are overinvested in gold. If some other assets go wrong for them, they will be forced to create liquidity and sell their gold positions.

Hickey: That's what happened in 2008.



[Enlarge Image](#)

Jennifer Altman for Barron's

Felix Zulauf: "I would short the Australian dollar against the U.S. dollar."

Zulauf: My next idea is how to play the slowdown in China. It will dampen prices for commodities, natural resources and Australian exports. China's boom was the main driver for the Australian economy in the past 10 years. Australia's last recession was in 1991. Despite rising exports to China, Australia runs a current-account deficit of more than 2% of GDP. GDP was up almost 2% last year. There is a budget deficit of around 3%. The current-account deficit was easy to balance because there was tremendous investment in the Aussie

dollar. It was the so-called high yielder among currencies. Carry traders [who borrow in cheap currencies to buy higher-yielding ones] have bought it, along with individuals and even central banks. Holdings of Australian dollars are widespread, but now the Aussie dollar will suffer.

Why is that?

Zulauf: The strong investment inflow led to credit growth when interest rates already were

too low. That led to a tremendous real-estate boom, with prices tripling. If China slows as dramatically, Australia will be hurt. The Australian central bank started raising interest rates in the fall of 2009. They went from 3% to 4.75% in November 2010. Last November they cut them to 4.5%. Now Australia is tightening fiscal policy because it has a growing deficit. The government cut spending, and as we have discussed, fiscal policy works much better in this environment than monetary policy. Short-term interest rates have declined to 3.2% and could fall another percentage point.

There are Australian government-bond futures with a three-year maturity. The yield is the difference between 100 Australian dollars and the futures price, which is currently A\$96.84. That means the yield in the futures market is 3.16%, and it could rise by another percentage point in the next 12 months. This is a conservative play and you can lever it. It is a liquid market. The Reserve Bank of Australia will have to cut rates a lot more. Therefore, I would short the Aussie dollar against the U.S. dollar. The Aussie dollar has nearly doubled in the past three years against the U.S. dollar, from 60 cents to \$1.02. It could correct by 20%.

Hickey: Do you have a view on the New Zealand dollar?

Zulauf: No, but I have one on Turkey. The global economic slowdown and the shrinking of bank balance sheets, particularly in Europe, will affect economies that depend on foreign capital flows. Turkey has huge external deficits. There will be a balance-of-payments crisis in Turkey, and one can profit by shorting the Turkish lira against the U.S. dollar. Turkey has been a booming economy for many years. Its leader, Recep Tayyip Erdogan, wanted to bring it into the European Union. The French didn't like that, and the Germans probably were happy the French blocked it. When Turkey's bid failed, Erdogan sought to boost its appeal as the leader of the Middle East.

To do that Turkey needed high economic growth, which required an aggressive and loose monetary policy. That created a credit boom, strong domestic demand and way too low interest rates for way too long. Economic growth was approximately 8% last year. Consumer price inflation is about 9.5%. The current account deficit is 10% of GDP. The budget deficit, despite the boom, is 2% of GDP. Ten-year government bonds yield 9.7%, around the inflation rate. Short-term rates were hiked to 11% from 8%. The 10% current account deficit won't be easy to finance.

So, what will happen?

Zulauf: Turkey is trying to cool its economy by hiking interest rates. They are trying to support the currency because they believe it is essential to have a strong currency to get continued capital flows to finance the current-account deficit. That is a dangerous strategy and will push the economy into a severe slump. At some point this year the government will have to change its focus from supporting the currency to supporting the economy. When that happens, the lira will go down. The dollar ranged from 1.80 Turkish lira to TRL1.15 for 10 years, and only recently broke out of that range. The dollar is trading at TRL1.88. Short term, it might rise, but long term it will drop.

Schafer: Don't high interest rates attract capital to Turkey?

Zulauf: Some investors are attracted, but when the currency falls there will be a new dynamic.

Finally, I am bearish on equities this year. It is best to short the EEM [[iShares MSCI Emerging Markets Index](#) exchange-traded fund] rather than individual stocks because it is dollar-denominated. Emerging-market currencies will decline against the U.S. dollar, and emerging-market equities will decline as much as developed markets, if not more. The EEM peaked at \$55 in the fall of 2007. It is currently at \$38.23 and could fall at least 20% later this year. Next January I hope to arrive with a more bullish message.

Faber: I don't disagree with you, but when would you reverse your position if you are wrong?

Zulauf: A 20% decline is my minimum expectation. If the Standard & Poor's 500 managed to rise above 1370, that would be a sign I am wrong.

Faber: Then you would buy?

Zulauf: Then I would close my short positions.

On that note, thanks.

E-mail: editors@barrons.com

Copyright 2011 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our [Subscriber Agreement](#) and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com