

Investment Outlook

Taking Away The Punchbowl

In the last Investment Outlook we reviewed several issues of concern to investors, and concluded that stocks did not deserve to be discounted 30% to 50% below normal valuations. Since September 1, the Russell 3000 has gained a whopping 25.75%. We are truly grateful. Now we face the reality that stocks are no longer the screaming bargains they were four months ago.

In addition, some ugly problems have surfaced. We have learned that mortgage lenders systematically ignored procedures required to maintain valid property rights. Millions of foreclosures may now be dragged out in ever longer judicial proceedings. This is good for few but the legal industry. Banks and Mortgage Agencies may also be forced to buy back defective mortgages from investors at full value. This could be a huge setback for the Housing and Mortgage Industries.

We also have a new majority party in the House of Representatives which seems intent on cutting government spending. This is a laudable long term goal, but I fear the short term effect on the economy will be negative. After all, most of the growth in the U.S. economy in 2009 and 2010 is attributable to increases in government spending. State and local governments are especially vulnerable to cutbacks in Federal subsidies, with many jobs at stake.

Speaker of the House Boehner recently stated there will be no increase in the Federal debt limit without meaningful action to cut spending. Congress will need to increase the Federal debt limit by the end of March or the Federal government will face default. Events are quickly coming to a head.

This issue of Investment Outlook is called "Taking Away The Punchbowl" because "Removing The Stimulus" is a crummy title. Yet there is an important difference between partygoers and investors. Even after the punchbowl is removed, many partygoers will continue to hang around, whereas investors will stampede at the first hint of the party ending. No investor wants to be the last one out the door. The point being that the mere perception of cutbacks can spook the market.

Given the runup in stock prices, the worsening foreclosure mess, and the potential spending cuts, it seems prudent to shift some investments out of stocks and into fixed income. For those stocks we continue to hold, we favor companies which are financially strong and serve a global customer base. I will briefly profile two of our recent picks to round out this issue of Investment Outlook.

Entegris makes a range of products used in high technology manufacturing, including filters, wafer and disk carriers, and liquid handling modules. It sells to a global customer base. Entegris is benefiting from the move to smaller manufacturing geometries which makes contamination control ever more critical. Entegris also benefits from its global reach, since global manufacturers demand global suppliers. Entegris enjoys a sticky relationship with customers because its products are fairly low cost but absolutely critical to manufacturing success.

Entegris recently traded at \$7.91, giving it a modest price/earnings ratio of 11.6 based on Q3 earnings. It has \$99 million in cash and no long term debt. Entegris expects to grow revenues 33% over the next three years, based on a detailed assessment of fab expansion plans, along with ongoing penetration of adjacent markets. Current management has done a great job of refocusing this 40 year old company.

Corning has been innovating with glass products for 150 years. Perhaps best known for Corningware, Corning sold its cookware business in the 1990's. Ten years ago, Corning's big business was optical fiber cable. Today, its largest business is glass for flat panel TV's and monitors. Its next big growth driver is expected to be Gorilla Glass, an ultra-tough cover glass for use in cell phones and tablet computers. It is ideal for touchscreens because it resists damage from scratches and drops.

Corning recently traded at \$19.84, giving it a price/earnings ratio of 9.9 based on Q3 earnings. Corning has \$5 billion in cash and short term investments, versus \$2.4 billion of long term debt. Corning has some unresolved litigation stemming from its 50% ownership of Dow Corning (breast implants) and 50% ownership of Pittsburgh Corning Corp. (asbestos). These matters have been in litigation for years, and amounts have been reserved for payments of claims. Liability beyond what has already been reserved is unlikely, in our opinion.

After winter comes the spring and another edition of Investment Outlook. Thanks for reading.



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