John Dessauer Investments, Inc.

John Dessauer’s Outlook

November 2013

It’s a Wow! World Stock Markets have Recovered

Pessimists are in shock. Optimists are relieved. October, a month with a really bad reputation, is over. Instead of crashing, stocks made new record highs in October 2013. They did so even as Robert Shiller was receiving his Nobel Prize for analysis showing stocks to be overvalued and vulnerable. Fortunately, stocks have been rising, not because optimism has become popular, but because pessimists are not sure when the stock market endgame will begin. Economist Ed Yardeni says institutional investors are “Fully Invested Bears.” They continue to hold on to stock positions even though, for at least the last two years, they have been convinced stocks would roll over and deliver a nasty “correction.” Instead stock market dips have been shallow, even in the face of the U.S. fiscal cliff, tax hikes, debt ceiling scares, a never-ending sovereign debt crisis in euro land, and slower growth in emerging markets. And, after each dip stocks have not just rallied, they have gone on to new highs.

Investors have learned a lesson. This is not the 1930s. It took 25 years and a world war for stocks to fully recover from the stock market crash of 1929. This time stocks have almost fully recovered in less than five years after a crash and near depression.

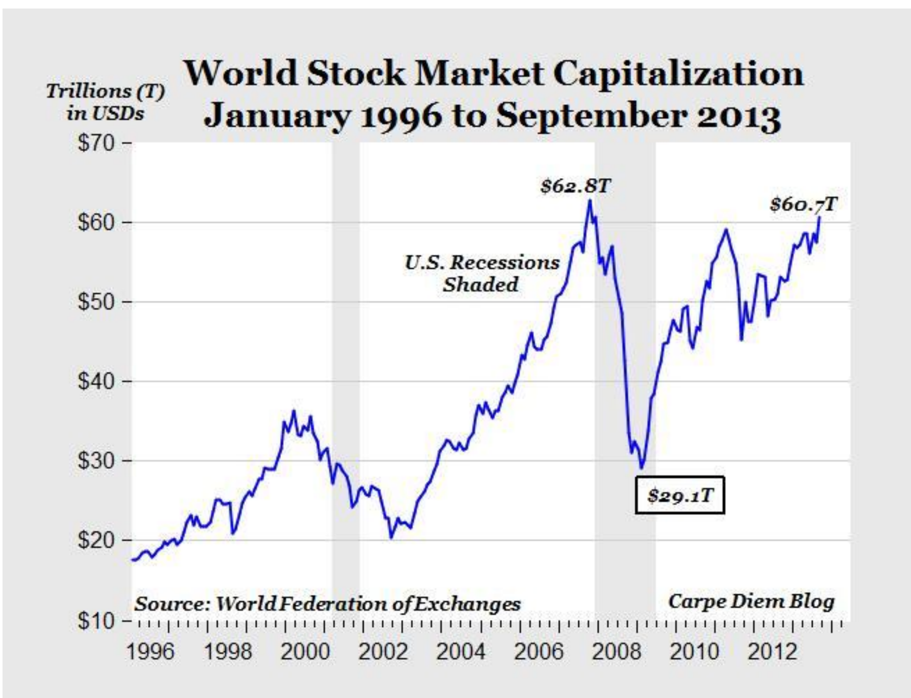
Lessons learned from major economic and stock market events tend to linger, influencing investor sentiment for years, if not decades. The stock market crash of 1929 was so dramatic and ruined so many lives that legions of investors refused to buy stocks well into the 1970s. Until very recently, pessimists have profited by exploiting 1929 fears and predicting that it would be decades for stocks to recover, if they ever did, from the crash of 2008. Supposedly, the lingering effects of the financial crisis combined with

Europe's sovereign debt crisis and central bank largess would once again crush stock markets either because of runaway inflation or its opposite. Central bank efforts were confidently predicted to end in either failure and another deep recession, or in inflation followed by another deep recession. Contrary to popular 1929 fear, this time the reality is that while central bank efforts have not been followed by a vigorous recovery, they have prevented a lingering recession and delivered years of slow but real growth. Slow growth has been a foundation for growth in corporate profits. And slow growth has discouraged speculative excesses and asset price bubbles.

The losers this time have been those who panicked and sold their stocks. That lesson will linger in the minds of investors for a long time. Stock market setbacks will be seen as buying opportunities, keeping the depth shallow and length short for any setbacks that come along.

It was a stock market crash of global proportions.

The World Federation of Exchanges (WFE), based in Paris, is an association of 58 publicly traded stock market exchanges from around the world. Website: world-exchanges.org Carpe Diem, Mark J Perry, October 13, 2013 www.aei-ideas.org/channel/carpe-diem/



Carpe Diem, Mark J Perry, October 13, 2013 www.aei-ideas.org/channel/carpe-diem/

From the 2007 high of $62.8 trillion the total value of world equities in those 58 stock markets fell 54%, to a recessionary low of $29.1 trillion. The loss in value was $33.7 trillion, more than twice the size of the U.S. economy. The 2008-2009 global stock market crash was a severe blow to individual investors, pension funds, and whole economies. Looking back we can understand why there was a tsunami size wave of pessimism that swept world financial markets. The global economy really was facing another depression. In the 1929 crash U.S. stocks lost 90% and took 25 years to recover. In early 2009 investors feared the 54% drop was a midpoint, far from the final stock market low point and that it would be decades before stocks recovered. They were wrong. Suddenly, in 2009 stocks around the world began to recover. Four and a half years later, in September 2013 the total value of world equities in those 58 major stock markets was back above $60 trillion, for almost a full recovery.

The stock market crash of 1929 and the depression that followed have been studied by economists ever since. All these years later, there still is debate about what really caused the stock market crash and the depression. Economists wonder what might have happened without the gold standard or if the U.S. central bank behaved then as it has recently. I think it is safe to assume that the 2008 financial crisis and its consequences will be studied for many years to come. Meanwhile, we know the epicenter of the financial earthquake that threatened the foundation of global financial markets was the United States and the fall of Lehman Brothers. The U.S. government saved AIG, bailed out banks, saved brokerage firms like Bear Sterns and then abruptly changed course and said no more bailouts. Lehman failed. The firm’s global financial reach was exposed. Supposedly safe money market funds were threatened. Struggling retirees in Hong Kong suffered losses on Lehman Brothers’ paper. Economists will likely spend years debating the question of what might have happened if Lehman, like AIG et al, had been saved. No doubt the conclusions will be of great help when the next global financial crisis comes along. Hopefully, policy makers will have learned that there are dire consequences for changing policies in the midst of a financial crisis. You either save them all or you save none.

The question that is already being debated is how in the world did we manage to avoid another great depression? All the ingredients were there.

Prize winning economists joined the pessimists in 2008 and early 2009 warning that the worst was yet to come.

While his policies are controversial, and there are critics among economists and politicians, in my view the evidence is overwhelming. We should be grateful that Federal Reserve Chairman Ben Bernanke and his team were willing to do the opposite of 1929 and use unprecedented policies to dramatically expand the Fed’s balance sheet. It didn’t happen immediately, but other central banks followed Bernanke’s lead. The result is very clearly seen in the performance of world stock markets.

The stock market gains are broad based. Believe it or not, the largest year-over-year gain has been in Greece, up 117%. The year-over-year gain in the Europe-Africa-Middle East region has been 18.6%; in the Americas stocks are up 13.6% and up 13.1% in the Asia-Pacific region. The recovery has been gaining strength. The total value of world equities increased $3.3 trillion from August to September 2013. That is the sixth largest monthly gain since the WFE started keeping records in 1995.

Some market pundits say the central banks printed money and all it did was puff up stock prices. That assumes there is a straight line from central banks to stock exchanges. But that is not true. When central banks expand their balance sheets they buy securities from banks. Central banks do not buy stocks. Some buy gold. So, it could be said that the central banks’ policies puffed up the gold price. That we never hear about central banks driving up the gold price and only hear that connection when it comes to stocks, tells you just how misleading so many popular financial myths can be. When it comes to stocks there is no direct connection with central banks. The pundits could say the central banks’ policies have been effective in supporting underlying economic activity. And, that one result of that success has been a recovery in corporate profits. However, that would be an admission that central banks have been successful and that stocks are up for good fundamental reasons. Don’t expect anything so sensible from the Fed’s critics any time soon.

Why a broad-based stock market correction is unlikely.

The last five years have been punishing for stock market pessimists. First, they were wrong about a coming depression. Then they were wrong about the recovery. And lately they have been wrong predicting a 10%-20%

stock market correction. The first reason a selling wave is unlikely is the recovery itself. Selling stocks at any time in the last five years has been a costly mistake. Second, the worst recession since the great depression has not crushed stocks. If that didn't do it, what could? Third, central banks are determined to keep interest rates low and liquidity ample until a more robust economic recovery develops. Finally, stocks are up, but valuations are still within reasonable historical limits and far from past market extremes. What is more likely is a stock-by-stock correction process. Individual stocks that rise more than the broad market can become vulnerable and pull back 10%-12%. That would be a healthy development and not be a threat to the broad market.

The greatest risk is a melt up in stock prices.

In 1999, exuberance pushed tech stock prices to the stratosphere. What followed was a decade of disappointment for tech stockholders. While I think it is unlikely, given all the basic economic concerns from Europe to unemployment here at home, a surge to unsustainable heights in broad stock market indices is a risk. However, that is a future possibility, not a present concern.

What stocks need is a stronger economic recovery.

Even the most optimistic experts I read and listen to see no more than modest 8%-10% gains in stock prices in 2014. Add on dividends and that makes stocks a good choice, but not as exciting as they have been the last few years. Corporations can keep earnings growing by buying back stock, using operating leverage and emphasizing technology. However, to drive earnings growth to a higher level they need growth in final demand - in other words, a stronger underlying economy.

The economic news from the United States has taken a turn for the worse. In September sales of existing home slumped by the most in three years. Factory production rose less than expected. New job creation came in lower than expected in September. In the first quarter job growth averaged 207,000 a month. In September the number was just 143,000. In October we had the government shutdown, which thankfully did not last long. The combination of higher payroll taxes and ongoing sequester cuts in government programs is expected to make the coming holiday sales season difficult. In short, the final quarter of 2013 is looking like a continuation of slow growth rather than an improvement.

There are rays of sunshine - hope for a stronger economy in the coming New Year.

The Bloomberg U.S. Financial Conditions Index provides a daily statistical measure of the relative strength of the U.S. money markets, bond markets, and equity markets, and is considered an accurate gauge of the overall conditions in U.S. financial and credit markets. The Financial Conditions Index closed at 1.65 on November first, setting an all-time record index high going back to 1994 when the index started. U.S. household wealth has recovered. And, the Federal Reserve is committed to buying bonds for as long as it takes. Economists like Richard Hoey at BNY Mellon see U.S. growth rising to a 3% rate in 2014, not because of any new sources of strength, but because of a fading of past drags on the economy. State and local spending is improving, household deleveraging is largely complete, and Europe is shifting from a double-dip recession to a modest expansion. China’s growth rate is stabilizing at the 7.5% government target rate.

The bottom line is that the conditions that have impeded growth in the U.S. and global economies have dissipated. To be sure we need policy changes at home and abroad before economic conditions will improve significantly. Hopefully that will happen in 2014. For now, however, the best investment strategy is to hold on to stock positions. Be happy with past gains. Do not fall prey to pessimistic stock market predictions. Instead be satisfied with modest returns for the next several quarters, perhaps for all of next year.

COMPANY NEWS AND VIEWS

BP, NYSE, BP, $46.55, reported third quarter profits down 34%. The reason was lower profit margins in the downstream refining business. Revenues were up 4%. Investors were not discouraged by the earnings plunge. They bought the stock, pushing the price up. The reasons are a dividend increase to $0.57 a share per quarter, $2.28 a year, planned asset sales of $10 billion which will benefit shareholders through additional stock buybacks and management’s guidance that operating cash flows will surge in 2014 to $30-$31 billion. Operating cash flows so far this year have been $15.7 billion. The legal risks from the Gulf oil spill have diminished. They have not been completely resolved, but BP is strong enough to continue recovering from anything less than a worst-case scenario. I rate BP a buy with a $50 twelve-month stock price target.

Bank of America, NYSE, BAC, $14.00, the nation's second largest lender, reported third quarter earnings of $0.20 per share. The $2.5 billion in net income was a huge improvement over last year's $340 million, but still less than analysts expected. Argus Research expected profits of $0.27 a share. Standard & Poor's looked for $0.25 a share. The ongoing problem is a lack of growth. Excluding accounting adjustments, revenues were down 1.3%. Management is actively managing costs. Total expenses were down 6.5% in the third quarter compared with a year earlier. Both Argus and Standard & Poor's rate the stock as a hold. Argus has a 2013 earnings estimate of $1.05 a share, which is slightly more than Standard & Poor's $1.02. For next year there is a wide difference of opinion. Argus looks for $1.50 a share. Standard & Poor's think the result will be $1.11 a share. Bank of America is making progress dealing with its mortgage mess. However, until there are signs of renewed revenue growth and an end to the mortgage losses, I also rate the stock as a hold.

Citigroup, NYSE, C, $48.74, had a big bond-trading problem in the third quarter. Profits from bond trading fell 26% dragging third quarter earnings down to $1.02 a share. Argus Research expected $1.15 a share. Standard & Poor's looked for $1.20 a share, so the miss was a big one. However, the major challenge for Citigroup is the same as for Bank of America: a lack of growth. Citigroup's third quarter revenue was down 5% from last year. Argus Research says sell Citigroup because the underlying business is still too complex and unpredictable. Standard & Poor's analysts like the progress they see and rate the stock a buy with a $55 stock price target. Both Argus and Standard & Poor's see 2014 profits at $5.35 a share. At less than ten times next year's earnings estimate, I rate Citigroup a hold.

Cheesecake Factory, NASDAQ, CAKE, $47.40 is a financially strong company that is committed to share buybacks. Cheesecake Factory bought back 2.1 million shares at a cost of $90.2 million in the third quarter. Management plans on spending $65 million to buy back shares in the fourth quarter. That is an increase of $30 million over previously announced buyback plans. The current plan is to buy back $200 million worth of shares.

Third quarter adjusted earnings were $0.52 per share, 6.1% better than last year. For all of 2013 the current estimate is $2.12 a share. For 2014 the current estimate is $2.38 a share, a 12% year-over-year increase. Cheesecake Factory has an affluent customer base and no debt. Thanks to share buybacks, earnings per share are likely to keep rising at double-digit annual rates even if sales growth remains modest due to the sluggish U.S. economy. My advice is to buy Cheesecake Factory below $43.

General Electric, NYSE, GE, $26.50, reported a solid third quarter and the stock rose to a new 52 week high. GE is downsizing the finance business. That will be a drag on earnings until the plan is completed. The other part of the plan is to grow the industrial business, and that is working well. In the third quarter, revenues from the industrial business were 2% better than a year ago. Better yet, orders grew 19%, indicating stronger future growth in industrial revenues. Excluding special charges, GE earned $0.40 a share in the quarter, about 8% better than last year. GE is a cash machine. Year to date, GE spent $8 billion buying back shares, used $8.6 billion for cash acquisitions and returned $6 billion to shareholders in dividends. With $133 billion in liquid assets, and more coming in every quarter, GE is likely to continue growing the business through acquisitions, and rewarding shareholders through stock buybacks and dividends. For all of 2013 Argus Research has a $1.66 a share earnings estimate. Standard & Poor’s expects $1.65 a share. For next year Argus has a $1.78 per share estimate and Standard & Poor’s says $1.85 a share. Both agree that the stock is a buy and both have a $28 stock price target. GE is a solid, long term investment that will reward shareholders through dividend increases and capital gains. I rate the stock a buy with a twelve month stock price target of $30.

Halliburton, NYSE, HAL, $53.20, reported a strong third quarter. Earnings, excluding items, were $0.83 a share, beating expectations by a penny. The floods in Colorado hurt sales in North America, but international sales rose 13% from a year ago. The stock dropped after the earnings announcement, but most likely that was “sell on the good news.” The stock is up almost 50% this year. Morningstar’s analyst looked at the quarter and had this to say: “We expect even better numbers in the seasonally strong fourth quarter due to year-end software and equipment sales and continued strong growth in 2014.” Full year 2013 earnings are expected to be $3.20. For next year the current estimate is $4.30 a share. Halliburton is a buy. My twelve month stock price target is $60.

Intel, NASDAQ, INTC, $24.30, reported third quarter earnings that were better than expected. Analysts were looking for earnings of $0.53 a share. Intel delivered $0.58 a share. Sales - at $13.48 billion - were also better than expected. Intel is getting a little more respect than it did a year ago. Both Argus Research and Standard & Poor's rate the stock a buy with a $28 stock price target. After the third quarter I expect both will keep their buy ratings and raise both their full year earnings estimate and their stock price targets. Full year 2013 earnings estimates will most likely be raised to $1.95 a share from $1.85. The new stock price target will likely be $30.

Intel is still looked down on by many analysts because of the slump in sales of Personal Computers (PCs). However, Intel is moving rapidly into chips for ultra-mobile devices, networking, storage and servers. Over 40 new small 22nm products have been introduced. On the PC front, sales in the third quarter, while down 3.5% from last year, were 3.5% better than in the second quarter. The data center group reported sales up 6.2% from the second quarter and up 12.2% from a year ago. Intel is doing quite well in a still difficult macro environment. The current $0.90 per share annual dividend provides a yield of 3.8% and is likely to be raised again next year. Intel is a buy. My twelve month stock price target is $30.

Kraft Foods, NASDAQ, KRFT, $54.60, reported third quarter results that included complicated accounting matters. There was a $0.18 per share boost from gains in the company's retirement plans and a loss of $0.05 from hedging activities. Sales were down about 4%, because last year's third quarter was swollen by inventory moves ahead of the split off of Mondelez. Management says the environment remains difficult due to high unemployment and slow growth. The good news is that the dividend was raised last month. The annual dividend is now $2.10 a share. Management has raised the earnings target for all of this year to $3.58 a share. Kraft is a stock to own for dividends and modest capital gains. My advice is to buy Kraft when the dividend yield is 4% or better. That means at $52 or less.

Microsoft, NASDAQ, MSFT, $35.52 puts the PC pessimists to shame. Over the last two months, analysts have been revising first quarter profit estimates for Microsoft down, from $0.57 to $0.54 a share. Microsoft published actual results on October 24. They crushed the pessimistic analysts' estimates. Sales rose 16%, and Microsoft earned $0.62 a share in the quarter - up 17% from last year's opening quarter, and well ahead of all the analysts' estimates. That was stunning news to Microsoft's nagging critics. They thought the headwinds - from sluggish PC sales to late entry into tablets and mobile devices - would stunt growth. Instead, an array of business oriented products, including the SLQ Server database, Exchange e-mail system and cloud services delivered robust growth. The Microsoft news is good on two fronts. It shows the company has better growth prospects than analysts believed, and it says that businesses are spending on technology. Estimates for fiscal 2014 earnings will be revised upwards - $3.00 a share could be too low. Even after the stock's rise following the good news, the P/E is still only 12. One great quarter will not turn analysts into raving optimists. However, if the next couple of quarters are also better than expected, the P/E should gradually rise to 15. Microsoft is a buy. My twelve month stock price target is $45.

Nokia, NYSE, NOK, $7.78, Nokia's stock price went up after reporting third quarter results. Sales in mobile devices were down, but that is of little interest for Nokia's future. The mobile devices unit has been sold to Microsoft for $7.2 billion. There was good news for Microsoft. Sales of Nokia's Lumia smartphones were up 40% over last year's third quarter. The stock went up because management said they expected a positive 12% profit margin and solid net sales growth in the remaining network business. Nokia is in a major transition. I rate the stock a hold until management makes final decisions on what will be done with the $7.2 billion cash.

Novartis, NYSE, NVS, $77.00 rose sharply after reporting sales and earnings that were in line with analysts' expectations. What gave the stock a boost were the CEO's comments about a possible sale of parts of the company. Analysts took that to mean a $4 billion sale of the company's animal health division. Estimates for this year are $5.15 a share and $5.45 a share for 2014. Even after the recent rise, the stock, at 14.3 times 2014 estimates, is not overvalued. Novartis is a remarkable company, well diversified with strong growth among core businesses. Selling off non-core businesses would make sense and could boost future growth in sales and earnings. My advice is to buy Novartis on dips below $75.

Pfizer, NYSE, PFE, $31.26, reported third quarter earnings that beat expectations. Excluding special items, Pfizer earned $0.58 a share. Analysts were expecting $0.56 a share. Sales fell 2% because of lingering effects of patent expiration and generic competition. Pfizer is now past the worst of the patent cliff, but patent losses take time to completely wash out. Morningstar analysts are right to the point on the near term for Pfizer: “On the bottom line, Pfizer continues to aggressively cut costs to drive earnings per share despite flat overall sales growth. We expect this trend will continue through the next three years. Aggressive share repurchases should also drive modest earnings-per-share growth.” Wall Street analysts are generally positive on Pfizer, rating the stock a buy. Standard & Poor’s got the third quarter right with an on-the-spot estimate of $0.58 a share. They see full year 2013 earnings at $2.20 a share, rising to $2.40 in 2014. They rate the stock a buy, with a $35 stock price target. I agree.

SEI Investments, NASDAQ, SEIC, $33.18, reported third quarter earnings that were 31% better than last year. Diluted earnings per share were $0.38, $0.04 better than analysts expected and well above last year’s $0.29. SEI is a very profitable, well- managed company, but is dependent on the capital markets. Strong markets in 2013 have benefited SEI’s top and bottom lines. For this year earnings are on track for $1.40 a share. For 2014, the current estimate is $1.66. In the third quarter SEI bought back $1.9 million shares at a cost of $58 million. Thanks to solid cash flows, the stock buyback program will continue and a dividend increase is likely. The long term average P/E is 20. At the current price and based on the 2014 current estimate, the stock is close to that level. However, after the solid third quarter the 2014 estimate may be raised, giving the stock more upside room. Longer term SEI is a merger or buyout target. My advice is to buy SEI on any dips below $30.

Texas Instruments, NYSE, TXN, $41.95, reported a strong third quarter, but shook investors with a gloomy fourth quarter outlook. Third quarter earnings, excluding special items, were $0.65 a share, well above the $0.57 analysts expected and better than last year’s $0.62 a share. Third quarter sales were down 4% from last year, but up 6.5% from the second quarter. The third quarter seemed to show a significant pick-up in Texas Instruments’ sales and earnings. But management threw cold water on that idea by forecasting a 4%-12% decline in fourth quarter sales. A seasonal decline due to lower calculator sales after students went back to school was expected and accounts for about half the forecasted sales decline. The other half is due to legacy wireless business. The company’s transition to more profitable analog devices is on track and doing well. Earnings expectations for this year are $1.95 a share. For 2014 the estimate is $2.25 a share. My advice is to buy Texas Instruments below $40.

CLOSING THOUGHTS

Steve Ballmer will soon retire as CEO of Microsoft. Contrary to popular myth, he leaves behind a remarkable record and a valuable lesson for investors.

Stock market pundits have been brutal to Steve Ballmer, accusing him of neglect, missing major market opportunities, and standing by while the stock price collapsed. The stock, split adjusted, peaked at $59.56 a few weeks before Ballmer took over as CEO in January 2000. In 2002 the stock fell to nearly $20, made another low at less than $18 in 2009 and fell below $15 in 2009. In more than 13 years the stock has not closed above $40. From a stock price point of view Steve Ballmer looks like a shareholders' nightmare. But is it right or fair, in the case of Microsoft, to focus solely on the stock price and blame the CEO?

Microsoft earned $0.70 a share in 1999. At the peak, the stock traded at 85 times earnings. The stock soared, melted up, along with many other technology stocks, in a massive tech-stock bubble, a bubble that had widespread popular support. I remember sitting on panels at investment seminars hearing fellow panelists defend the sky high tech stock prices. Some recommended buying at those high prices. When my turn to speak came, I simply said that the companies looked fundamentally sound and attractive, but I would not buy the stocks at such high prices. After the tech stock bubble burst and the stocks came sharply down there was a lot of finger pointing. The blame tended to fall on CEOs like Steve Ballmer, even though they had nothing to do with driving the stocks to such unsustainable heights. Credit went to the few pessimists who charted stock trends and warned that tech stocks were at heights that could not be justified by current and likely future fundamentals. When the tech stocks plunged, fortunes were lost and retirement plans severely damaged. Lost in all the hindsight fury is Steve Ballmer's actual record.

Here is what Bloomberg editor Dina Bass wrote on October 24, 2013: "Ballmer is no Bill Gates, but he presided over a six-fold increase in server-software sales, now one of the company's largest businesses. Sales from the Office unit tripled. Ballmer instituted dividends that would have yielded $8.23 for investors who held the stock the whole time the CEO was in charge. There was no Xbox for sale before Ballmer. After amassing huge losses early on, it's gone on to generate $7.1 billion in sales during the last fiscal year. Perhaps more important, people actually love the product. Even the Windows business, Microsoft's original cash cow, has more than doubled sales since Ballmer became CEO."

Yes Microsoft under Ballmer has missed opportunities in smartphones and tablets, but earnings per share in the 2013 fiscal year were $2.62, a massive 275% gain over the $0.70 earned in 1999. And in the opening quarter of this fiscal year Microsoft shocked analyst with a 16% gain in per share earnings. Find the perfect company, one that never falls behind, never misses an opportunity and I will accept the critics' opinion of Ballmer and Microsoft. Of course that company does not exist. Today's tech favorite, Apple, once was brutally beaten by Microsoft. For a couple of decades Apple's PC operating system had only a small market share. Windows dominated the market, even though in many ways it was inferior to Apple's operating system. Will Microsoft be able to gain a large enough share of the smartphone and tablet market to be a real player with solid profits and good growth prospects? Apple did well enough during the days when Microsoft dominated the PC market. Odds are Microsoft will at least follow in Apple's footsteps and might surprise critics by mounting a real challenge to current leaders Apple and Samsung.

Looking back at the last thirteen years we can see that investors who bought high and sold low suffered huge losses. They made two mistakes: buying too high and then punishing themselves for having made a "mistake." A far better strategy would have been to focus on the fundamentals, and as earnings grew, buy more when the stock was cheaper.

Just as there are no perfect companies, there are no perfect investors. We all make "mistakes." Success in the stock market comes from turning "mistakes" into opportunities. Will Microsoft's stock trade above $60? With earnings growing at double-digit rates, it won't take long for fundamentals to support a stock price of $60 or higher. When that happens, all those who sold low will have regrets and tears in their eyes.

Next issue: The December issue of *John Dessauer's Outlook* will be ready on Wednesday December 4, 2013.

Next weekly hotline: Wednesday November 13, 2013

All the best,

John Dessauer
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