

Jack Adamo's Insiders Plus

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Dear Friend & Client,

Thanks for joining me.

Not much went on this week, as expected. The big drop in stock prices on Thursday is of no concern unless it continues well into next week when the big players are back from the holidays. With Christmas and New Year landing in the middle of the week, it encouraged anyone who was able to take Thursday and Friday off to get a good long rest.

I noticed one interesting thing during the week. The day the Dow fell 138 points, none of our preferred stocks fell. Some even some rose. There's a good chance this is a trend in the making. A few years ago I predicted investors would go for higher dividend stocks. My only mistake was not going full bore into that class and getting more heavily invested. Despite the S&P 500's big run-up this year, its Dividend Aristocrat Index trounced it with a 33.3% rise. My guess is that it's quite a bit overvalued by now, but that probably won't stop it from rising more this year, unless story stocks get hot, in which case some part of that money will migrate to Tesla and Amazon, etc.

That said, I sense that there's a significant segment of investors who don't trust the market and are determined not to be sucked in again. They will gravitate more to the preferreds, since investment-grade bonds pay nothing, and junk bonds pay less than you can get in preferred stocks. Moreover, preferreds are available with lower credit risk than most junk bonds. Being of like mind, I may direct us more toward the preferred as well.

Optimism Unbowed

With 99% of S&P 500 companies reporting, Q3 earnings per share came in with 2.1% growth in CAE (Conveniently Adjusted Earnings) and just 0.7% growth in EPS according to Generally Accepted Accounting Principles. Despite this anemic growth, estimated earnings growth for Q4 is 6.3%. That is one-third lower than the 9.6% estimate for Q4 earnings that was given back in September. This huge miss in estimates is not cause for undue alarm. Estimates are almost always way off, and virtually always to the upside. It doesn't mean Armageddon is ahead, it just means companies and analysts will probably be significantly overly-optimistic again.

Also noteworthy is that in Q4, S&P 500 companies bought back an estimated \$138 billion worth of stock. It's the biggest quarter for buybacks since 2007 and a 40% jump from a year ago. If that doesn't help Q4 earnings look at least decent, then the market is in trouble.

So far, 94 companies have issued negative EPS guidance for Q4 2013 and 13 companies have issued positive guidance. The rise in negative guidance is 9% above average; the number of companies issuing positive guidance is 50% *below* average. That does not bode well for Q4 bottom lines.

Despite the lack of quarterly growth this year, I will reserve judgement on the earnings outlook until the 10-Ks come out. Unlike the financial press, I'm more interested in year-over-year results than sequential quarter growth. Getting too bogged down in that is like looking at a stock's price every day. It doesn't tell you much.

Still, given that, even after massive share buybacks to boost EPS, valuations are stretched, I'm cautious on the market. Another thing that puts me on guard is that seemingly every money manager I read, hear or see, concedes that we'll have a 10% correction sometime in 2014, then

the bull market will resume. It's just that kind of mindset that can give cover to a much larger pullback, while the chorus sings the correction song all the way down.

Believe none of what you hear and only half of what you see

You probably can't find a better source of great quotes than one of the greatest Americans of all time, Benjamin Franklin. Given the NSA's push for Big Brother-like power, lately I'm usually thinking of his quote about trading liberty for security. But this week I was reminded of the above quote about being skeptical of what you hear, etc. My wife pointed out an article on a website that said Warren Buffett was dumping American stocks like crazy. It went on to name some high profile holdings, then said other billionaires like John Paulson and George Soros were doing likewise.

Soros isn't much of a stock picker in my opinion; he made his money in currencies, but when I hear Buffett is selling, I take notice. So, I went back to Berkshire-Hathaway's latest 13F filing to see if I'd missed something when I looked it over a couple of weeks ago.

As it turned out, the piece was lying to drum up sensationalist fervor for the product it was selling. Yes, Berkshire had sold some portion of some stocks mentioned, and it had in fact sold all of its Intel. However, the Intel sales were more than a year ago, and the other sales were small portions of still large holdings.

Still, besides reminding me of Ben Franklin's wisdom, the article served me well in that looking back over the last 10 quarters of 13Fs I noticed that Buffett and his associates had sold 75% of their GlaxoSmithKline. (Something not mentioned in the article). Perhaps the Wizard of Omaha, like me, became disenchanted with Glaxo's increasingly opaque accounting; buybacks that hide the slow growth in earnings, and the likelihood of difficulties over the next few years with patent expirations.

Since we've only been waiting for a catalyst to sell the stock, let's consider the Berkshire sales an adequate signal. It may very well be that in Berkshire's next 13F filing the stock is absent altogether.

TAKE PROFITS IN GLAXO

For all the reasons stated above, **GlaxoSmithKline plc** (NYSE: GSK) looks ripe for culling. We have a 30% gain for two years worth of work. I'm more than happy with that. It may continue to rise in this inflated market, but the gain is likely to be ephemeral. Next year at this time, we'll most likely be glad we sold it. [Sell GlaxoSmithKline.](#)

PORTFOLIO UPDATES

General Mills, Inc. (NYSE: GIS) announced that it will stop using genetically modified oats in Cheerios. Most food companies have fought to keep from having to disclose on their labels whether the ingredients they use are genetically modified, so, this can readily be seen as a trial balloon to see if it improves sales. It will be interesting to see if others in the industry follow suit. My guess is that it won't improve sales and that will be the end of that. Most folks who are worried about these issues aren't buying Cheerios anyway.

The stock has treated us well, rising 21% in a little over one year. At 17-times estimated forward earnings the shares are a bit expensive for their expected growth rate, but their steady long-term performance, 3.1% dividend yield and very low volatility should allow them to hold up relatively well during any future market unpleasantness. [General Mills, Inc. is a buy on pullbacks below \\$44.](#) Take a 2% position in the Main Portfolio.

In doing my year-end portfolio tune-up, I realized I made some errors in dividend calculations due to stock splits. The return for **Westpac Banking Corp.** (NYSE:WBK) was overstated and that for **Ambev, S.A.** (NYSE: ABEV) was understated. I corrected them by using the split-adjusted prices from the day we bought them through the end of this year. I did the same with **Aberdeen Australia Equity Fund** (ASE: IAF) because its payouts are part dividend and part return of capital. Normally, I leave buy prices at the historical price at which we bought them, then I just

add the dividends to the total return. On these three stocks, I've changed the original buy prices. The return results are the same. I just wanted you to know why the buy prices changed.

We will know our full-year results when Hulbert's publishes later this month. Obviously we underperformed the market by a lot. As I believe I mentioned last week, this doesn't bother, just as it didn't bother me in 1999. The buy/sell errors are what I try to reduce each year. So far, having shorted the market remains my one big gaff. That won't be repeated. It remains to be seen whether we should have bought those gold miner options or should have just held our gold stocks as they were. Whether they work out or not, I won't buy options in these pages again. They're too nerve wracking.

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I wish had something more upbeat to say today, but until I see some real improvement in earnings or a few months of consistently positive economic statistics, I can't justify putting more money into the market just because the Fed is pushing us to. Market valuations will tell us when it's time to get fully invested, and I don't hear it saying that yet.

That's all for today. I look forward to talking with you again soon.

Jack

Questions? Write to Jack at: jack@jackadamo.com

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