

# The Turnaround Letter

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## **BEWARE AN ITCHY TRIGGER FINGER**

We recently came across some statistics that we found quite surprising and, frankly, quite scary. According to the New York Stock Exchange, the average holding period for a stock in 1960 was a little more than eight years. By 1980 it had dropped to a little less than three years and by 2000 to a little more than a year. By 2010 the average holding period was down to about six months.

We've been hearing for a while that "buy and hold" is dead, but we disagree – at least if you want to make money from your investments. We strongly recommend being patient with your stocks for several reasons.

First of all, very few people, if any, are consistently good at picking the right time to get into and out of a stock. It is hard enough to find a good stock to own and almost impossible to pick just the right time to buy and sell it. You are much more likely to make money by identifying stocks with good potential and then giving them plenty of time to reach that potential. Computers might be able to execute a lot of short-term trades and actually make money at it, but it is very difficult for humans to do.

Another factor contributing to the difficulty in making money at short-term trading is transaction costs. Every time you get into or out of a stock you pay a brokerage commission. And brokerage commissions are only part of the cost of making a trade. There is always a "spread" between the bid price (what someone is willing to pay for a stock) and the asking price (where someone is willing to sell the stock). Moreover, if the stock is not actively traded, even a small transaction can

adversely affect the price – i.e. someone trying to sell a stock will push the price down and a buyer will push the price up. The more you trade, the more all of these costs add up and reduce your return.

Next, taxes can have a significant effect on your profits. If you hold a stock for more than a year before selling, your gains will be taxed as long-term capital gains at a maximum federal rate of 15%. If you sell in one year or less, your gains are taxed at short-term rates, which can be as high as 35% at the federal level. That's a big difference in the amount of your profits you must share with Uncle Sam. And many states get their piece too.

Finally, many short-term traders miss out on the beneficial effects of dividends. Over the long haul, →

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### TURNAROUND WITH DIVIDENDS WHILE YOU WAIT

COMPANY	SYMBOL	RECENT PRICE	5-YEAR RANGE	MARKET CAP. MIL.	PRICE TO SALES	DIVIDEND YIELD
Applied Materials*	AMAT	11.63	21.99 — 7.80	14,620	1.58	3.20
CA	CA	25.89	28.11 — 12.00	12,140	2.52	3.90
Dow Chemical	DOW	29.26	47.43 — 5.89	35,060	0.60	4.30
General Dynamics	GD	65.76	95.13 — 35.28	23,200	0.71	3.10
Intel	INTC	25.00	29.27 — 12.05	125,080	2.28	3.60
Nucor	NUE	38.30	83.56 — 25.25	12,160	0.60	3.80
Pfizer*	PFE	23.85	25.71 — 11.62	178,150	2.75	3.70
Republic Services	RSG	27.71	36.52 — 15.05	10,120	1.24	3.40
Raytheon	RTN	56.23	67.49 — 33.20	18,670	0.76	3.60
Walgreen	WAG	35.40	48.09 — 21.28	30,390	0.42	3.10

\*Previous TL Recommendation

dividends can make up a substantial portion of your profits on many stocks. For example, since 1926 dividends have made up approximately one third of the total return on the stocks in the S&P 500. For some ten-year periods, it was more than half.

With these things in mind, we went looking for some stocks that could be good long-term holdings. All of the stocks discussed below are solid companies with strong positions in their respective markets. They all pay dividends above 3.0%. And they are generally out of favor with investors right now, making them look cheap to us.

**APPLIED MATERIALS** is the largest supplier of semiconductor manufacturing equipment. The semiconductor sector will always be cyclical, but Applied has the resources to make strategic acquisitions, allowing it to capture market share during downturns. An aggressive stock buyback program and the solid dividend should enhance shareholder value.

**CA**, formerly CA Technologies, is a major information technology services provider. It survived a maze of legal problems in the early 2000's, and is now working to stay at the forefront of the IT sector. CA has a robust product development pipeline, a worldwide presence and strong strategic partnerships. The

financials are solid; debt has been reduced by 50% over the last four years and there is an ongoing stock repurchase plan.

**DOW CHEMICAL** is the nation's largest chemical company. The product line is very diverse, and about two thirds of sales come from outside North America. Investor concerns about a worldwide economic slowdown have dampened the stock performance recently, but we believe that the current stock price adequately discounts this risk.

**GENERAL DYNAMICS** has long been a leading defense contractor supplying a range of products and services ranging from land- and sea-based combat vehicles to information systems and other advanced technologies. The company is also one of the largest suppliers of corporate jets via its Gulfstream product line. The uncertainty about possible defense department cuts has led to historically low valuations, providing a good entry point for patient investors.

**INTEL** is the largest chip maker in the world, and it still commands some 80% of the PC market. Intel needs to expand its presence in mobile devices, notebook/ultrabook PCs and server products, but if history is any guide, it will be successful in doing so. The financials are outstanding, and the dividend is unusually

large for a technology leader.

**NUCOR** pioneered the mini-mill steel industry, a smaller-scale steel production process that uses scrap steel as the main raw material. Management has a good reputation for both operational efficiency and financial conservatism. Economic concerns are currently a two-edged sword: revenue forecasts are soft, but on the other hand, raw material (scrap) prices are low. Nucor is well positioned to profit when global economic conditions improve.

**PFIZER** is the world's largest drug company. The expiration of patent protection on *Lipitor* and several other drugs has caused many investors to shy away from the stock. But Pfizer's pipeline of potential new drugs is quite robust, with 31 compounds in registration or Phase 3 development. To sharpen its focus on its core markets, Pfizer is selling several non-core units. Moreover, the company has a strong and growing presence in emerging markets.

**REPUBLIC SERVICES** emerged from the 2008 purchase of Allied Waste as one of the largest solid waste disposal/recyclers in North America. It is using smaller acquisitions to enhance its reach, especially in faster growing geo-

graphic regions. The company is transitioning to natural-gas vehicles to reduce future costs. Cascade Investments, Bill Gates' investment firm, recently upped its holdings to over 21%.

**RAYTHEON** is a leading defense contractor specializing in missiles, missile defense and electronics. While U.S. government budget cuts would almost certainly affect the company, its product offering is quite diversified, and it is seeing growing international demand as tensions escalate in different parts of the world. Management has been proactive in managing costs, and so any upside surprises in defense spending could result in significant earnings growth.

**WALGREEN** is the largest U.S. drug retailer and distributor. A contract dispute with prescription manager Express Scripts was resolved in July, but it may take Walgreen a while to regain the customers it lost as a result of the dispute. The recently announced acquisition of a 45% stake interest in Alliance Boots will greatly expand the Walgreen's global reach in the long run, but there may be some integration issues in the shorter term. Nonetheless, we view Walgreen as an attractive long-term holding.

## **EUROPEAN BANKS: STILL RISKY BUT GOOD GAIN POTENTIAL**

One of our favorite sayings is "Buy when there is blood in the streets," which is attributed to Baron Rothschild in the early 1800's. It is particularly appropriate to pull out the Baron's statement now because he was a member of one of the most prominent European banking families, and the European banking sector is one of the bloodiest areas in the worldwide financial markets today.

No doubt there is risk in European banks. Even huge banks can fail, or their stockholders can get wiped out if they are nationalized.

But there is also great opportunity in this sector. Most of these banks are cornerstones of their respective nation's economy, and many of them have major global franchises as well.

We highlight on the next page, ten very large European-based banking companies with global reach. We can't promise that any of them will emerge unscathed from the current turmoil in Europe, but we're pretty confident that some – and possibly even all – of them will increase sharply in price when the turmoil subsides. ➔

European Banking: Time for A Deposit?						
COMPANY	SYMBOL	RECENT PRICE	5-YEAR RANGE	MARKET CAP. MIL	PRICE TO SALES	DIVIDEND YIELD*
Banco Santander	SAN	6.94	22.34— 4.87	65,920	1.83	11.96
Barclays	BCS	11.88	58.35— 2.75	36,280	1.00	3.19
Credit Agricole**	CRARY	2.64	11.34— 1.72	13,140	0.72	0
Credit Suisse	CS	19.12	71.96—16.09	25,530	1.01	4.29
Deutsche Bank	DB	34.31	143.01—21.13	31,480	0.85	2.68
HSBC Holdings	HBC	44.18	99.52—22.89	142,370	2.45	4.64
Lloyds Banking Group	LYG	2.13	47.35— 1.33	36,930	1.63	0
Societe Generale Group	SCGLY	5.22	36.25— 3.66	19,610	0.73	0
The Royal Bank of Scotland	RBS	7.12	74.68— 2.86	22,660	0.86	0
UBS	UBS	11.16	58.02— 7.04	41,830	1.60	0.97

*\*Dividends are variable and do not reflect potential withholding taxes.*  
*\*\*Began trading in October 2008.*

Several of them even pay sizable dividends to compensate you while you wait for a recovery. But we want to emphasize that none of these dividends can be considered secure in the current environment.

**BANCO SANTANDER** is based in Spain, but 54% of profits come from emerging markets, and the balance is spread across a range of developed countries. Recent “stress tests” suggest that the company’s capital base is adequate, but the reliability of these tests is much debated. The stock could be hurt in the short run if there is more negative news about Spain, but the firm’s global presence provides good upside potential over the longer term.

**BARCLAYS**, headquartered in the U.K., was strong enough during the meltdown in 2008 to come in and scoop up the best assets from Lehman. But right now it is embroiled in a scandal over LIBOR interest rates, which has already cost the CEO and COO their jobs. Many investors are waiting for new top management to come in and prove itself, but the profits will probably be higher for those who buy the stock before then.

**CREDIT AGRICOLE** was created some 100 years ago to help French farmers. Today the

company is seeking to extricate itself from its ill-timed international expansion plans. Doing so will allow management to better focus on its French retail operations that showed good revenue growth in the latest quarter. Credit Agricole is in compliance with regulatory requirements for 2012, but will need additional capital to meet next year’s targets.

**CREDIT SUISSE** operates in 50 countries from a base in Zurich, Switzerland. After being forced to raise new capital in 2008-09, management has been working to cut the firm’s general risk exposure, including dramatically reducing its proprietary trading, and strengthening capital levels. The Swiss national bank has suggested Credit Suisse needs to raise further capital and questioned the firm’s dividend. But management has responded that the bank’s capital is quite sufficient, and it is committed to maintaining the dividend.

**DEUTSCHE BANK**, headquartered in Frankfurt, Germany, provides banking and investment banking services around the globe. The company may have some exposure to the current scandals over LIBOR and the funneling of funds to sanctioned nations, but those are likely to be short-term issues. Longer-term, as the largest bank in Europe’s largest market

and as a major international investment bank, Deutsche Bank should be well positioned to profit.

**HSBC HOLDINGS**, based in London, is one of the largest money-center banks in the world. A new management team came on board in 2011 that is aggressively restructuring the company. The company is the subject of a money laundering probe, but we think the damage will be short-lived. Europe remains challenging, but Hong Kong and the rest of Asia along with the Middle East have been solid.

**LLOYDS BANKING GROUP** provides a range of banking and financial services primarily in the U.K. Mortgage and credit issues in 2008-09 required a government bailout, and the company has struggled to some extent ever since. However, the balance sheet and liquidity appear to be headed in the right direction, and with a substantial presence in U.K. banking, Lloyds has significant gain potential if these trends continue.

**SOCIETE GENERALE GROUP** is the second largest French bank, but it also has extensive

operations worldwide through offices in more than 80 countries. Management continues to work through its mistakes that were brought to light during the financial crisis. Capital ratios are in line with current regulatory requirements, but the ratios will need to be boosted as the standards continue to get tougher.

**THE ROYAL BANK OF SCOTLAND** was hit hard during the financial crisis, and the stock, adjusted for a reverse stock split, languishes near its lows of recent years. A new chairman took over in 2009, and the bank embarked on a recovery plan that is largely on track. There are still ongoing regulatory issues, but overall operational risks are being reduced.

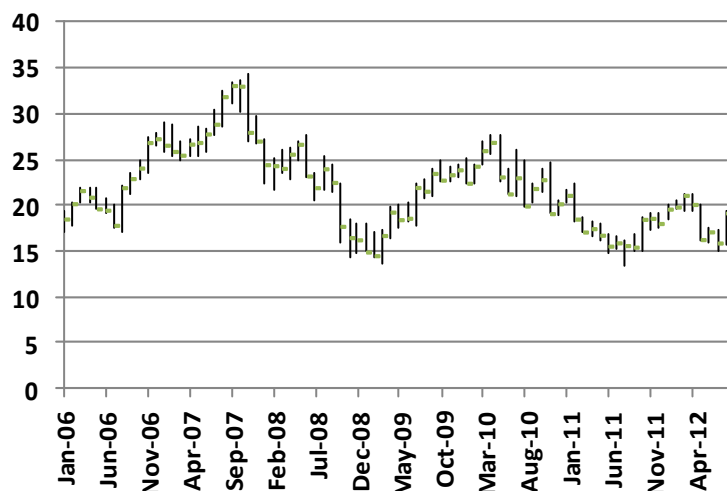
**UBS** is based in Zurich, Switzerland, but it has extensive banking, investment banking and wealth management operations around the globe. The company staggered a bit during 2008-09 and was forced to offload troubled assets. In the wake of these problems, management is reshaping the business. A rogue trader further tarnished the bank's image in late 2011 with a \$2 billion loss, but the current strategy of focusing on wealth management shows promise.

## RECOMMENDATIONS

### Purchase Recommendation: Cisco Systems, Inc.

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**CATEGORY: LARGE-CAP (\$102 BIL.)**  
**SYMBOL: CSCO EXCHANGE: NASDAQ**  
**BUSINESS: COMMUNICATION DEVICES**  
**ANNUAL REVENUE: \$46.1 BIL (7/28/12)**  
**EARNINGS: \$8.0 BIL.**  
**8/29/12 PRICE: 19.18**  
**12 MONTH RANGE: 21.30-14.93**  
**MAX. REC PRICE: 26**  
**EST. DIVIDEND YIELD: 2.9%**



**Background:** Cisco is a world leader in networking and other data transmission products. Its stock soared during the tech/Internet bubble of the late 1990's. The company used its high-flying stock to make a number of acquisitions that further fueled its growth. The stock peaked at 77 in early 2000 before declining sharply as the bubble burst. The stock has bounced around in the teens and twenties for much of the last decade.

**Analysis:** Cisco finally appears to be on the verge of breaking out of its more than decade-long doldrums. While the company has not given up on acquisitions entirely, it is now focused on building up its market-leading positions in some of the most important technology segments in order to build profits and cash flow. Moreover, the company is now committed to returning a significant portion of that growing cash flow to shareholders.

Cisco is the dominant supplier in many of its markets. Moreover, its products provide the backbone for several of the fastest growing technology sectors, including cloud computing, video, smart phones, and social networking. In addition to its hardware businesses, Cisco is seeing steady growth in its service offerings, which generally have higher margins.

Not only does Cisco have a broad product line, but its markets are well diversified geographically. More than 40% of revenue comes from outside the Americas. Emerging markets continue to grow in importance for Cisco, accounting for more than 12% of revenues last year.

In its quest for improved profitability, the company is cutting costs as well as growing revenue. It has reduced worldwide headcount by more than 5,000 over the past year and streamlined its operating structure. In addition, it has sold off several of its consumer businesses that had been a drag on overall profits.

The company's balance sheet is impeccable, with more than \$48 billion in cash and equivalents and relatively little debt. Cash flows are growing, and management is committed to returning 50% of free cash flow to shareholders through dividends and share repurchases. The company's nearly three percent dividend yield puts it in the top echelon of dividend payers in the tech sector.

Cisco has been like the sleeping giant of the technology industry since the Internet bubble burst in 2000. We now believe that the giant is awakening, and will give shareholders a good ride in the coming years. We recommend buying Cisco stock up to 26.

## Sale Recommendation: Exxon Mobil

Exxon Mobil has had a good run recently as oil prices have firmed. We think it is time to take our profits now because we have no idea

where oil prices are going in the future, and we think the best gains in the stock are behind us.

## NEWS NOTES & UPDATES

Both **Acco** and **Hewlett-Packard** fell quite sharply in recent weeks when they posted disappointing quarterly results. We still like the long-term prospects for both stocks and recommend continuing to hold them (or even

adding more, if you are still underweight the names).

**Coca-Cola** underwent a 2-for-1 split in mid-August. We remain bullish on the stock.

## PERFORMANCE

The tables below and on the next page show the performance of all of our currently active recommendations, plus recently closed out recommendations. The categories are based on market capitalization on the recommendation date, except that recommendations made prior to August 2004 are categorized by their 8/20/04 market cap.

### SMALL CAP (under \$1 billion) CURRENT RECOMMENDATIONS

RECOMMENDATION	SYMBOL/ EXCHANGE <sup>(1)</sup>	REC. ISSUE	PRICE AT REC.	8/29/12 PRICE	TOTAL RETURN <sup>(3)</sup>	CURRENT STATUS <sup>(2)</sup>
Bristow Group	BRS/N	Nov 86	0.75	46.52	+6209	Hold
Kadant Inc	KAI/A	Apr 02	14.28	22.99	+61	Hold
Newpark Resources	NR/N	June 06	5.65	7.03	+24	Buy (10)
Electro Scientific Ind.	ESIO/O	Feb 07	21.24	13.02	-38	Buy (20)
CTS Corporation	CTS/N	Nov 07	12.54	9.99	-16	Buy (15)
Wet Seal	WTSLA/O	Oct 09	3.93	2.80	-29	Buy (6)
ACCO Brands	ACCO/N	Mar 10	7.17	6.74	-6	Buy (12)
M/I Homes, Inc.	MHO/N	July 10	10.08	18.47	+83	Buy (20)
Superior Industries	SUP/N	Sept 10	14.75	17.14	+23	Buy (30)
Kemet	KEM/N	Feb 11	14.75	4.59	-69	Buy (11)
Drew Industries	DW/N	Mar 11	23.13	29.07	+26	Buy (33)
Fairpoint	FRP/O	July 11	9.42	6.63	-30	Buy (14)
OfficeMax, Inc.	OMX/N	Nov 11	5.12	5.67	+11	Buy (12)
Builders FirstSource, Inc.	BLDR/O	May 12	4.17	4.56	+9	Buy (7)
Exide Technologies	XIDE/O	July 12	3.36	3.06	-9	Buy (5)

### MID CAP (\$1 billion - \$10 billion) CURRENT RECOMMENDATIONS

RECOMMENDATION	SYMBOL/ EXCHANGE <sup>(1)</sup>	REC. ISSUE	PRICE AT REC.	8/29/12 PRICE	TOTAL RETURN <sup>(3)</sup>	CURRENT STATUS <sup>(2)</sup>
Newell Rubbermaid	NWL/N	June 04	23.24	17.52	-4	Buy (20)
Goodyear Tire	GT/N	July 04	9.14	11.87	+30	Buy (20)
Tenet Healthcare	THC/N	Sept 04	10.27	5.27	-49	Hold
Janus Capital Group	JNS/N	Aug 05	15.27	8.72	-37	Buy (17)
Portland General	POR/N	Nov 06	25.70	27.23	+27	Buy (33)
Interpublic Group	IPG/N	Dec 06	11.94	10.70	-7	Buy (14)
Tellabs	TLAB/O	Feb 08	6.66	3.62	-42	Buy (7)
Federal-Mogul	FDML/O	May 08	21.00	9.46	-55	Buy (15)
Old Republic	ORI/N	June 08	14.64	8.84	-21	Buy (14)
Terex Corporation	TEX/N	Feb 09	12.57	21.67	+72	Hold
Calpine	CPN/N	Dec 09	11.12	17.42	+57	Buy (21)
Lear	LEA/N	June 10	33.84	39.28	+18	Buy (58)
Boston Scientific	BSX/N	Aug 10	5.60	5.55	-1	Buy (9)
Owens Corning	OC/N	Dec 10	26.31	33.16	+26	Buy (40)
MGIC	MTG/N	Jan 11	10.11	1.21	-88	Buy (8)
Delta Air Lines	DAL/N	Oct 11	8.11	8.61	+6	Buy (12)
MetroPCS	PCS/N	Dec 11	8.38	9.74	+16	Buy (14)
Wendy's	WEN/O	Mar 12	5.18	4.37	-16	Buy (8)
E*Trade Financial	ETFC/O	Aug 12	7.53	8.62	+14	Buy (12)

**KEY:** <sup>(1)</sup> Exchanges: N = New York; A = American; O = OTC; <sup>(2)</sup> Maximum recommended buy prices in parentheses; <sup>(3)</sup>

## LARGE CAP (over \$10 billion) CURRENT RECOMMENDATIONS

RECOMMENDATION	SYMBOL/ EXCHANGE <sup>(1)</sup>	REC. ISSUE	PRICE AT REC.	8/29/12 PRICE	TOTAL RETURN <sup>(3)</sup>	CURRENT STATUS <sup>(2)</sup>
Carnival Corporation	CCL/N	Jan 01	30.50	35.18	+45	Buy (45)
A T & T Inc.	T/N	May 03	23.05	36.82	+119	Buy (44)
Ford	F/N	Dec 03	13.00	9.32	-19	Buy (15)
Schwab	SCHW/N	Mar 04	12.20	13.39	+31	Buy (20)
Time Warner	TWX/N	Dec 04	53.46	41.85	+1	Buy (45)
Campbell Soup	CPB/N	Apr 05	28.14	35.35	+50	Buy (42)
Microsoft	MSFT/O	Oct 06	27.94	30.65	+22	Buy (40)
Pfizer	PFE/N	Mar 07	25.84	23.96	+13	Buy (25)
General Electric	GE/N	July 07	38.12	20.82	-36	Buy (25)
Motorola Solutions	MSI/N	Aug 07	68.52	48.13	-28	Buy (60)
Amgen	AMGN/O	Oct 07	56.56	83.72	+50	Buy (95)
DuPont	DD/N	Jan 08	45.07	49.94	+27	Buy (60)
Sprint	S/N	Mar 08	8.09	4.86	-40	Buy (7)
Kraft	KFT/O	Aug 08	31.82	41.67	+44	Buy (43)
Bank of America	BAC/N	Oct 08	35.00	8.00	-76	Buy (14)
Emerson Electric	EMR/N	Aug 09	36.03	51.54	+59	Buy (65)
Sysco	SYI/N	Nov 09	27.01	30.34	+23	Buy (36)
Marsh & McLennan	MMC/N	Feb 10	21.71	34.03	+67	Buy (35)
Applied Materials	AMAT/O	Apr 10	13.45	11.70	-6	Buy (20)
ExxonMobil	XOM/N	Oct 10	61.79	87.90	+49	Buy (90)
Fifth Third	FITB/O	Nov 10	12.56	15.12	+23	Buy (17)
Coca-Cola	KO/N	Apr 11	32.86	37.46	+21	Buy (45)
General Motors	GM/N	May 11	32.09	21.30	-34	Buy (40)
Xerox	XRX/N	Aug 11	9.58	7.39	-22	Buy (14)
Sony	SNE/N	Sept 11	22.01	11.73	-47	Buy (32)
Johnson & Johnson	JNJ/N	Jan 12	65.45	67.37	+6	Buy (85)
Corning, Inc.	GLW/N	Feb 12	12.61	11.76	-6	Buy (18)
Weyerhaeuser Co.	WY/N	Apr 12	21.89	24.88	+15	Buy (30)
Hewlett-Packard	HPQ/N	Jun 12	22.74	16.94	-25	Buy (30)

## RECENTLY CLOSED OUT RECOMMENDATIONS (ALL CATEGORIES)

RECOMMENDATION	SYMBOL/ EXCHANGE <sup>(1)</sup>	REC. CAT.	BUY ISSUE	PRICE AT BUY	SELL ISSUE	PRICE AT SELL	TOTAL % RETURN <sup>(3)</sup>
Zhone Technologies	ZHNE/O	Small	May 05	11.40	Oct 11	1.27	-89
MF Global Holdings	MF/N	Mid	June 11	7.71	Nov 11	1.20	-84
Solutia	SOA/N	Small	Sept 08	15.58	Feb 12	27.37	+76
RadioShack	RSH/N	Mid	Apr 08	15.87	Feb 12	10.23	-25
Tyco International LTD	TYC/N	Mid	Mar 09	20.05	Mar 12	52.00	+172
Taiwan Semiconductor	TSM/N	Large	Dec 05	9.29	Mar 12	14.69	+88
Winn-Dixie	WINN/O	Small	Jan 10	10.14	Mar 12	9.50	-6
Presstek	PRST/O	Small	June 05	8.58	Apr 12	0.58	-93
Midas	MDS/N	Small	July 08	13.50	May 12	11.50	-15
U.S. Airways	LCC/N	Small	May 09	3.79	June 12	12.69	+235
Sara Lee	SLE/N	Large	Apr 06	15.28	July 12	20.28	+57
Bristol-Myers Squibb	BMJ/N	Large	Aug 03	26.07	Aug 12	35.63	+78

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