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# ❖ The Stahl Report Compendium ❖

*Studies in Large Capitalization Securities*

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October 2009

*Citigroup Inc. (C)*  
*Capital One Financial Corp. (COF)*  
*Viacom (VIA-B)*  
*Masco (MAS)*

## **Horizon Research Group**

Steven Bregman	Naveen Kumar
Thérèse Byars	David Leibowitz
Peter Doyle	Eric Sites
Michael Gallant	Fredrik Tjernstrom
Matthew Houk	Steven Tuen
Murray Stahl	



*PCS Research Services*  
125 Maiden Lane 6<sup>th</sup> Floor New York, NY 10038  
(212) 233-0100  
[www.pcsresearchservices.com](http://www.pcsresearchservices.com)

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## *Murray's Musings*

### *A Fundamental Problem for Large Cap Investing*

The topic in this *Musings* section deals with a fundamental problem for the large capitalization investor, which is that the opportunity set of the large capitalization stocks waxes and wanes in a very dysfunctional manner. Many of these securities declined so much in 2008 that they no longer meet the customary definition of being large capitalization stocks. The fact that they declined greatly is the main reason why, at the moment, they may be undervalued and should be studied; however, because they declined greatly, they also became ineligible for purchase if one uses a constant measurement to define large capitalization securities.

Table 1 contains a list of companies in the S&P with their respective weights and market capitalizations. I believe that they are undervalued, at the moment, to the point that they present an interesting investment opportunity. I would assert that the customary demarcation line between large capitalization and small capitalization securities lies between \$7 billion and \$8 billion at the moment. Table 1 lists 21 companies that I think are, by anyone's standard, large capitalization at the moment, and represent intriguing values.

**Table 1: Large Capitalization Stocks**

	% Weight in S&P500	Market Capitalization (\$ in billions)
Bank of America (BAC)	1.56%	\$141.0
Wells Fargo (WFC)	1.56%	122.0
Goldman Sachs (GS)	1.35%	92.0
Citigroup (C)	1.01%	103.0*
US Bancorp (USB)	0.65%	41.0
Morgan Stanley (MS)	0.50%	40.0
American Express (AXP)	0.43%	39.0
Bank of New York (BK)	0.37%	33.0
MetLife (MET)	0.32%	29.0
State Street (STT)	0.28%	25.0
PNC Financial (PNC)	0.23%	20.0
Schwab (SCHW)	0.20%	20.0
Northern Trust (NTRS)	0.15%	13.0
Loews (L)	0.13%	13.0
Sun Trust (STI)	0.12%	10.0
Hartford Financial (HIG)	0.11%	8.0
Vornado Realty (VNO)	0.10%	10.0
Ameriprise (AMP)	0.10%	9.0
Forest Labs (FRX)	0.09%	8.6
Principal Financial (PFG)	0.09%	8.1
Fifth Third (FITB)	0.08%	7.4

\* Includes preferred

Table 2 presents another set of companies with smaller market capitalizations that might be more intriguing values, but their declines have been sufficient that it could be argued they are no longer large capitalization companies. It's interesting to observe that in the last six months the market cap of some of these companies has increased dramatically. Therefore, the opportunity set should not be judged by the market caps as they exist at this moment, but by those that existed on March 9, 2009. On that date, the opportunity set had diminished to the point that it wouldn't have included some of the 21 companies that currently qualify for the list in Table 1, though they were better values.

If one studies that list, it will be seen immediately that the opportunity set is very dense in financials, because financials were the centerpiece of the storm that befell the country. As all the financials declined, the formerly defined large capitalization opportunity set very rapidly became relatively financial stock poor. It was never without financial stocks, but a great proportion that would otherwise have been included no longer qualified by virtue of depreciation.

At its nadir on March 9, 2009, that opportunity set (which might be mimicked by the S&P 100) was largely comprised of what can only be characterized as business franchises that remain relatively stable in any economic environment. Examples of these companies are included below in Table 2.

**Table 2: Stable Business Franchises**

Procter & Gamble	Medtronic
Johnson & Johnson	Kraft
Coca Cola	Walgreen
Google	Time Warner
Pepsi	Baxter International
Philip Morris International	General Dynamics
Abbott Labs	Lockheed
Merck	FedEx
McDonald's	Mastercard
Pfizer-Wyeth	Entergy
Amgen	American Electric Power
UPS	Avon
Colgate	Heinz
Gilead Sciences	Campbell Soup

It is difficult to imagine an environment, however austere, in which the earnings of many of the stable companies would diminish greatly, though it's not difficult to imagine one in which the earnings would diminish. The formal approach of assigning a numerical value to the definition of large capitalization is a fallacious one, and one should have a different approach. A much more reasoned approach would be the scope of business activity as measured by revenue, which is not very different from the Fortune 500 approach.

The membership of the S&P 100 changed in a detrimental manner on or about March 9, 2009 because, like every index, the S&P 100 is periodically rebalanced to reconstitute the Index in proportion to its formal definition, which is market capitalization.

An interesting comparison that could be done would be to compare the S&P 500 or Dow Jones Industrial Average as they exist today with the Dow Jones Industrial Average as it existed on January 29, 1930. I think one would see a very interesting point. As an index, the Dow Jones, whatever its deficiencies may be (one of which is the price weighting rather than market capitalization mechanism of index construction), in January 1930, was comprised almost entirely of cyclical companies.

**Table 3: Dow Jones Index January 29, 1930**

Allied Chemical	Johns-Manville
American Can	Mack Truck
American Smelting	Nash Motors
American Sugar	National Cash Register
American Tobacco	Paramount Publix
Atlantic Refining	Radio Corp.
Bethlehem Steel	Sears Roebuck & Co.
Chrysler Corp.	Standard Oil (N.J.)
Curtiss-Wright	Texas Company
General Electric	Texas Gulf Sulphur
General Foods	Union Carbide
GM	U.S. Steel
General Railway Signal	Westinghouse Electric
Goodrich	Woolworth
International Harvester	

The only companies in the Dow Jones Index in January 1930 that might be said to be relatively non-cyclical was General Foods. If one examines the cyclicity of some of the companies in the 1930 Dow, there's virtually nothing in the S&P that is as cyclical. For example, International Harvester or General Motors, which now is excluded, are certainly cyclical, as are Texas Gulf Sulphur, Union Carbide, American Smelting, American Sugar, Atlantic Refining, Chrysler Corporation and Nash Motors (which eventually went bankrupt).

The cyclical character of the indices themselves has changed, probably for all time. In our own indices, there's a goodly supply of stable value companies that, in times of crisis, come to dominate the index. At its nadir, it is now being dominated by the stable value companies, and has established its own new equilibrium. The cyclical companies decline greatly and exit the opportunity set. That situation leaves us with a group of companies with relatively stable earnings and, therefore, the index has a way of stabilizing itself.

Many investment opportunities have now exited the index, if one believes that the more cyclical companies can reestablish something akin to their former earnings. A mechanism needs to be generated to capture that loss of membership in the index. It's probably a worthwhile idea for an ETF.

## *Industry Thoughts*

### *Healthcare*

In this section, I'll present some interesting statistics. Healthcare is said to be roughly 16% of GDP. With GDP at \$14 trillion, or thereabouts, 16% would be roughly \$2.25 trillion. For the most part, that \$2.25 trillion is comprised of the wages of the many people who work in the healthcare industry, which is one of the reasons why the problem of high healthcare costs is so intractable. For example, according to the United States Department of Labor, the United States has 2,542,760 registered nurses. A registered nurse in the United States makes an average wage of \$65,130 per annum. Ignoring payroll loads like Social Security, unemployment tax, and healthcare insurance (most nurses are unionized and have healthcare insurance plans), the raw salary bill, merely for the nurses, is \$165 billion.

Physicians are somewhat higher paid. According to the World Health Organization, there are 1.5 million physicians in the United States. However, according to another source, which is the American Medical Association, there are only 853,187 physicians in the United States. Based on raw data, one cannot explain the difference. In any case, I will use the lower and more conservative number generated by the American Medical Association.

The average wage of a physician varies greatly with specialty; for example, an anesthesiologist typically makes \$321,000 a year, while a pediatrician makes approximately half that at \$161,000 a year. Obviously, the country is not as appreciative of the role of pediatricians as they are anesthesiologists, which is an interesting compensation choice. Nevertheless, let's presume that the average wage for a physician in the United States is roughly \$250,000. That would mean that the physician cost is \$214 billion, before any payroll load like health insurance or Social Security tax, since most physicians are self-employed. The sum of the nurse bill plus the doctor bill is \$379 billion, or 17% of the healthcare bill, without payroll loads.

**Table 4: Earnings of Doctors with More Than 1 Year of Experience**

Anesthesiologists	\$321,686
Surgeons	252,504
Obstetricians	247,348
Psychiatrists	180,000
Internists	166,420
Pediatricians	161,221
Family Practice	156,010

Of course, there are also laboratory technicians, orderlies, maintenance people, and the general cost of maintaining hospitals, in addition to the doctors' offices, administrators and the cost of maintaining the records. There aren't very many large pools of earnings

that the government authorities could potentially attack in their pursuit of not only arresting, but reversing, the rise in healthcare costs.

There are, however, some costs that are visible, though not necessarily meaningful, in relation to the numbers quoted here. For example, the 10 largest health insurance companies, led by United Health and WellPoint, have net profitability of \$9.2 billion. It's much more politically tractable to try to control health insurance costs, meaningless though it is in the total cost that is well in excess of \$2 trillion. It's much more politically tractable to attempt that reduction than to attempt to control the cost by controlling the compensation of the participants in the health industry. Therefore, there's a certain degree of intrinsic regulatory risk associated with that group of companies that cannot be diversified away.

**Table 5: The 10 Largest Health Insurance Companies**

	Profits (\$ in billions)
United Health (UNH)	\$3.5
WellPoint (WLP)	2.4
Aetna (AET)	1.3
Humana (HUM)	0.84
Cigna (CI)	0.6
Health Net (HNT)	0.1
Coventry Health Care (CVH)	0.2
Amerigroup Corp	0.1
Centene Corp. (CNC)	0.1
Molina Healthcare (MOH)	0.05
Total	\$9.2

Similarly, the list in Table 6 of pharmaceutical companies, led by Pfizer, Wyeth and Merck, is not exhaustive, but the companies included in it generate aggregate profits of \$61.5 billion per annum. The number of members in that group is relatively small, and is, therefore, a tractable problem from a regulatory point of view.

**Table 6: Pharmaceutical Companies**

	Net Profits (\$ in billions)
Pfizer	\$7.5
Wyeth	4.6
Merck	5.7
Amgen	4.4
Schering Plough	2.5
Glaxo	7.3
Bristol Myers	3.4
Johnson & Johnson	12.7
Abbott	5.2
Becton Dickinson	1.2
Baxter	2.1
Eli Lilly	4.9
Total	\$61.5

Healthcare costs in the United States are rising by 8% per annum. The typical investor would not accept an 8% annual rate of return for an equity as adequate compensation for the risk that is being carried. If one were to study the pharmaceutical companies in the last decade, one would see that the rate of return on a compound annual basis is not far from about 8%. That 8% was earned in a very dysfunctional manner, meaning that, very early in the decade, there was a significant amount of appreciation in healthcare companies. Since that time, there has been no appreciation and, in many cases, modest depreciation, which was balanced, of course, by the annual, and in some cases not insubstantial, dividends. The pattern of returns was not successful either.

The question to be posed is whether or not there is an escape from this state of affairs. Is there another way to invest in healthcare in which one is open to a potentially higher rate of return and, failing that, at least not necessarily exposed to the same degree of regulatory risk? I think that the answer is yes. There is a group of companies listed in Table 7 that can only be described as quasi-medical. By that I mean that, formally speaking, they do exist in the medical realm, but they are not obvious members of the medical system in the same manner as the companies listed in Tables 5 and 6.

**Table 7: Quasi Medical Companies**

Sigma Aldrich (SIAL)	produces chemicals used in research
Perrigo (PRGO)	over the counter drugs
Life Technologies (LIFE)	lab equipment
Edwards Life Science (EW)	products used in cardio treatments
Qiagen (QGEN)	pre-analytical sample equipment
Henry Schein (HSIC)	supply distributor
Millipore (MIL)	filtration
Bio-Rad Laboratories (BIO)	lab equipment
Thermo Fisher Scientific (TMO)	lab equipment
Novo Nordisk (NVO)	insulin
Techne Corp. (TECH)	lab equipment
Charles River Labs (CRL)	animal research, models, pre-clinical trials

Sigma Aldrich is a chemical company that makes literally hundreds of thousands of chemicals, many of which are used in high-caliber pharmaceutical research. Any one of those chemicals may be crucial for an experiment, but involves the expenditure of nothing more than several hundred dollars. Therefore, the company has never come under the scrutiny or the price pressures that formal members of the medical community experienced.

Similarly, Perrigo makes over-the-counter drugs, which have no patent and require no prescription. One can debate the effectiveness of most of these drugs because, in many cases, they are nothing other than a palliative designed to modestly alleviate certain symptoms and no more. Since they can easily be dispensed with, there is very little, if any, pressure to regulate them or to control the price. Therefore, Perrigo has had a much better profit experience from producing pharmaceuticals that are non-proprietary than the companies that produce those that are proprietary.

Life Technologies produces laboratory equipment, which is not an expenditure made by the general populace, but by pharmaceutical companies. If pharmaceutical companies wish to advance their earnings, they have no other avenue open to them than engaging in more research, which requires more laboratory equipment. Therefore, ironically, the supplier to the pharmaceutical industry outperforms the pharmaceutical companies over long periods of time.

Other companies of this type include Qiagen, which makes pre-analytical samples, the Henry Schein company, which is a distributor of pharmaceuticals and Millipore, which is involved in filtration, a necessary process in all types of research. There may well be a better way to invest in the medical industry than being a formal participant in it.

## *Featured Companies*

### *Citigroup Inc. (C)*

Though I do so with some degree of trepidation, the time has come to recommend Citibank. As a company and as a share, Citibank has many deficiencies, the most obvious of which is that it continues to suffer extensive credit losses. In the most recently reported quarter, Citibank had \$12 billion of credit losses, and there is very little either in the economy or the character of their lending portfolio that would lead one to believe that the third quarter or fourth quarter experience is going to be radically different. Nevertheless, in its currently reconstituted form, Citigroup does have some interesting virtues. It has over \$1.5 trillion of interest-earning assets that earn, on average, 497 basis points. Of course, that's funded through deposits and bank paper. The spreads earned thereon have never been wider. Every 100 basis point of spread earned by Citigroup equals \$15 billion of annual profits.

The company has some other virtues, one of which is the company's loss-sharing agreement with the United States government on a pool of loans that were considered to be the most dangerous in the company. At the inception of the agreement, this pool of loans totaled \$301 billion. At the moment, partially through amortization and partially through default, the loan pool now totals \$266 billion. According to the terms of the agreement, Citigroup will absorb the first \$39.5 billion of losses, and after that, the government absorbs the balance.

Citigroup has \$78 billion of common equity, \$152 billion of total equity. Its common equity plus the mandatorily convertible preferred, which might be said to be its true measure of tangible common equity, equals \$102 billion. The total equity of \$152 billion includes \$42 billion of deferred tax assets. Given the magnitude of the losses experienced by Citigroup, it's not likely to pay taxes for some considerable period of time.

If one presumes that Citigroup can earn a spread of 300 basis points, it would generate \$45 billion of earnings annually. The company also has somewhere between \$10 billion and \$11 billion per annum of normalized non-interest income, which includes various and sundry fees that Citibank applies to its clientele. The term "normalized" is a very dangerous term to use, because the company is actively involved in raising fees across the spectrum of product offerings. It's not clear how large normalized non-interest revenue is going to be, except that it's likely to be much higher than the so-called normalized non-interest revenue.

Citibank is determined to reduce, even from the current diminished level, its operating expenses of between \$11 billion and \$12 billion. Let us presume \$11 billion, or more, of non-interest income and interest, or spread, and income of \$45 billion, for total income of \$56 billion. Let us also presume four quarters per annum of \$12 billion of credit losses

for an annual figure of \$48 billion, and roughly \$11 billion of operating expenses, which is perhaps reducible. That would result in the company being at, or close to, operational break-even.

It's worthy of note that Citigroup, for accounting reasons, actually earned money recently, but on an operating basis it's not yet profitable. Let's assume that the losses were to diminish by half, and the company had nothing other than \$6 billion of credit losses per quarter, then the company would probably make not far from \$24 billion a year in profit. It has a \$100 billion market capitalization; therefore, why could it not be argued that it would trade at a multiple of no less than 8x, meaning that the stock would double?

On the risk exposure side, it's difficult to imagine that, whatever its deficiencies, Citigroup's viability as an enterprise is to be questioned. It's been sufficiently recapitalized such that it should survive, and it could survive even \$12 billion of quarterly credit losses without meaningful erosion of tangible shareholders' equity. It appears that the revenues, both interest and non-interest, as they exist today are sufficient to maintain the value of its capital base.

Ultimately, there will be an improvement. The character of the loan portfolio is constantly changing, because there are amortizations, prepayments of loans, defaults and new lending standards that are much more exacting than the old ones. Logically, if one continues that process for a sufficient length of time, there should be an improvement in credit losses, though it may not come for very many quarters.

Even if Citigroup were to double over the course of three or four years, it would be a very high return instrumentality. It seems reasonable to believe, however, that such a period of time will not be required, and it should be meaningfully shorter. Consequently, and amazingly, Citigroup is recommended for purchase.

### ***Capital One Financial Corp. (COF)***

A similar, though perhaps not as daring, argument may be used to support the next recommendation. Capital One Financial Corp is largely a credit card company. Whatever its deficiencies, the company did not require the recapitalization that was required of Citigroup. As a matter of fact, Capital One recently repurchased the \$3.6 billion of TARP preferred that it had issued to the government.

As far as numbers are concerned, at current loss rates, the company is losing approximately \$1 billion per quarter for credit charges. It has \$1.9 billion of quarterly operating expenses, which might be somewhat reducible, but not greatly reducible. Against these figures, the company has \$2 billion per quarter of net interest income and \$1.2 billion of so-called non-interest income. Some of that non-interest income is associated with securitization of credit card receivables which, at the moment, is a very weak market, and some is associated with various charges that the company cares to impose upon its modestly delinquent credit card customers, meaning those who might be

one to three days late with payments. Total funding is very low-cost and, because Capital One became a bank, 65% of all total funding is deposits. At the moment, total funding costs are 240 basis points per annum. Measured against the interest charges on credit cards, one can see how wide the spread income really is.

At the moment, the delinquency rate is a little over 4% per annum, which should begin to drift downward, in the not too distant future. The reason for the decline would not be because the credit environment is likely to improve, nor because the economy is likely to improve, but because, in the world of credit cards, though one can't do much about historical exposures, one can immediately terminate the borrowing line of anyone who is sufficiently delinquent as to be worrisome. Therefore, the credit card issuance standards are much higher than they were just a year or two ago.

At a 2% return on assets, which is achievable at current loss rates and current spreads, the company would earn \$3.2 billion. The current market capitalization at Capital One is \$15 billion. There's no reason to believe that it couldn't trade at a P/E of at least 10x; therefore, on that logic, Capital One should double. This company has much the same appreciation potential of Citigroup, with far less risk and complexity attached to it. It's further arguable that ultimately, if indeed the loss rates decline, Capital One should be awarded a higher multiple, because there aren't very many franchises with that magnitude of customers in credit cards. It might trade at 12x or even 14x earnings.

### *Viacom (VIA-B)*

Viacom is a media content company, and I'll describe the nature of the content momentarily. Before that, however, it's worthwhile observing that Viacom has been affected by the economy. Its second quarter revenue declined by 14%. While the cost of producing content is relatively fixed, it is not fixed in the same manner as an industrial company has the fixed expense of maintaining a factory, but there is a certain cost to producing a certain quantity of programming content. The operating leverage comes in as more and more people view that content. When fewer people view that content, and therefore less advertising revenue is earned, the cost of production doesn't diminish at all, which explains the operating leverage.

Domestic advertising revenue was only down by 6%. The worldwide advertising revenue was only down by 8%. The challenge that Viacom faces is not radically different from that of a pharmaceutical company. Viacom produces, among other things, filmed entertainment, which has the property that its revenue can be extremely variable from one quarter to the next. It's unbelievably difficult to manage, because one has to account for changes in popular taste quarter by quarter in relation to new product offerings.

Last year, at this time, it will be recalled that Viacom had released the ever-popular *Iron Man* movie and *Indiana Jones and the Kingdom of the Crystal Skull*, which proved also to be rather popular. This year's offering, also popular, was known as *Transformers*,

which is an entirely different form of entertainment. It appears that *Transformers* was released sufficiently late in the second quarter such that the comparisons were not as favorable as they would otherwise have been.

When viewed in a revenue sense, the business was not as impacted by its fundamentals as it might appear. It was much more affected by the revenue product mix. With all that, Viacom is likely to earn \$1.8 billion in free cash flow. It happens to have a \$16.7 billion market capitalization. On the face of it, it's probably an undervalued share.

Apart from measuring Viacom on its cash flow and revenues, there's another way to measure the company. Its ultimate franchise value is going to be powerfully dependent upon the number of subscribers to its various offerings. An easy way to count the number of subscribers is to view the Viacom television program offerings. In the second quarter of 2009, MTV, which was historically its largest offering, had 591.6 million viewers compared to the second quarter of 2008 which had 562.2 million viewers. Nickelodeon is also a very important constituent of viewership. In the second quarter of 2009, it had 282.7 million viewers, while a year ago it had only 231.8 million viewers.

**Table 8: Primary Viacom Television Program Offerings**

	Second Quarter 2009 Subscribers (in millions)	Second Quarter 2008 Subscribers (in millions)
MTV	591.6	562.2
Nickelodeon	282.7	231.8
VH1	182.8	177.7
Noggin	68.8	64.5
MTV2	89.5	84.7
SPIKE TV	104.8	102.6
Comedy Central	162.8	142.8
BET	103.7	99.2
TV Land	96.3	93.7

Viewing the primary Viacom program modalities, to a greater or lesser extent, they all increased viewership. Therefore, it is not illogical to posit the following set of affairs when, or if, the economy should ever be as robust as it was two years ago. Since the company's revenue is ultimately a function of advertising, and advertising value is ultimately a function of cost per impression, and cost per impression is powerfully driven by the number of subscribers, the amount of revenue it is possible to generate is ultimately a function of the number of subscribers. The number of subscribers is increasing; therefore, the company's ability to generate revenue has increased at the same time that its actual revenue experience has declined.

Viacom's franchise value should be judged, it would seem, on its ability to generate revenue in the fullness of time, rather than its revenue creation at a uniquely bad point in time. Therefore, the measure of market capitalization to free cash flow, as inexpensive as Viacom appears, genuinely understates the company's franchise value. Viacom should,

in the fullness of time, appreciate substantially from current levels, and therefore it is recommended for purchase.

### *Masco Corp. (MAS)*

Masco, formally considered, should not even be classified as a large capitalization company, because it has a market capitalization at the moment of only \$4.4 billion. This company makes faucets, plumbing and cabinets, which are all products used in the housing industry. It's needless to add that the housing industry activity is dramatically reduced from its levels of one or two years ago. Revenues have declined accordingly, though not as much as one might have expected. Housing activity declined much more than Masco's revenues declined. Revenue, year over year, has only diminished by 23%, which is a very serious state of affairs, but it's worthwhile noting that the products, while certainly used in new construction, also have a certain wastage rate in existing construction. There will always be a certain demand for Masco products, even in a prolonged environment of diminished home construction.

The company has been able to manage its costs accordingly. Believe it or not, in 2009, Masco should realize \$360 million of free cash flow. In relation to its market capitalization, it's trading at a free cash flow multiple of 12x, but it's a depressed multiple. That's one of the ironies of the current situation, and it says much more about the market's perception of risk than it says about the company.

Historically, when a cyclical company experienced dramatic earnings diminution, the multiple on current earnings and free cash flow increased enormously, because it was generally recognized that the diminution of earnings was likely to be temporary, though possibly prolonged. In the case of Masco, a multiple is applied that could well be appropriate if the earnings had reached a permanently low level, but that does not seem to be the case.

Let us presume that the earnings return to a higher level, but not the level realized in the housing bubble of the early part of the current decade. It seems reasonable to assert that a more normal time would be the year 1997 when home sales were not far from 750,000 a year. Given the United States population, the number of households that exist in United States, the need to provide new homes for an increasing population, and some reasonable allowance for household wastage, because the life of no home is infinite, 750,000 homes represents a more normal rate for the United States. At the high, new home sales were well in excess of 1 million.

Using 1997 as a benchmark, the company should produce, in a so-called normal environment, \$10 billion of revenue. In 2009, it's likely to produce more like \$8 billion of revenue. In 1997, it happened to earn a 10% net after tax margin. There's no reason to believe, at comparable levels of business activity, that it shouldn't earn that net margin once again. Therefore, at a so-called normal margin, Masco could actually earn \$1 billion. There's no reason to believe that Masco shouldn't trade at a P/E of 12x, which

would mean a \$12 billion market capitalization instead of a \$4.4 billion market capitalization, and Masco shares would nearly triple.

It's interesting that Masco was historically a large capitalization stock and, in lockstep with the rest of the housing industry, it declined to the point that many people would now exclude it from large capitalization status based on its market capitalization, though the scope of its business activity would argue for its inclusion. Therefore, I include Masco as a recommendation.

## *From the Readers*

### *Abbott Laboratories (ABT) & Bristol-Myers Squibb Co. (BMY)*

*Q: Abbott Laboratories seems to have a pipeline comparable to that of Bristol-Myers, but without the large patents coming due such as Bristol-Myers has with Plavix. Abbott Labs seems to be a better buy right now, though I agree that a few months back Bristol-Myers looked good. What are your thoughts are on Abbott Labs. Do you find it more or less attractive than Bristol-Myers and why?*

**A:** I agree with the reader that, at the current moment, Abbott is more attractive than Bristol-Myers. Abbott is not merely a pharmaceutical company; it is also a hospital supply company. By its very nature, a hospital supply company is not subject to the potential disruptions in revenue and earnings that replacement of an off-patent drug could create. Therefore, from merely a business stability standpoint, Abbott Labs is interesting and attractive, and it might be said to be a superior buy to Bristol-Myers, at the moment.

That being said, the challenge for any pharmaceutical company is to create blockbuster drugs. Though it's not an impossible task, it has become more difficult, because the drug industry has exhausted the supply of chronic ailments for which to invent blockbuster drugs. Most of the ailments are self-limiting and don't lend themselves to blockbuster revenue status. Though it's certainly not impossible, the comments stand that Abbott Labs appears to be more attractive than Bristol-Myers at current prices and circumstances.

***CB Richard Ellis Group, Inc. (CBG)***

**Q:** *Given the sharp move in CB Richard Ellis since July, what is your current opinion of the company?*

**A:** I'm still recommending CB Richard Ellis, because the company has appreciated mightily from its lows, but the lows on Richard Ellis represent the view that the company was likely to become extinct, which is unlikely. It will be recalled that several years ago the general consensus view on CB Richard Ellis was that it would prosper in any economic environment. The basic rationale at the time was that commercial real estate had not become characterized by large construction projects as in years past. The outlook was for a more stable experience without the sorts of vacancy rates of prior cycles. That view was accurate; nevertheless, the problem became not the vacancy rates, but the rollover of commercial mortgage obligations.

In 2009, the view was the opposite of the one just described. It was expected that there would be little if any commercial real estate activity, because so many buildings were going to be repossessed by the banks. Though there will certainly be repossessions by the banks, it will not be due to the insufficiency of cash flow with which to service debt, but to the unwillingness, or perhaps the inability, of a bank to roll over the debt. That situation is not likely to inhibit the opportunities for CB Richard Ellis.

At the end of the day, properties will still change hands, and the company's role as an intermediary is likely to be every bit as robust as it ever was. It will also be recalled that CB Richard Ellis has some interesting real estate investment portfolios. To the extent that it can take advantage of the current once-in-a-lifetime opportunity to expand that portfolio at current depressed prices, and raise more funds, it's likely to evolve into a fairly profitable asset manager in the context of the broker, and ultimately have a more stable, not less stable, earnings profile in the future. Therefore, I would still purchase CB Richard Ellis.

**APPENDIX A**

**Money Manager Index**

From Jan 1983 to Aug 2009

Annualized return

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Yr. End	Index	Yearly return	(since inception)
1983								1.00	0.81	0.76	0.87	0.75	1983	0.75	(60.5)%	(50.2)%
1984	0.75	0.71	0.70	0.66	0.67	0.67	0.61	0.83	0.79	0.76	0.67	0.65	1984	0.65	(13.5)%	(26.5)%
1985	0.92	0.93	0.99	0.95	1.20	1.30	1.32	1.38	1.28	1.50	1.86	2.02	1985	2.02	211.8%	33.7%
1986	2.46	2.78	2.47	2.31	2.36	2.33	2.03	2.23	1.98	2.37	2.34	2.34	1986	2.34	15.9%	28.2%
1987	3.21	3.27	3.16	2.55	2.37	2.30	2.39	2.47	2.22	1.56	1.44	1.52	1987	1.52	(35.0)%	9.9%
1988	1.80	1.87	1.78	1.79	1.69	1.94	1.92	1.96	2.01	1.97	1.95	2.07	1988	2.07	36.0%	14.3%
1989	2.42	2.37	2.54	2.63	2.64	2.64	2.93	3.12	3.07	3.05	3.23	3.26	1989	3.26	57.8%	20.2%
1990	3.12	3.15	3.53	3.06	3.47	3.45	3.30	2.70	2.68	2.40	2.52	3.02	1990	3.02	(7.3)%	16.1%
1991	3.08	3.49	3.70	3.68	3.71	3.61	3.86	4.05	4.07	4.69	4.47	5.72	1991	5.72	89.4%	23.0%
1992	5.76	5.61	5.30	5.12	4.98	4.99	5.93	6.06	6.19	6.56	7.25	7.36	1992	7.36	28.6%	23.6%
1993	8.06	8.04	8.20	7.94	8.15	8.57	9.05	10.00	9.99	9.31	8.97	8.90	1993	8.90	21.0%	23.4%
1994	9.52	8.73	8.05	7.85	7.81	7.53	7.66	8.31	8.15	8.52	7.88	7.95	1994	7.95	(10.6)%	19.9%
1995	7.74	8.38	8.72	8.77	9.20	9.35	9.93	10.78	11.22	10.53	10.89	10.40	1995	10.40	30.8%	20.8%
1996	11.12	11.50	11.33	11.62	11.86	12.53	11.91	12.36	13.32	14.03	14.42	15.02	1996	15.02	44.4%	22.4%
1997	16.04	16.81	15.32	17.27	18.42	20.29	22.28	21.39	25.31	24.95	24.95	25.50	1997	25.50	69.8%	25.2%
1998	25.67	29.00	29.89	30.60	28.90	30.44	27.67	21.33	21.74	25.16	27.27	25.41	1998	25.41	(0.4)%	23.3%
1999	26.00	23.71	23.92	26.77	28.94	29.74	28.78	26.74	25.89	27.73	28.54	30.55	1999	30.55	20.2%	23.2%
2000	31.07	31.19	36.01	35.60	35.20	40.32	43.58	45.75	45.62	48.69	44.05	49.84	2000	49.84	63.1%	25.2%
2001	50.23	46.41	44.27	46.96	48.90	49.98	50.67	49.70	46.47	44.81	48.04	51.91	2001	51.91	4.2%	23.9%
2002	53.62	53.74	55.11	52.52	52.83	50.48	42.58	44.92	41.54	42.66	45.78	43.17	2002	43.17	(16.8)%	21.4%
2003	42.72	41.18	42.36	45.98	49.02	50.71	53.47	53.97	53.46	56.12	55.83	58.49	2003	58.49	35.5%	22.1%
2004	64.38	65.08	64.63	61.68	60.86	62.30	58.71	64.08	65.73	68.86	73.53	78.16	2004	78.16	33.6%	22.6%
2005	76.46	77.94	74.06	72.83	77.02	80.25	83.59	83.07	86.03	89.19	96.58	97.35	2005	97.35	24.6%	22.7%
2006	107.62	111.44	110.75	111.88	101.89	100.61	100.62	104.98	114.61	116.64	113.78	118.05	2006	118.05	21.3%	22.6%
2007	125.73	123.77	122.62	127.58	133.57	134.68	126.61	124.07	133.57	148.09	135.13	135.56	2007	135.56	14.8%	22.3%
2008	127.53	115.76	115.94	121.58	130.51	115.68	119.94	120.55	109.69	72.70	62.95	67.91	2008	67.91	(49.9)%	18.1%
2009	57.51	51.76	65.63	79.49	85.67	90.79	99.97	101.69					2009	101.69	49.7%	19.4%

Name	Amount Invested
Affiliated Manager	\$ 22,947
Alliance	\$ 7,633
BlackRock	\$ 23,205
Waddell & Reed	\$ 27,513
Eaton Vance	\$ 2,641
T. Rowe Price	\$ 2,423
Franklin resources	\$ 908
Legg Mason	\$ 1,000
Federated Inv	\$ 26,381

Name	Amount Invested
Pzena Investment Mgt	\$ 122,426

**APPENDIX B**

**International Money Manager Index**

From Jan 1983 to Aug 2009

Year	31-Jan	28-Feb	31-Mar	30-Apr	31-May	30-Jun	31-Jul	31-Aug	30-Sep	31-Oct	30-Nov	31-Dec	Yr. End	Index	Yearly return	Annualized return (since inception)
1986											1.00	1.02	1986	1.02	10.0%	10.0%
1987	1.25	1.37	1.48	1.48	1.37	1.33	1.39	1.40	1.33	0.81	0.76	0.73	1987	0.73	(27.7)%	(23.3)%
1988	0.75	0.92	1.02	0.95	0.80	0.89	0.88	0.82	0.86	0.88	0.89	0.93	1988	0.93	26.4%	(3.4)%
1989	1.03	1.02	1.06	1.17	1.19	1.18	1.25	1.16	1.17	1.20	1.21	1.28	1989	1.28	37.8%	8.1%
1990	1.24	1.24	1.18	1.19	1.22	1.24	1.26	1.26	1.23	1.24	1.25	1.33	1990	1.33	3.7%	7.0%
1991	1.34	1.52	1.56	1.58	1.57	1.47	1.52	1.64	1.81	1.89	1.94	1.92	1991	1.92	44.8%	13.5%
1992	2.01	1.93	1.88	2.14	2.19	2.13	2.08	1.99	1.95	1.77	1.76	1.96	1992	1.96	1.9%	11.5%
1993	1.98	2.03	2.20	2.39	2.42	2.45	2.54	3.05	3.01	3.07	3.01	3.30	1993	3.30	68.7%	18.1%
1994	3.72	3.39	3.17	3.04	2.99	2.89	3.01	3.14	3.13	3.19	3.15	3.15	1994	3.15	(4.7)%	15.1%
1995	3.07	3.12	3.28	3.41	3.56	3.59	3.87	3.76	3.76	3.77	3.70	3.73	1995	3.73	18.6%	15.4%
1996	3.76	3.85	3.70	3.79	3.96	3.90	3.75	3.96	4.16	4.47	4.90	4.86	1996	4.86	30.3%	16.8%
1997	5.11	5.37	4.99	4.96	5.43	5.94	6.57	6.32	7.45	7.24	6.80	7.19	1997	7.19	47.9%	19.3%
1998	7.12	8.05	8.78	9.25	8.95	8.74	8.91	6.67	6.08	7.01	7.51	7.71	1998	7.71	7.3%	18.3%
1999	7.99	8.21	8.68	9.07	8.71	8.61	8.63	8.43	8.47	8.79	9.80	10.79	1999	10.79	39.9%	19.8%
2000	11.23	12.27	13.95	13.50	13.73	15.39	15.85	16.82	17.07	16.31	14.43	16.76	2000	14.43	33.8%	20.7%
2001	17.42	15.88	13.46	15.14	15.84	15.15	14.21	13.61	10.77	11.43	13.90	14.12	2001	14.12	(2.2)%	19.1%
2002	14.74	13.78	15.09	15.11	16.38	14.14	12.92	12.10	11.23	11.06	11.33	10.50	2002	10.50	(25.6)%	15.7%
2003	10.18	9.52	9.69	10.62	12.17	13.04	13.98	15.38	16.67	17.88	18.16	18.07	2003	18.07	72.1%	18.4%
2004	20.00	22.41	29.98	35.46	26.68	30.80	25.37	25.20	23.67	23.34	27.56	31.48	2004	31.48	74.2%	20.9%
2005	32.19	32.57	31.88	27.79	27.36	29.05	30.38	31.49	33.39	32.24	32.95	37.18	2005	37.18	18.1%	20.8%
2006	41.01	40.97	43.69	46.45	42.39	41.58	40.60	43.32	43.55	43.70	44.58	49.38	2006	49.38	32.8%	21.3%
2007	50.95	51.18	53.59	56.09	58.16	56.37	53.90	48.65	50.96	57.03	48.21	45.75	2007	45.75	(7.3)%	19.8%
2008	38.71	39.71	38.59	40.18	39.25	35.10	34.59	33.33	26.09	18.72	14.50	15.79	2008	15.79	(65.5)%	13.3%
2009	14.62	13.24	14.96	19.63	22.82	23.73	26.14	27.05					2009	27.05	71.3%	15.5%

Name	Amount Invested	Name	Amount Invested
IGM FINANCIAL INC	\$1,000	HENDERSON GROUP PLC	\$14,447
F&C ASSET MANAGEMENT PLC	\$1,203	RAB CAPITAL PLC	\$24,603
INVESCO PLC (PREVIOUSLY AMVESC	\$1,357	AZIMUT HOLDING SPA	\$21,908
SCHRODERS PLC	\$1,208	EVEREST FINANCIAL GROUP LIMITED	\$23,437
RATHBONE BROTHERS PLC	\$1,208	CHARLEMAGNE CAPITAL LTD	\$36,848
ABERDEEN ASSET MGMT PLC	\$1,208	PARTNERS GROUP-REG	\$36,848
CI FINANCIAL INCOME FUND	\$2,585	INVISTA REAL ESTATE INV MNGT	\$36,589
MAN GROUP PLC	\$2,862	ASHMORE GROUP PLC.	\$36,688
AGF MANAGEMENT LTD-CL B	\$3,343	BLUEBAY ASSET MANAGEMENT/UNI	\$37,469
SPARX GROUP CO LTD	\$11,762		