LOUIS RUKEYSER'S WALL STREET

200TH ISSUE

LEST WE FORGET

1933 – 2006

OCTOBER 2008

A September to Remember, But the Pain Will Not Last Forever

By Nikolas Lanyi

If a market pundit had predicted, as recently as six months ago, that by the end of September the federal government will have seized control of Fannie Mae, Freddie Mac and AIG, and that Lehman Brothers would go bankrupt, and that Merrill Lynch would be forced to sell itself from one day to the next, no one would have believed him.

Yet all these impossible-to-imagine events occurred in September, in a period of eight days. Faced with a potential meltdown of the U.S. credit markets—which would have precipitated an even worse global credit crisis—the federal government took emergency action. While these activities will and should be debated, there's no question that something had to be done, because in a climate in which little trust exists that loans will be repaid, all lending will cease.

What does this mean for the average investor? Everything and nothing. Everything, because the events of mid-September probably will set back the U.S. economic recovery by a quarter or two, as lenders take a while to get out of a defensive crouch that has been attenuated by the collapse of Lehman and near-collapse of Merrill Lynch and AIG. The thinking is that if these bulwarks can fall, who's next?

There's a light at the end of the tunnel: most economic forecasters think the housing market is beginning to bottom. But it likely won't show clear signs of recovery until the first quarter of 2009 at the earliest. Until that happens, the credit crisis will remain in place, as financial institutions with mortgage-backed securities on their books will find it difficult to value those assets, and thus use them as collateral to borrow the money they need to keep loans flowing out their doors.

How do the epochal happenings of the past month mean nothing for the average investor? Because unless you own stock in one of the companies involved, or were heavily invested in banks or financial-services companies, your portfolio probably is focused on companies that aren't doing too poorly, even in a weak economic environment. The rest of the U.S. economy is hanging in there, and some areas—energy, infrastructure, industrial materials, consumer staples and technology, to name a few—are more than muddling through. Investing in companies with good businesses, strong balance sheets, solid managements and exposure to growth areas will pay off not only in the long run but, I believe, over the next quarter or two as well.

What does this mean for the average investor? Everything and nothing.

September was a frightening and painful month for the U.S. stock market, and for Wall Street in general. I won't try to put a cheery gloss on it. But bear markets have always—always—been followed by bull markets, and normally in fairly short order. History may not repeat itself this time, but I would not bet against it. ■

Frank Beck Senior Portfolio Manager, Capital Financial Group (Austin, Texas)

Comments & Outlook

"Unfortunately, we still have a lot of unwinding to do in the financial sector, where a lot of bad loans were securitized and need to be dealt with. In addition, we may not have seen the worst of the foreclosure rate yet.

We are avoiding financials until the first quarter of next year; at that point, we may start to get out of the woods."

Recommended Strategy

"We recommend a position of about 50% in cash, short-term Treasuries, inflation-protected securities and selected currencies such as the yen and Swiss franc. We also recently added a gold position," based on valuation and as an inflation hedge. Long-term investors should look for opportunities among mining companies, fast-food restaurants and consumer-staples retailers, energy-services companies and companies supplying essential items with rising long-term demand—such as food and water.

What to Buy Now

Among mining companies, **Freeport-McMoran** (FCX) is attractive, but don't invest all at once; add to your position gradually. **McDonald's** (MCD), **Yum! Brands** (YUM) and **Wal-Mart Stores** (WMT) all will perform fine in a recessionary environment. ■

Sebastian Henry Financial writer and contributor to *Louis Rukeyser's Wall Street*

Comments & Outlook

"We're officially in a bear market, and until there's more clarity regarding the credit crisis it will be difficult for a sustained rally to develop. The psychology of investors is poor, and bad news could be blown out of proportion—but that will create buying opportunities for attractive companies."

Recommended Strategy

"The financial sector should be avoided at this point, but buying opportunities exist for steady-growth companies, particularly those that pay dividends and have businesses that can continue to thrive in a weak economy. Look longer term: by the end of 2009, the recession will probably be over and economic growth will be picking up. Before that happens, shares of companies that will benefit from stronger growth will begin to perform better."

What to Buy Now

In addition to the stocks profiled on page 12, **McDonald's** (MCD), **Coca-Cola** (KO) and **PepsiCo** (PEP) are worth purchasing on price dips. ■

Ron Weiner President and CEO, RDM Financial Group

Comments & Outlook

"The system is really stretched, so investors have reason to be somewhat fearful in the short term. Washington Mutual, AIG and Lehman Brothers are not the only companies with problems. The government can't bail out everybody. In fact, the government could do some good by removing rules that force banks to mark to market securities that are not maturing for many years. That would help smooth things out. We're probably in a recession, and that won't end if banks aren't lending."

Recommended Strategy

"Diversification is your best friend. Don't make big bets, make a number of small bets. Own a little foreign exposure, not a lot—because the dollar is rising as the rest of the world is getting weaker. Diversify among small, mid- and large-cap stocks, with a lean toward multinationals, which could do better going forward because most have foreign exposure."

Energy stocks have been beaten up and represent good value. Healthcare and industrial-materials stocks also should be overweighted now.

What to Buy Now

In energy, **ConocoPhillips** (COP) and **Hess** (HES). In healthcare, **Johnson & Johnson** (JNJ), **Genentech** (DNA) and **Abbott Labs** (ABT). In industrial materials, **Freeport-McMoran** (FCX) and **Monsanto** (MON). Also, **Google** (GOOG) is a stock to own for the rest of your life as a play on the growth of the Internet. ■

THE CHECKUP

Not Flickering? *General Electric* (GE, $24.60), which we have written about many times over the years, sold off heavily in the market decline that followed Lehman Brothers' liquidation announcement. Although GE is one of the most-owned U.S. stocks and is considered by many to be a traditional "blue chip" core holding, it also is a bellwether of world economic strength *and* has financial-services subsidiaries. That put it directly in investors' sights when they looked for sell candidates.

However, the selloff may have been overdone in GE's case. GE's lending businesses are exposed to credit-card defaults, and writedowns are a possibility there. However, the company's overall financial businesses—which include insurance and asset management—are now exposed to real estate only outside of the U.S.; this is not a company with much subprime-mortgage exposure. GE's investments include some that are backed by insurance issued by troubled insurance giant American International Group, yet most analysts think the risk of default is minor and would not have a significant impact on GE's balance sheet. In addition, GE has a stronger loan-to-capital ratio and reserves than most equivalent companies.

The most compelling reason to be bullish on GE is that its financial services business is only a small part of the overall company, which includes media, consumer products, technology, healthcare and—most important—a fast-growing industrial-materials business that continues to benefit from growing infrastructure capital spending in China, India and large emerging markets. It has a huge and growing order backlog for such products as turbines, and while these could slow somewhat they remain a terrific long-term play on the global infrastructure buildout.

In addition, GE overall has a very strong balance sheet that mitigates the risk from the financial-services division. S&P rates GE's credit AAA, the highest possible rating. The company's dividend appears safe and at recent levels it traded at only 11 times the estimate for forward per-share earnings. While negative news on the financial-services side could continue to impact the stock, investors who are willing to endure short-term risk for long-term gain should take a close look at GE now. ■

SURPRISE! SURPRISE!

Good Deal. *Shuffle Master*, the world's largest maker of automatic card-shuffling machines and electronic games for gaming casinos, reported higher-than-expected earnings for the third quarter. Net profit rose 10%, with earnings per share of 11 cents (not counting one-time charges), vs. analysts' expectation of 10 cents. Revenue was up about 10% to a third-quarter record of $49.5 million thanks to a 23% increase in lease and service revenue. More casinos are opting to lease rather than purchase machines, and Shuffle Master's growing base of installed machines is resulting in rising service revenue.

On a per-share basis, the company's earnings were flat year over year because of a secondary stock offering that diluted per-share figures. But the company says its refinancing strategy has paid off in sufficient capital to continue to expand its business, so an additional equity offering is unlikely at this point.

While gaming tends to suffer during recessions, most analysts think overall gaming industry sales will continue to rise thanks to the ongoing gaming expansion in Macau, as well as some smaller gaming markets in Asia.

The company also recently was upgraded to "buy" from "hold" by Deutsche Bank analyst William Lerner, who says the addition of 2,600 casino tables in the U.S. through 2012, along with 6,000 in Macau through 2011, will boost the company's earnings by about 25%. Lerner thinks Shuffle Master will achieve a 60% market share in Macau, the fastest-growing gaming market in the world. His price target is $7 a share. At its recent share price, Shuffle Master traded at less than 17 times analysts' consensus estimate for per-share earnings for the fiscal year ending October 2009. ■

WHO'S BUYING WHAT

Bucking the Trend? *SAP*, the #1 global provider of business-management software, was upgraded to "outperform" from "neutral" by analyst Rajesh Balasubramanian of Credit Suisse, who cited the company's ability to increase profit margins and its prospects to benefit from the rising dollar vs. the euro.

Based in Germany, SAP sells products that help large enterprises (businesses, government agencies, nonprofit groups, etc.) integrate their various electronic functions—accounting, administration, production, distribution, human resources, customer service, data storage, and the like—into smoothly functioning, easily usable systems. The company is a leader in helping companies who want to integrate Web capabilities in their systems. It has almost 50,000 customers in 120 countries around the world, an enormous installed base that leads to recurring revenue in the form of licensing fees, upgrades, maintenance and services. (In fact, more of its revenue—about 37%—came from support services last year than for software, at 33%.)

SAP has expanded its targets to include smaller businesses, both by acquiring other companies in that niche and through a major advertising campaign to increase awareness of its brand among small-business owners.

Although the global economic slowdown has had an impact on enterprise IT budgets, SAP's sales in Europe and the U.S. have held up well this year. And the stock has attracted buying from several top investment firms this year, including Capital Research & Management and Thornburg, both of which initiated positions in the second quarter. At recent levels, SAP trades at 15 times analysts' consensus earnings estimate for next year's earnings. ■

CLOSER LOOK

Company (Symbol)	Recent Price	52-Week High/Low	Book Value Per Share	Revenue* 2007/2008 ($billions)	Earnings Per Share*/ % Change 2007	Earnings Per Share*/ % Change 2008	Debt/Equity ($billions)	No. of Shares Outstanding (billions)	No. of Analysts Following Stock/No. Who'd Buy
SAP (SAP)	$54.02	$59.86/$43.00	$4.93	$11.8/$14.1	$1.60/+5%	$2.97/+86%	$3,120/$6,151	1,246.7	15/7
Shuffle Master (SHFL)†	5.02	16.32/3.93	3.23	0.2/0.3	0.47/–24	0.20/–57	69.2/171.0	52.9	6/3

*Estimates. †FYs ending October 2007 and 2008. **Source:** Bloomberg, Zacks.

***In the midst of one of the most tumultuous storms of bad news in the history of Wall Street—one that has washed away Fannie Mae, Freddie Mac, Lehman Brothers and Merrill Lynch in the course of eight days—we are all seeking the shelter of common sense, calm and caution. One dependable source of all three over the years has been Nick Sargen, chief investment officer of Cincinnati-based Fort Washington Investment Advisors. Nick, a longtime friend of this newsletter and a former panelist on Louis Rukeyser's television programs, combines an insider's savvy with an ability to speak plainly about complex subjects in terms any investor can understand. As you'll see, Nick preaches prudence right now, but he's far from panicked.*—Nikolas Lanyi**

Button Up Now, But Get Ready for Sunnier Days

Nick, is this the mother of all bear markets or something a little less frightening?

The data tell us we're in a global bear market, certainly. And looking at the even bigger picture, Alan Greenspan just said that what's transpiring in the financial system is a once-in-a-century event. We're seeing things I certainly have never seen in my lifetime in terms of the number of firms that are under severe strain. That's the new epicenter of this storm. It started with housing, but the locus is now in the financial system.

What's your outlook at this point?

First of all, I don't expect to see conditions stabilize until I see housing prices find a bottom. They've already fallen about 20% from their peak, as measured by the Case-Shiller Index, which captures the 20 major metropolitan areas. The good news on housing is that the drag on activity, the decline in housing starts, seems to be leveling off. But the bad news is that there's still a large inventory overhang, and you've got foreclosures happening. So my expectation is there's still another 5% or maybe 10% downward movement in housing prices.

Why is that important? Because when we come to the problems in the financial system, everybody is trying to figure out what is the value of these mortgage-backed securities that financial institutions have on their books. And the answer to that very much hinges on where housing prices stabilize.

So my prognosis is that we're still going to be on a rocky road at least through the balance of this year, into next year. I'm more hopeful that we start to see some stabilization in spring or the middle of next year.

When you look at the major investment banks and commercial banks, are there more shoes to drop?

I think there are more shoes to drop. So far, the writedowns by financial institutions are in the ballpark of about $500 billion. Some of the estimates that were put out at the beginning of the year, including by the International Monetary Fund, were $1 trillion by the time the dust settles. We're not including writedowns on the part of Fannie Mae and Freddie Mac in that tally, by the way. So we have to prepare for more.

So far, we've been talking about mortgage-related losses. But as the world economy is impacted by this credit slowdown, it's natural to assume that there are going to be problems of traditional bank lending, such as we're already seeing in the auto sector. So I think there will be more institutions failing over the next six to 12 months.

What impact is all this having on some of the fast-growing large emerging markets that a couple of quarters ago were seen as the salvation of the global economy?

It's interesting: the emerging equity markets this year have sold off substantially more than either the U.S. or other developed markets. I think the reason is that while there have been positive developments—we haven't seen a slowdown so far in China, for example—there is no doubt that there's a major slowdown taking place in Europe and Japan, along with the U.S. So if you're an emerging economy, you're dependent on export growth, and that's begun to slow—especially into the U.S. and Europe. The second thing is that the emerging economies were the great beneficiaries of the commodity-price boom, but once investors realized about the middle of this year that this is a worldwide slowdown, we've now seen major declines in oil prices and the prices of other commodities. So that's why we're seeing a more traditional impact. In the past, it was whenever the U.S. sneezes, the rest of the world catches a cold. It didn't appear that way earlier this year, but now it's certainly playing out to script.

Not a pretty picture for equity markets anywhere, it sounds like.

Yes. As I said, you have to call this a global bear market. In the U.S., you're down more than the conventional 20% from the peak a year ago—and outside the U.S., international and emerging equity markets have fallen even more.

What about fixed income?

If you've been in government bond markets of the world, including U.S. Treasuries, those have been a refuge. You don't want to be in corporate or high-yield markets, because the worries about credit have caused a significant widening in the spreads between high-yield corporate bonds and U.S. Treasuries. So far, the places to be have been either cash or Treasury bonds.

Are there any silver linings?

Yes. First of all, I was getting more concerned in the second quarter when we saw an economic slowdown as well as a major increase in headline inflation rates in the U.S. and around the world. So the decline in oil prices and commodity prices is a definite plus for the longer term, for two reasons. Reason one is there's less risk now of central banks abroad raising interest rates, and my forecast is that it's only a matter of time before they will be lowering interest rates; some will take longer than others. Point two is that the rise in food and energy prices was a tax on consumers of these commodities. And so now we're getting some respite from that. It's not going to impact us immediately, but down the road that's a positive development.

Second, in housing, we're getting closer to seeing a bottom—again, I wouldn't say this year, but I do peer into next year and hope for stabilization by spring.

And I think the last thing to remember is that equity markets are discounting mechanisms; they're not going to wait for the bottom and then rally—they will anticipate the bottom. So if the bottom for the economy is the middle of next year, one could very well see a rally beginning in equity markets, say, six months ahead of that.

You said one sign of that might be a clear bottom for housing. Anything else?

Yes, because housing was the genesis of this crisis. We've got to get closer to home-price declines leveling off so that financial companies can determine how much their underlying collateral is worth.

Another positive I would point to is that the U.S. economy has held up better than expected so far this year, thanks to two factors. One is temporary, one is ongoing. The temporary factor was that we did have well-timed tax rebates that got us through the spring period. The other factor has been that U.S. exports have been remarkably resilient, which has been a major boost to corporate profits. More than a third of it is coming from overseas operations of U.S. companies or their exports abroad. That's been their salvation. But I think investors are starting to realize we can't count quite as much on that export strength.

Are there any pockets of opportunity right now for investors?

I think the answer is yes, but I'd say right now, the first objective of any investor is to make sure their portfolio is protected. So the first thing I'm trying to do is get through the storm. We're holding more cash than normal, and we're making sure our portfolios are pretty diversified. Now, we're value investors, but some of the great value investors of modern times are having terrible periods now. Why? They jumped into financials, because they looked cheap. So I believe that amid this carnage, there are opportunities. But I've got to make sure I'm not in position that if I deploy my cash too soon, I could get that capital wiped out. So I'm basically still playing defense, but beyond that here are some things going through our minds.

UNDER NICK'S UMBRELLA

Stock (Symbol)	Recent Price	52-Week High/Low	Earnings 2007/2008*
American Express (AXP)	$35.48	$63.63/$35.10	$3.36/$2.75
Deutsche Telekom (DT)	15.35	23.05/15.28	0.18/1.01

*Estimates. **Source:** Bloomberg.

On financials right now, we're trying to figure out who will be the survivors. Some of them will face less competition in the future. One example would be *American Express*, which has been hit to some extent—but the core franchise is intact, and it looks relatively cheap to us. That's a stock for the long run.

In energy, we were reluctant to invest in energy stocks when oil prices were going up toward $150 a barrel, because we just didn't think that was sustainable in a weak economy. Now that oil prices have retraced below $100, we're more interested. We're looking at a variety of strategies, including natural gas providers, offshore oil companies and master limited partnership (MLPs). They're investing in energy infrastructure—pipelines, storage facilities and the like. They provide high current income along with the potential for capital gain.

Another area we've looked into is telecommunications, where we're seeing a lot of value in overseas telecom providers, such as *Deutsche Telekom*.

Finally, Nick, what's your single best piece of advice for investors over the next 12 months?

I'd come back to the earlier point: we're in a world bear market right now, but it's not going to go on forever. Your number one job is to protect your capital. Keep some extra cash on hand for when there's a turn in the market. When I'm getting more confident that I'm getting closer to a bottom in housing prices, that's my signal. And that's when I'm going to want to redeploy that cash. ■

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***In September 2007 on this page, we profiled a stock that turned out to be a huge winner, one of the biggest beneficiaries of the historic bull market in food-commodity prices that marked the first half of this year. As commodity prices have declined since mid-summer, so has the share price of this market-leading company. But its long-term prospects remain very strong, and many savvy investors are telling us they are buying it now. Indeed, the lower share price gives us another chance to tell you about the global leader in agricultural products.*—The Editors**

Growing Profits

The world's #1 seed producer, ***Monsanto*** is riding a wave of increased demand and rising prices for its products, thanks to technological superiority that seems to be growing over time—and the company plans to double its profits between now and 2012.

Best of all: Monsanto's stock price has dropped about 22% from its June 17 high, making the stock attractively valued again.

Monsanto's business consists of two broad segments: seeds & genomics (55% of revenue) and agricultural productivity (45%), which mostly sells herbicides, including the best-selling weed-killer Roundup. Its seed division produces advanced seeds of all kinds, with an emphasis on corn, soybeans, wheat and cotton, as well as fruits and vegetables.

Thanks to its powerful research & development budget, Monsanto is the world's top innovator in the rapidly changing science of genetically modified (GM) seeds. By providing customers with unique, superior products, the company can charge higher prices and keep its profit margins high. For example, the company has developed species of corn that are highly resistant to pests, diseases and drought.

Rising population levels and increased wealth in some of the world's most populous countries is leading to increased calorie consumption and more-varied diets, which in turn is placing pricing pressure on food products and incentivizing farmers to increase production. So although some aspects of GM are controversial, most analysts think technologies like Monsanto's are here to stay; they'll play an increasingly important role in feeding the world in the coming years.

Thanks to technological superiority, excellent profitability and an unmatched distribution network, Monsanto's DeKalb unit has increased its share of the corn-seed market to almost 25%, up from only 10% in 2001.

Roundup has enjoyed a renaissance in profitability over the past year, thanks to Monsanto's ownership of phosphorus production facilities that reduce its expenses for the chemical, the price of which has skyrocketed; Roundup thus has enjoyed rising prices but has remained less expensive than the competition, making it the most profitable weed-killer of its kind. The rising operating-profit margin for Roundup was a prime reason the company's most recent quarterly earnings rose 34%.

Monsanto also is benefiting from government efforts to increase the use of ethanol to help fight global warming, as well as to decrease U.S. dependence on foreign oil. Analysts think the percentage of corn acreage in the U.S. used to make ethanol will almost double over the next six years. Monsanto's highly fermentable corn product, DeKalb Processor Preferred, gives it a proprietary edge in this market. And it has invested in new products, some developed in partnership with other firms, to make sure it maintains its edge.

Monsanto has a strong balance sheet and generates robust free-cash flow of $1.3 billion a year, giving the company ample resources to fund its R&D budget (typically at about 10% of revenue), buy back shares and increase its dividend in the past year. Monsanto also has made several strategic acquisitions, most aimed at maintaining or increasing market share in various niches of the seed market.

Monsanto is expected to increase its earnings at an annualized rate of 22% over the next few years, making its recent price/earnings ratio of around 32 a relative bargain for this best-in-breed agricultural supplier.—***Nikolas Lanyi*** ■

WHY TO BUY

MONSANTO (MON • $105.40)

- Market leader's sales surging on demand for seeds, pesticide and other products
- Huge R&D and acquisition budget helps maintain competitive edge
- Also benefiting from shifting trends in energy consumption

MONSANTO

St. Louis, Mo. (314-694-1000)
www.monsanto.com

Revenue ($billions)	Earnings per share	Oper.-profit margin	Share price high/low
2009*	$13.8	$4.52	26.0%	na
2008	11.6*	3.47*	25.0*	$145/$90
2007	8.6	1.83	23.0	116/49
2006	7.3	1.31	23.1	54/38

Common shares outstanding: 550 million
Debt: $1.7 billion
Equity: $10.2 billion

What Wall Street Says

Number of analysts covering stock: 9

▲▲▲▲▲▲ Buy—7

●● Hold—2

FY ends August. *Estimates. **Source:** Bloomberg, Zacks.

RISING TARGET

Credit Suisse analyst Mark Connelly increased his rating on Monsanto to "outperform" from "neutral" in September. His price target is $145.

CHINA CROP

Monsanto recently invested $85 million to expand its partnership with China National Seed Group to distribute Monsanto seeds throughout that country's corn-growing areas. Expanding its operations in China, the world's most populous country, will be important to Monsanto's long-term growth prospects.

***What goes down** must go back up? Not necessarily, as shareholders in Lehman Brothers recently discovered. Sometimes, a seemingly undervalued investment is nothing more than a value trap; its beaten-down price reflects a new reality rather than a temporary problem. However, the majority of energy experts believe crude oil's recent fall from around $140 to the double digits marks a buying opportunity rather than a value trap. That's because worldwide demand for energy is likely to continue to outstrip new supply in the coming years, even if the gap has narrowed due to economic weakness this year. Read on for a blue chip integrated oil company with a healthy yield and solid prospects.*—**The Editors**

Oil Opportunity

Chevron boasts a geographically diverse production profile, excellent refining assets and a strong balance sheet that makes its dividend safe and increases its chances of above-average earnings growth in the coming years.

The world's fifth-largest integrated energy producer, Chevron was formed by the 2001 merger between Chevron and Texaco, as well as the major acquisition of Unocol in 2005. (The company was named ChevronTexaco until 2005.) Like the other four so-called "major" integrated energy companies, Chevron has a hand in every aspect of the oil and gas business: exploring for, buying and owning oil and natural gas assets around the world; producing oil and gas from them; transporting it to its own refineries (10 fully owned, with interests in 12 more) and producing gasoline, chemicals and other petroleum and gas products; transporting these products around the world; and selling them directly to end users, including through about 25,000 gasoline stations.

Thanks to its acquisitions as well as the rise in the price of oil, Chevron's revenue has expanded rapidly over the past decade: from $29.9 billion in 1998 to $214.1 billion in 2007. Earnings per share have risen from $1.02 to $8.77 during the same period, and analysts look for $12.22 for all of 2008 and $13.07 in 2009. While those numbers could be revised downward if the global economy slows further, they are a flavor of the favorable climate in which Chevron is operating as oil demand continues to rise while supply gets harder to come by.

Chevron has an attractive pipeline of potentially deep, but hard-to-access, oil assets that can be profitable even if crude oil remains around $100 but will be extremely valuable if the price of crude oil rises further. The Unocal merger made Chevron the biggest owner of oil assets in Asia, a fast-growing market for oil consumption in the coming years.

And the company's production assets include 40 projects in development, including in some of the hottest oil-exploration areas of the world today, including deepwater projects in the Gulf of Mexico and off of Nigeria, as well as promising discoveries in the Caspian Sea, Kazakhstan, Angola, Brazil and Australia. Chevron is the operator and half-owner of the Gulf of Mexico's Jack #2 well, the deepest major project yet—the oil sits under 7,000 feet of water and 20,000 feet of sea floor.

After being one of the darlings of oil analysts in the years after the Texaco merger, Chevron's star dimmed a bit as its expenses for developing new supplies have run above the industry average over the past three years. However, the company seems on track to increase oil and gas by 2% to 3% a year over the next five years, slightly below its initial forecasts but sufficient to keep revenue and earnings on the rise, particularly if oil rebounds. The company is considered one of the best-managed and most profitable in the business, despite its recent bout of above-average expenses.

Chevron's balance sheet is extremely strong, with debt less than 10% of capitalization. The company spends $20 billion or more on capital expenditures each year, but its cash flow is more than sufficient to cover these costs, the minimal interest on its debt and regular stock repurchases—while still boosting the dividend more than 10% a year in each of the past four years.—***Sebastian Henry*** ■

WHY TO BUY

CHEVRON (CVX, $80.09 • 3.1% YIELD)

- Crude oil is likely to rally over the next year
- Chevron has excellent assets with strong growth potential
- Strong balance sheet, safe dividend

CHEVRON

San Ramon, Calif. (925-842-1000)
www.chevrontexaco.com

Revenue ($billions)	Earnings per share	Dividend per share*	Share price high/low
$299.0*	$12.22*	$2.60*	$105/$76
214.1	8.77	2.26	96/65
204.9	7.80	2.01	76/53
193.6	6.54	1.75	66/50

Common shares outstanding: 2.1 billion
Debt: $5.4 billion Equity: $82.3 billion

What Wall Street Says

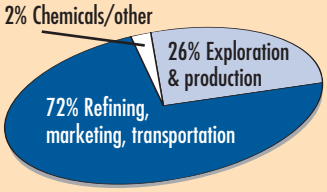
Number of analysts covering stock: 8

▲▲▲▲▲ Buy—5

●●● Hold—3

*Estimates. **Source:** Bloomberg, Zacks, analysts.

CHEVRON'S REVENUE



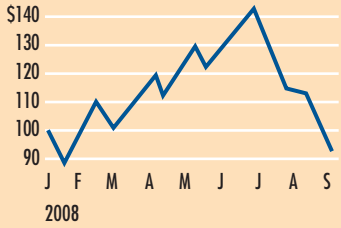
Source: Standard & Poor's.

DOWN UNDER

Chevron also is developing a liquefied natural gas facility (LNG) in Australia, staking a claim to another potentially fast-growing part of the energy industry—gas demand is expected to rise considerably worldwide, and Australia is a major producer but needs LNG capacity to ship gas overseas.

CRUDE DECLINE

Crude oil has dropped about a third from its June high, as increasing signs of economic weakness around the world led experts to decrease their estimates for oil consumption and demand. And the U.S. dollar's rally reduced investor interest in crude-oil futures, which serve as a hedge against a weaker dollar.



Source: Bloomberg.

FYI Chevron has paid a dividend every year since 1912

***Volatility is frightening**, but it can be an investor's best friend if he uses selloffs to add to positions in terrific long-term investments. That's especially true for fund investors, who don't need to make the scary decision to invest in a single stock that's just dropped 5% in a day; instead, they can spread their bets among dozens of stocks—selected by a professional manager who presumably is taking good advantage of a major selloff by adding to positions of those stocks most unfairly punished. As we enter an election season marked by a shaky market, here are three candidates for additional money after broad market declines.*—**The Editors**

Growth Stars

All three of these funds are large-cap growth vehicles with enough panache that they have a good chance to outperform the market on the upside when stocks rebound. Risk-averse investors should stay away; those who can handle volatility should take a look.

Brandywine Blue. Bill D'Alonzo, who has managed the fund since January 1991, has a five-year annualized returns of 10.1% respectively rank it among the top 7% of all large-cap-growth funds, according to Morningstar.

D'Alonzo invests in undervalued stocks with prospects for accelerating earnings growth; the typical holding has a below-average price/earnings ratio but an above-average prospective earnings-growth rate, based on analysis by D'Alonzo and his analysts. Faster earnings growth could come from any number of causes, including a restructuring, business cycle or new product cycle. According to the fund, its average holding will increase earnings 22% in 2008, vs. only 6% for the S&P 500.

When D'Alonzo and his analysts identify a company that seems attractive, they conduct extensive research before he buys the stock for the fund. Because D'Alonzo and company are always on the lookout for companies they think will surprise Wall Street in the next quarter or two, the fund's turnover tends to be high, which can lead to taxable distributions in non-retirement accounts.

D'Alonzo recently had strong overweights in energy and very little in financial services. The former should boost returns if oil and gas prices rebound, as many experts predict they will eventually. Consumer staples companies are another top area of concentration; this could help the fund if the economy continues to weaken.

Jordan Opportunity. Manager Jerry Jordan and his small team of analysts focus on three to five themes they think will drive strong earnings growth over the next several years, then pick three or four companies whose earnings are all leveraged to those themes—and invest in them when the price is right. Two of his favorite themes are energy and electricity generation, both of which are driven by rising long-term demand from emerging markets as well as North America.

The approach has worked wonders: over the past three years, Jordan Opportunity's 12.2% annualized return ranks it among the top 2% of all large-growth funds, according to Morningstar. Over the past 12 months, Jordan has a 2.8% positive return, vs. the S&P 500's decline of 11.1%.

Marsico 21st Century. Managed by Cory Gilchrist since February 2003, this fund has one of the very best records among all large-cap-growth funds: its five- and three-year annualized returns of 11.6% and 9.1% respectively rank among the top 5% and 4%, respectively, of funds in the group, according to Morningstar.

Gilchrist invests in a concentrated portfolio of well-managed companies with rising cash flows in industries benefiting from economic, societal or industry-specific trends. After identifying investment themes about which he feels confident, Gilchrist looks for companies that can surf the trends and generate sustainable cash-flow growth. He favors companies that are low-cost providers and market-share leaders in their industry, because they're the most likely to reap the benefit of the underlying trend. Marsico 21st Century is relatively focused, with about 40 holdings. About 25% to 30% of the fund is in mid-cap and some smaller companies. Gilchrist has invested more heavily in financials, but with a lean toward credit-card providers rather than investment banks; he also currently likes casino stocks and discount retailers. ■

WHY TO BUY

BRANDYWINE BLUE (BLUEX)
JORDAN OPPORTUNITY (JORDX)
MARSICO 21ST CENTURY (MXXIX)

- Top records vs. other large-cap growth funds
- Large fast-growing companies should rebound after being unfairly beaten down
- All three funds run by excellent stockpickers

MARSICO 21ST CENTURY

Denver, Colo. 888-860-8686
www.marsicofunds.com **MXXIX**

Sales fee: none **Assets:** $2.2 billion
Expense ratio: 1.33%
Largest qtrly. loss*: –14.1% 1st Qtr '08
Largest qtrly. gain*: +11.3% 1st Qtr '06
Top three holdings (% of assets): Costco Wholesale (7.4%), MasterCard (6.8%), Wells Fargo (5.5%).

JORDAN OPPORTUNITY

Boston, Mass. 800-441-7013
www.jordanopportunity.com **JORDX**

Sales fee: none **Assets:** $171 million
Expense ratio: 1.6%
Largest qtrly. loss*: –4.7% 2nd Qtr '06
Largest qtrly. gain*: +13.1% 2nd Qtr '07
Top three holdings (% of assets): Weatherford International (5.1%), Arch Coal (4.4%), Schlumberger (4.3%).

BRANDYWINE BLUE

Greenville, Del. 800-656-3017
www.brandywinefunds.com **BLUEX**

Sales fee: none **Assets:** $4.1 billion
Expense ratio: 1.1%
Largest qtrly. loss*: –12.2% 1st Qtr '08
Largest qtrly. gain*: +9.0% 3rd Qtr '05
Top three holdings (% of assets): CVS Caremark (4.6%), Costco Wholesale (4.2%), Thermo Fisher Scientific (3.9%).

	Total Return		
	2006	07	08†
MXXIX	18.7%	19.3%	-17.2%
JORDX	9.5	25.8	-3.5
BLUEX	10.9	23.5	-15.5
S&P 500	15.8	5.5	-11.4

*Past 3 years. †Through August 31.
Source: Morningstar.

***The stunning swiftness** of September's historic changes among some of the country's largest financial institutions—and the stomach-churning market drop that followed these developments underscored the importance of maintaining some percentage of one's total investment portfolio in cash or cash-equivalent investments. Most readers will be familiar with the different alternatives for low-yielding but safe investment that protect principal, either fully or with minimal risk; but for a refresher course, and several suggestions if you're looking for a place to stash your cash, read on below.*—**The Editors**

Cash Havens

Earlier this year, many investment professionals warned against putting cash into the money-market funds, because they were unlikely to yield enough to compensate for the threat of higher inflation.

With the prices of oil and other commodities on the rise, the notion that inflation could rise to 4% or 5% on an annualized basis was very real. In recent weeks, however, the decline in commodity prices, combined with increasing evidence of economic weakness, has stilled inflation fears. That means money-market funds, while still extremely low-yielding, aren't unsuitable today for ultimate safety.

In a **money-market fund**, the value of your principal should never waver. Such funds invest in a diversified pool of extremely short-term debt: Treasury notes, so-called repurchase agreements, and high-quality corporate notes that mature in days or weeks (the weighted average maturity of the fund's entire portfolio can't be any longer than 90 days). The share price of your investment remains at $1 (see "Steady Share Price," at right); only the interest rate fluctuates—and it tends to be lower than almost any other fixed-income investment.

Money-market funds come in a few different varieties, including tax-exempt versions that invest in municipal bonds; while yields differ somewhat from fund to fund, it usually makes sense to use a money-market fund through an existing brokerage or mutual-fund account rather than worrying about shopping around for the best deal. But if you're investing a large amount of money and intend to keep it in cash for a while, you could look for the highest-yielding money-market funds online, at such sources as www.imoneynet.com.

Short-term bond funds provide higher yields, but also more risk, than money-market funds. For most investors, the short-term risk is minimal and worth the slightly higher yield. Here's an update on two of our long-time favorites:

At *Vanguard Short-Term Investment Grade* manager Bob Auwaerter combines a short duration (a measure of interest-rate risk) with a high-quality portfolio to keep interest-rate and credit risk low. Within those constraints, he moves in and out of various bond asset classes to boost yield and returns in small but meaningful ways. Over the past 10 years, the fund's annualized return is 4.8%, placing the fund in the top 11% of Morningstar's short-term bond fund category. Auwaerter's task is made easier by the fund's low expense ratio of 0.21% (vs.1.0% for the typical short-term-bond fund, according to Morningstar). To increase yield somewhat without taking on much more risk, he invests 15% to 20% of the fund in asset-backed securities (bondholder interest payments are funded by interest paid on car loans or credit-card debt).

At *Fidelity Short-Term Bond*, manager Andy Dudley boosts performance by making subtle sector bets, which never happens in a money-market fund. In recent years, for example, he has boosted yield by cherry-picking undervalued bonds in the asset-backed sector. But make no mistake: this fund is highly conservative, with a short duration, a strict focus on higher-quality bonds and an extremely diversified portfolio. The fund has never lost money in a calendar year since Dudley took over.—***Nikolas Lanyi*** ■

WHY TO BUY

MONEY-MARKET FUNDS & SHORT-TERM BOND FUNDS

- Given the market turmoil and uncertainty, a cash stash is prudent
- With inflation less of a threat, money-market funds are the safest havens
- Short-term bond funds provide slightly higher yields

Vanguard Short-Term Invest. Grade

Valley Forge, Pa. (800-662-2739)
www.vanguard.com **VFSTX**

Sales fee: none **Assets:** $11.2 billion
No. of holdings: 868 **Exp. ratio:** 0.21%
Recent SEC yield: 4.6%
Avg. duration: 2.1 years
Avg. credit quality: AA
Min. initial investment: $3,000
Largest qtrly. loss*: –0.2% 2nd Qtr '08
Largest qtrly. gain*: +2.3% 3rd Qtr '06

Fidelity Short-Term Bond

Boston, Mass. (800-544-9797)
www.fidelity.com **FSHBX**

Sales fee: none **Assets:** $6.7 billion
No. of holdings: 1,615 **Exp. ratio:** 0.45%
Recent SEC yield: 4.1%
Avg. duration: 1.6 years
Avg. credit quality: AA
Min. initial invest.: $2,500; $500 for IRA
Largest qtrly. loss*: –1.0% 1st Qtr '08
Largest qtrly. gain*: +2.1% 3rd Qtr '06

	Total Return		
	2006	07	08†
VFSTX	5.0%	5.9%	0.9%
FSHBX	4.6	1.7	-0.9
Average#	4.1	4.3	-1.0

*Past three years. †Through August 31.
#Average short-term bond fund.
Source: Morningstar.

Steady Share Price

Although in theory, a money-market fund's share price could change, in practice no established money-market fund manager wants its share price to waver; even if the underlying value of the securities the fund owns changed enough to cause the net asset value to change, the management company would compensate the fund for the difference or risk losing all credibility. There are only two documented cases of a money-market fund closing the day with a NAV below $1; one occurred this week, in the wake of the Lehman liquidation.

■ **Norfolk Southern**'s rating was raised to "buy" from "neutral" by UBS analyst Rick Paterson in September. His price target is $76 a share.

■ **Total** reduced its target for annual production growth to 2% to 3% annualized over the next decade, down from the previous target of 4% annualized growth. CEO Christophe de Margerie said the initial estimate was based on average crude-oil prices around $60, but with crude oil now in the mid-$90s—and having been above $140 earlier this summer—Total's partners will demand a greater share of output from joint ventures.

■ **Accenture** landed a 10-year, $550-million contract to provide a range of back-office consulting services to Bristol-Myers Squibb, extending a contract initially signed in 2004. In other news, Accenture won an extension of its contract as prime integrator of the U.S. Visitor and Immigrant Status Indicator Technology (US-Visit) program for the U.S. Department of Homeland Security.

■ **Valero Energy** lost power at two of its Texas refineries as a result of Hurricane Ike's landfall on September 13. Power was soon restored at the refineries, in Texas City and Houston.

■ **Lorillard** could be sought as an acquisition target by Reynolds American, according to analysts and news reports, if Altria Group succeeds in purchasing snuff maker UST. At this point, the rumors seem to be just that—but analysts say consolidation in the industry is inevitable, and Lorillard's strong franchise in menthol cigarettes makes it attractive.

■ **Telefonica** reportedly is seeking a 10% stake in Telecom Italia, which would give it more control over Italy's telephone industry.

■ **CapitalSource** declared a quarterly dividend of 5 cents for the third quarter of 2008, a drastic reduction from its previous quarterly distribution of 60 cents. The company fulfilled its obligation to distribute most of its income as a REIT. ■

Specific investments recommended by advisers on pages 6 through 9 (in each issue, you'll find them highlighted in blue) are tracked below for one year, until the adviser no longer would buy the investment or until he or she no longer covers it—whichever comes first. It is our hope, however, that many of the investments on this page will prove to be profitable long-term performers, so investors need not sell a holding simply because a year has passed since its original recommendation.

Investment (Symbol) • Who Recommended It	Issue Recommended	Price Then*	Price Now†	Total Return#	Recent Yield	Earnings 2007 Actual	Earnings 2008^ Estimate	Change from Last Month
STOCKS FOR GROWTH								
Norfolk Southern (NSC) • Consensus pick	Sept. 2008	$69.45	$65.87	–5.2%	1.9%	$3.68	$4.32	↑2¢
Western Union (WU) • Consensus pick	August 2008	25.07	25.56	2.0	0.2	1.13	1.32	no change
Total (TOT) • Consensus pick	July 2008	81.25	60.94	–25.0	5.1	7.94	10.28	↑70¢
Procter & Gamble (PG) • Consensus pick	June 2008	66.86	72.14	8.6	2.2	3.04	4.03	↑5¢
Cisco Systems (CSCO) • Consensus pick	May 2008	24.89	22.38	–10.1	0.0	1.23	1.55	no change
Naga Corp. (NGCRF) • Consensus pick	April 2008	0.22	0.24	4.9	10.1	0.02	0.03	no change
Accenture (ACN) • Consensus pick	March 2008	34.56	36.22	4.8	1.2	1.95	2.65	no change
Valero Energy (VLO) • Elliott Gue	Feb. 2008	54.03	31.19	–41.7	1.9	7.72	3.47	↓20¢
Diageo (DEO) • Consensus pick	Jan. 2008	85.57	73.44	–11.3	4.2	4.85	4.82	↓3¢
Yum! Brands (YUM) • Consensus pick	Dec. 2007	37.80	37.91	1.6	1.7	1.66	1.90	no change
Wrigley (WWY) • Consensus pick	Nov. 2007	67.60	79.00	18.6	1.7	2.25	2.56	↑1¢
STOCKS FOR INCOME								
Lorillard (LO) • Charles Norton	August 2008	$67.69	$74.02	10.7%	5.0%	$5.16	$5.10	↓2¢
Chunghwa Telecom (CHT) • Yiannis Mostrous	July 2008	25.32	22.91	–9.5	4.8	1.57	1.57	↓1¢
Daylight Resources Trust (DAYYF) • Roger Conrad	June 2008	11.47	9.65	–12.5	15.9	2.16	1.49	no change
Enerplus Resources Fund (ERF) • Consensus pick	May 2008	46.24	36.11	–13.6	14.9	2.68	4.58	no change
Comcast 7% Preferred (CCT) • Consensus pick	April 2008	24.30	22.38	–7.5	7.7	0.83	0.89	no change
Genesis Lease (GLS) • Consensus pick	March 2008	20.49	10.85	–41.9	17.4	1.24	1.10	↓2¢
Telefónica (TEF) • Consensus pick	Feb. 2008	94.39	71.27	–22.9	5.1	6.35	7.61	↓18¢
CapitalSource (CSE) • Consensus pick	Jan. 2008	17.16	10.87	–30.5	1.7	2.40	1.43	↓4¢
Compass Minerals Int'l (CMP) • Consensus pick	Dec. 2007	35.57	56.29	62.0	2.3	1.84	4.22	no change
TEPPCO Partners LP (TPP) • Consensus pick	Nov. 2007	39.96	27.11	–26.7	10.5	1.93	1.97	↓6¢

FUND FAVORITES						Stocks/Bonds /Cash‡	3-Year Annualized Return
Vice Fund • Nikolas Lanyi	Nov. 2007	$23.92	$17.83	–22.9%	0.1%	97%/0%/3%	6.1%

Investment (Symbol) • Who Recommended It — DROPPED THIS MONTH	Issue Recommended	Price Then*	Price Now†	Total Return#	Reason Dropped
Transocean (RIG) • Consensus pick	Oct. 2007	$104.90	$116.79	5.0%	1 year since recommended
Southern Company (SO) • Consensus pick	Oct. 2007	34.57	38.10	9.8	1 year since recommended

*Price when recommended. †As of Sept. 15, 2008. #Total return includes dividends, interest and any capital-gains distributions. ^Consensus estimates. **Actual. ‡Recent allocation may not add up to 100% because of other investments. [a]Cash flow per unit. [b]FYs end January. [c]FYs end March. [d]FYs end February. [e]FYs end June. [f]FYs end July. [g]FYs end August. **Source:** Advisers, Zacks, I/B/E/S, Bloomberg, companies.

In Deep

By Nikolas Lanyi

With crude oil having fallen from above $140 to below $95, energy-services companies may look less attractive at first glance. After all, their business is dependent on demand from oil exploration-&-production companies looking for new production sources; the higher the price of crude, the more economically feasible an expensive drilling project.

It's no wonder, then, that shares of drilling companies have fallen sharply in recent weeks.

However, analysts say that major E&P companies will find it profitable to continue most existing projects and continue to pursue new ones even if crude oil falls all the way to $70—a highly unlikely prospect. In fact, the majority of analysts and economists think oil's price will rise again, particularly once the current period of global economic weakness ends, because global demand is rising faster than supplies are growing.

One of the most intriguing areas of new drilling activity is in deepwater areas, where exploratory work can cost more than $100 million and daily rental rates for rigs run in the hundreds of thousands of dollars. Companies that provide reliable drilling services in these areas will continue to attract demand from E&P companies, and they have enormous pricing power because the number of deepwater vessels around the world is limited. Utilization rates that stood around 80% five years ago have risen to above 95%, and they remain that high even as the price of crude oil has fallen by about a third.

Thus, long-term investors should take note: deepwater drillers are trading at historically low valuations, despite the fact that their long-term growth prospects remain almost as strong as ever. It's a clear buying opportunity, even if the short-term outlook remains unpredictable.

Transocean, the world's largest deepwater contract driller, became even larger in November 2007 when it merged with Global SantaFe. The company boasts 137 vessels, more than twice the number of the nearest competitor. They include 65 jackup rigs and 39 offshore drilling vessels, some of which are capable of drilling to depths of 35,000 feet, double the drilling capabilities of previous-generation machines. The company also is the world's #1 "floating" rig driller.

Over the past five years, as crude oil prices moved higher and higher, Transocean increased its revenue at an astounding 29% annual rate, with operating income increasing tenfold. The company generates strong free-cash flow, and analysts think it will pay down the $17 billion in long-term debt it took on to make the Global SantaFe acquisition.

Analysts look for Transocean to post operating-profit margins north of 40% for years to come, and that prediction is boosted by the company's order backlog of $41 billion over the next five years. Even as the price of crude has fallen, Transocean has continued to line up contracts for more rig rentals.

At recent levels, Transocean trades at only 8 times analysts' expectations for 2008 per-share earnings, an extremely low price/earnings ratio for a company expected to grow this quickly. Citigroup recently initiated coverage of the stock with a $159 price target.

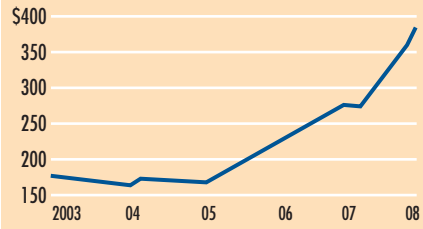
Noble Corp. operates shallow and deepwater rigs around the world, with a particularly strong presence in Latin America, West Africa and the Middle East. The company's earnings have increased more than fivefold in the past three years, as its revenue tripled from $1 billion in 2004 to $3 billion in 2007.

Noble's most interesting growth area is its exposure to one of the fastest-growing deepwater markets: Brazil, where national oil company Petrobras recently have made a series of discoveries that will greatly expand the country's oil production capacity. Petrobras has announced it wants to contract up to 40 deepwater vessels by 2017, enormous demand that will push day rates even higher. With the highest percentage of its day rigs based in the Brazil region (about 40%), Noble is the purest play on Brazil's offshore oil industry.

Noble is known in the industry for its high-quality, state-of-the-art offshore rigs and well-trained operators, allowing the company to command above-average rental rates. In the first half of 2008, for example, Noble's earned day rates averaged $142,900, vs. the industry average of $123,600, according to Citigroup.

Average Deepwater Day Rate

($thousands)



Source: Citigroup.

The company's revenue is expected to rise 20% to 25% a year over the next three years, with earnings increasing at a 20% pace.

In addition, Noble is further along in its construction of new deepwater vessels and other rigs than many of its competitors, so it is expected to start cranking higher free-cash flows in mid-2009 as its capital spending projects wind down. Already one of the most-profitable contract drillers, by virtue of its management team's skill at reining in costs, Noble could boost its profit margins even more over the next two or three years.

Noble is financially strong, with free-cash flow sufficient for regular share-repurchase programs. The company's debt is less than a quarter of total capitalization, despite an aggressive building program.

Note that Noble's earnings, while rising considerably year to year, can disappoint from one quarter to the next due to short-term cycles in rental rates, which can fluctuate wildly based on supply and demand.

Noble shares recently traded at 7.3 times analysts' consensus estimate for 2008 earnings per share, well below the company's expected long-term earnings growth rate. This is a great opportunity to snag shares of a well-managed driller with great exposure to the Brazilian market. ■

Nikolas Lanyi is executive editor of Louis Rukeyser's Wall Street.

Drilling for Dollars

Company (Symbol)	Recent Price	52-Week High/Low	Market Cap ($billions)	Revenue ($billions) 2007/2008*	Earnings per share/ % Change 2007	2008*	P/E†	Long-Term Debt/Equity ($billions)	No. of Analysts Following Stock/ No. Who'd Buy
Transocean (RIG)	$116.79	$163.00/$111.25	$38.4	$6.4/$12.7	$14.65/+203%	$14.59/none	8.0	$15.6/$14.9	22/17
Noble Corp. (NE)	42.42	68.99/39.89	11.9	3.0/5.8	4.52/+68	5.82/+29	7.3	1.0/4.8	18/12

*Estimates. +Price/earnings ratio based on analysts' consensus per-share estimates for 2008. ^FYs end August. **Source:** Bloomberg, Zacks, analysts.

Steady As They Grow

By Sebastian Henry

These are the times that try investors' souls, or at least their ability to stay invested in the stock market. But for those intrepid enough to take advantage of the recent downturn by picking up shares of high-quality companies on the cheap, here are three that look attractive—and not an investment bank or financial-services firm among them.

In fact, all three of these large-cap steady growers should continue to perform relatively well even if the U.S. is in a recession. That's because they provide goods or services that aren't linked to strong economic growth, in most cases ones that folks require in good times and bad. All four have excellent managements, long-term track records of sales growth, exposure to faster-growing international economies and strong balance sheets.

Johnson & Johnson is one of the world's largest healthcare-products companies, with operations in more than 60 countries. Its divisions include a major pharmaceuticals unit (45% of profits) specializing in drugs for neurological, autoimmune, pain relief and blood conditions; top-selling drugs include Risperdal (schizophrenia), Remicade (psoriasis and Crohn's disease), Topamax (epilepsy), Velcade (multiple myeloma), Concerta (attention-deficit disorder) and Ortho Evra (contraceptive). The company's Medical Devices and Diagnostics unit (about 40% of profits) makes surgical supplies, diabetes testing devices, vision-care products and orthopedic devices, as well as arterial stents. Finally, the company's Consumer division (15%) boasts top-selling household-name brands such as Tylenol, Neutrogena, Listerine, Sudafed, Benadryl, Zantac, Splenda and Johnson's baby shampoo.

Johnson has not been without problems of late: for example, its Cordis stents have suffered from lower sales due to health problems associated with drug-eluting stents. In addition, some of its top drugs face imminent patent protection.

However, the company's rising sales—revenue rose from $41.8 billion in 2003 to $61.1 billion in 2007 and is expected to top $75 billion in 2009—and tip-top financial strength shelter it from problems in any one area. Its profits are expected to grow 8% to 10% in the coming years, and its share price has held up well during the recent market turmoil. This is a buy-and-hold core holding worth adding to when its share price dips.

Yum! Brands is the world's second-largest fast-food company after McDonald's (which has higher sales, although Yum! has more stores). Its KFC, Pizza Hut and Taco Bell concepts are each #1 in their market and well-established globally, with 35,000 restaurants in more than 100 countries around the world. Thanks to international expansion—most of its sales come from outside the U.S.—Yum! is growing its earnings at a double-digit annual rate.

Yum! is a rare investment, because it serves both as a defensive hedge against recession (its low-priced fare actually may be enjoy higher demand in tough economic times) and a play on the long-term growth of China and other emerging markets. Yum! is the largest fast-food company in China, with more than 2,600 restaurants in more than 450 cities—mainly KFC. The company's China business is booming, with the 38% profit growth in the most recent quarter, helping Yum! increase overall earnings 15% year over year. Operating-profit margins are higher in China than in the U.S., and Yum! has ample room to grow—restaurant chains currently account for only 3% of the Chinese restaurant market. Yum! is building 350 to 400 new stores in China every year, as it moves beyond the largest cities into smaller cities and towns.

Yum! also has attractive growth opportunities in other emerging markets in Asia and Latin America, as well as in developed markets such as Japan and Australia. Yum! also has achieved efficiencies in recent years from so-called multibranding of its stores: combining two of its concepts under a single roof (for example, Pizza Hut and Taco Bell). This approach has been proven to increase the number of customers passing through each store, boosting each store's annual sales considerably.

Yum! generates strong free-cash flow, enough to easily service its debt, repurchase shares regularly and pay a modest dividend. At recent prices, the stock trades at around 20 times earnings; that's not a screaming buy, but it's reasonable for this high-quality company whose growth prospects stretch far into the horizon.

Costco Wholesale is the #1 operator of membership warehouse stores, with more than 540 stores in North America, Puerto Rico, Japan, South Korea, Taiwan and the U.K. Costco stores sell a variety of products (groceries, clothing, office supplies) at deep-discount prices in huge stores.

The company keeps prices low with no-frills layout and service and good deals with distributors; while their profit margins are much lower than most retailers, Costco makes money through high volume and inventory turnover, tight control of overhead costs and by carrying little or no debt on their balance sheets. About half their operating profit comes from membership fees required of shoppers, which also encourage customer loyalty and more-frequent visits to the store.

Costco was the industry pioneer, and it has remained an innovator with such ideas as private-label merchandise, pharmacies and gas stations at its stores. Costco has used clever merchandising and marketing to attract a diverse clientele, including affluent consumers looking for bargain prices on luxury goods such as wine. This has led to rising sales per square foot, a key metric in the industry. But in a slowing economy, Costco's inherent appeal to low- and middle-income consumers could be especially important, as families increasingly look for bargains.

Costco has produced steady sales increases: from $60.1 billion in 2006 to more than $72 billion this year, with expected growth to more than $86 billion by 2010. Earnings per share are rising at a 12% to 13% annual clip, and at recent levels the stock traded around 23 times earnings. For a high-quality growth stock with recession-hedging qualities, it's a good one to look to buy when its share price falls. ■

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WHY TO BUY

JOHNSON & JOHNSON (JNJ)
YUM! BRANDS (YUM)
COSTCO WHOLESALE (COST)

- Large, solid, steady-growth companies
- Little financial exposure
- Should perform fairly well in a recession

Standard Bearers

Company (Symbol)	Recent Price	52-Week High/Low	Market Cap ($billions)	Revenue ($billions) 2007/2008*	Earnings per share/ % Change 2007	Earnings per share/ % Change 2008*	P/E†	Long-Term Debt/Equity ($billions)	No. of Analysts Following Stock/ No. Who'd Buy
Johnson & Johnson (JNJ)	$69.61	$72.76/$61.17	$195.1	$61.1/$64.5	$3.67/-2%	$4.51/+23%	15.4	$19.9/$46.4	13/8
Yum! Brands (YUM)	37.91	41.73/30.99	18.0	10.4/11.0	1.74/+15	1.90/+9	20.0	4.6/0.6	9/3
Costco Wholesale (COST)^	68.95	75.23/58.17	30.0	64.4/72.4	2.42/+3	2.91/+20	23.7	2.5/9.2	14/1

*Estimates. †Price/earnings ratio based on analysts' consensus per-share estimates for 2008. ^FYs end August. **Source:** Bloomberg, Zacks, analysts.