CHARLES PAYNE'S COMMON SENSE NEWSLETTER

November 2011

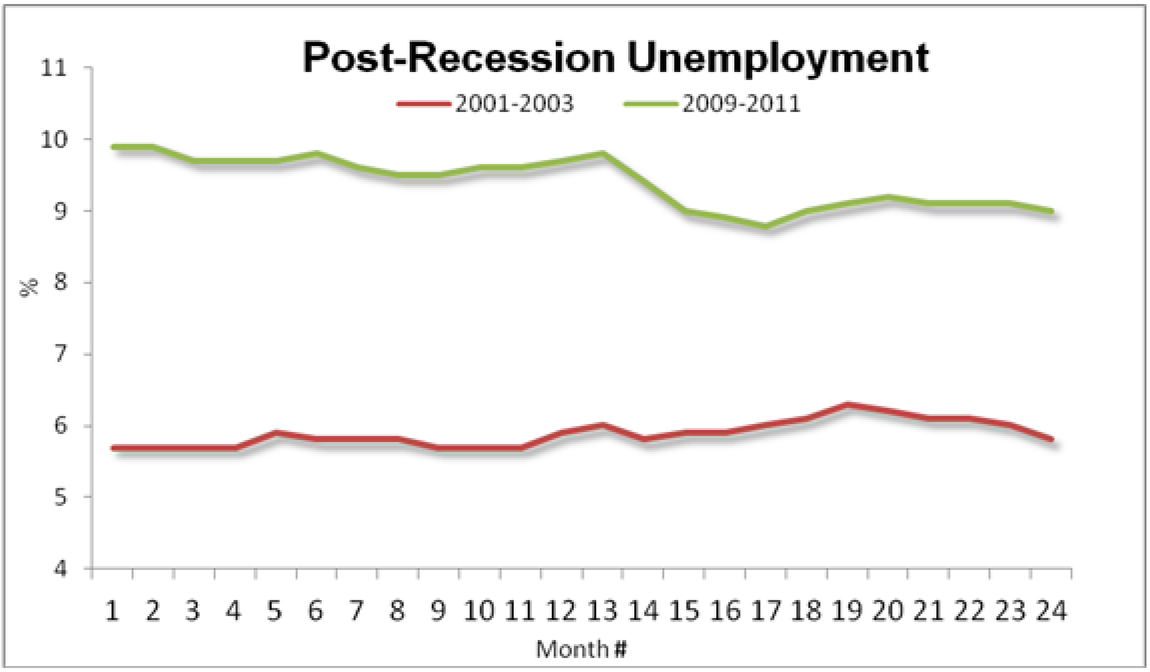
Wall Street Strategies- Providing independent stock market research since 1991 through a balanced approach to investing and trading

Not Feeling Like a Recession Recovery

I was looking for a strong fourth quarter rally and indeed October was one for the ages for stock investors and traders, but November has gotten off to a mixed start with massive selloff days. There is the saga of the Greek situation, which continues to cloud the future of that nation, the euro and even the European Union. This crisis cannot be ignored, as the focus on Greece takes all eyes off Spain, Portugal, and the biggest and perhaps most vulnerable domino, Italy. So, the ultimate solution for Greece will serve as the template for the rest of the continent.

That's so important because banks will have to take massive haircuts on sovereign debt, yet, we are hearing from President Obama and other western leaders that the only way to spark economic revival is to tax those same banks even more. At the G-20 Summit, President Obama pointed to "shared sacrifice" and took a victory lap on "high level" financial reforms. For me, the irony is that these same leaders complain that banks aren't lending, and yet, each day banks are being told they must hold onto more money as to not be reckless, and the White House would like to make banks pay for things like the bailout of auto companies.

I suspect governments are trying to nationalize banks as much as possible without actually making it official. That of course would be a disaster, and yet, a lack of imaginative thinking and flaccid political will on both sides of the Atlantic means low hanging fruit in a period when Occupy protest is the only game plan. It would be expensive, mitigate hard lessons that must be learned and bog down any real growth opportunities. In the meantime, there have been mixed messages on the economy from all of the different data points, including anecdotal evidence. One thing is true, this is still the worse post recession recovery in American history, and it could use a spark or some kind of positive surprise from the administration.



The jobs report was another one of those data points that had a few silver linings, based mostly on the notion of severely low expectations.

- Job growth was revised higher
- Long term unemployed decreased 366,000, the most in a single month since 1948
- Private sector employment is edging higher, although nowhere near the 200,000+ actually needed

I'm more excited about corporate earnings that point to the greatness of America and our economic system. I call the rally the "Dirty Fingernails Rally" because it's been companies that move earth, fire coal into steel, put cranes to work, and churn out machine tools. Still, a lot of that story is also the story of the international economy, especially those emerging growth nations that while sizzling have cooled a little.

The Real World

The world is growing in population and status, and there are investment opportunities based on that growth. In the last couple of years the price of pork is up 34%, and this year live cattle is up 13%; a lot of that is a reflection of demand from outside America. Don't get me wrong, a lot of that is Americans that continue to ask "where's the beef" and say "pass the bacon," but those questions and phrases are expressed in other languages as well. I do fault polices such as protectionism and using food for fuel, but the message is really clear. Over the next two or three decades, those that control food and fossil fuels will control the world.

Here are comments on the topic from a recent market commentary I wrote.

No "Pop" to Population Boom

"Every man takes the limit of his own vision for the limits of the world"- Arthur Schopenhauer 1985

This week the world's population will eclipse 7,000,000,000 people and it recalls all the talk throughout the years of doom and gloom; all the predictions of starvation and mankind somehow killing the planet. (I've always thought it was arrogant of man to think its output could be so destructive as to kill the planet but we would still be around, maybe walking around in hi-tech gas masks, while a handful of trees would be kept under glass. We would die off before we could kill the planet). This is a great time to reflect on all the notions of doom and gloom presently circulating, attempting to sway policy based on ideology often cloaked in the veneer of science.

Top 10 Bio-Capacities

Brazil

China

USA

Russia

India

Canada

Australia

Indonesia

Argentina

France

India

Canada

Australia

Indonesia

Argentina

France

In 1798, Thomas Malthus published his theory that population growth would soon reach a point where it outstripped resources. His theories included the premise that population could be checked by famine, disease, and war, or even abstinence made possible by delayed marriage. By slowing or reducing population there would be positive results like increased literacy, health standards and quality of life. Furthermore Malthus felt there was a limit to agricultural improvements. There were six editions of *an essay on the principle of population,* with each giving greater focus on moral restraint. His notions surrounding virtue also drove his thinking on economics.

He felt poorer classes should practice virtuous habits and adopt the high moral character of the rich. Criticized for his belief that poor laws should be abandoned, he saw "inevitable laws of nature" societies divided into a class of proprietors and a class of laborers. The wealthy class would accumulate the wealth of society and share it with the poor. It was also his belief that redistribution of wealth and income, and legislative efforts to redistribute would stimulate poverty within a society. So here we are on the verge of hitting a number of people in the world Malthus thought impossible (the planet was approaching its first billion when Malthus sounded his alarm) and yet it's his theories on economics that might be more relevant today.

Malthus believed wealth would also go back to the morally fit even if it was redistributed. There is no doubt in my mind if somehow all the assets in America could be evenly divided today within a generation there would be the same kind of income inequality and wealth gaps so many falsely blame for the current economic malaise. But we should broaden out the discussion to nations, in which case Americans are very rich and seem to be following the birth code of Malthus. We have low birth rates despite the fact we are rich and this is a country where children generally have pleasant lives.

On the other hand, countries with the highest mortality rates tend to also have the highest birth rates and the most rapidly growing populations. Darwin looked at Malthus' work when coming up with his idea of survival of the fittest. But it seems to me that birthrates in Niger, Uganda, Mali, Zambia, Burkina Faso, Ethiopia, Angola, and Burundi go beyond upping the odds for survival. On the contrary, as Malthus pointed out in their own eco-systems these populations threaten the ability of nature to feed everyone.

The good news is the world is mobile and birth rates in Japan, Europe and even America mean these nations must allow for greater immigration.

Malthus can still be right...right?

There is still a call for the earth to run out of resources at some point soon and not be able to sustain all the humans. The World Wildlife Foundation reports in its "Living Planet Report" that in 1970 humanity passed the point of annual ecological bio-capacity to match human consumption. Since then, human consumption has far surpassed the ability of renewable resources to regenerate, and in the meantime man is releasing more CO_2 than the ecosystem can absorb. The WWF calls this "ecological overshoot." Yet here we stand in a time and place where there has never been less starvation as a percentage of total earth population.

Part of the reason is what some call the First Green Revolution that saw global yields increase 2% per annum from 1950 to 1990.

Now scientists and others, including Bill Gates, see mankind in need of second green revolution in order to feed the planet and its wildly growing population. On that score, we are said to have a deficit of minerals like phosphates which means we're doomed- I guess.

On the contrary, I don't think we are doomed but I think the shift in power in the next century will go to those that control resources including fossil fuels and food. On that score, it's not a coincidence that the fastest growing economies in the world are all agricultural super powers with the most bio-capacity to meet not just domestic consumption demands but export sustenance as well. On this score China has been brilliant, locking up multi-decade deals that include millions of acres of land/production in other countries. There is a chance the future will be marked by wars over food and water, but more than likely it will be part of centrally traded and true wealth redistribution

Long Idea

Agrium, Inc. (AGU)

Agrium is a provider of phosphates and potash and the company's shares are extremely undervalued. One reason for this is the amazing inconsistent earnings performance that mitigates the fact the consensus for next year has surged to $9.63 from $8.27 a few months ago. Nonetheless, as some point, in the next few years there could be a massive shortfall of potash and in the meantime global population growth and prosperity will increase demand. The stock is straddling key moving averages now but the big upside breakout comes with a close above $90.00. The stock is changing hands at two times book and less than one times sales.

In the next two years I think this could be a $150.00 stock.

Two Year Chart– AGU

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List of Recommendations from the WSS Equity Research Team

VCA Antech, Inc. (WOOF)

- Price Target: $24.00
- Recommending Analyst: David Urani

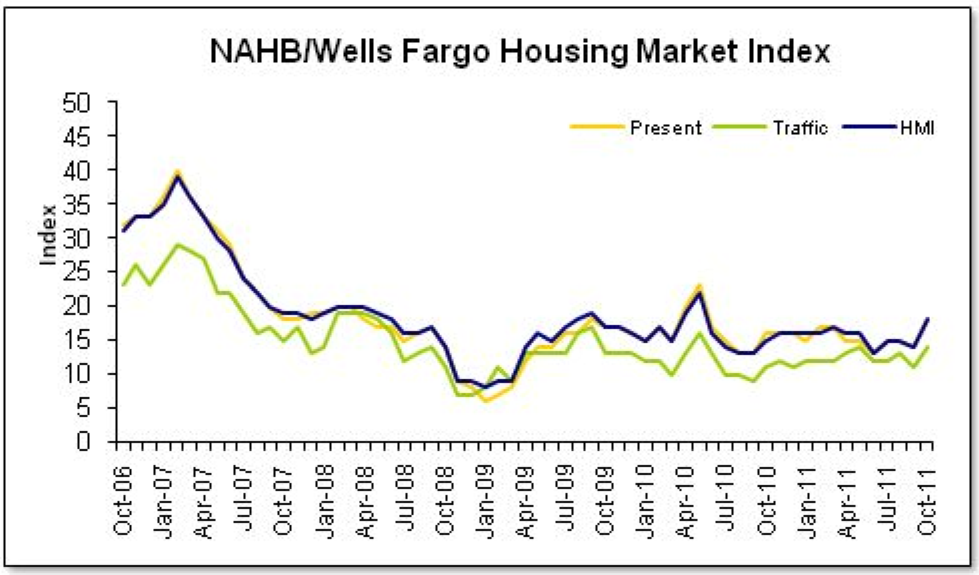
Western Digital Corp. (WDC)

- Price Target: $35.00
- Recommending Analyst: Carlos Guillen

Thoughts from the WSS Equity Research Team

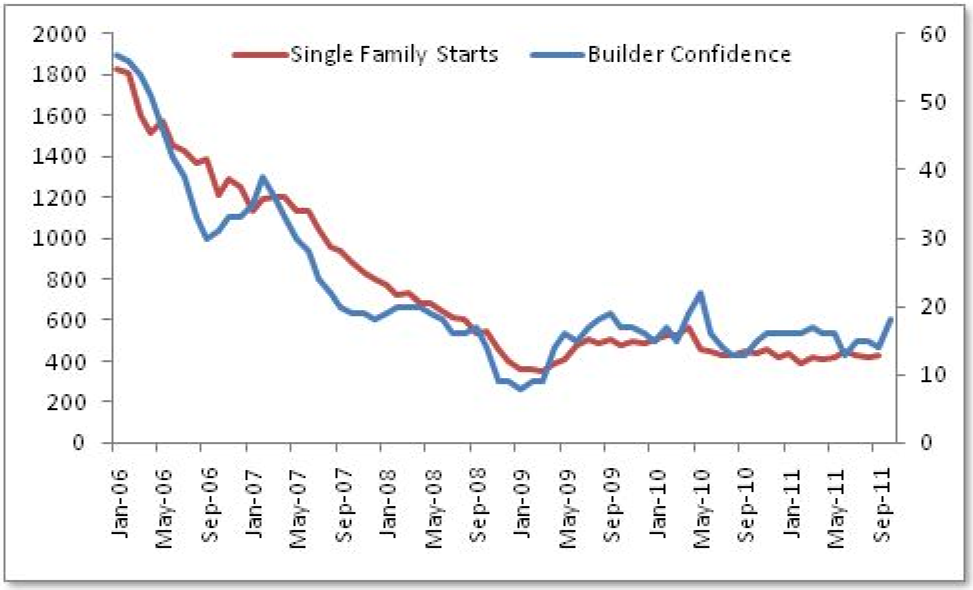
A Glimmer of Housing Hope
By David Urani

Homebuilders made an impressive leap on the back of the NAHB/Well Fargo Housing Market Index. The index showed an increase to a reading of 18 for October from 14 the previous month. That took the index to its highest level since May 2010, back when the Federal housing tax credits were in place. It was a surprising result; the market was looking for a slight increase, but the actual four point rise was beyond expectations. The West showed a big jump to a reading of 21 from the depressed level of 12 in the previous month, while the Midwest and South rose by 4 points each and the Northeast was flat. Builders reported that there were pockets of strength in certain markets, and a nice drop in mortgage rates (which briefly fell below 4% earlier this month) helped to spur some buyer confidence. That all being said, 18 is still not a great reading for the index, and it reflects a market that continues to be troubled. Most of the rise in confidence was reported to be builders changing their opinions to "fair" from "poor", while still relatively few rate the market as "good."

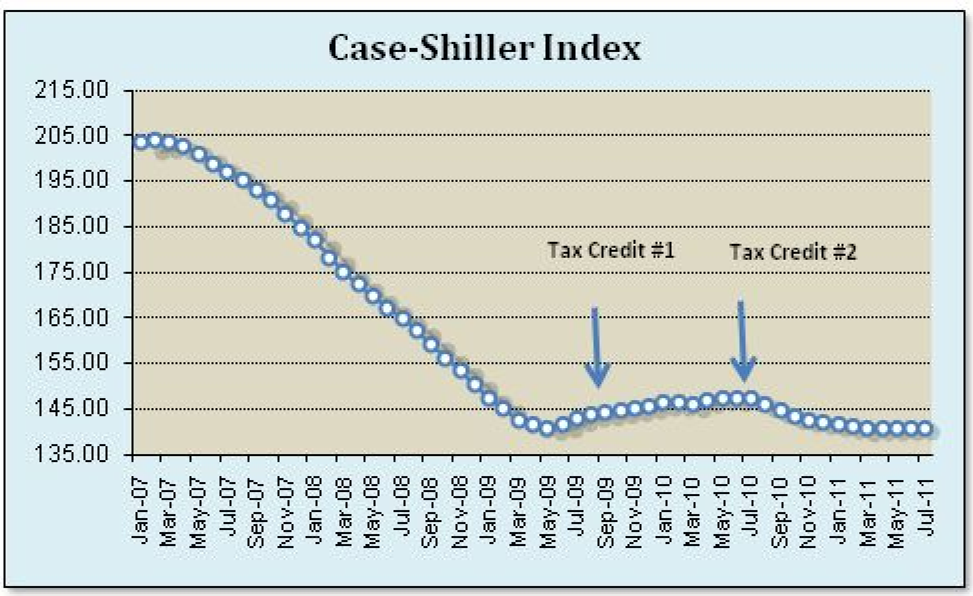


Housing starts data was a bit inconclusive. The big headline beat versus expectations (658k vs. 594k exp.) was not necessarily genuine because most of it was a big spike in multifamily units (apartments and condos), which tend to be volatile each month. Single family starts were also up, but not a lot at 1.7%. If you look at the single family starts regionally, the South was a drag on the rest of the country, as it is the biggest region, and its starts were down 9.4%. However, the Northeast and Midwest were well higher, while the West was flat. It goes to show that it is looking as if activity is up in certain pockets. On the forward looking permits side, single family units were down just slightly at 0.2%. The South and West held back gains in the Northeast and Midwest.

Perhaps the most important takeaway, if you ask me, is that the starts data is from September, which of course was a very back and forth month in terms of global economic sentiment. We are still intrigued by the NAHB confidence index, which was a more recent reading, for October rather than September. The good news is that over the years, the NAHB confidence index has been able to foreshadow single family starts fairly well (see below).



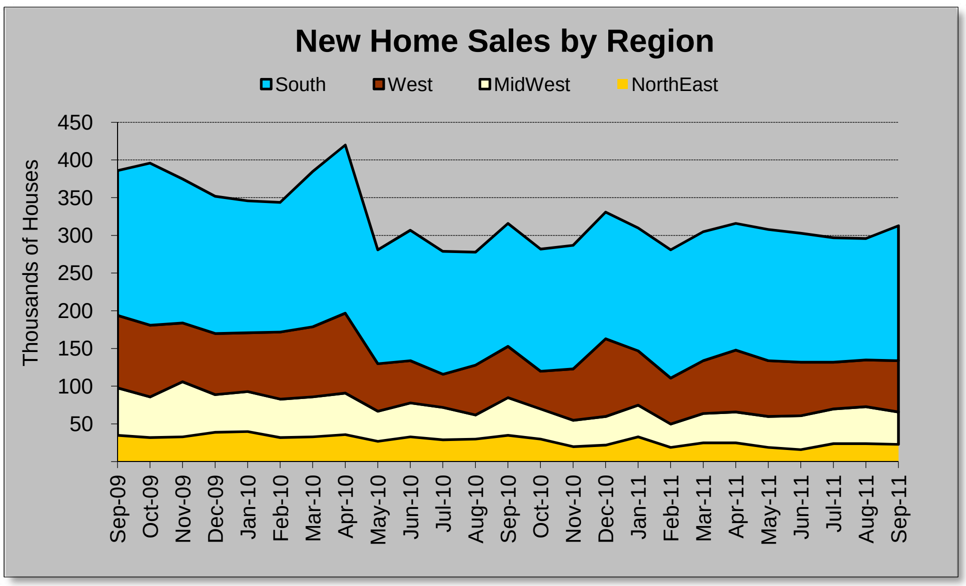
While the Housing Market Index is a nice initial report on demand, we continue to be concerned on the pricing side. The seasonally adjusted Case Shiller home price index was flat from May through July, and remains just 0.2% above the lows. Going into the fall and winter, we wonder how well prices will hold. It is likely that home prices were down in August and September given the fear in the global economies and we suspect it hit, or possibly fell below, the lows.



The number one unknown at the moment has to be foreclosures. You may recall late last year when the robo-signing scandal broke open and mortgage lenders froze foreclosures for months to review filings and to comply with regulators. New delinquency filings surged by 33% month to month in August and remained at a more elevated level in September, showing that the foreclosure pipeline began to thaw. Consequentially, we will be keeping an eye out for an influx of new foreclosure inventory. Naturally, that would be a drag on prices. However, as defunct as the foreclosure process is, it is hard to say when (or if) said inventory will be cycled through.

There is a sense that housing stocks got oversold, particularly in August. A lot of housing stocks dropped 30% or more in August as doomsday hit the global markets. Yet, the Housing Market Index suggests home buying activity is at least as strong as at the same time last year, if not stronger.

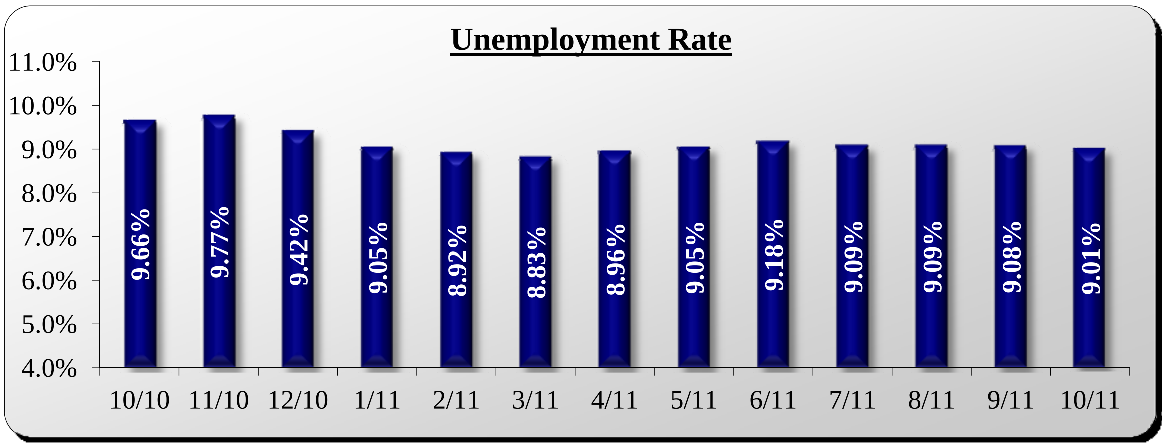
In fact, new home sales as measured by the Census Bureau increased by 5.7% month to month annually adjusted in September, leaving them just 1% below year ago levels. Gains in the South and West offset declines in the Northeast and Midwest. On the other hand, pending sales of existing homes were down 4.6% month to month, and fell for a third straight month. Given the conflicting data, September is a little inconclusive. However, October is the month we are interested in given the surge in builder confidence.



Jobs Grow, but at a Crawl
By Carlos Guillen

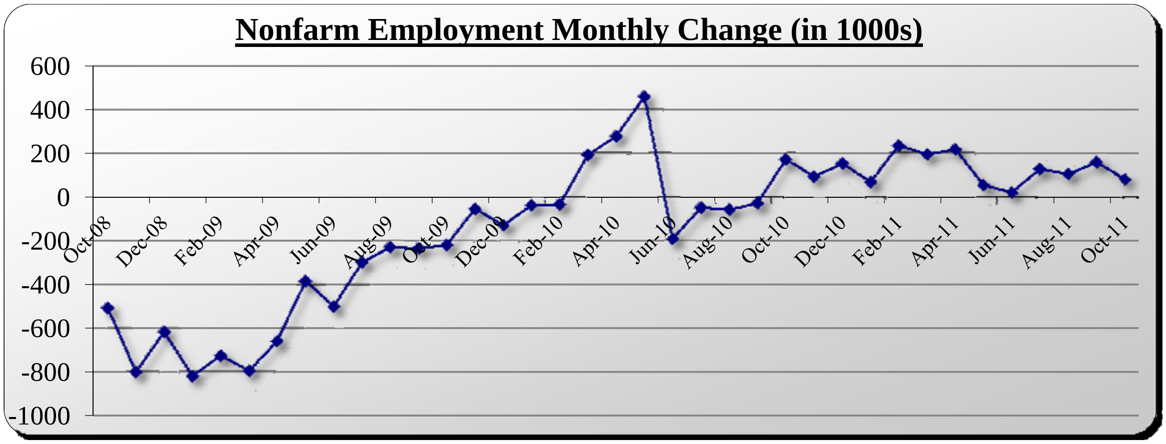
The unemployment story during October was nothing to rejoice over, but it at least gave some reassurance that the situation was not getting worse, helping to slightly attenuate fears of a double dip recession scenario. Of course, to many out there that are hurting without jobs, a lower likelihood of a "double dip" is meaningless; however, the direction of employment as least gives some hope.

Earlier on Friday, the department of labor reported an unemployment rate of 9.0 percent corresponding to October, which decreased from the 9.1 percent level reached in September and landed better than the Street's 9.1 percent estimate. More encouraging, however, was that the nonfarm figure came in better than expected despite significant revisions.

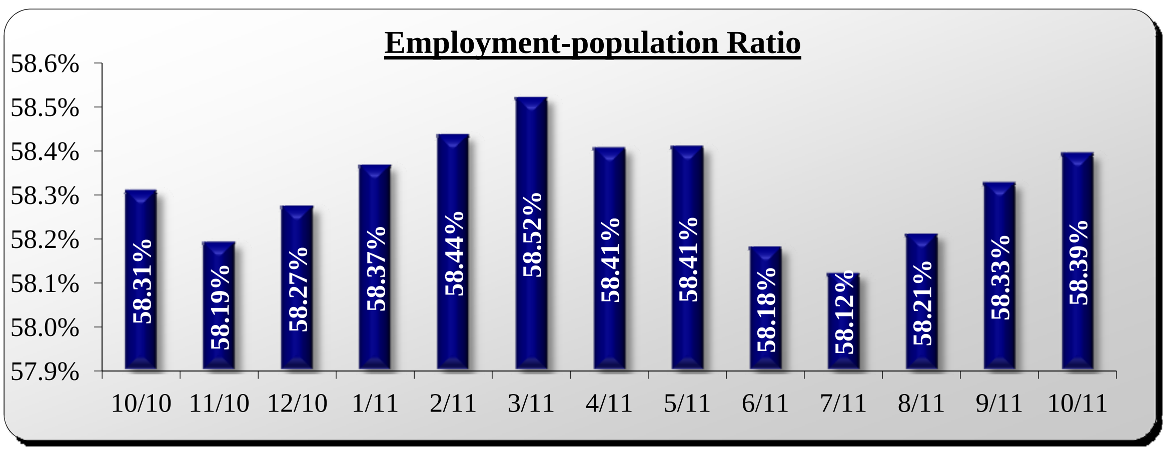


The October Household Survey Data was encouraging once again. It was good in the sense that the employment level increased by 277,000, and it was also good because the number of people unemployed decreased by 95,000. Moreover, the fact that the unemployment rate decreased slightly was better than what the number reflects as the market was able to absorb a worker population growth (Civilian Non-institutional Population) of 199,000 during the month. Nonetheless, the unemployment rate is still at an unacceptable level, and I estimate that the economy needs to add approximately 125,000 jobs per month (using data for the past ten years) in order to just satisfy worker population growth; and more than that to bring the unemployment rate to normal (5%–6%) historic levels.

Unfortunately, the change in nonfarm payroll jobs was a bit below the Street's expectations, as it showed an increase of 80,000 jobs while the Street's consensus called for a gain of 85,000. This result also came in below ADP's nonfarm jobs number posted on Wednesday that showed an increase of 110,000 jobs, which was better than the Street's estimate calling for a gain of 100,000 jobs. However, it should be noted that nonfarm data was revised higher for August and September by 47,000 and 102,000, respectively. So, excluding the revision, nonfarm employment would have increased by 187,000, which would have been much higher than the Street's forecast and ADP's number.



From a different perspective, it was encouraging to see that the Employment-population ratio continued to trend higher. This measure gives a better view of what has been occurring most recently, as it is not affected by people moving in and out of the labor force like the unemployment rate is affected, since it is the percentage of the civilian non-institutional population that is employed. As it can be observed below, this ratio had been consistently getting worse, but now it appears to be ramping higher for the third consecutive month.



In sum, the jobs numbers were good, not great but good. The Household Survey data showed that the jobs market was able to handle worker population growth while being able to improve the unemployment rate slightly; excluding revisions, the Establishment Survey Data showed that nonfarm employment increased much better than expected; and the Employment-population ratio continued its uptrend. While there was a slight improvement to the Jobs backdrop, the fact of the matter is that there are still many people without jobs, and the long-term unemployed need help. The economic backdrop continues to teeter around a "double dip" scenario, and the situation in Europe is not helping. Moreover, consumers continue to worry about the situation in Washington as all ideas to generate jobs are either failing or being rejected. The sense at the moment is that consumers' view on Washington's macroeconomic results is at an all time low – "Houston … we have a problem."

Long Ideas

VCA Antech, Inc. (WOOF)
Sector: Personal Services
Price Target: $24.00
Stop Loss: $17.00

Sure, maybe you've been struggling over the past year, but Fido and Mittens definitely have not. A recent report from the American Pet Products Association shows that 2011 pet spending is expected to reach $50.8 billion, a new record and a 5.1% increase over last year. When it comes down to it, owners aren't going to deprive their furry friends, and there aren't a lot of options for cutting pet spending anyway besides, perhaps, switching to a cheaper food. Out of the $2.49 billion of total expected spending increases, $1.1 billion will come from vet care. That's an 8.5% increase year over year in veterinary spending to $14.1 billion.

Enter VCA Antech, a veterinary care company with nearly 500 hospitals in 40 states. Like human healthcare, animal health care is one area of spending where consumers do not like to cut costs. As a result, a bad economy is not going to make an immediate, significant dent in the business. Pet care costs have actually behaved much like human healthcare over the years, spiking higher. For instance, cat surgery costs were up 73% from 1999 to 2009 compared to a 76.7% increase for people. The same factors apply to veterinary health costs, including better technology, increased preventative procedures, and legal actions.

We see the current price of WOOF shares as being too low, considering the veterinary industry is as strong as ever, with fundamentals continuing to favor ongoing increases in pet care spending.

Two Year Chart– WOOF

Western Digital Corp. (WDC)
Sector: Technology
Price Target: $35.00
Stop Loss: $25.00

We see strong upside potential to shares of Western Digital Corp. (WDC) as the company, in spite of difficulties due to natural disasters, continues to see strong demand for its products. The company reported a record quarterly shipment level for the hard drive industry, demonstrating the value of hard drives in the overall digital universe even during global economic uncertainty. The company's financial results and share growth demonstrated continuing strong execution as management focuses on its acquisition of HGST. We believe Western Digital is providing high quality product with speed, flexibility, and low cost, which we see as a path to long-term success and shareholder value creation in this dynamic market. As such, we see shares of WDC moving to $35.00 and then to $37.00; use $25.00 as a stop loss.

Two Year Chart– WDC