Reprinted from the Milwaukee Journal Sentinel

ArcaTaur Capital Management LLC

April 15, 2007

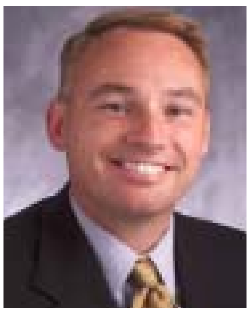
Arcataur Capital Management,LLC
826 North Plankinton ▲ Suite 300
Milwaukee, Wisconsin 53203

414 225.8200
Fax 414 225.0043
www.arcataur.com

Still time to gain with right stock

Former leaders ready to soar again, manager says

By KATHLEEN GALLAGHER, kgallagher@journalsentinel.com



Confused? You're not the only investor.

Take this sampling of what Wall Street has been wrestling with in recent months:

• When Japan's central bank doubled interest rates to 0.5% in late February, the Chinese stock market dropped 10% and the U.S. stock market had its worst day since the Sept. 11, 2001, terrorist attacks.

• The U.S. unemployment rate dropped to 4.4% in March, its lowest level in six years.

• Sales of existing single-family homes fell 8.4% to about 6.5 million in 2006, the biggest annual decline since a 14.8% drop in 1989. With homes on the market longer and prices drifting downward, as well as rising food and energy costs, some fear a recession.

We're in a classically data-dependent market, where the day's information can move stocks up or down dramatically in a single trading session or even just a few hours.

Ignatius L. Smetek says these sorts of cross-currents - and the slowdown in earnings growth many companies are likely to show as they announce quarterly results in the next few weeks - are typical in the middle of a stock market cycle.

But he says he believes the stock market is still a good place for most investors to be.

"Valuations are reasonable and the general ability to have sustainable growth is still there," said Smetek, president and chief investment officer at Arcataur Capital Management LLC in Milwaukee.

Sure, there's a risk the economy could slow too fast, prompting the Federal Reserve to lower interest rates, and driving capital to other markets. The housing market could also get worse, although the overall economy is still decent and corporate balance sheets are strong, Smetek said.

But the 10-year Treasury bond, a bellwether indicator for everything from the bond market to mortgage rates, is at about 4.75% - around the middle of its trading range of 4.4% to 5.25% during the last 18 months. That suggests a range of interest rates are still relatively low, minimizing the risk of a recession.

Here are some of the stocks Smetek owns that fell on hard times after leading the market in the late 1990s but now have potential to outperform:

Microsoft Corp. (MSFT, $28.61), Redmond, Wash., has been focused on introducing its Vista product and strengthening itself in other areas. Like many of these companies, it has a strong balance sheet and low valuation.

EMC Corp. (EMC, $14.60), Hopkinton, Mass., is a data storage equipment maker that plans to spin out 10% of its VMWare subsidiary in an IPO, a move Smetek says is underappreciated by Wall Street. VMWare, which EMC bought in 2004, sells programs that let server computers run several operating systems.

International Business Machines Corp. (IBM, $94.93), Armonk, N.Y., has remade itself into a more service-based company. That service orientation should allow IBM, which already is well-managed with a good balance sheet, to show stable growth going forward, Smetek said.

Lowe's Cos. (LOW, $31.14), Mooresville, N.C., like many of its peers has been punished for its relationship to the housing market and consumer spending - both concerns for investors.

Now these shares are cheap, and the company may have an easier time beating its disappointing 2006 earnings, Smetek said. "If you don't think the economy is going into recession, there's a good risk / reward play here," he said.

American International Group Inc. (AIG, $66.91), New York, has come through a legal attack and the hit delivered to financial stocks in February.

The large insurer and financial services firm in 2005 said its top executive of 40 years, Maurice "Hank" Greenberg, would retire after allegations of fraud by then-New York Attorney General Eliot Spitzer. In a settlement with regulators early last year, AIG agreed to pay $1.64 billion to resolve the allegations, and the issue is behind it, Smetek said.

AIG is selling at a reasonable valuation, has a strong balance sheet, and is getting its house in order after the management changes, Smetek said. Also, the insurance side of AIG's business isn't based on taking advantage of interest-rate spreads, so the company shouldn't be hurt by interest-rate moves or credit-quality issues in the housing market, he said.

General Electric Co. (GE, $35.38), Fairfield, Conn., the broadly diversified conglomerate whose medical imaging equipment division has substantial operations in Waukesha, has been underperforming the market for the last five years.

Smetek says GE has a great balance sheet, the ability to have stable earnings in these unsettling times, and is a diversified company that makes everything from jet engines to large appliances and offers a range of services.

"I really think this is going to be the time for GE to work," Smetek said.

The biggest risk he associates with the shares is that investors leave them for dead, Smetek said. "People say it's too big, so its stock is at about a market multiple which is on the low end of its historical range. But its earnings growth rate is higher than the broader market," he said.

GE shares are trading at about 16 times 2007 earnings, and analysts are expecting the company to increase its earnings by about 12% in 2007 vs. 5% to 8% for the Standard & Poor's 500 index.

Smetek is still buying these shares for new clients at $34 or lower and says they could go as high as $42 in the next 12 months.

This column examines one stock through the eyes of a professional investor to show how market pros make investment decisions. Neither Kathleen Gallagher nor the Journal Sentinel recommends specific investments or endorses the recommendations of those interviewed.

From the April 15, 2007 editions of the Milwaukee Journal Sentinel