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Emerging markets, Europe may be investment targets

By KATHLEEN GALLAGHER, kgallagher@journalsentinel.com

With U.S. stocks trading at what he calls elevated valuations, Milwaukee money manager Ignatius L. Smetek says European and emerging markets may have more growth potential.

Ignatius L. Smetek

But mining that potential doesn't have to involve investing directly in those areas, said Smetek, president and chief investment officer at Arcataur Capital Management LLC.

"If Europe is improving and emerging markets are stabilizing, that will benefit companies that feed into the world economy," Smetek said.

The eurozone has officially emerged from a dramatic recession.

And China and other developing nations may be stabilizing after several years of declining growth rates, Smetek said.

Arcataur is reducing its holdings of small- and mid-cap domestic stocks on the belief that large-cap, multinational companies will benefit more over the next two to three years from the slowly improving U.S. economy and stabilization in international markets, he said.

During the last two years, the U.S. stock market has grown faster than corporate earnings, he said.

Also, a multiyear transition to higher interest rates resulting from a devastating credit crisis could disrupt global financial markets.

So the market could see a 5% to 10% correction.

"We're looking for more market volatility in the next two months," Smetek said.

Smetek says he would buy on dips the stocks of companies with a good share of international customers.

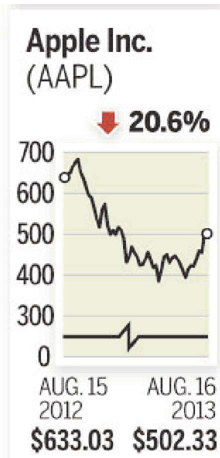
Caterpillar Inc. (CAT, $85.16), Peoria, Ill., makes construction, mining, agricultural and forestry machinery.

Caterpillar is a world leader in construction equipment whose stock has struggled as China's growth has slowed. China's woes, however, may represent a future opportunity.

"It's a cyclical company, and when a good portion of the customer base is trying to come out of recession, that's future opportunity for demand," Smetek said.

Caterpillar shares have traded in a 52-week range of $79.49 to $99.70. Smetek said he would buy them at $83 or lower.

They could rise to $100 in the next 12 to 18 months if economies in Europe and emerging markets pick up, he said.



Graphic/Journal Sentinel

Apple Inc. (AAPL, $502.33), Cupertino, Calif., makes mobile phones, portable music players and personal computers.

Apple shares are trading in a 52-week range of $385.10 to $705.07.

Apple's dramatic fall from its highs in September have made it "one of the cheapest stocks out there," Smetek said.

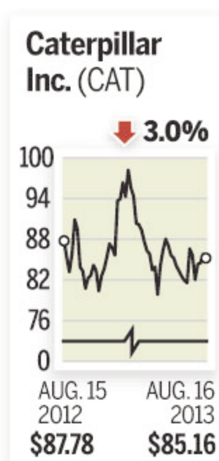
The company trades below 12 times earnings and will have relatively easy comparisons in 2014, he said.

Meanwhile, he said, Apple's 2.7% dividend yield is higher than that of the overall market.

Apple's stock has struggled because the iPhone has become such a large share of its business, and slower Chinese sales have translated into slower revenue growth, Smetek said.

Smetek would buy Apple shares at $450 or less. The stock could rise to as high as $600 over the next 12 to 18 months, he said.

If the new product Apple is announcing in September generates a lot of excitement, it could push the shares even higher, to as much as $600 or $700, he added.



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The biggest risk with holding both Apple and Caterpillar shares is the possibility that China and other emerging economies might have big problems down the road.

"But if you believe China and the others will stabilize and slowly improve, you want some of your investments levered to them," Smetek said.

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About this

The Journal Sentinel focuses on one Wisconsin money manager or analyst in this weekly feature, looking at a trend that helps investment pros make their decisions.

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.

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