Trade Secrets
Top Oregon advisors share their investing strategies

When it comes to money, everyone has an opinion. But not everyone's opinion makes money. These four investors have proven financial track records, and here they share their insights for making successful investments.

Keeping Your Investments Safe

Investing with Robert Schaeffer of Becker Capital Management Inc.
By Gary Corbin

As a young man, Robert Schaeffer helped keep U.S. soldiers serving in Vietnam safe from harm by equipping them with state-of-the-art armor and training them in how to use it. Now he protects retirement and endowment funds, rather than tanks and bodies.

Schaeffer carries this philosophy forward into Becker Capital Management Inc.'s investment strategy. "We're a bottom-up value manager," he says. Unlike "top-down" companies, whose investment decisions are based on a macro view of the direction of the economy, he says Becker "looks for individual companies with good quality fundamentals."

While that may sound conservative, a second element of their approach, Schaeffer explains, makes it very growth-oriented. "We look for stocks that are unpopular with other investors," he says. "That is, companies whose stocks are trading at below-average valuations."

In other words: Buy low, sell high. Sounds simple — but if it were, everybody would be a millionaire. "The trick is knowing not only what to buy," he says, "but when."

Take, for example, General Electric Co., literally a household name with a Triple-A bond rating. GE's stock values have stayed flat for the past five years. But Schaeffer likes the stock and is buying it now, confident of its future growth. "The company is going through a transition, moving away from old financial and consumer businesses and toward being an international development company," he says. "They're in places like Kuwait, building infrastructure and utilities for the 'oil belt.' That niche is growing 15 to 20 percent a year."

It's also an increasingly important part of GE's business, according to Schaeffer, and a sign of profitability in years to come.

It makes sense: U.S. consumer confidence is low, and the financial industry has taken a beating in the past year or so. But as gas prices climb, oil-rich nations will be centers of capital and investment — and sources of profit for companies like GE.

There's other evidence, too. A typical company in today's market trades at a little above 17 times earnings, for example, at a P/E ratio of 17.4. GE trades below market, at about 14, up slightly in recent years. "I believe their transition is paying off now," he says and points to their above-average dividend, more than 3 percent, compared to the industry-average 2 percent.

Criteria
Quality financial fundamentals top Schaeffer's list of criteria for selecting a company for investment. Another criterion is stability. One measure of stability is, as with GE, a large company with large capitalization (more than 51 million shares, in GE's case). Mid-size companies can qualify, too. Starwood Hotels and Resorts Worldwide Inc., parent company of Westin and other hotel and timeshare chains, is another company currently on Schaeffer's list.

Starwood is a "consumer cyclical" type of stock, which includes other sectors such as retail and housing. "Consumer cyclicals came under high pressure in 2007, which is a nice way of saying they took a beating," he says. "But I think a lot of people threw out the baby with the bathwater." Starwood's stock values fell from a high of about $75 to the high 30s. Schaeffer bought at around $40. At press time, the price is just over $45, and Starwood expects 2008 dividends of about $2.50, more than 5 percent of current stock value.

A third factor is that the stock must be at an undervalued stock price. This can take one of two forms. First, a good quality company whose valuation dwells in the bottom third of the market becomes a stock to watch. But a better than average company with a significantly better than average growth rate and financials is also of interest. For example, after the technology stock bubble burst five years ago, Microsoft became a "clearly superior company with an average stock price." Then, selling at about $24 per share, the software giant topped out at $36 before the recent Yahoo merger bid.

The fourth and final major factor is the source of corporate profits. Companies with foreign exposure are currently growing faster than those with only a domestic U.S. market. In 2007, the Standard & Poor 500 showed a 4.6 percent decline in domestic profits versus 2006 but a 36.5 percent increase in profits from exports. The weakening dollar, Schaeffer says, and the strength of foreign consumer markets compared to the U.S. are the reasons for this disparity.

Honda Motor Co. Ltd., a Japanese company traded in the U.S., is a good example. Honda stock is inexpensive, but the company is gaining market share because of its reputation for reliability and quality — and because of its cars' fuel mileage. "Ironically, they're a beneficiary of high gas prices," he says, "unlike most other car companies."

Their sales in the U.S. are okay, Schaeffer says, but their real strength is in Europe and Asia, where they have been showing strong growth.

This was an accidental find, he admits. "Originally, we weren't looking for companies with strong exports. We found them because their stock prices were cheaper."

How do they know?
To many, the workings of the stock market are a black-box mystery. Schaeffer chuckles at this. "There are no secrets," he says. Becker Capital's 30-plus years of success are based on old-fashioned research methods. "We have eight stock analysts, each following specific industries, with working knowledge of the companies they follow," he explains. "We look at the amount of debt, the structure of the firm's debt, their cost structure, their cost of health insurance, things like that. We study financial reports, and if we're still

interested, we contact the company for more information. We may even visit their headquarters or talk to their competitors."

But it's not a crystal ball activity. "I'm not much for forecasting," he says. "I have a saying: We're much better at predicting the future than we are at predicting the future accurately."

What does Becker do differently then? "One thing is, we look at insider trading activity," he says. "Do top executives own much of their company's stock? Are they currently buying or selling? If they're buying, that shows that they feel the company is in better shape than other people think."

On the selling side, it's simple arithmetic. When a stock drops 15 percent from its purchase price, it triggers an automatic review of the company's fundamentals. If the financials have changed materially (for example, a major merger or acquisition), then they'll sell. Otherwise they'll hold on until it drops 25 percent from the initial purchase price. On average, Becker holds a stock about three years.

Financial armor

Schaeffer claims no special genius. When asked how often he's right, he deadpans: "Fifty-one percent."

"If you're in this market, you'll make a lot of mistakes," he says. "The key is not to make debilitating mistakes."

An example: In the late 90s, Becker had avoided technology stocks, which were up 75-100 percent. "In 1999, we looked like complete idiots," he says. "We thought they were over-valued. But we didn't violate our investment disciplines, so we didn't get killed when those stocks collapsed."

"Performance in the market," he says, "is not just a matter of what you own. Often, it's a matter of what you don't own."

For this former National Guardsman, financial armor may be the best long-term investment.

Asset Allocation

Investing with Greg Houser of Chinook Capital Management LLC

By Jim Pasero

Greg Houser doesn't care much for mob rule. "We are not a top-down manager, taking our cue from economic signals, economic expectations. There's a lot of irrationality in the market, and we exploit the irrationality in the market." Under Houser, Chinook Capital Management LLC brings value to their clients in three ways: 1) through the company's asset allocation decisions; 2) through stock selection — their equity portfolios ("Core Equities" and "Emerging Growth"); and 3) by encouraging clients to allow them to manage all of their assets. These days Houser is focused especially on asset allocation, recommending a mix of stocks from large cap to small cap.

The large cap stock Houser has been eyeing this year is Accenture Ltd., the former consulting arm of Arthur Andersen that went public in 2001. "Accenture is a world leader in business consulting and technology services, what is called business process outsourcing (BPO). They help companies develop enterprise networks — hardware, software. And they allow their clients to outsource their accounting work, their retirement plans."

What Houser likes about Accenture is how dominant the company is in its industry. "They operate in 49 countries, have thousands of clients, and a revenue base of $24 billion. Accenture, like any business, is not immune to economic vagaries worldwide, but because of its diversified business it is working in many areas that are recession resistant."

Houser believes that globalization has made large companies more productive, and he cites Accenture as an example. "In Accenture's most recent quarter, they were up 10 percent in the U.S. in earnings, 14 percent in Europe and the Middle East, and 21 percent in the Pacific. Those numbers are interchangeable for a lot of companies with international exposure."

Houser also likes that Accenture has relatively low annual capital expenditures, something he looks for in companies he purchases.

"Accenture has a high book-to-bill ratio. They are bringing in new orders into their pipeline, constantly replenishing it. They increased their dividend by 20 percent, they have low debt, and their cash is about 10 percent of their market value," Houser says. "They are prolific buyers of their own stock, which suggests confidence. We like companies that are cash rich, generate huge amounts of cash, and don't make silly acquisitions with it."

In Houser's opinion, what's not to like about Accenture?

The mid cap stock Chinook Capital is currently emphasizing is Monster Worldwide Inc.. "This company is the preeminent online employment solution provider. They are the international leader, providing the platform for job seekers and employers, and they do it through online resumes, job listings and career information."

The company's revenue last year was $1.3 billion, and it's been in business for 12 years. "It is periodically discussed as a takeover candidate," says Houser.

One quality Houser likes about Monster is that, like Accenture, it only spends 20 percent of its cash flow on capital expenditure. "That is pretty low," says Houser. "America's Rust Belt is spending 50 to 75 percent."

Houser hates capital intensive businesses and industries.

He also sees opportunity with Monster because of its recent management shakeup. "The company recently had a management upheaval. They had problems with top executives backdating options. Now," Houser says, "they have settled with their former CEO and CFO and brought in a new management team."

Houser is impressed with the management's emphasis on overseas markets. "The new management has done the necessary things, with more focus on international operations, which produced about 45 percent of the company's revenues but only 10 percent of their income. It was a huge disparity, an opportunity. They basically under-spent on international infrastructure. Now, they have ramped up their spending, and international business is up 59 percent."

Houser is bullish on Monster. "The company is dominant in its marketplace. It has recurring revenues, has double-barrel growth, and can grow its top line, which will magnify their bottom line and improve their profit margin. Their valuation is extremely attractive. We are cash buyers."

A California company called JDA Software Group Inc. is Houser's best pick in the small cap market. JDA's revenues last year were more than $800 million. For Houser, picking small cap companies is his favorite part of the business. "We find companies that are under-followed, under-appreciated. With small cap companies, it is much easier to make a difference as an analyst and money manger."

Why does JDA appeal to Houser? "They dominate their space in what is called demand and supply management solutions. Their primary industry is vertical in retail. They supply software to retail industry and now more recently to distribution and manufacturing industries. They have a blue chip list of clients, including Boeing and British Airways. Their software has the potential for an end-to-end solution for a manufacturer and for a retailer; it allows them to manage their entire supply chain on decisions about pricing, or what is called yield management."

Besides being impressed with their product mix, Houser is also impressed with their number of new clients. So, any downside to JDA? Houser doesn't see much. "JDA had some execution problems. The company was prosperous for one or two quarters, and then they would disappoint for a quarter or two."

Houser points to JDA's acquisition of competitor Manugistics in 2006 as smoothing their path. "What we saw after the acquisition was deals going up, larger deals, the breath of the deals, new customers, customers outside of retail. Last quarter, 38 percent of their business came from new customers, up from 21 percent the year before."

But is JDA recession proof? Is their product a discretionary item? Houser doubts it. He is impressed with management's aggressive position toward growth. "They are going to spend a considerable amount of money to build out a more comprehensive development center in India for software and customer development. This looks like a good move. The math is compelling. Their competitors have done it, so they are a little behind the game."

Houser also likes knowing that JDA gets more than 40 percent of their business in annual maintenance contracts. "When people buy the product they sign a maintenance service upgrade contract so that they will get all of the software upgrades. Their customers will get various consulting services to implement these upgrades, annual subscriptions, and that rings the cash register.

In the long run, what Houser likes about JDA is what he likes about his other picks: their cash position. "It is a company with considerable cash. They throw off cash far greater than what they show on their earnings per share."

Accenture, Monster and JDA Software. Houser's three picks, and what's their upside from their valuation? "Accenture has a 30-35 percent upside. Monster has about a 40 percent upside. JDA, from our valuation, has 50 percent plus appreciation upside."

And when to sell? "We sell when the appreciations get to that point, unless there is new information to adjust our modeling.

Alpha, Beta, Capital

Investing with Eric Davidson of Paulson Investment Company Inc.
By Gary Corbin

When he's not investing other people's money at Paulson Investment Company Inc., Eric Davidson can probably be found coaching or playing sports with his children. Either way, he's balancing payoff and risk, and aiming for optimal performance — and having some fun, too.

"Risk tolerance is the main issue for most clients," he says, "especially if the client is a couple. Usually one is more risk tolerant than the other. I have to manage the portfolio to fit both."

As vice president of sales, Davidson is responsible for bringing in new product lines so that he can find unique opportunities for the risk his clients are willing to take. "My job is to bring alpha to the portfolio," he says. Alpha, he explains, is the product's performance compared to the market. This must exceed the "beta" — the risk represented by that stock, bond, annuity, IPO, or the like. With a volatile market in both stocks and bonds right now, bringing in new investment opportunities to meet a diverse range of risk tolerances is a dynamic enterprise, to say the least.

Founded in 1978, Paulson Investment is the largest brokerage firm in the Pacific Northwest, with about 120 employees and $1 billion in managed assets. Paulson Investment specializes in publicly-traded micro-capital issues — companies with under $100 million in market capitalization. In a strong market sector, "big players, obviously, will do well," he says. The smaller players are harder to predict. "That's the service I provide to my customers," he says. "And I only have to be right about 60 percent of the time."

Macro to micro: An insider's game

Step one in picking a winner in the micro-capital market is to identify which of the big players — the "large caps" — are performing well in terms of volume, earnings and price. Davidson looks for companies whose earnings visibility is strong over the next 12-18 months. "You can usually count on them being right," he says. "They tend to be pretty conservative."

Once he's found the strong players at the large-capital end of the scale, then he begins digging down to find the small- and medium-sized firms that supply and service the big companies. For example, "If a company like Cisco has clear guidance for the next 18 months, especially if it's in a ramping-up business sector and they're in a sweet spot in that sector, I want to find the small cap companies servicing them. Even a small bump for Cisco can mean a 2-300 percent increase for small cap companies."

To find the specific smaller firms, Davidson goes through a screening process, looking at who is buying and selling their stock. In particular, are their executives and board members buying or selling? “CFOs are usually the most conservative with their investments. If they’re buying a lot of a firm they’re involved with, it shows that they believe the stock price will be higher in six months.”

His next step is to look at these executives’ track records. With a six-month minimum holding period on insider buys, the key question is, what is the return on these executives’ insider investments six months later? If their returns tend to be strong, and they’re buying a small cap company with good fundamentals in a strong sector, then they fit his investment profile.

“At that point,” he says, “I buy into both the large cap and the small cap. For every share I buy in the large cap, I buy maybe two shares of the small cap.” The reason, he says, is that he might be wrong about which small cap will benefit, but he doesn’t want to miss the overall wave. Buying into the small company can provide higher returns, but buying the big firm provides a hedge against picking wrong at the micro level.

Following that logic, Davidson invested in two big firms in the networking sector — Cisco Systems Inc. and EMC Corp. — and then bought heavily in two companies servicing them — Opsware Inc. and INX Inc. Both moves paid off well, but especially Opsware, which was bought out by HP in 2007 for $14 a share, $4 more than its then-current trading price.

Green earnings

Besides the micro-capital specialty, Paulson Investment, led by firm Chairman and Founder Chet Paulson, has also developed a niche in successful investments in “green” industries. In particular, Paulson picked three big winners in the green sector in the last few years: Ascent Solar Technology Inc., maker of building integrated photovoltaic systems; Converted Organics Inc., a firm that collects and converts waste products into environmentally-friendly agricultural fertilizers; and DayStar Technologies Inc., a company that develops, manufactures and markets photovoltaic products that convert sunlight directly into electricity in North America and Europe.

“It’s not just that they’re green,” Davidson explains. “These stocks have had a great run, and so long as oil stays above $65 a barrel, they’ll stay strong.” Converted Organics, he says, is perhaps in the most enviable position: “They get paid to haul your waste away, then they sell it as fertilizer, and then — since they’re doing something sustainable and green — the government gives them tax breaks, too.”

Sounds safe enough. But looking closer, they may not be for the risk-averse after all. “The risk is that their stock will get a quick spike from traders who are in, then out,” he says. For example, Ascent’s stock rose from about $2 a share to $29 in 20 months — then fell to $12 before settling in around $18.

Of course, the green businesses are in good company when it comes to volatile stock prices, and the bond market, Davidson says, is even more volatile. This volatility, he says, shortens the investment time frame, causing him to sell sooner than he used to. “I don’t believe the [company’s] story as much,” he says. “If they’ve gone up 40 or 60

percent, I'm more likely to take the profit rather than hold it. It causes me to be more active."

Israeli sports connection
Interestingly, Davidson's passion for his kids' sports activities led to another great investment, this time in an Israeli company whose U.S. headquarters are based in Oregon: Tefron Ltd.

"I was buying Under Armour for my kids, and I got curious about it," he says. "I couldn't find out much about them, but I found Tefron."

Tefron produces the seamless fabric material used for Under Armour as well as for many other large apparel companies, such as Nike and Victoria's Secret. As such, they fit Davidson's profile quite well: a small cap servicing big players in a strong business sector. He bought at around $6 and sold at around $11. The stock now lists at $5.27.

It just goes to show that performance in investments, as in sports, is all about timing.

A Big Ship for Rough Seas

High quality for the stability to go forward
By Jim Pasero

The market these days is shaky, volatile and down right bearish. But Bob Unger of Platte River Capital believes he has spotted a long trend that can help his clients through these times. Unger calls it "Big ships for rough seas." Says Unger, "Since 2000, the S&P has been basically flat, and all you have gotten is your dividend return. The way you made money was with small companies or commodity plays. We think going forward with your money should be in more of the S&P names, the large cap growth companies."

What many investors would like to know is why the S&P has been so flat for so long. A recent *Business Week* article, "How Real was the Prosperity," partially addressed this subject: "We're just beginning to figure out how much of the nation's recent growth was the result of a credit-induced frenzy."

Unger has some additional thoughts, and they are generational and cyclical. "The baby boomer market began in 1981 and ended in 2000. At the end of the market, after you have hurt so many investors, it takes a period of 12 to 15 years to get a new crop of people. Right now, a lot of people are disenchanted with stocks and sell them when they have an opportunity. There has been a liquidation of mutual funds in the last eight years because a lot of them have been large cap dominated — now that is an opportunity going forward," Unger says. "But the investor is pretty disenchanted after eight years of mediocrity. Now people are getting into international markets such as Europe and small, fast specialty products at the wrong time. Now you should be selling those and getting into large U.S. companies."

What large U.S. companies does Unger recommend?

"We are looking for companies that have international business, that are priced close to the same evaluations as value names, where there is a small premium paid for growth, which provides an opportunity for buying at very high quality, a company with a good

balance sheet, a company with growth of earnings looking forward to the future and modest evaluations."

Today that company is Cisco Systems Inc. Unger says he bought Cisco because it is selling at 14 times this year's earnings, and it is still a 12 to 17 percent grower, which is 1/10 the evaluation on P/E that the stock carried seven or eight years ago. "And they have business in BRIC (Brazil, Russia, India, and China) markets that are very attractive," he says.

Another Unger large cap favorite is Whirlpool Corp. "Whirlpool is a soft cyclical company that we have recently invested in — a very high-quality company with more than 50 percent of its business overseas and dominant in those BRIC markets, number one in Brazil, number one in India, and number two in China. And now they have merged with Maytag Corp.

They have taken a lot of costs out of their business, and their company is selling now at about 10-and-a-half times earnings and has a growth expectation far superior to the S&P." Unger continues, "It has a good balance, makes good quality products in markets that are going to grow, and the stock has a low multiple because people view it as a housing sensitive issue … New homes are now only 10 percent of its business, down from 30 percent if you go back 20 years ago. Today, there is a lot more discretionary spending and replacement of washers and dryers, household appliances."

Whirlpool, like Cisco, fits Unger's current thinking. "We are looking for big ships, rough seas, high-quality companies that are low evaluation that provide good stable growth going forward, and we think investors can still make good solid returns on those type of investments. We would be avoiding the smaller companies, which we think are much more risky, and those companies dependent solely on the U.S. market."

Since he started Platt River Capital in 2005, Unger now finds himself spending more and more time in his Denver office than his Portland office because Denver's financial strengths are closer to his investment philosophy. "The Northwest is a small cap manager's market, and Denver is more of a large cap market because of companies such as Janus and Marsaco that are located there."

Unger's Denver office is located one block from Janus Capital Group Inc.'s headquarters. Being located in Denver gives Unger an opportunity to spend some face time with some fairly prominent large cap executives, such as Muhtar Kent, the chief operating officer of Coca-Cola Co. and soon to be the company's new CEO in July.

"By being in Denver I was able to see the vision that Coca Cola has, and that vision is not in carbonated beverages," says Unger. "It is in juices, such as Simply Orange and the acquired Vitamin Water. The fastest growing grocery category is the beverage market, and carbonated beverages are growing less than the rest, so they are diversifying into other parts of the beverage market, much like Pepsi did years ago. They have turned around the Philippines and Japan, which were both problem markets for them. We think Coca Cola has its mojo back, is on a growth path, and so it is a significant holding for us. Being located in Colorado, being able to see the COO one-on-one saved us traveling and gave us an opportunity."

Big ships for rough seas — probably no one better to pick them than Bob Unger.