# THE VIEW FROM PRINCETON

***Market Commentary ♦ August 2014***

## VALUATION, VALUATION, VALUATION

The long upward advance in general market indices, as these continue to edge higher, has been accompanied with an evident increase in commentary that warn of the perils of overvaluation. Surely, the easiest of all risks to avoid is that of overvaluation — simply, by not owning these. The American Stock Market includes such a broad variety there is nearly always the overvalued, the reasonably valued, the attractively valued, and the overlooked undervalued. For all of which, the valuation vis-à-vis forward opportunities is more germane and useful than valuations relative to the historical performance. Reference to the past has some worth because it descriptively reveals effectiveness of managements and of product attributes.

While a flow of funds analysis and the support of national (and international) monetary policy continue supportive to advances of stock prices generally, it seems increasingly important to give primary attention to the vigor and strength of well-run enterprises. And, as ever, give special attention to the specific expansive opportunities addressed by enterprises, and gauge concepts of the appropriateness of valuations accordingly. Valuation on both historical reference and on appraisal of prospects infers there are many strong enterprises that are not overvalued. Also, there are many shares significantly undervalued, especially among the middle-sized and smaller enterprises.

Looking ahead, from the standpoint of further increases in corporate revenues, there are two nationwide huge opportunities that are supported by critically urgent needs. These are cyber security that requires extremely sophisticated products and intellect; the other, of greater scale in the use of materials, is the urgent need to improve transportation infrastructure in nearly all of its forms and aspects. This requires (literally) "down-to-earth" product analysis that begins with earth-moving equipment, stone, aggregate, and cement. In terms of a general, pervasive stimulus to the economy, this has enormous scale and geographical spread. This will include the need for many structural materials, and a variety of supervisory devices for control of transportation use. For relieving ourselves of the intolerable inconvenience and horrendous costs of inadequate facilities, an accounting (if it were done) in societal terms would show savings that much exceed financial costs, which seemingly assures the advent of rebuilding at all levels of governmental jurisdictions.

The pessimist sees inflation, imagines a bubble, and fears a bubble-bursting that will induce a collapse. Inflation, yes. It is part of the package, eventually, of a stimulative monetary policy. Arithmetically, if money is cheapened all things of worth that can be expressed (denominated) in dollars (money) have higher than otherwise price tags. When, as now, America has entered the mature stage of the effects of stimulation and monetary policy, the broadening increases in activity become self regenerative. Circumstances now allow a retreat toward normalization, letting interest rates move in conformity as these may. Look to economic activity for guidance in visualizing the changing landscape, with major industrial and commercial enterprises leading (as evident in the last few years).

For economic stimulus, there is another very pervasive substantial influence in the prospect for a long downtrend in fossil fuel prices. This stems from discoveries of gas and oil, use of alternatively sourced fuel (wind and sun) and more careful use of fuels in America where consumption is more profligate than in other developed nations. The political support to the strong decades-long advance appears to be ebbing broadly in effectiveness. From the standpoint of corporate earnings, lower fuel costs will boost earnings for most industries other than fossil fuel providers, especially for transportation, thermally driven manufacturing processes, and many chemical companies.

For investors, it would seem to be much preferable to measure valuations according to incipient prospects than by looking over their shoulders downward to the financially precipitated depths of 2007-2009. The physical factors influencing equity prices withstood the negative noise of media commentary, which fomented fear and complaints throughout this irrepressible advance. The "show me" incredulousness is dying slowly. Seemingly, there will be increasing evidence that such doubts and fears are unwarranted.

With enduring good wishes,

| | | | | |
|---|---|---|---|---|
| Alfred R. Berkeley | James Fitzpatrick | Hugh Fitzpatrick | Ken Berents | Steve Reynolds |

♦ ♦ ♦ ♦ ♦

The Appendix that follows is an update to the exhibit included in our November "*View*."

# PRICES AS OF JUNE 30, 2014

**BOEING (BA)**

| | 2007 | 2014 | % change 2007-2014 |
|---|---|---|---|
| Revenues ($ millions) | 66,387 | 90,000 | 36% |
| Market Capital/Revenues | 1.1 | 1.0 | -3% |
| Revenues/Share | 90.1 | 125.0 | 39% |
| Price/Earnings | 17.9 | 20.1 | 12% |
| Price/Cash Flow | 12.8 | 13.7 | 7% |
| Working Capital ($ millions) | -4,258 | 10,500 | NMF |
| High Share Price | 107.8 | 144.6 | 34% |
| Low Share Price | 84.6 | 118.8 | 40% |

**BUNGE (BG)**

| | 2007 | 2014 | % change 2007-2014 |
|---|---|---|---|
| Revenues ($ millions) | 37,842 | 64,660 | 71% |
| Market Capital/Revenues | 0.3 | 0.2 | -45% |
| Revenues/Share | 312.1 | 452.2 | 45% |
| Price/Earnings | 15.1 | 15.7 | 4% |
| Price/Cash Flow | 10.5 | 7.7 | -26% |
| Working Capital ($ millions) | 5,684 | 5,500 | -3% |
| High Share Price | 125.5 | 82.3 | -34% |
| Low Share Price | 69.9 | 73.1 | 5% |

**CISCO (CSCO)**

| | 2007 | 2014 | % change 2007-2014 |
|---|---|---|---|
| Revenues ($ millions) | 34,922 | 47,000 | 35% |
| Market Capital/Revenues | 5.2 | 2.7 | -47% |
| Revenues/Share | 5.7 | 8.8 | 54% |
| Price/Earnings | 22.0 | 12.0 | -45% |
| Price/Cash Flow | 20.6 | 10.1 | -51% |
| Working Capital ($ millions) | 18,216 | 42,250 | 132% |
| High Share Price | 34.2 | 25.2 | -26% |
| Low Share Price | 24.8 | 21.3 | -14% |

**CORNING (GLW)**

| | 2007 | 2014 | % change 2007-2014 |
|---|---|---|---|
| Revenues ($ millions) | 5,860 | 10,100 | 72% |
| Market Capital/Revenues | 6.1 | 2.8 | -53% |
| Revenues/Share | 3.7 | 7.8 | 107% |
| Price/Earnings | 16.7 | 18.3 | 10% |
| Price/Cash Flow | 12.4 | 9.5 | -23% |
| Working Capital ($ millions) | 2,782 | 6,000 | 116% |
| High Share Price | 27.3 | 22.2 | -19% |
| Low Share Price | 18.1 | 16.5 | -9% |

**DEERE (DE)**

| | 2007 | 2014 | % change 2007-2014 |
|---|---|---|---|
| Revenues ($ millions) | 21,489 | 33,505 | 56% |
| Market Capital/Revenues | 1.4 | 1.0 | -30% |
| Revenues/Share | 48.9 | 91.1 | 86% |
| Price/Earnings | 14.5 | 10.5 | -27% |
| Price/Cash Flow | 13.6 | 8.3 | -38% |
| Working Capital ($ millions) | 2,433 | 5,445 | 124% |
| High Share Price | 93.7 | 94.9 | 1% |
| Low Share Price | 45.1 | 83.4 | 85% |

**DuPONT (DD)**

| | 2007 | 2014 | % change 2007-2014 |
|---|---|---|---|
| Revenues ($ millions) | 29,378 | 36,600 | 25% |
| Market Capital/Revenues | 1.5 | 1.6 | 12% |
| Revenues/Share | 32.7 | 40.7 | 24% |
| Price/Earnings | 15.0 | 15.5 | 3% |
| Price/Cash Flow | 9.8 | 10.4 | 6% |
| Working Capital ($ millions) | 4,619 | 11,000 | 138% |
| High Share Price | 53.9 | 69.8 | 29% |
| Low Share Price | 42.3 | 59.3 | 40% |

**GENERAL ELECTRIC (GE)**

| | 2007 | 2014 | % change 2007-2014 |
|---|---|---|---|
| Revenues ($ millions) | 172,738 | 148,600 | -14% |
| Market Capital/Revenues | 2.2 | 1.8 | -19% |
| Revenues/Share | 17.3 | 14.9 | -14% |
| Price/Earnings | 17.2 | 15.7 | -9% |
| Price/Cash Flow | 11.6 | 9.7 | -16% |
| Working Capital ($ millions) | 244,405 | 253,000 | 4% |
| High Share Price | 42.2 | 27.9 | -34% |
| Low Share Price | 33.9 | 24.3 | -28% |

**INTEL (INTC)**

| | 2007 | 2014 | % change 2007-2014 |
|---|---|---|---|
| Revenues ($ millions) | 38,334 | 54,120 | 41% |
| Market Capital/Revenues | 3.6 | 2.8 | -20% |
| Revenues/Share | 6.6 | 10.9 | 65% |
| Price/Earnings | 19.9 | 16.0 | -20% |
| Price/Cash Flow | 11.8 | 9.0 | -24% |
| Working Capital ($ millions) | 15,314 | 19,000 | 24% |
| High Share Price | 28.0 | 31.0 | 11% |
| Low Share Price | 18.8 | 23.5 | 25% |

**MICROSOFT (MSFT)**

| | 2007 | 2014 | % change 2007-2014 |
|---|---|---|---|
| Revenues ($ millions) | 51,122 | 84,250 | 65% |
| Market Capital/Revenues | 5.9 | 4.1 | -30% |
| Revenues/Share | 5.5 | 10.3 | 88% |
| Price/Earnings | 19.9 | 15.3 | -23% |
| Price/Cash Flow | 19.4 | 12.6 | -35% |
| Working Capital ($ millions) | 16,414 | 75,000 | 357% |
| High Share Price | 37.5 | 42.3 | 13% |
| Low Share Price | 26.6 | 34.6 | 30% |

**UPS (UPS)**

| | 2007 | 2014 | % change 2007-2014 |
|---|---|---|---|
| Revenues ($ millions) | 49,692 | 58,000 | 17% |
| Market Capital/Revenues | 1.5 | 1.6 | 5% |
| Revenues/Share | 48.0 | 63.1 | 31% |
| Price/Earnings | 17.8 | 21.5 | 21% |
| Price/Cash Flow | 12.5 | 14.1 | 13% |
| Working Capital ($ millions) | 1,920 | 7,000 | 265% |
| High Share Price | 79.0 | 104.9 | 33% |
| Low Share Price | 68.7 | 93.2 | 36% |

# APPENDIX

## SEVEN YEARS OF ENTERPRISE PROGRESS IS NOT WELL REPRESENTED IN SHARE PRICES

For all of the ten large enterprises listed on the previous page (except GE, owing to divestiture) that are owned by clients, revenues increased substantially. Their share prices value revenues, revenues per share, and earnings per share more conservatively than seven years earlier. Working capital increased by low multiples for seven, adding to extraordinary sums; the other three — Bunge, GE, and Intel — already were abundantly provided with cash or near-cash instruments. The market capitalization of revenues increased (slightly) only for DuPont and United Parcel. For the other eight, the bench mark of market capitalization of revenues was substantially lower than seven years ago.

Broadening the reference to industry leaders such as Exxon, Proctor and Gamble, IBM, and Comcast, shares are priced more conservatively than seven years ago. For the awesome trio — Amazon, Apple, and Google — for which growth has been extraordinary, the share prices, irrespectively, do not excessively capitalize former progress or prospective high rates of growth of the very large advances. Also, share prices show very little appreciation for capital expenditures and accumulation of cash during recent years.

### THE PERCENTAGE CHANGES FOR 7 YEARS OF GROWTH

| | | REVENUES | SHARE PRICE | MULTIPLE OF REVENUES |
|---|---|---|---|---|
| Amazon | (AMZN) | 6x | 4x | 4x |
| Apple | (APPL) | 7x | 3x | 3x |
| Google | (GOOG) | 4x | 1.4x | 5x |

Strong industry leaders typically benefit from recessions attributed to financial stress (especially a debacle such as 2008-2009) by taking product market share from the weaker. There is little evidence that these recession-sponsored advantages accruing to the strong is valued in share prices.

This market seems to be overvalued only vis-à-vis an assumed downturn in economic activity. This assumption has much less substantial supporting factors than prospects for ongoing expansion of economic activity.