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TRENDS & IDEAS

BUYSIDE: FORGET D.C. GRIDLOCK, CERTAIN STOCKS & SECTORS SET TO RISE

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Despite S&P Equity Strategy data showing gridlock in Washington not being good for the equity markets in the two years after midterm elections, some buy-side professionals see the next 12 to 24 months as providing upside of up to 10% for equities, with commodities likely leading the way, even though the United States should still experience sub-par economic growth.

"Regardless of how the elections turn out, growth will be slow," says Albert Meyer, founder and president of Bastiat Capital. Meyer, who is also the portfolio manager of the Mirzam Capital Appreciation Fund (MIRZX 10 ***), thinks there will be "slow but certain improvement in the economy." For stocks, he foresees the S&P 500 advancing about 10% in both 2011 and 2012.

Daniel Genter, president, CEO and chief investment officer at RNC Genter Capital Management also sees 10% appreciation for shareholders in 2011. In the short term, he thinks that investors may applaud gridlock and subsequently drive stocks higher.

"Economic growth is suspect and there is no confidence right now of where the earnings will come from," he says. "But with partial gridlock, I think you are going to get a bump in multiple from about 14 now on the S&P 500 to 15, and then you track earnings," Genter projects. He sees 8% upside for the S&P 500 next year, not including the blue chip benchmark's 2% dividend.

"A Republican victory in the House won't be a surprise," notes Frank James Ph.D., founder and chairman of James Investment Research. But no matter which party receives the majority in Congress, "the country has too many empty houses, too much debt, and too many people out of work," he adds.

Dr. James also sees stocks "moving up a bit, with momentum, and celebrating Republican victories," however, that euphoria may be short-lived and he "would not be surprised by a moderate pullback shortly after the election."

James Dailey, the chief investment officer at TEAM Financial Asset Management sees gridlock boosting stocks over the next 12 to 18 months and also thinks the markets may see some profit-taking after the elections. He also projects that commodity prices will spike, but notes that will have nothing to do with who sits in Congress.

"The global business cycle is such right now that we really have some tight commodity markets. Couple that with an expected reemergence of growth in the emerging markets and the devaluation of developed market currencies - this scenario could stoke commodity prices even higher," Dailey says.

However, he also thinks that should fiscal stimulus continue, along with two more years of Bush tax cuts, these policies should set the stage for an environment in which hard assets fair well despite longer term structural problems the country is facing.

For the time being, Dailey sees the sweet spot in mid- to late-cycle plays in the energy sector and continues to like agriculture plays. He also likes the materials sector, especially Martin Marietta (MLM 80 ***) and Vulcan Materials, (VMC 36 ***), both of which he thinks may also do well if Washington decides to reemphasize infrastructure spending.

Genter also likes energy stocks, particularly driller Schlumberger (SLB 69 *****), but he also sees dividend-paying technology and telecom stocks doing well over the next several months following the midterms.

Dr. James believes that commodity stocks, in general, should continue to do well along with United States exporters, precious-metal stocks, and basic material stocks, due to the ongoing developed-market currency devaluations.

But a market strategist at SCM Advisors is skeptical. Although he believes midterm elections will likely give a clue as to what can be expected over the near-term about fiscal stimulus, and over the longer-term about the continuation or retrenchment of government overreach, "my guess is that there will be a lot of position-squaring going into the week and lots of volatility coming out. As a result, I'd recommend a reevaluation after the smoke clears a bit," says SCM's Chief Strategist Max Bublitz.

But Bastiat's Meyer would be wary of certain industrial stocks. "Massive cuts in the defense budget are on my wish list," Meyer says. He thinks investors would have to give some thought to "how massive cuts in the defense budget would impact holdings of defense-related stocks."

Note: The fund rankings in this article - from five star (highest) to one star (lowest) - are quantitatively derived from performance, holdings, risk, and expense analysis. S&P Equity Research's stock rankings or STARS - using a scale of 5-STARS (Strong Buy) to 1-STARS (Strong Sell) - are based on S&P equity analysts' qualitative and fundamentally driven

TAKEAWAY: Investment professionals see stocks advancing over the next couple of years, and these stocks may benefit.

POSITIVE IMPLICATIONS:

Schlumberger Ltd	★★★★★	[SLB]
Vulcan Materials	★★★	[VMC]

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