



Changing Assumptions for Sin Stock Investors

For the income and/or value stock investor, sin stocks have generally always had a certain allure. Proven business models, regularity in human behavior and barriers to entry made most companies perfect for the investors looking to hold stable value companies or those in need of an income stream. Lately cigarette companies, a large staple of the sin stock realm, have been outperforming the market. They have provided a safe haven for investors in this volatile period and investors have rewarded the companies in higher share prices valuations.

Is 2012 the year for current cigarette investors to lighten their investment load? I believe the answer is yes when considering companies focusing mainly on developed economies. We are in a period that has favored the stocks because of their financial strength and stability, but danger lurks on the horizon. To outperform the market you must anticipate the market's moves prior to the actual reaction. The future as described below will occur throughout this decade and may not be reflected in the coming months or even this year, yet destiny awaits. We just don't know exactly when destiny will call.

The first edition of *The Economist* for 2012 had a very interesting article that focused on a trend in Britain. The trend identified I will refer to as pragmatic virtue. Pragmatic virtue is what we are seeing exhibited not only in Britain, but throughout the Western world in countries hit by the Great Recession. It is the exhibition of virtue by people because of the financial and political pressures placed upon their lives.

In Britain the government is feeling the unintended consequences of pragmatic virtue. The income derived from taxes on items, such as tobacco, are trending in the last few years and are expected to continue their decent because people want better physical and financial health. Having less discretionary funds is placing an extra emphasis on individuals to avoid consumption of harmful products like cigarettes.

For the investor, the rise of pragmatic virtue amongst consumers means that the assumptions that were held for many sin stocks are in the process of changing. In the specific example of cigarette companies, the industry is experiencing a gradual change that will ultimately lead to a fundamental deterioration of their main business. This will change investor expectations and thus, place downward pressure on stock prices.

We're early in the game in terms of the changing assumptions that have been held for cigarette makers that focus on developed Western economies. Therefore, investors have time to plan a suitable exit point in terms of time and price for their investments. Investors also need to identify alternative investments that will likely bring comparable returns and contain similar levels of risk. As you plan, governments around the world, such as Britain, are doing

comparable exercises to demonstrate what the future will hold as they see a deterioration of tax revenue from their citizens indulging in certain vices.

TheMarketCapitalist.com Portfolio Selection

Company	Ticker	Buy Date	Buy Price	Last Price	Performance	Buy Target
SeaDrill Limited	SDRL	9/7/2011	30.25	33.97	12.30%	Up to 38
Weatherford International Ltd.	WFT	9/7/2011	16.31	15.48	-5.09%	Up to 26
American Tower Corp.	AMT	9/7/2011	53.75	59.66	11.00%	Up to 68
PowerShares Water Resources	PHO	9/7/2011	16.42	17.28	5.24%	Up to 22
Cisco Systems, Inc.	CSCO	9/7/2011	15.42	18.99	23.15%	up to 21
Deere & Company	DE	9/7/2011	78.97	80.47	1.90%	Up to 92

The Demographic Case for Dividend Value Stocks

In this turbulent market the spotlight has been recast on dividend-centric stocks. These stocks are from companies with stable business models who pay sizable dividend yields that have continued to grow overtime. As an investing class, they are seen as largely “value” stock and are often prescribed for the more conservative investor.

Whether you are that conservative investor that gravitates toward value stocks or some other type of an investor, the dividend driven value stock sector of the investment universe should interest you. Why? This investment realm should be of interest because a major demographic shift is in the process of occurring in which dividend driven value stocks will become the life blood for a huge class of investors.

Demographic shifts have consequences from the types of goods and services people make to the type of investments people enter into. As the Baby Boomer generation transitions into the time of their retirement, the reliance upon dividend income will become more significant than ever. Stable, sizable and regular income payments will be needed by a growing pool of retirees. Thus, demand for such stocks will rise throughout this decade.

Looking at a recent McKinsey Institute report titled, The Emerging Equity Gap, the institute foresees a future environment where raising capital through equity offerings will become increasingly more expensive for businesses. This consequence will occur because large amounts of wealth will not be focused on equity driven investments, but debt driven instruments, such as bonds.

Why does McKinsey foresee a favoritism of debt over equities? First, the shift transition of a large amount of the current working population into a state of full or semi retirement will cause personal and pension investments to be geared towards investments which are more secure and make regular payments. Bonds (debt) issued by private or public organizations is a tool that fits the need. In general equities do not. Yet, certain areas of equities do fulfill the need for stability and consistent cash distributions (dividends).

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While I agree with the conclusions made the McKinsey study, I must add that all equities are not equal. Different classes will be treated differently because of the nature of the investment. Equity offerings will become more expensive because companies raising capital through equity are usually those that are in growth mode. Value stocks are not known for raising capital through massive equity offerings and often offer dividend yields that are comparable or superior to bond yields.

Forget about the notion that McKinsey noted regarding equity offering becoming more expensive. The point to take away is that a huge class of investors is transitioning towards investments that provide a revenue stream. Value stocks that have a history of paying sizable dividends fit that need.

As we move into 2012 and throughout the decade, it would be prudent for investors to begin at least by identifying, if not investing in, value stocks that have shown characteristics of price stability, consistent dividend payments and dividend appreciation. Such characteristics will bode well as more retirees look to establish a steady income stream to support themselves in their retirement years.

Personal Finance: Fund Performance and Management Fees

If you hold any form of personal retirement account, it is likely that you hold some form of fund in your investment portfolio. Funds are often the path investors choose because they simplify the investment selection process, provide diversification, can be actively managed and allow investors to focus on one or multiple investment areas without having to be an expert. Though it's not difficult to point out the benefits funds can bring, they also bring about problems with underperformance and management fees.

As an investor, the return you receive on your investment is your primary concern. If your investment underperforms against its benchmark, then something is wrong and you are losing money you should have earned. Performance is one of the most important aspects to consider when evaluating a fund. Every fund must benchmark itself against some form of an index. The index allows the manager and investor to gauge how the fund has actually done in comparison to what can be defined as "the market."

If you are investing in an actively managed fund, you want the fund to be, on a consistent basis, outperforming against the market. If this is not the case, then you might as well simply invest in the index the fund is benchmarking itself against. This is the case because a fund that cannot regularly beat the market is costing you money, not only in the fact that it is not on average beating the market, but because you have management fees incurred annually that reduce the total return your investment will realize.

Performance and management fees are the two headed monster of the fund underworld. They are what you should have in the center of your radar screen when evaluating funds you hold or are considering. Regulations have made annual fees charged by funds pretty straight forward. Performance benchmarks are typically straight forward too, when they are shown on a website. The caveat I would add to the performance factor is that if you are speaking with someone that is

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attempting to sell you on investing in a fund, make sure you know that the benchmark they are using as a comparison to the funds performance is relevant.

For example, if you are told that the fund has outperformed the S&P 500 the last X years, but the fund really is heavily weighted towards growth stocks and should be compared to the Russell 1000, then you are being deceived. The average investor will not be able to distinguish this deception immediately. To get around this problem, make sure to ask for a prospectus on the fund (or other literature) and take a couple minutes to look up the fund using an online brokerage account or a service like Yahoo! Finance.

The information you gain via the Internet or published literature will provide you will guidance as to what the fund is actually measured against. Knowing the funds “benchmark index” will equip you with the knowledge you need to determine if the fund is actually performing as any investor would hope. From that point, management fees can then be considered in light of how much on average the fund is under or over performing against its benchmark.

Remember, numerous fund companies exist and many of them offer very similar products. They are fighting for your business in a landscape where it is difficult to consistently beat the market (their benchmark). Add to this fact that they must charge management fees to cover operating costs and you have a condition where you, the consumer, must be wary regarding the best use of your investment money.

Don't be afraid to ask questions. You're the customer, it's your money and you have the ultimate power.

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