ARGUS UPDATE

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IN THIS ISSUE

DIRECTOR'S NOTE
For 2011, we expect an ongoing lag for the consumer economy, but think global circumstances are setting up for a decent stock year.

THE ARGUS TOP 30 2
New Selections
Cisco Systems Inc.
Halliburton Co.
Watson Pharmaceuticals Inc.

Deletions
FedEx Corp.
Windstream Corp.
Oracle Corp.

Highlights
Halliburton Co.
Watson Pharmaceuticals Inc.
CSX Corp.

DIRECTOR'S CHOICE
Cisco Systems Inc.

THE ARGUS TOP 30 3
Table
Research Methodology

THE ARGUS STOCK SCREEN 4
Going Against the Grain

DIRECTOR'S PERSPECTIVE

Early Look to 2011

BY JIM KELLEHER, CFA, DIRECTOR OF RESEARCH

We think one feature of 2011 will be rising interest rates and a concurrent weakening in fixed-income prices, amid the first signs of price recovery. At the same time, The Commodity Research Bureau/Reuters U.S. Spot Raw Industrials (CRB/RIND) index is accelerating higher.

A disconnect between interest rates (low) and commodity prices (high) is nearly unprecedented, and cannot sustain. The two potential outcomes to bring these dichotomous trends back into accord would be a slide back into recession (which would ease global inflation and bring down commodity prices) or a transference of commodity inflation through producer prices and into consumer prices (which would prompt the Fed to reverse course in order to contain inflation). Currently, we see a higher likelihood of the latter. We think the inflation drivers come more from overseas, as the BRIC and BRAC economies continue to ramp.

One likely outcome of a reversal in FOMC policy, and global central bank policy in general, would be a reversal in bond-price trends. According to Morningstar data, $357 billion has flowed into domestic taxable and municipal bond mutual funds over the past 12 months. Most of the inflow has come from money market funds, but Morningstar also estimates that $70 billion has flowed out of domestic equity mutual funds. Based on caution among institutional investors, estimates of total outflows from domestic equities range as high as $250 billion over the past year.

Should economic recovery win out over double-dip recession, the implications for asset allocation could be profound. Inflation imported from ramping growth economies could reverse the trend in bond prices. Once the momentum out of bond funds begins, the world could be awash in liquidity anxious to find a new home. While some of this bond wealth will roll back into the money markets, the portion of bond funds shifting into stocks could be a hugely positive equity market-driver in 2011.

That could also be net beneficial for Financial sector earnings. In the past 18 months, large banks borrowed TARP money and, instead of lending it, bought bonds that experienced steady appreciation. In our view, banks will need higher interest rates and widening credit spreads, as well as renewed equity activity, to compensate for a quick run-off in fixed-income profits. Another benefit to the Financial Service industry would be a more-vibrant recovery in the industrial economy.

The current, partly seasonal pick-up in industrial economic activity is having a limited effect on the consumer economy — and growth in non-farm payrolls is not at levels that support surging consumer confidence and above-trend GDP growth. Argus looks for roughly 2% average GDP growth in 2H10, and growth of 2.5%-3.0% for 2011. For 2011, we expect an ongoing lag for the consumer economy behind the leading industrial and commercial economy.

Netted out, we think global circumstances are setting up for a decent stock year in 2011. We expect risk to return and growth to prevail, meaning that favored sectors could include early to mid-cycle favorites. As such, we have meaningfully adjusted our recommended sector weightings relative to the S&P 500 benchmarks.

We continue to recommend an Over-Weight in the Industrial sector, and a Market-Weight in Energy. We are raising our recommended weighting in Materials to Over-Weight from Market-Weight, and our weighting in Consumer Discretionary to Over-Weight from Under-Weight. We are raising our weighting in Financial Services to Market-Weight from Under-Weight. We are lowering our recommended weightings in Information Technology and Healthcare to Market-Weight from Over-Weight. Finally, we are lowering our recommended weightings in Consumer Staples, Utilities and Telecommunications to Under-Weight from Market-Weight.

New Selections

Cisco Systems Inc.
Halliburton Co.
Watson Pharmaceuticals Inc.
See comments on this page.

Deletions

FedEx Corp.
We are concerned that operational weakness and restructuring efforts in the Freight division will pressure margins and earnings over the next several quarters. Since inclusion in our list early in September 2009, the FDX shares advanced approximately 24% — meaningfully outpacing the S&P 500.

Windstream Corp.
The shares have rallied strongly over the last year, pushing valuation metrics above their historical ranges and peer average multiples. Since inclusion in our list early in July 2010, the WIN shares advanced approximately 17% — outpacing the the S&P 500 over that span.

Oracle Corp.
Management attributed a recent revenue increase to company specific factors and not an overall pickup in business technology spending. The ORCL shares have advanced 35% since inclusion in our list in October 2009.

Highlights

Halliburton Co.
Halliburton provides engineering, construction, and maintenance services to energy, industrial, and government customers worldwide. The company's U.S. business has benefited greatly from the high level of activity in shale plays. In addition, two of the company's peers – Schlumberger and Baker Hughes – recently completed large acquisitions and now have to manage the related integration issues. Concerns shading the HAL shares include depressed natural gas prices, which could reduce capital spending in that sector, and HAL's involvement in the Deepwater Horizon fire and gusher. Both events are reflected in the share price, in our view. Over the long term, we believe that Halliburton's focus on expanding its market share while reducing input costs will enhance its market position.

Watson Pharmaceuticals Inc.
Watson is a specialty pharmaceuticals company engaged in the development, manufacture, sale and distribution of both branded and generic drugs. As of the end of 2009, it marketed 170 generic product families and 30 brand product families. The company generated sales of $2.8 billion in 2009 from its Generic (60%), Branded (16%) and Distribution (24%) segments. With healthcare reform in place, we think generic drug companies such as Watson are well positioned to benefit from the public's increased focus on cost-effective care. WPI shares have dipped almost 10% from their 52-week high and have approached their 200-day moving average — which has historically provided support. Overall, the company appears on track to deliver modest organic growth in the near term, and valuations are historically attractive.

Highlights

CSX Corp.
CSX Corp. provides rail, intermodal and rail-to-truck trans-load services. The subsidiary CSX Transportation Inc. operates a 21,000-mile rail network in the eastern U.S., connecting 23 states, the District of Columbia and two Canadian provinces. CSX Intermodal Inc. is a stand-alone integrated intermodal company serving customers with its own truck and terminal operations, plus a dedicated domestic container fleet. All these assets stand to benefit as the industrial recovery takes shape. We believe that improved economic conditions should boost volume and revenue growth going forward. We expect further growth in operating margins as the company continues to cut costs, and note that margins have expanded 460 basis points since 2006. On valuation, the shares are trading at a P/E discount to peers on both a current- and forward-year basis. They also appear favorably valued based on historical P/E, price/cash flow and price/EBITDA multiples.

DIRECTOR'S CHOICE

Cisco Systems Inc.

Originally created to provide routers and switches for ethernet-based data networks within enterprises, Cisco now participates in virtually every niche of the networking market and has expanded into information processing, connected home & consumer products, web 2.0 and mobile broadband. For the fourth quarter of the July 2010 fiscal year, Cisco delivered record fiscal revenue, non-GAAP operating income, net income and EPS. Cisco CEO John Chambers acknowledged that its customers are more uncertain regarding recovery than they were in the spring. Although investors remain concerned about sequentially tighter gross margins and perceived revenue softness, management is guiding for 18%-20% annual growth in the current fiscal 1Q11. Cisco has put in place long-term plans to grow new competencies such as smart grid, virtual healthcare, and connected communities. Given the company's skill in developing interdependencies among core competencies and new adjacencies, the Cisco strategy appears well positioned for long-term success.

Given the company's skill in developing interdependencies among core competencies Cisco appears well positioned for long-term success.

The Argus Top 30

Recent Price	12-mo. Target	Buy Limit	Company Name	Industry	Stock Symbol	Current EPS	Current PE	5-Yr. Growth %	PEG Ratio	Div. Rate	Annual Yield %	Fin. Strength	Beta
$11	$18	$17	Activision Blizzard Inc	X	ATVI	0.72	15.3	15	1.0	0.15	1.4	H	0.82
35	42	39	Broadcom Corp	X	BRCM	2.58	13.7	13	1.1	0.32	0.9	MH	0.85
22	**34**	**31**	**Cisco Systems Inc**	**X**	**CSCO**	**1.77**	**12.6**	**14**	**0.9**	**0.00**	**0.0**	**H**	**1.00**
20	28	26	EMC Corp	X	EMC	1.19	16.5	12	1.4	0.00	0.0	H	0.97
41	54	50	Hewlett-Packard Co	X	HPQ	4.53	9.0	11	0.8	0.32	0.8	MH	0.96
74	90	83	Visa Inc	X	V	3.95	18.6	20	0.9	0.50	0.7	H	0.94
12	18	17	Alcoa Inc	B	AA	0.69	17.7	3	5.9	0.12	1.0	MH	1.69
46	48	47	E I du Pont de Nemours and Co	B	DD	2.98	15.5	6	2.6	1.64	3.5	MH	1.20
32	36	34	JC Penney Co Inc	C	JCP	1.44	22.0	12	1.8	0.80	2.5	ML	1.38
29	32	31	Limited Brands Inc	C	LTD	1.82	15.7	15	1.0	0.60	2.1	M	1.51
23	30	28	Lowe's Companies Inc	C	LOW	1.40	16.2	15	1.1	0.44	1.9	MH	1.23
42	48	45	Yum! Brands Inc	C	YUM	2.52	16.5	12	1.4	1.00	2.4	ML	0.87
56	65	60	Chubb Corp	F	CB	5.33	10.5	6	1.8	1.48	2.6	H	0.87
26	31	29	Sun Life Financial Inc	F	SLF	2.50	10.5	10	1.0	1.38	5.3	H	1.40
18	21	20	Allscripts Misys Healthcare	H	MDRX	0.78	23.3	20	1.2	0.00	0.0	MH	1.21
27	30	29	Bristol-Myers Squibb Co	H	BMY	2.22	12.3	5	2.5	1.28	4.7	M	0.79
7	9	8	Health Mgmt Assocs In	H	HMA	0.59	12.9	8	1.6	0.00	0.0	ML	1.44
44	**51**	**49**	**Watson Pharmaceuticals Inc**	**H**	**WPI**	**3.40**	**13.1**	**10**	**1.3**	**0.00**	**0.0**	**M**	**0.78**
89	104	96	3M Co	I	MMM	5.85	15.2	12	1.3	2.10	2.4	MH	0.87
57	61	60	CSX Corp	I	CSX	3.74	15.2	8	1.9	0.96	1.7	M	1.27
53	60	56	Emerson Electric Co	I	EMR	2.70	19.7	12	1.6	1.34	2.5	MH	1.01
59	68	65	Coca-Cola Co	S	KO	3.48	17.1	8	2.1	1.76	3.0	H	0.64
65	73	68	Costco Wholesale Corp	S	COST	3.24	20.1	12	1.7	0.82	1.3	MH	0.84
61	66	64	Procter & Gamble Co	S	PG	3.94	15.4	8	1.9	1.93	3.2	H	0.64
60	72	67	ConocoPhillips	E	COP	6.25	9.6	8	1.2	2.20	3.7	M	1.02
34	**40**	**38**	**Halliburton Co**	**E**	**HAL**	**1.95**	**17.2**	**8**	**2.2**	**0.36**	**1.1**	**MH**	**1.23**
82	98	93	Occidental Petroleum Corp	E	OXY	5.60	14.7	6	2.5	1.52	1.8	H	1.12
28	32	30	AT&T Corp	T	T	2.28	12.4	5	2.5	1.68	5.9	M	0.77
19	22	21	Great Plains Energy Inc	U	GXP	1.50	12.6	3	4.2	0.83	4.4	MH	0.86
29	34	32	UIL Holdings Corp	U	UIL	2.05	13.9	4	3.5	1.73	6.1	MH	0.94
			Portfolio Average				**15.4**	**9.0**	**2.1**		**2.6**		**1.07**
1141	**1300**	**-**	**S&P 500**			**$78.50**	**14.5**	**12.6**	**1.2**	**$22.24**	**1.9%**	**NM**	**1.00**

THE ARGUS TOP 30 STOCKS: Prices as of September 30, 2010. New additions are in BOLD.
5-Yr. Growth is Argus' estimate of compound annual EPS growth.

Research Methodology

Argus Research Co. applies a top-down framework to investment selection. Argus' Economics Department models the economy and determines GDP growth and interest rate forecasts. The Director of Research uses this information, as well as performance models, to identify favored industries. Argus industry analysts then determine the top companies in each industry in terms of financial strength, earnings and valuation. Every month, Argus publishes its list of top selections, grouping these companies into categories according to their risk levels. Buy Limits are calculated according to the Capital Asset Pricing Model. Once a stock approaches the Buy Limit, Argus either reaffirms the rating and adjusts the target price or changes the rating.

Going Against the Grain

Recent Price	52–Wk. Range	Company Name	Stock Symbol	Market Cap.	PEG Ratio	Price Performance	Profit Margin	EPS Growth (Projected YOY)	Consensus Recommendation
$11	$35-$46	DST Systems Inc.	DST	$2.0B	-4.7	-4.60%	13.09%	-23.31%	Strong Buy
11	59-77	Devon Energy Crop.	DVN	$27.9B	-5.3	-5.61%	24.27%	62.87%	Buy
64	8-15	Thompson Creek Met Com	TC	$1.5B	0.2	-5.44%	12.24%	162.00%	Buy
11	17-36	Career Education Corporation	CECO	$1.7B	0.4	-15.44%	11.49%	217.00%	Buy
20	28-40	Cymer, Inc.	CYMI	$1.0B	0.7	-5.52%	13.85%	344.00%	Buy
36	13-28	Assured Guaranty Ltd.	AGO	$3.2B	0.2	-9.10%	34.99%	25.34%	Buy
11	11-15	First Niagara Financial Group	FNFG	$2.4B	0.6	-5.42%	11.99%	82.77%	Buy
39	35-48	JPMorgan Chase & Co.	JPM	$157.B	0.4	-10.41%	12.35%	61.34%	Buy
40	37-52	SVB Financial Group	SIVB	$1.7B	0.6	-4.68%	10.86%	71.88%	Buy
39	37-57	Ultra Petroleum Corp.	UPL	$6.0B	0.5	-19.91%	34.18%	22.74%	Buy
15	14-28	Petrohawk Energy Corp.	HK	$4.6B	0.3	-36.00%	11.44%	40.51%	Buy
63	50-122	ITT Educational Services, Inc.	ESI	$2.2B	0.6	-38.36%	23.45%	41.74%	Buy
7	6-9	On Semiconductor Corp.	ONNN	$2.9B	0.6	-17.60%	11.39%	143.00%	Buy

Prices and Data as of September 27, 2010.

Argus Screen Analysis

Goal of the Screen:

To identify stocks that have recently underperformed but have positive net profit margins, are rated BUY or STRONG BUY, and are expected to generate strong earnings growth this year.

Criteria:

- The stock has underperformed the S&P 500 by 10% or more over the past year.
- The consensus analyst recommendation is BUY or STRONG BUY.
- Projected EPS growth this year is at least 20%.
- The company has a profit margin of at least 10%.
- The PEG ratio is less than 1.0.

Although no investor wants to "catch a falling knife," with the equity markets volatile, we went looking for opportunities among the so-called "fallen angels." In short, we looked for firms that have underperformed the market, but have continued to post high profit margins throughout the downturn. These companies have typically maintained pricing power or strong productivity growth, or some combination of both. We believe that these firms will have a jump on the competition as the economy rebounds, and may achieve even stronger margins.

Nevertheless, for a variety of reasons, these stocks have fallen from grace, and have underperformed the S&P 500 by 10% or more over the past year. At the same time, they have maintained profit margins greater than or equal to 10% and are expected to grow earnings by at least 20% this year. The stocks are also rated BUY or STRONG BUY by analysts and have PEG ratios of less than 1.0.

We note that this screen is only a starting point, and that the stocks on our list require additional analysis before being included in a broadly diversified portfolio.

Each month, Argus Research "screens" the broader markets seeking stocks with favorable investment characteristics. The database used in the screen contains financial information on more than 8,800 companies that trade on the New York and American stock exchanges, as well as on the FINRA National Market System. The Argus Stock Screen is designed as a starting point for further research.