



Take Advantage of the Fear

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Fear and pessimism reign supreme in the corporate world right now. Enthusiasm and complacency are a distant memory. In every conference call, in every company presentation, you hear CEOs discuss only defensive, risk-averse strategies (e.g., paying down debt, laying off employees, cutting capital expenditures, accumulating cash). Not only are there no CEOs playing offense right now but there are no CEOs even talking about it.

It's extraordinarily bullish, for both the economy and for investors. Implicit in this sentiment extreme is that it will be a long time (a few years, at least) before we come full circle back to enthusiasm and complacency.

In addition to listening to CEOs, an easy way for investors to monitor corporate sentiment is to watch merger and acquisition activity. That we're in the early days of a bull cycle is evident by the measured, conservative nature of M&A activity. It's a yawner that consumer staple **Kraft** (KFT) made a bid to buy consumer staple **Cadbury** (CBY). So, too, is the proposed joint venture between **Comcast** (CMCSA) and **General Electric** (GE) involving NBC Universal. Bull markets don't end until M&A activity is imbued with excitement and marginal companies start gobbling up other marginal companies.

Get Ready for Some Good News

In the early stages of a bull market, stock prices rally in the face of bad news. And then, gradually, the tenor of the business news morphs from negative to positive. It'll start in January, when fourth-quarter earnings are released. It's the first of four consecutive quarters of easy earnings comparisons. For most companies, revenue dropped like a brick in the fourth quarter last year, creating a severe revenue/expense mismatch. It necessitated a massive adjustment to the expense line, an adjustment that couldn't happen overnight.

Over the last year, the hard work has been done (e.g., inventories cut to the bone, payroll slashed, capital expenditures dropped to subsistence levels). As a result, sales in the fourth quarter can be flat (or even down), and because of expense cuts, we'll still see big gains when earnings are released in January.

Need another reason why we're on the cusp of a bullish news cycle? Business spending, not consumer spending, will light a fire under the economy in 2010 and 2011.

Virtually every set of financial statements I've reviewed tells the same story: Companies cut way too deep in the months just past, hoarded too much cash, fired too many workers, all in an effort to prepare for a Great Depression that's not going to happen. After they peek out from their bunkers and realize that the world is not coming to an end, you'll see a reversal of many of these cuts and a resumption of spending.

To get a sense of how extreme the cuts have been, consider **CarMax** (KMX), a stock from my Top 10 list at the end of last year and a one that I continue to own. The company didn't just take a carving knife to capital expenditures in the face of a weak economy; it fired a bazooka. A trim to capex of 25% or 35% would have been reasonable, maybe 50% if management was really worried. Similar to many companies, though, CarMax flat-out panicked, chopping nearly 90% from year-ago capex spending levels.

Recent draconian reductions in capital spending are temporary for most companies. And it's not just because their long-term viability requires them to reinvest in themselves. In many cases, such as with CarMax, such huge cuts are unnecessary. The company chopped capex spending down from \$70 million to \$7 million per quarter, a tiny spend considering that it's generating healthy profits on sales of about \$1.9 billion per quarter.

The Latest Obsession of CEOs: Cash

Fuel for a resumption in business spending comes from the latest obsession of CEOs -- that is, hoarding cash. At the top of a business cycle, CEOs talk primarily about growth: growth in earnings, growth in sales, organic growth vs. growth through acquisition. In conference calls this month, growth will hardly get mentioned. You'll hear a lot of discussion, even outright boasting, of how much cash has piled up on the balance sheet, of how management has harvested cash from reducing inventory and cutting capex, of how much additional cash the company intends to accumulate.

To illustrate, I'll pick on **Terex** (TEX), a superbly managed company that I mentioned in my last column and a stock that I continue to buy. Similar to most companies, Terex is hoarding cash as if it will never have enough. Cash has doubled so far this year, from a reasonable cushion of \$484 million to an over-the-top \$939 million. Just last month, when questioned about its cash hoard in the midst of a difficult economy, Terex CEO Ron Defoe admitted, "We can weather this storm and a few more."

That's the wrong attitude. A CEO's job is not to position a company to weather multiple storms; it's to weather the current storm and then to come out on the other side making even more money for shareholders than before. Terex did just that in the last downturn, buying **Genie Lift** in 2002 for \$270 million. The market turned around shortly thereafter, allowing the company to generate \$1.3 billion in cumulative pre-tax profit from the acquired company.

Companies are not going to covet cash forever. Sooner or later, Terex and other companies with boatloads of cash are going to deploy it. It's going to surprise a lot of people, however, led by a resumption of business spending, the economy will strengthen considerably in 2010.

At time of publication, Alsin and/or ACM was long KMX AND TEX, although holdings can change at any time.

Arne Alsin is the founder and principal of Alsin Capital Management, a California-based investment adviser. Under no circumstances does the information in this column represent a recommendation to buy or sell stocks.
