Reprinted from the MILWAUKEE JOURNAL SENTINEL

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October 21, 2012

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Stocks remain a good bet despite fears over economy

There are opportunities for better economic growth in the U.S. and abroad, and stocks are likely better long-term investments than bonds, a Milwaukee money manager says.

Ignatius L. Smetek

By KATHLEEN GALLAGHER,

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Despite the stock market's strong performance, investors are skeptical.

Many are still pouring money into bonds. They are seeking shelter from fears of the effects of the so-called fiscal cliff, the automatic tax hikes and spending cuts that would happen at the end of 2012 without political intervention.

Such fears could well cause a market correction, but Milwaukee money manager Ignatius L. Smetek said he would see that as an opportunity to buy stocks.

"The economy still has a lot of positive things going on, and the stock market has been stronger in the short run than we expected," said Smetek, president and chief investment officer at Arcataur Capital Management LLC in Milwaukee.

"We're in a transition from credit crisis-related issues to more normal economic issues."

The economy is still in the bottoming process, and the stock market could drop slightly more before the end of the year, he said.

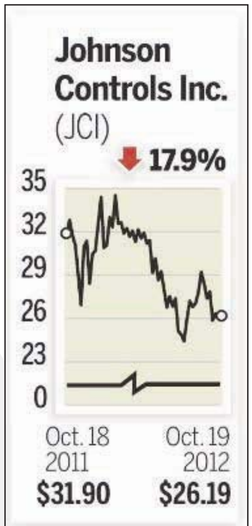
"In the short run, skepticism is probably warranted because we've had this huge run up in stocks, we are facing elections and there are issues with the fiscal cliff, tax policy and e conomic growth this year," Smetek said.

However, there are opportunities for better economic growth in the U.S. and abroad, and stocks are likely better long-term investments than bonds, he said. In fact, he says the biggest risk for investors is probably bonds. Investors who buy the 10-year Treasury bond with its 1.8% yield are guaranteeing themselves a negative real rate of return, given the inflation rate of about 2%, Smetek said. If inflation rose, that negative real return would be worse.

He says these stocks are well-positioned to benefit from economic growth:

Johnson Controls Inc. (JCI, $26.19), Glendale, is a leader in building efficiency, battery technology and automotive interiors.

Smetek sees a "decent buying opportunity" in these shares in anticipation of a general economic pickup domestically. They have declined because of concerns about the auto industry and the economy, but the company is well-capitalized and its stock trades at a low valuation, he said.



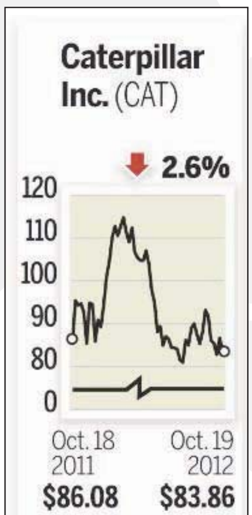
Graphic/Journal Sentinel

Eighteen months ago the stock traded in the mid-$40s and it now trades near $25, despite higher earnings, Smetek said.

"This is a classic cyclical that has a leadership position in many of its key businesses," Smetek said. "The best time to buy it is when investors give up and make a macro call. Then you sell it when investors are trying to explain this is a new growth company."

These shares have traded in a 52-week range of $23.37 to $35.95. Smetek said the stock could trade as high as $31 in the next 12 months, assuming a favorable economic backdrop.

Caterpillar Inc. (CAT, $83.86), Peoria, Ill., is the world's largest maker of bulldozers, excavators and other heavy construction machinery. It has a dominant share of the U.S. market and a major international presence.



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Caterpillar is one of the better global plays on an improving economy, Smetek said. Its shares have gone sideways recently, but would gain strength if China started showing more signs of growth, he said.

The biggest risk with the stock is the possibility of more significant economic problems in Europe and the emerging markets, Smetek said.

Caterpillar shares have traded in a 52-week range of $78.25 to $116.95. Smetek said the stock could, "without a lot of heroic assumptions," get back to $100 a share in the next 12 months.

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About this

The Journal Sentinel focuses on one Wisconsin money manager or analyst in this weekly feature, looking at a trend that helps investment pros make their decisions.

This column examines one stock through the eyes of a professional investor to show how market pros make investment decisions. Neither Kathleen Gallagher nor the Journal Sentinel recommends specific investments or endorses the recommendations of those interviewed.

From the October 21, 2012 editions of the Milwaukee Journal Sentinel