

“The Oath”

Here is the oath that House and Senate Members take:

I do solemnly swear (or affirm) that I will support and defend the Constitution of the United States against all enemies, foreign and domestic; that I will bear true faith and allegiance to the same; that I take this obligation freely, without any mental reservation or purpose of evasion; and that I will well and faithfully discharge the duties of the office on which I am about to enter: So help me God.

Dereliction of duty is a specific offense under United States Code Title 10 § 892, Article 92, which applies to all branches of the U.S. military. **A service member who is derelict has willfully refused to perform his duties (or follow a given order) or has incapacitated himself in such a way that he cannot perform his duties.**

Last week, certain members of Congress were guilty of dereliction of duty when they “willfully refused to perform their duties” by failing to cut government spending. While the focal point was the “dirty dozen” (aka the Super Committee), by our count there are some 68 members of Congress that also qualify for dereliction of duty. No wonder a recent *New York Times* poll found that more Americans approve of polygamy than they do of Congress. Indeed, with a 9% approval rating Congress has the lowest rating ever! And, while we can’t vote them out quite yet, the D-J Industrial Average (INDU/11231.65) has certainly voted with the worst Thanksgiving week decline (-4.78%) since 1932. Last week’s wilt brought the “selling stampede” to session 19, and punctuated the now ~8.2% decline by the senior index since the Industrials’ closing reaction high of October 28, 2011 (12231.11). Recall that such stampedes typically last 17-25 sessions with only one- to three-session pauses, or rally attempts, before they exhaust themselves. In addition, the S&P 500 (SPX/1158.67) has experienced seven consecutive sessions on the downside, and markets rarely go that many days in a row in one direction. Moreover, as of last Friday the selling skein left the McClellan Oscillator as oversold as it was at the August 8-9, 2011 “lows.” Therefore, the stage was set for some sort of tradable bottom; last week certainly felt like capitulation to me.

Quite frankly, when I wrote the strategy report titled “Crescendo” on October 31, 2011 where I suggested a trading top was “in,” I really didn’t think the ensuing decline would violate my long-standing pivot point of 1217 on the SPX, nor did I think some of our core investment positions such as EV Energy Partners (EVEP/\$63.22/Strong Buy) and LINE Energy (LINE/\$35.19/Strong Buy) would decline by the amount they have. Still, we like the MLPs and think 2012 will have some interesting twists for the group. As our energy analyst Kevin Smith writes:

“Recently there have been several high-profile takeouts of C-corps with pipeline assets by master limited partnerships (MLPs), with at least one transaction sparking a bidding war. You are probably thinking: E&P companies don’t have pipeline assets – this won’t affect our E&P investments. Don’t be so sure. The gates have been opened and the sharks have been let loose in your pool too. While Upstream MLP acquisition activity has picked up, the partnerships have generally lacked the need, the financial firepower, or desire to significantly ramp up C-corp acquisitions. That is changing. We believe the question should not be if, but when will the flood of C-corp acquisitions by MLPs manifest itself?”

Interestingly, most MLPs trade at 8-9x EBITDA, while E&P C-corps trade at 4-5x EBITDA. The implication is that an MLP could acquire a C-corp and the acquisition would be earnings accretive. Though neither the company nor our covering analyst have given any indication that a tie-up is in the picture, if this line of reasoning proves correct, one potential acquisition candidate would be Berry Petroleum (BRY/\$36.93/Outperform) given its valuation metrics and our analyst’s positive view of the company’s fundamental outlook.

Another theme applicable for this time of year is the correlation between a decent stock market and good Christmas sales. Up until the past few sessions we have experienced a pretty good stock market. Said correlation is about 89%, so our sense is that this Christmas selling season is going to be good. Speaking to this, our softline retail analyst, Samantha Panella, said that Black Friday looks like it is going to be better than last year but that it is extremely promotional with heavy price discounting. Sam’s observations at the Roosevelt Field Mall on Friday caused her to suggest the clear “winner” is Express Inc. (EXPR/\$20.14/Outperform), while the **Please read domestic and foreign disclosure/risk information beginning on page 3 and Analyst Certification on page 3.**

clear loser is Gap Stores (GPS/\$17.62/Market Perform). Yet, there is another player that has come to the fore over the past 15 years.

Indeed, according to www.ftportfolios.com:

“A survey from Shop.org found that over 50% of all workers plan to do some of their holiday shopping online on Cyber Monday (November 28), according to CNNMoney.com. Eight out of 10 online retailers plan to offer special promotions on that day. Some 75.9 million workers in the U.S. have access to the Internet. Sales are expected to set a record at \$1.2 billion, according to comScore. Internet stocks have performed quite well since the market bottomed on March 9, 2009. From 3/9/09-11/21/11, the Dow Jones Internet Composite Index posted a cumulative total return of 149.8%, compared to gains of 106.0% for the S&P Information Technology Index and 86.5% for the S&P 500.”

As our Internet analyst Aaron Kessler writes, “Through the first three weeks of the 2011 holiday season, e-commerce sales remained robust as indicated by ChannelAdvisor (same-store sales up 28% y/y) and the Chase Holiday Pulse Index (31% y/y). While still early in the holiday period (first three weeks represented 22% of the 2010 holiday season), the strong initial data increases our confidence in the 2011 e-commerce holiday season outlook.” In addition, while I think it is a stretch to call it an e-commerce company, Shutterfly (SFLY/\$31.28/Outperform) is one of Aaron’s favorites.

The call for this week: The week before Thanksgiving has been “up” eight of the past nine years . . . that is up until last week. While many pundits cited the failed German Bund auction, China’s slowing PMI Index, another bank “stress test,” a downwardly revised GDP report, Euroquake, etc.; my hunch is the real reason for the recent swoon is our own dysfunctional government. To be sure, the breakdown of the Super Committee has clarified the differences between the two parties. Hence, it is pretty clear that Americans must now decide to accept either serious reductions in their healthcare and pension programs, or substantially higher taxes, and probably both. Whatever the reason, my sense is that the November weakness has burned itself out and consequently I look for a continuation of the traditional year-end rally that began on our “buy ‘em” call of October 4th. That belief is based on the fact that trading volume has contracted so sharply it reveals the public is g-o-n-e from the investing scene (read: bullishly), the economy is NOT slipping into recession (our recession indicator has the odds down to 11% from 35% in September), Euroquake will be resolved, earnings will continue to surprise on the upside (like they did in the 3Q10), that last week’s reduction in real GDP was because of inventory adjustments that should actually boost growth in 4Q11, that Domestic Final Sales accelerated to 3.1% in the third quarter (versus 1.4% and 0.4% in the previous two quarters), and the “bull list” goes on despite all of the negative nabobs rants. And this morning Germany and France are rumored to be exploring “radical” methods to solve Euroquake, which has the preopening futures up more than 30 points.

P.S. I am in New York City all week; these will be the only strategy comments of the week.

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