

## April/May Newsletter

Title: "Sorting Out the Opportunity"

I ended my March Newsletter, which offers a positive perspective on the outlook for investing in the next decade, with the following statement. "I believe that today's (stock) prices reflect the most attractive valuations I have seen in my 40 year career." While the S&P 500 has rallied nicely since I made this statement, I'm not backing away from my conclusion. Stock prices remain attractive.

But how do you go about sorting out this opportunity? How do you pick a manageable number of names among all the attractively priced stocks that exist in today's investable universe? I believe that you need focus, discipline and leverage.

**Focus.** My clients own shares in small, medium and large-sized companies and I try to help them understand the investment merit of each security as best I can. But in developing new ideas for them, I focus on medium-sized companies. This is the so-called "mid cap space" in investment management parlance. These are companies whose shares have been in the public domain for a number of years, whose managements are professional and seasoned, which have demonstrated a durable business model and have achieved sales in excess of \$100 million, are reporting profits and have enough cash flow to be largely self-financing. They command market capitalizations (number of shares of common stock the company has outstanding multiplied by its stock price) of between \$1 billion and \$5 billion. Interestingly, this group of companies includes smaller ones that are taking market share and as a result their market capitalizations are expanding; as well as larger ones that have stumbled and are re-inventing themselves; their growth has stalled, they have lost market share and as a result their market capitalizations have contracted. My objective is to identify companies in the mid cap arena of either type that can grow their sales and earnings rapidly over a 3 to 5 year period and whose market capitalizations it is believed continue to expand or begin to expand again.

**Discipline.** At any given time, there are a handful of important long term investment themes at work in the marketplace. The emergence of China, fueled by the inexorable growth of its middle class, as the major driver of global economic activity is an obvious example of an investment theme at work today. Identifying a few overarching, and in certain cases multi-industry, investment themes is an important discipline for me in providing portfolio management services to my clients. This identification process isn't rocket science. It's really about demographics, like the exploding middle class in China and the ageing of the population in the developed countries. An awareness of the key demographic trends that are driving economic growth at any given time and the linking of these trends to a manageable number of individual ideas represents the kind of disciplined approach to investment management that I seek to provide to my clients.

**Leverage.** While I have been in the investment business for almost 40 years, have had formal investment training and practiced for a number of years as a stock analyst, I am just one individual trying to sort out a myriad of attractive opportunities in a vast and dynamic global environment. I need all the help I can get. But from the right people. So I look for those who are part of a longstanding culture devoted to high quality, action-oriented, differentiated investment research. Which brings me to the leverage my clients and I get from my association with Oppenheimer & Co. Inc.

When I joined the firm approximately a year ago, I did so for a number of reasons. Independent ownership, a feeling of “family”, a clear mission of advising clients and an unleveraged balance sheet were at the top of the list. I also felt strongly that my clients would benefit from the excellent investment research the firm was providing. An emphasis on research is a tradition at Oppenheimer, which goes back to the 70’s when two of the firm’s partners Jack Nash and Leon Levy pioneered the concept of covering of small and medium-sized companies. Maintaining this tradition has led to the firm’s increasingly prominent position on Wall Street, particularly in light of the recent demise of Lehman Brothers and acquisition of previously independent firms Merrill Lynch and Bear Stearns.

Today the Equity Research Department at Oppenheimer is headed by John Parks, who has broad experience in the capital markets. John manages a group of 41 Senior Analysts who provide research coverage of over 700 US-listed companies. While the emphasis is still on smaller and mid cap companies, which constitute approximately 80% of the firm’s coverage list, Oppenheimer does cover the 20 largest companies in the S&P 500. Providing coverage of these “core” US names is important to me since investments in these companies make up the majority of my clients’ holdings. Equally important however is the opportunity to identify the “up and comers” in the most rapidly growing sectors of the economy, the kinds of companies that can produce outsized investment gains. The majority of Oppenheimer’s research coverage is devoted to this latter goal.

The firm’s research department has a global perspective and is theme-driven. The 7 sectors covered by the department were selected because each is driven by strong demographic trends. Covered sectors are

- Consumer Growth
- Healthcare
- Technology
- Media & Telecommunications
- Financial Services
- Industrial Growth
- Energy and Power

The firm also provides a “big picture” market strategy commentary to build context for its “bottom up” individual security research coverage.

Drilling down into the 36 sub-sectors that comprise the 7 industry groups, I have found the firm’s coverage of the life science, medical device, and “clean” technology companies particularly useful in trying to identify a group of mid cap names to focus on. I have also found Oppenheimer’s coverage of the energy-related Master Limited Partnership sector helpful in finding names for more conservative investors interested in a combination of income and growth.

A detailed examination of one of the industry sub-sectors covered by Oppenheimer will underscore the elements of the firm’s research philosophy mentioned earlier. Ittai Kidron’s coverage of the Communication Technology companies within the Technology universe is currently comprised of 17 names. This is the sector headlined by Cisco, Nokia, QUALCOMM and Research in Motion, all large and important companies. They are the “incumbents” that want to continue to grow, but whose businesses are being challenged by a group of smaller companies intent on taking market share from the industry leaders. Ittai covers 13 smaller companies, including increasingly well known mid cap names

like F5 Networks and Juniper Networks, which are growing more rapidly than the incumbents. The firm's coverage of this tension between market leader and "up and comer" is prevalent throughout its research, which creates a unifying approach to analyzing each sector. Ittai also covers Motorola, which has lost market share, has become a mid cap company again and is attempting to re-invent itself in the hopes of regaining market share.

Enough already about the "positioning" of the Oppenheimer research effort. My clients want to know less about how it is organized and more about how useful its ideas are in identifying good investments. As an indication of the firm's success in identifying outperforming investment ideas, I call your attention to a Bloomberg Survey from last July which rates Oppenheimer #1 in "Batting Average" at 58.2%— defined as the number of accurate calls divided by stocks covered for the top 20 research firms.

There is no shortage of investment opportunities. The hard part is developing the focus and discipline to sort these opportunities out and find a good list of high quality names that I can recommend to my clients. Concentrating on the mid cap space within a manageable number of demographically driven sectors works for me, as does the leverage I get from using research provided by Oppenheimer & Co. Inc. I look forward to continuing to bring new investment ideas to your attention.

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