The Goldman Guide

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Okay, Now What?

We recently recommended selling some of our high-flying picks into the strength of the market. As we reviewed financial reports and trading of companies large and small this week, we were struck by something that seems to have occurred in the market that has gone unnoticed.

In 2011, the stock market was fickle at best, schizophrenic at worst, and volatility was a daily occurrence. However, thus far in 2012, volatility seems to have waned, or disappeared altogether. We have had a few big up days but few big down days. Intraday changes in investor sentiment seem tempered and the direction of the key indices tends to change only incrementally from mid-morning to late afternoon.

So, where is the volatility?

We deduce that it has disappeared as we remain with the *same gloom* but *less doom* in economic data. Plus, after many months of squabbling, we have just grown accustomed to the European mess. Interestingly, there has not been a material change in the economy save for an incremental uptick in employment.

In a sense, it appears that the investing public seems to be drawing strength from the relative strength in the market itself, pushing volatility to the sidelines. With the exception of the drop on Friday due to lower-than-expected GDP numbers, economic statistics seem to be taking a back seat to earnings and valuation.

The absence of volatility is great news, but with small cap indices up 6-7% and large and midcap indices up 4-5%, already this year, what happens when earnings season is over in mid-February?

We do not have a crystal ball. (It is in storage.) In the absence of such a device, we recommend that investors closely monitor volume. One hallmark of the stock market rise this month is that volume hasn't really increased much. This "tell" signifies that money is being used with little conviction, pending more evidence of a recovery.

Therefore, unless volume at least stays at the same level or increases, it could be a ho-hum spring. We would not commit new money to stocks until we see tell-tale signs of renewed conviction. Once that occurs, hop on board because the train will be similar to the great returns of the past 6 weeks. If stocks head south, regardless of volume, take money off the table.

Look, volatility will still be present and fueled by geopolitical situations and to a lesser degree by economic statistics. The reasons behind that volatility should be measured against volume and valuation. It is also possible that it remains tempered for the near future. Nonetheless, for you optimists, volume is your best indicator for the next couple of months that another spurt higher is starting, and that spurt may longer-lasting as investors will likely have more conviction than during the early stages of recovery.

Are You a Pessimist? This One's for You

Benjamin Franklin once wrote:

"But in this world nothing can be said to be certain, except death and taxes."

Well, if you are a true pessimist, what better way to play that philosophy than invest in the funeral industry?

Stewart Enterprises, Inc. (NASDAQ – STEI - $6.34) is the oldest publicly-traded death care company in North America, and is also the second largest provider of funeral and cemetery products and services in the death care industry in the United States. The Company operates over 200 funeral homes and 140 cemeteries in 24 states, with a large presence in the Southern, Western, and Mid-Atlantic regions.

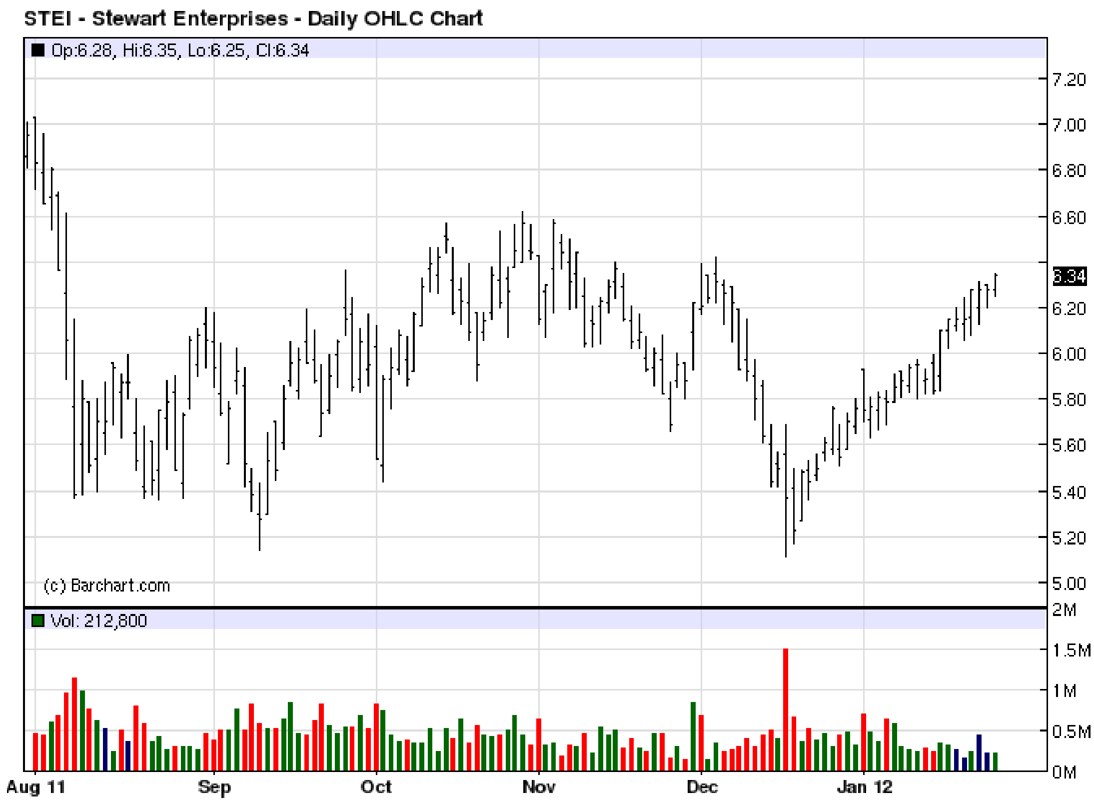
Stewart provides a basket of services, including funeral, burial, cremation, and pre-need.

The Company has a great reputation and with the strength of its one-site, integrated services approach, Stewart has had a great deal of success. In fact, 4Q11 and FY11 results, which were announced in mid-December, were the best revenue and earnings Stewart has posted in three years.

Revenue for the year was $512.7M and EPS of $0.42. Results were so solid across the board that management increased the annual dividend by 17%.

Looking ahead, the Company's "Pre-Need" sales are an important driver for Stewart. As of 4Q11, the Company had a backlog of $1.7 billion, which represents more than 3 full years of revenue. At current levels, the stock is trading near the low-end of its 52-week range, with a valuation around 13x FY12 EPS, and a PEG ratio (price/earnings ratio/earnings growth rate) of 1.2x. Furthermore, the stock's P/E and PEG ratio are at meaningful discounts to small and midcap indices.

The chart, as seen below, is pretty good too.



Source: barchart.com

Stewart Enterprises’ stock seems attractive, even if it’s business I not. While there have been some declines in the popularity of burials and a related rise in less-profitable cremations during the past 3 years, Stewart’s backlog, new marketing and operating initiatives should result in continued solid top-line and bottom-line growth. The strong 2011 performance illustrates that the worst is behind the Company and investors have a unique opportunity to buy a stock that has measurably turned the corner, primed for growth.

We project that the stock could trade 20% higher from here, which would still remain below its 52-week high. Even at those levels, the P/E multiple is only around 15x FY12EPS. Plus, investors get to enjoy an annual 2.2% dividend, to boot.

A cheap death care stock with a nice dividend. STEI is a stock even a pessimist could love.

Until next week…

Analyst: Robert Goldman

Rob Goldman has over 20 years of investment and company research experience as a senior research analyst and as a portfolio and mutual fund manager. During his tenure as a sell-side analyst, Rob was a senior member of Piper Jaffray's Technology and Communications teams. Prior to joining Piper, Rob led Josephthal & Co.'s Washington-based Emerging Growth Research Group. In addition to his sell-side experience Rob served as Chief Investment Officer of a boutique investment management firm and Blue and White Investment Management, where he managed Small Cap Growth portfolios and *The Blue and White Fund*.

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