BARRON'S COVER

2017 Roundtable, Part 2: Manual for a Mixed-Up Market

Scott Black, Jeffrey Gundlach, Meryl Witmer, and Mario Gabelli offer investment picks for the new year.

By
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The Trump rally looks to be fading, even as the presidency of Donald Trump begins. But if some investors have lost their enthusiasm for stocks following a postelection surge, not so the members of the *Barron's* Roundtable. These nine market mavens confessed at our annual get-together, held on Jan. 9 in Manhattan, that they expect the major indexes to post muted gains, if any, in 2017, given today's rich valuations and a likely rise in interest rates. But they insist the outlook for their picks couldn't be brighter. That could be especially true if Trumponomics translates into lower tax rates for corporations, less burdensome regulations, and a more robust economy.

Last week, *Barron's* featured the big-picture views of all our panelists—on equities, interest rates, economics, geopolitics, and more—and the specific investment recommendations of Zulauf Asset Management's Felix Zulauf and Epoch Investment Partners' William Priest. This week, we turn the mic over to Scott Black, Jeffrey Gundlach, Meryl Witmer, and Mario Gabelli, whose best bets for the new year range from commodity producers to auto-parts suppliers to closed-end funds to companies bearing the indelible fingerprints of yet another investment maestro, John Malone.

The 2017 Barron's Roundtable, L-R: Jeffery Gundlach, Meryl Witmer, Scott Black, Mario Gabelli *Brad Trent for Barron's*

Scott, a numbers whiz who runs the show at Boston's Delphi Management, favors companies with a high return on equity and lots of free cash flow, particularly if he can scoop up their shares at a discount. Jeffrey calls himself "a bond guy who thinks about macro stuff," which doesn't begin to hint at the enormous success of DoubleLine Capital, the Los Angeles-based fixed-income firm he founded in 2009 and grew to more than $100 billion in assets.

Meryl, a general partner at New York's Eagle Capital Partners, and a member of the Berkshire Hathaway (ticker: BRK.A) board, has earned a sterling reputation for uncovering value among lesser-known companies in unglamorous businesses, whose financials she masters better than any CFO.

4 Stock Picks From Mario Gabelli

The CEO of Gamco Investors sees two infrastructure plays for the Trump economy, plus a beverage company and a cheap broadcaster.

Mario, head of Gabelli Funds and its parent firm, is a Wall Street legend, for good reason. He's a shrewd thematic investor with a love of deals, an eye for steals, and an encyclopedic knowledge of multiple businesses and the people who built them.

To learn what this quartet likes now, please read on.

Barron's: *Where are you finding value in this market, Scott?*
Black: At Delphi, we like companies that have a high return on equity and generate free cash flow. We look to buy them at low price/earnings multiples. The stock market looks expensive. I'm not counting on price/earnings multiple expansion to drive it higher. But I have five inexpensive recommendations.
D.R. Horton [DHI] is the largest home builder in the U.S. It is based in Fort Worth. Home-building stocks are out of favor, and this one has pulled back to around $28 from the mid-$30s, even though the company has had only one quarterly earnings disappointment in the past five years. Horton's fiscal year ends in September. This year, Horton will build 44,500 homes—that's the midpoint of the expected range—up from 40,309 in 2016. That represents 5% of all single-family homes built in the U.S. Horton homes averaged $297,000 last year. This year, they could average $305,000. That's $13.6 billion in expected revenue.

Gundlach's 4 Picks: 2 ETFs, 1 Fund, and Gold

The founder of the DoubleLine Capital says you can get a 6.8% yield with little risk, plus he explains why a couple of overseas markets and gold look tempting.

Horton aims to generate a 20% gross profit margin. We model an 11% operating profit margin, which leads to $1.493 billion in operating income. The company's financial-services arm, which finances 55% of Horton's homes, could generate $98 million in pretax income this year. The pretax margin on finance operations is about 30%. We estimate total profit before taxes of $1.59 billion. Taxed at 35%, Horton could earn $1.03 billion in 2017, or $2.72 a share, fully diluted. Pro forma return on equity is 14.2%. The P/E, based on a stock price of $27.85, is 10.2, and the price-to-book ratio, 1.5.

What kind of cash flow does Horton have?
Black: Most home builders have negative free cash flow as they buy lots and build. But Horton generated free cash of $467 million in the past 12 months, on $886 million of net income. The objective for this year is to generate $300 million to $500 million of free cash flow. The net debt-to-equity ratio is extremely low, at 22%.
Horton operates in 78 markets in 26 states, and has leadership positions in many markets. The company aims to grow revenue by 10% a year in the next three to five years, and profits at a faster pace. As for the product mix, Horton, the middle-priced brand, accounts for 73% of revenue. Express, the lower-price-point line, is 18%, and Emerald, the high-end brand, is about 9%. Horton has done an excellent job of managing earnings. Its supply chain is cost-efficient.

Priest: Scott, what does the company do with its free cash flow?

2 Scott Black Stock Picks, Including a Miner

The value-stock maven makes the case for a tech stock as well as mining giant Freeport McMoRan.

Black: Horton pays a dividend of 40 cents a share. It has used most of its cash to make acquisitions and reduce debt. In the old days, the company owned much more land than now. Today, it has 204,500 lots, of which 55% are owned and 45% optioned. Management wants to get to 50/50 in the next two years. Its land supply could support double-digit earnings growth in the next four or five years.
Schafer: You recommended Horton in the 2016 Midyear Roundtable [" *Barron's* 2016 Midyear Roundtable: 24 Investment Ideas," June 11]. What happened to the stock?
Black: It didn't work out [the shares fell 14.6% through Dec. 30]. People worried as mortgage rates rose. I expect housing to do better, but there is an affordability issue. Horton tells me that 22% to 23% of would-be customers who want financing don't qualify. This will become a bigger issue if interest rates back up to 3.5% to 4%.
Zulauf: The situation won't get better.
Black: My next pick is Fabrinet [FN]. It operates mainly in Thailand. The stock is selling for $36. There are 36.8 million shares outstanding, and the market capitalization is about $1.3 billion. The company doesn't pay a dividend. Fabrinet is a contract manufacturer to the optical networking industry. It specializes in optical components, including lasers, sensors, and optical switches. The business is growing nicely. Revenue could be up 38% in this fiscal year, ending in June.

Meryl Witmer: Bullish on Trump, Lanamar

he Eagle Capital Partners stockpicker recommends an undervalued auto parts maker.

What is driving this growth?
Black: New business represents 25% to 30%, and demand is growing in existing markets. Revenue could total $1.35 billion for the fiscal year. An operating profit margin of 9.4% translates into estimated pretax income of $127 million. Taxed in Thailand at only 7%, the company could have net income of $118 million, or $3.20 a share. Return on equity is about 19%, after tax. Fabrinet has $254 million in cash and equivalents, but has to set aside $125 million to self-insure; Thailand had massive floods several years ago. Remove that portion and net cash is $2.57 a share. Last year, the company had 26 cents a share in stock-based compensation; this year, it will be closer to 50 cents. We exclude it from earnings, as it is a cost. If you back out the net cash and exclude the 50 cents from estimated calendar-year earnings of $3.40, you get a price/earnings multiple of 11.6.
Fabrinet had $19 million of free cash flow last year. This year, it will be between zero and $5 million, because the company is more than doubling manufacturing capacity in Thailand. North America accounts for 54% of revenue; Asia/Pacific is 36%; and Europe, 10%. To sum up, Fabrinet offers 30%-plus revenue growth and a 19% return on equity, at a P/E of 11 or so.

Sounds appealing. What is your next pick?
Black: Zimmer Biomet Holdings [ZBH] makes orthopedic products. It has been hurt by concerns about rising health-care prices, but in this case, the baby might have been thrown out with the bathwater. Zimmer reported disappointing earnings in the latest quarter.

The stock is down 21%, to $105, from last year's high. Unlike drug companies, which have been raising average selling prices by 8% to 10% a year, Zimmer's prices have declined by 1% to 3% in the past two years. It can't be accused of price-gouging.
Management is committed to 10% earnings growth. We expect revenue to grow about 4% this year, to $7.94 billion. The company could earn about $8.70 a share. Zimmer bought Biomet in 2015. It has promised $350 million in savings and has already achieved $225 million. Zimmer is reducing its interest expense, as it has been paying off debt. It has already repaid more than $1 billion in debt from the Biomet merger. In the first nine months of 2016, Zimmer had $910 million of free cash flow and $972 million of non-GAAP income [calculated not in accordance with generally accepted accounting principles]. Return on equity is about 16.3%. The P/E ratio on 2017 earnings is 12.1.

How does that compare with the industry?
Black: Competitors such as Stryker [SYK] and Medtronic [MDT] have substantially higher multiples. In knee products, Zimmer has 36% of the market worldwide. In hips, it has 30%. In sports, extremities, and trauma, or SET, it has 11%. In spine products, including thoracic, it has roughly 14%, due to the Biomet acquisition.
Demographics are working in its favor. Typically, patients who need joint surgery are 65 and older. The world's 65-and-over population was 7.6% of the total in 2010. By 2020, it will be 9.3%. Joint-related medical procedures are growing by 2% a year in the U.S. Zimmer generates 63% of revenue in the U.S., 23% in Europe, and 14% in Asia/Pacific. It is losing money in its dental business, but has vowed to turn it around.

Gabelli: We own Zimmer. It is a great company and a great business.
Rogers:I have a Zimmer hip. I will do a demonstration later, if anyone is interested.
Black: My next stock, Royal Dutch Shell [RDS.A], is a yield play. It was on the cover of *Barron's* last year ["Shell: The Best Big Oil Stock Yields Juicy 6.6%," July 16]. The stock is trading for $55.79, and the market cap is $226 billion. We recommend the A shares, which yield 6.74%. Individual U.S. investors pay a 15% withholding tax on the dividend, and institutional investors pay zero. The net yield for individuals is 5.73%.
Royal Dutch has upstream and downstream operations [exploration and production, and refineries and distribution]. Earnings are almost impossible to model. The company earned 70 cents a share in the latest quarter; I assume an annual earnings run rate of $2.80 a share. The company produces 1.8 million barrels of oil a day. Oil is up about $7 a barrel from the prior quarter, adding about $1.25 in earnings per share. That brings total earnings to $4.05 a share. Royal Dutch also produces 10.4 billion cubic feet of natural gas per day, and refines about 2.7 million barrels of oil a day.

Is your estimate in line with Wall Street's?
Black: No. Analysts' consensus earnings estimate for this year is $3.76 a share, but you could drive a truck through the spread between the low estimate of $2.30 and the high of $5.84. My estimate implies a P/E of 13.8. Many analysts also value the company on discretionary cash flow, which adds depreciation, amortization, and dry-hole expenses back to net income. I estimate it is trading for 7.5 times discretionary cash flow. I add DD&A [depreciation, depletion, and amortization] of $27 billion to estimated net income of

$32.8 billion, and subtract capital spending of $25 billion, to get $34.8 billion of free cash. After dividend payments of $10.6 billion, the company will have free cash flow of $24.2 billion this year.
One knock on Royal Dutch is that it leveraged up to buy BG Group last year and hasn't reduced debt fast enough since. It planned to divest $30 billion of assets, but hasn't sold off a lot of these properties. Management's priority now is free-cash-flow generation and cost and debt reductions. The company also wants to increase its production from deepwater plays to 900,000 barrels a day by 2020 from 400,000 barrels now, and expand its worldwide chemical production in the same period from six million to seven million tons of ethylene. The free cash flow gives you a margin of safety, and the stock is reasonably priced. And, you get paid to wait for the shares to rise.

My last pick is atypical for Delphi. It is a value stock, but more speculative than our usual investments. Freeport-McMoRan [FCX] is a major copper producer. For the first time in a while, copper supply and demand are in balance, at roughly 16 million tons. China represents about 40% of world demand.

Where are Freeport's mines?

Black: Freeport operates seven mines in North America, producing 1.8 billion pounds a year; it has two mines in South America, producing 1.3 billion pounds. And it operates the Grasberg mine in Indonesia, in partnership with the Indonesian government. That mine produces 1.2 billion pounds a year. The company also produces 1.3 million ounces of gold a year as a byproduct of copper mining.
Freeport has lowered its worldwide operating cost from $1.52 a pound in 2015 to $1.14 a pound. The company has restructured its balance sheet and sold a lot of properties. It has raised $1.5 billion through the sale of new shares. The net debt-to-equity ratio, once staggering, is only 1.14 now. If the copper price holds at around $2.50 a pound, the company will earn $1.40 a share this year. The stock is $14.90 and trades for 10.6 times expected earnings. Return on equity is 26%. Management will continue to drive down the debt load, lifting return on total capital to 13% to 14%.

Schafer: Did the company sell these businesses above or below book value?
Gabelli: Come on, you know the answer. They bought them at the wrong time and sold them at the wrong time.
Schafer: That's why book value is so low and return on equity is so high.
Gabelli: Look through the windshield, Oscar, not the rearview mirror.
Black: Freeport has about $10 billion in NOLs [prior net operating losses, which can be used to offset future taxes]. We expect Freeport to generate about $1.9 billion of free cash this year, much of which will go toward further debt reduction.

Scott Black on Royal Dutch Shell: "The free cash flow gives you a margin of safety, and the stock is reasonably priced." *Jenna Bascom for Barron's*

Gabelli: Share the math on the company's leverage to copper prices and excite us.
Black: OK, for every 10-cent change in the copper price, there is a $410 million change in earnings before interest, taxes, depreciation, and amortization. For every $50 change in the price of gold, Ebitda changes by $130 million.
Gundlach: Scott, the balance sheet has been an ongoing issue.
Black: It has, but Carl Icahn took two seats on the board in 2015 and has been pushing to restructure the balance sheet and sell assets. The process is well along.

Scott Black's Picks

Company / Ticker	Price 1/6/17
D.R.Horton / DHI	$27.85
Fabrinet / FN	36.19
Zimmer Biomet Holdings / ZBH	104.96
Royal Dutch Shell / RDS.A	55.79
Freeport-McMoRan / FCX	14.90

Source: Bloomberg

Gabelli: How much stock does Icahn own?
Black: He owns about 8%.
Zulauf: Do you buy Freeport because it is a good value, not because you believe in much higher copper prices?
Black: We bought it for both reasons. There has been some inventory destocking; with global GDP growing by north of 3%, the supply/demand situation will work in your favor. But the stock won't be a runaway freight train, as it was prior to 2015 when copper prices were going through the roof at around $4.50 a pound. Given the current valuation, the stock has a lot of upside potential. If copper prices go up, the stock could shoot up to $20 or $25.
What is the downside?
Black: The downside is a global recession.
Gabelli: The more interesting question is, what projects are in the pipeline that could increase supply and threaten prices?

Black: Nobody is going to bring on a new mine for under $2.50 a pound. The price would have to approach $4.
Rogers: There has been a lot of irrational behavior in this industry from time to time.
Black: Correct, but companies like Rio Tinto [RIO] have gotten religion, and Glencore [GLEN.UK] isn't in the best financial shape.
Thanks, Scott. Let's move on to Jeffrey.
Gundlach: One of the best indicators of the direction of bond yields is the ratio of copper prices to gold prices. It signaled the selloff in bonds that started in July. The copper/gold ratio has come down a little, which supports the recent bond rally. The yield on the 10-year Treasury got as high as 2.64% late last year, and has since fallen back to 2.37%. [Bond prices move inversely to yields.] We expect the yield to fall below 2.25%.
Why is the ratio such a good indicator?
Gundlach: Copper is an industrial metal. A higher ratio suggests more manufacturing activity, and that implies an uptick in inflation and yields. As I explained this morning, I expect interest rates to rise later this year. One way to position yourself for further rate increases is to look for things that don't have much interest-rate risk. Last year, I recommended the Brookfield Total Return fund [HTR], which invests in mortgage-backed securities. It was trading at a steep discount to net asset value. As luck would have it, it got merged into a new fund at its net asset value, producing a total return of 21.7% on a bond-like investment in a 2%-type year. This year, I am recommending something a little less juicy— Putnam Premier Income Trust [PPT], launched in February 1988. Its longevity is a good sign.
Putnam Premium Income is a one-stop-shopping, low-risk bond-portfolio investment with a decent yield. And it is trading at an 11% discount to net asset value. Unlike the Brookfield fund, there is little chance the price will rise sharply and converge with net asset value, as this closed-end fund has been hanging around with a 10% discount to NAV for a long time. Last year, the discount narrowed to 8%.

What are your return expectations?
Gundlach: You might get a capital gain of 3% this year, and the dividend yield is 6.3%. The portfolio is 80% invested in the U.S. The other 20% is a little spicy, and includes Greek, Russian, and Brazilian bonds. While the higher-risk holdings account for less than 10% of the portfolio, they are probably the source of much of the rich yield.

Jeffrey Gundlach: "I'd short German Bunds. They are yielding 0.27%, and Germany's inflation rate is 1.7%. The gap is a record. The Bund yield is unsustainably low." *Jenna Bascom for Barron's*

The duration of the fund is 0.3, according to Putnam, which means the fund holds allocations to assets, probably floating-rate or lower-credit securities, that dampen interest-rate-related volatility. But almost a third of the portfolio is invested in something liquid and easy to price: Fannie Mae mortgage-backed securities. Given the discount to NAV, you are buying Fannie Mae 3's [the coupon is about 3%], basically the current coupon mortgage-backed security, at a price 11% below the actual market price, which

translates to a yield about 150 basis points above market yields. It is an unequivocal bargain—kind of like buying a 10-year Treasury today at 4% instead of 2.37%. It is a great starting point.

Does the fund use leverage?
Gundlach: The Putnam fact sheet reports no leverage, but when I add up the numbers, leverage looks to be 20% to 25% of net assets. But leverage doesn't increase your interest-rate risk because you don't really have much risk. There is a small risk of your spread [between the yield on assets and the cost of borrowed funds used for leverage] shrinking. Maybe the fund is earning a 4% or 5% spread, which is contributing about a percentage point to the yield. If LIBOR [the London Interbank Offered Rate] goes up 100 basis points [one percentage point], you might lose 25 basis points on the yield. But you are still comfortably at 6% in a world where a total-bond-market index fund would have a net yield of around 2½%.The fund has about $600 million in assets. If someone wants to own one bond investment after this rally is over, this is a good one to have.
BKLN, or PowerShares Senior Loan Portfolio, is an exchange-traded fund. It holds bank loans, which have credit risk, but are at the top of the capital structure in bank debt. There isn't a lot to worry about, even if oil prices fall. I agree with the consensus that oil will hang around the mid-$40s to high-$50s. Energy-company debt represents only 5% to 6% of the bank-loan market.

Jeffrey Gundlach's Picks

Fund / Ticker	Price/Yield 1/6/17
BUY	
Putnam Premier Income Trust / PPT	$4.98/6.3%
PowerShares Senior Loan Portfolio / BKLN	23.42/4.1
iShares MSCI India / INDA	27.11/0.9
WisdomTree Japan Hedged Equity / DXJ	51.19/1.9
SHORT	
Investment	**Price 1/6/17**
10-Yr German Govt Bund Futures*	€162.84

*March '17 contract

Source: Bloomberg

What does the fund yield?
Gundlach: It yields 4.1%. If you combine PPT and BKLN, you'll have a 5%-plus yield and little interest-rate risk. Your total return for the year could be as high as 7% or 7.5%.
Next, like Felix, I would short German Bunds. They are yielding 0.27%, and Germany's inflation rate is 1.7%. Historically, it is very rare to have a Bund yield below the inflation rate. The current gap is a record. The Bund yield is unsustainably low.

Schafer: What is the best way for an individual to short German Bunds?
Gundlach: Short the futures. I agree with Felix that the Italian bond market is deeply troubled. Shorting Italian bonds could potentially produce a massive home run; they are yielding 47 basis points less than 10-year U.S. Treasuries, which represents a full buy-in on the idea that the euro zone will last forever. If the euro zone breaks up, a possibility we have discussed, and Italy has to go it alone, sovereign bonds could yield 1.9%. The current yield is insanely low. But shorting German Bunds appeals more. They are more vulnerable at this point than U.S. bonds.
One argument for U.S. bonds when yields hit a low last July was that they yielded more than German Bunds, which had negative yields. In other words, U.S. bonds were better than something really terrible,

but that didn't make them good. Underlying the argument was the notion that German yields would stay negative forever. Well, forever lasted about a month. Since then, Treasury yields have risen more than German rates, but Bunds could underperform in the next leg of the bond bear market.

Zulauf: In 2012, there were widespread fears about the euro zone breaking apart. Back then, money flowed from the southern countries to the northern countries, and into Bunds. The next time the euro zone looks endangered, money will flow out of the euro completely and into another currency, primarily the U.S. dollar.

Schafer: Do you short in your bond funds?

Gundlach: We don't short in our bond funds. We run a macro fund [DoubleLine Multi-Asset Growth (DMLIX)] and short markets there from time to time. I have a somewhat nonconsensus perspective on equity markets. U.S. investors are heavily invested in U.S. stocks. The U.S. has significantly outperformed emerging markets in the past five years. Now it looks like things might reverse. I'm not suggesting that investors abandon U.S. equities, and certainly don't short them. But this is a moment to think about diversifying. Articles often tout the benefits of diversification after huge outperformance by emerging markets or European markets. But you should do just the opposite: Buy the underperformers. Investors ought to decrease their U.S. allocation and increase their allocation to non-U.S. markets.

Do you like specific foreign markets?

Gundlach: I still like India, which I recommended buying last year through the INP [iPath MSCI India exchange-traded note]. You can also buy it through the iShares MSCI India ETF [INDA].

The iShares fund is less costly and easier to trade.

Gundlach: Then go with that. I'm not a stockpicker. I'm a bond guy who also thinks about macro stuff. India is a long-term play, based on positive demographics and improving fundamentals. It could take 10 to 20 years to play out. Yes, India is plagued by horrific regulations and cronyism. But that just means there is room for improvement. If you had recommended the Chinese stock market 35 years ago, you would have gotten the same pushback.

Because of India's demographics, there will be a massive increase in the labor force. That runs counter to so many other countries, particularly parts of Europe, Russia, and even China. India could have up to 300 million people in the labor force over time. That will necessitate an economic expansion. But you have to think long-term. There could be a lot of volatility in the market.

Zulauf: India isn't interwoven much with the world economy. That is a positive.

Gundlach: Japan is another market I like; it seems to be a consensus pick at this Roundtable. The Bank of Japan is engaged in quantitative easing, and the government is encouraging the purchase of stock. There have been three sources of pretty much automatic buying of the Japanese stock market that totaled an annualized $163 billion in last year's third quarter: pension funds, the Bank of Japan buying ETFs, and corporate buybacks. Together, these buyers are buying shares at an annual rate in excess of 5% of the total market capitalization. Further buying could come from the Japanese public, which is broadly underinvested.

Rogers: How would you gain exposure to Japan?

Gundlach: Buy the DXJ [WisdomTree Japan Hedged Equity]. It is dollar-based. Further supporting the case for Japan is the substantial weakening of the yen, now 117 to the dollar. Longer term, it could go to 200. The Japanese economy could get a significant share of global growth.
Priest: Going back to Europe, Italy is the eighth-largest economy in the world. It has issued the fifth-largest amount of sovereign bonds. Most of them are held outside Italy. To me, that is an accident waiting to happen. If the ratio of nonperforming loans to GDP were as high in the U.S., our banks would have $2 trillion of nonperforming loans. Some kind of default appears to be looming.
Gundlach: You could short the bonds in the futures market. But shorting German Bunds could be a more profitable trade right now.
Black: People look at the euro zone from an economic perspective, but the creation of the euro was also about forming a supranational bloc to keep the peace. Remember, Germany went to war with the rest of Europe in 1870, 1914, and 1939. I once went to a dinner with Mario Draghi [president of the European Central Bank] and asked him about the 3% rule. Euro-zone countries aren't supposed to run a deficit exceeding 3% of GDP. He said countries are evaluated on a case-by-case basis, and that policy makers will do everything possible to preserve the euro, long term.
Gundlach: You have to wonder about the euro-zone concept when everybody broke the rules underpinning it in the first year.
Zulauf: The Maastricht treaty [Treaty on European Union] has been broken 70 times. Every nation does what it wants. The euro zone is decaying in reality, if not in legal terms.
Jeffrey, would you hedge out currency risk on non-U.S. investments generally?

Gundlach: U.S.-based investors should do so. I'm not a big dollar bull. As I said this morning, I'm not sure Donald Trump is a strong-dollar person. If he really wants to deliver for the forgotten middle class, a strong dollar is a hard way to do it. The DXY [U.S. dollar index] is at**102.22**. It would be hard to for the DXY to get above 120.
The Federal Reserve has barely been mentioned today, in contrast to other years. What is your expectation for Fed rate hikes?
Gundlach: It is refreshing, isn't it? I got so tired of the world focusing on 25 basis points. I expect the Fed to follow the market. The rise in bond yields after the election gave the Fed the green light to raise interest rates in December, which it did. There is a green light to raise them in June. The Fed probably won't act at its March meeting, which follows too soon after the inauguration of a new president. I wouldn't be surprised if the Fed raises rates three times this year.
Cohen: Underscoring Jeff's comments, there are finally policy players besides the Fed. Central banks, and the Fed in particular, as the central bank to the world's largest economy, were put in an untenable position because fiscal policy was frozen in so many countries, including the U.S. Now that fiscal policy changes are likely in the U.S., global capital flows are adjusting. It remains to be seen whether the policy changes are favorable to long-term economic expansion. Some other countries are undertaking structural reforms, showing that there are ways to spur economic growth other than through monetary policy.
Rogers: The same political regime has been in place in the U.S. since 1988. Nothing new has really happened. Finally, something is happening with Trump's election as president. We will find out whether it is good or not.
Zulauf: If the dollar stays strong and the Fed raises rates, that will equate to a dramatic tightening of global liquidity. It could trigger an accident at some point.

Cohen: We have seen that tightening in financial conditions through the dollar's action. Yet U.S. economic growth hasn't deteriorated. That is encouraging. There is currently a solid domestic-growth dynamic in the U.S. in terms of job creation and industrial production. Although exports usually are hurt by a strong currency, much of what the U.S. sells abroad is high-value goods and services and isn't notably price-sensitive, mitigating the impact of the dollar. But I agree with Felix that we won't have enormous swings in the world's major currency without a negative impact occurring somewhere.

Zulauf: It hurts Mexico tremendously. Turkey is another accident waiting to happen, and problems there could be reinforced by politics. The countries most exposed to the negative impact of a strong dollar are those that run chronic current-account deficits and depend on foreign financing and capital inflows. Turkey is high on the list on both counts.

Felix, what is your view on Russia?

Zulauf: Putin [Russian President Vladimir Putin] did the right thing by letting the currency fall 50% or so. That helped him balance the domestic economy after oil prices dropped sharply. Now oil is recovering and Russia is doing better, but structurally it isn't a strong economy, and the long-term outlook isn't promising.

Gundlach: Russia could see the biggest drop in population in world history, absent wars or famines. The mortality rate is high, fertility rates are low, and the Russian culture is under threat because of demographic trends.

Thanks for your insights, Jeffrey. It is time to hear from Meryl.

Witmer: I am recommending four companies. In three cases, management owns a significant percentage of the shares outstanding. The founders created superior companies from scratch.

Dart Group [DTG.UK] is a U.K.-based airline operator and vacation packager with 148 million shares outstanding and a market cap of 740 million pounds [$912 million]. The stock is trading for 500 pence. While the shares are valued like an airline, the company is an outstanding operator in the leisure travel business. Philip Meeson is a passionate owner-operator. He owns about 38% of the stock.

Dart began as a carrier of flowers between the Channel Islands and the U.K. It evolved into a low-cost airline, and then into one of the largest vacation-package providers in the U.K. The company operates under the brands Jet2.com and Jet2holidays. Jet2.com is rated No. 1 in the U.K. on TripAdvisor. Unlike competitors, it is known for great service. In the U.K., more than 15 million people a year buy vacation packages through companies like Jet2, Thomas Cook Group [TCG.UK], and TUI [TUI.UK]. The British consider vacations somewhat sacrosanct, as the U.K. is a cold, wet, and cloudy island.

Meryl Witmer: Dart Group is valued like an airline, but has become "an outstanding operator in the leisure travel business." *Jenna Bascom for Barron's*

Other than that, it is a beautiful place.

Witmer: Customers pay in advance, and the company earns a fee from the hotels booked. This is similar to a franchise model, in that Dart earns a percentage of another business' revenue without the capital costs. The company owns planes, however, so it makes some capital investments. The after-tax return on

capital exceeds 20%. Hotel operators love Jet2holidays, as it delivers customers and pays faster than the competition. In return, Jet2 customers get the best rooms. Some travel agencies are looking to co-brand with Jet2 because of the halo effect of the brand. The travel business has grown from zero passengers in 2007 to 1.5 million in 2016. Vacation-package travelers are about half the travelers on Jet2 planes.
Jet2 is at an inflection point as the company begins to fly out of southern U.K. markets such as Stanstead and Birmingham. That will enable it to attract travelers from the London area. It built the brand by dominating the northern U.K. market. The southern market is roughly twice as large. Jet2 has contracted for 34 new Boeing 737-800 planes over the next few years, which could enable the company to grow by about 15% a year.

Tell us about earnings.

Witmer: In the 12 months ended September, Dart earned about 70p a share. Reported earnings could be lower in the next 12 months as Dart invests in advertising and other costs to build out the southern market. If you add back the one-time costs, adjusted earnings could be 70p or higher. With capacity additions, earnings will grow thereafter at a 10% to 15% annual clip. Dart deserves at least a 10 to 12 price/earnings multiple, which implies a near-term price target of 700p to 850p a share. The shares fetched 700p early in 2016. If the growth plan succeeds, earnings could top 90p in a few years and the stock could then trade around 1,000p.

Schafer: Why did the stock fall?

Witmer: It was hurt by Brexit [Britain's vote in June to leave the European Union]. Ryanair [RYA.UK] also fell sharply and then rebounded, but this stock hasn't come back. Only two brokerages follow Dart, and the company doesn't do earnings conference calls.

Schafer: Has the business been hurt by a weaker pound?

Meryl Witmer's Picks

Company / Ticker	Price 1/6/17
Dart Group / DTG.UK	502.50 pence
Linamar / LNR.Canada	C$60.50
Virtu Financial / VIRT	$16.50
Cooper-Standard Holdings / CPS	106.74

Source: Bloomberg

Witmer: No. Dart has hedged out a lot of the fall, and the pound hasn't fallen as much versus the euro, relative to the dollar.

Black: What is the income demographic of Jet2's target audience?

Witmer: The company offers everything from two- and three-star hotels up to five-star properties. I'd say they attract a four-star customer. When you buy a package, you also get travel insurance, which is a good deal.

Black: Does Dart have the cash flow to buy 34 new planes?

Witmer: It will borrow some of the money, and use cash flow. The cost is about $1 billion, which they can manage over three years. Dart's management is financially savvy. The growth has been self-financed.

Zulauf: That's a great story.

Witmer: My next pick is Linamar [LNR.Canada]. It is a global auto-parts supplier, based about an hour from Toronto. The stock price is 60 Canadian dollars [$45]. There are 66 million shares outstanding, and the market cap is C$3.9 billion. Linamar has two segments: powertrain/driveline and industrial. The former generates about 80% of operating income. The company utilizes precision machining, casting, and forging

technology to make powertrain and driveline components for automotive OEMs [original equipment manufacturers]. Linamar focuses on sophisticated components that are lightweight and fuel-efficient.
What does the industrial division do?
Witmer: It makes aerial work platforms, such as scissor lifts, under the Skyjack brand. There are two major competitors: Terex [TEX] and OshKosh [OSK]. Linamar purchased Skyjack in 2001-'02 for $32 million. Skyjack is on track to earn $140 million, pre-tax, in 2016, so it was a good buy. Linamar was founded by Frank Hasenfratz, a remarkable man. An ethnic German, he was born in Hungary and fled to Canada in the 1950s after the Hungarian uprising against the Soviets failed. The Canadian government gave him $5 and sent him on his way. Frank had an advanced skill set as a machinist from an apprenticeship in Hungary, and started a predecessor to Linamar in 1964 in his basement.
In 2002, his capable daughter Linda took over as CEO. She has a chemistry degree and an M.B.A., and started on the shop floor. Together, they own about a third of the stock. They think long-term about growing the business and achieving 20% pre-tax returns on capital. The company is relentless about keeping costs low through process efficiency and product innovation. Every plant manager at its more than 50 plants worldwide is responsible for his or her own P&L [profit and loss]. Despite its growth, Linamar has retained an entrepreneurial culture.

Linamar is benefiting from the trend toward outsourcing powertrain and driveline manufacturing, the last major area of automotive production that is still done partly in-house. OEMs realize they can achieve better and more cost-effective results by outsourcing. Linamar is well-positioned to garner new business as a trusted supplier. It often has sole-source status as a supplier on these critical elements. It can grow through a downturn. If North American vehicle sales fell by one million units, Linamar would lose only about $150 million of revenue. While it is valued like a run-of-the-mill auto supplier, it deserves a higher valuation.

What would you give it?
Witmer: The company projects that with flat automotive production, revenue will grow by about 30%, from C$6 billion to more than C$7.8 billion over the next four years, based solely on new business wins it has already signed. Past projections have been conservative by about C$500 million. We estimate that Linamar will earn more than C$7 a share in 2016, growing to more than C$9 a share by 2020. The stock could trade north of C$90 a share in a few years, based on a pricing/earnings multiple of 10. We'd argue a multiple of 12 is more appropriate, producing a target price of C$110 a share.
Schafer: Have you heard of the company, Mario?
Gabelli: Yes. One of my analysts picked it as his stock of the year for 2017.
Rogers: What are gross profit margins like in this business?
Gabelli: Probably 20%, at best. Pre-tax operating margins are around 10%, which is great.
Witmer: Next, Virtu Financial [VIRT] was founded by Vincent Viola, now chairman.
Gabelli: He's a military guy. [Viola, an army veteran, has been nominated by Donald Trump to be Secretary of the Army.]
Witmer: Yes, my kind of guy. Virtu is an electronic market maker, operating on more than 200 trading platforms around the world. It came public at $19 a share in 2015 and is trading for $16.50. Assuming conversion of the pre-IPO [initial public offering] partnership interests, it would have 140 million shares

outstanding, for a market cap of $2.3 billion. Just over a quarter of the interests have been converted to common equity.
Virtu gets painted with a high-speed-trading brush, but that misstates what it does. Its primary business is making markets as efficient as possible and ensuring it provides the best bid-ask spread for the thousands of securities it trades every day. It doesn't make directional bets and isn't front-running trades. It makes money from the bid-ask spread.

Virtu's management team, led by CEO and co-founder Douglas Cifu, is serious about doing business ethically. JPMorgan Chase [JPM] chose the company as its market maker on the New York Stock Exchange after it was unhappy with its prior representative, signaling Virtu's trustworthiness. The founders together own about 70% of the company on a fully converted basis. Virtu carefully monitors trading in all securities and will lock down trading and strategies if it is making too much money, because there could be an error in the algorithm from, say, a corporate event like a spinoff. Similar situations have hurt other high-speed trading firms.
What will drive Virtu's growth?
Witmer: The company will benefit as more markets "electronify" and become more efficient. Pending EU legislation regarding MiFID II [the Markets in Financial Instruments Directive, a law aimed at harmonizing financial-services regulation across 31 European countries] will expand Virtu's market opportunity as more securities, including ETFs, will be required to trade through liquid, well-regulated markets. Virtu also has been building an agency business to execute trades on behalf of buy-side clients. Its trade execution is in high demand. Brian, you might know something about that. [T. Rowe Price began sending a small portion of orders through Virtu in 2015.]
Rogers: Yes, I do.
Witmer: Virtu estimates the agency business could account for at least 10% of revenue in the future. The company also is developing technology service deals with additional partners. It recently announced it would be partnering again with JPMorgan to help the bank trade a portion of its U.S. Treasury business. Virtu will provide the market access and order-routing capabilities, and JPMorgan will provide the capital. Virtu's base business likely earned about 90 cents a share in after-tax free cash flow in 2016. That's down from $1.30 in 2015, when one-time events generated excess earnings, and $1.06 in 2014.
Volatility and trading volume were unusually low last year. Virtu is relentless about keeping costs low, so as volatility and volume pick up, incremental revenue will drop to the bottom line. Assuming modest growth in the agency business and technology services deals, and a return of volatility and volume to more normal levels, we could see Virtu earn $1.50 to a $1.60 a share, or more, in the next three years. The company pays a quarterly dividend of 24 cents, so you are paid to wait. If everything plays out, the stock could trade for 13 times earnings, or more. That, plus a few years of dividends, could give you $22 a share.

Would losing Viola to Washington be a big negative for the company?
Witmer: Cifu is really running the show.
My last pick is Cooper-Standard Holdings [CPS], a global auto-parts supplier based in Novi, Mich. The stock is trading for $107. There are 19 million shares outstanding, for an equity capitalization of $2 billion. The company went through bankruptcy proceedings in 2009 and emerged in 2010 with a better balance sheet, but with the equity largely owned by debt holders. We looked at it after it emerged and passed, but

became intrigued at the roadshow when some large holders did a secondary offering. We were impressed with the management team, especially CEO Jeff Edwards, hired in 2012. He came from Johnson Controls and by all accounts was a star there.

What does Cooper do these days?

Witmer: It has four major product lines. Sealing systems and fuel and brake delivery represent three-fourths of revenue. The sealing business is about half; Cooper is the global leader, with a 24% market share. Its products protect vehicle interiors from weather, dust, and noise. They are the black rubber frames around doors and windows. In fuel and brake delivery, Cooper is No. 2 globally, with a 9% share. Its products are used to deliver and control fluids throughout the vehicle. When Edwards took the helm, he put some resources into R&D [research and development] and the team developed some breakthrough products in materials science.

What distinguishes them?

Witmer: The new materials are significantly lighter than the incumbent materials, and have superior durability and weight characteristics. They save up to 40% in weight, and last years longer. Given stringent CAFE [Corporate Average Fuel Economy] regulations, which admittedly might be loosened under President Trump, we expect the adoption of these products to meaningfully increase Cooper's market share and profitability as it wins placements on new platforms over time. In the past year it received six development contracts, an indication of OEMs' excitement about the products.

Since Edwards and Chief Financial Officer Matt Hart took over and implemented their Cooper operating system, they improved Ebitda margins from 9% to 12.5% and return on capital from under 6% to up to 10% last year. Cooper's operating margins could reach 15%, and return on capital 15% to 20%, by 2020. Cooper has restructured its manufacturing footprint and created a culture of excellence. The company has made some opportunistic foreign acquisitions, including a stake in a joint-venture partnership in China, and repurchased shares at attractive prices. We acknowledge the risk of peak U.S. auto sales, and concerns about the cycle. However, Cooper is a global supplier and gets half its revenue from outside North America. Any weakness in North America can be offset by growth in new products, market-share gains, and strength in Asia, where Edwards has great relationships.

What is your earnings forecast?

Witmer: We estimate Cooper earned $10 a share last year, and could earn $11 this year. Earnings could grow to $12 to $13 a share by 2020. We have a near-term price target of $125, but think $140 could be possible within three years. Both Linamar and Cooper are being lumped with basic auto-parts suppliers. But they have something different, and will gain market share over time.

Gabelli: With the presence of exchange-traded funds, a lot of portfolio moving is taking place. Stocks fluctuate without regard to fundamentals, leaving plenty of opportunities.

Witmer: That's when you want to be there with a basket. In fact, Cooper traded down to $85 not long ago, and we bought more.

Thank you, Meryl. Speaking of opportunities, how about sharing your ideas, Mario?

Gabelli: To echo my comments this morning, in electing Donald Trump, the U.S. is moving away from creeping socialism toward the reinvigoration of capitalism. We are seeing a wave of confidence in America, which will spark a wave of innovation. Individual tax rates could fall from 39% to 33%; a new tax plan could create only three tax tiers, and the earned income credit could rise, returning money to the working class. Also, regulatory reform could help improve the tone of business. The U.S. consumer had a

record net worth of $105 trillion as of Sept. 30. Minus debt, that's $90 trillion. There are two pockets of concern: Auto loans are up substantially in the past 10 years, and student loans have ballooned to $1.3 trillion. That's a big drag.
That's the macro backdrop. On stocks, I recommended CBS [CBS] last year and it rose nicely. I expected CBS to buy Viacom [VIAB], but it didn't happen. Viacom has 397 million shares. About 50 million are class A, controlled by the Redstone family's National Amusements. The rest are class B. With the B shares around $38, Viacom has an equity valuation of $15 billion. The enterprise value, including debt, is $25 billion. Viacom's Paramount movie studio is a great brand, but it lost about $400 million last year. It must revitalize its theatrical and television production, and it will. Viacom could also do some creative financing with Paramount—selling assets, entering joint ventures, and such.
Viacom's cable TV networks aren't performing well, either. How can the company turn those around?
Gabelli: The basic business includes Nickelodeon, MTV, and other networks. The new CEO, Bob Bakish, must trim the portfolio and energize product development. We look for Viacom to report $13 billion of revenue in this fiscal year, ending Sept. 30, and $3.7 billion of Ebitda. The stock trades for seven times enterprise value to Ebitda. If I'm Apple [AAPL] and want to get into the entertainment business and have a market cap of $600 billion, Viacom wouldn't be hard to buy. But Shari Redstone [president of National Amusements] likely won't sell.
Black: Don't you think Viacom is a value trap? It has been depressed for several years.
Gabelli: You are correct. The assets weren't managed right by the previous management team. The company's ratings are starting to improve. Viacom stations, in the aggregate, have more viewers than ESPN, notwithstanding millennials' penchant for cord-cutting [cancellation of cable service]. The stock potentially could double in three years. The rules are changing in the media business. The industry will consolidate globally.
Schafer: The problems are priced into the stock.
Gabelli: Thank you. A year ago Congress passed the FAST Act—Fixing America's Surface Transportation. Stocks like Astec Industries [ASTE] and Gencor Industries [GENC], which make machinery used in highway construction, surged. If we get more visibility on infrastructure spending, vendors to industrial companies will do well. We like the rental-equipment business, the Uber of the industry. It is a $47 billion business in the U.S., growing at 4.5% a year.

Which stock are you picking?
Gabelli: Herc Holdings [HRI], a rental-equipment supplier, was spun out of Hertz Global Holdings [HTZ] on July 1, 2016. The company is a work in progress, but should have a significant tail wind if the Trump administration launches a big infrastructure initiative. Herc has an Ebitda margin of 38%. The stock is trading for $40, and the market cap is $1.2 billion. Herc has $2.1 billion of debt, courtesy of Hertz, but it isn't overleveraged.
Construction-equipment companies also are well positioned. My pick today is CNH Industrial [CNHI], formerly Case New Holland. The company has 1.36 million shares, and the stock is trading for about $9. Exor, the Agnelli family's holding company, controls CNH, after it merged with Fiat Industrial in 2013. CNH has a large global presence in the construction-equipment business. It is also known for farming equipment and engines. Profits have been slim in the construction business, but that is going to change. CNH recently struck a deal with Hyundai Heavy Industries [009540.Korea] to make mini excavators.

Through the Fiat merger, it owns Iveco, a European truck maker. The class A truck market in Europe is improving. The stock could double in the next two years.
About 10 years ago, I identified the single-serve coffee market as an exciting growth opportunity.

You were hardly alone.
Gabelli: Today, I like the prospects for sparkling water—in particular, National Beverage [FIZZ], which markets LaCroix. The company is based in Florida and has 47 million shares. The stock sells for $49. The CEO, Nick Caporella, is 80.
Sugary soft drinks are perceived to be bad for you, and in some places they're being taxed. But LaCroix has no sugar or additives. Carbonated soft drinks are a $90 billion business, and sparkling water is the fastest-growing subset. It is growing by 30% a year. LaCroix gets significant floor space at grocers, and has a 13% market share in its category.

Cohen: What are the profit margins on this?
Gabelli: Let me give you the math first. The fiscal year ends April 30. National Beverage has been rolling up beverage companies. It bought the Shasta brand—which is popular in the West—and Faygo, and others. Energy drinks are a small part of the business. LaCroix should generate $340 million in revenue this fiscal year, and $90 million of Ebitda, so the profit margin isn't as high as you would expect. The CEO is tax-sensitive. The company declared a dividend of $1.50 a share in late November, but it isn't payable until Jan. 27, after Trump becomes president. If Congress abolishes the estate tax, and the tax on long-term capital gains comes down, would he be likely to sell the company? I doubt it. But eventually Coca-Cola [KO] or PepsiCo [PEP] or Dr Pepper Snapple Group [DPS] will knock on the door.

Mario Gabelli's Picks

Company / Ticker	Price 1/6/17
Viacom / VIA.B	$37.79
Herc Holdings / HRI	40.00
CNH Industrial / CNHI	8.94
National Beverage / FIZZ	49.34
Davide Campari-Milano / CPR.Italy	€9.31
Liberty Braves Group / BATRK	$20.65
Live Nation Entertainment / LYV	27.68
Mueller Water Products / MWA	13.35

Source: Bloomberg

Rogers: Is LaCroix nationally distributed?
Gabelli: Yes, more or less. National Beverage has significant bottling capacity. LaCroix is their premier brand.
LaCroix's revenue could rise to $670 million over the next several years, driving overall revenue to more than $1.1 billion. Shasta is doing okay, and the other brands are small. National Beverage is likely to earn $2 a share this year, rising to $2.45 in the year ending April 2018. Capex is de minimis, maybe $11 million. The company doesn't put money into trucks or delivery routes.

Priest: What is the market cap?
Gabelli: It is about $2.5 billion. We look for new products and new channels of distribution. The one I kick myself for is Amazon.com [AMZN]. If only we'd known Jeffrey Bezos [Amazon's founder] back when he worked on Wall Street.

Moving on to the booze market, known as spirits in the trade, we own Davide Campari -Milano [CPR.Italy]. It is selling for €9.30 and has 580 million shares. The Garavoglia family owns 50% of the company, but it is professionally managed. Management uses cash flow smartly. Campari will have about €2 billion of revenue in the current year. The company owns a number of brands, including Campari, Wild Turkey bourbon, Aperol, and Skyy Vodka. It recently bought Grand Marnier. Campari acquires niche brands globally; they are huge cash generators with high gross profit margins.

Give us the numbers, please.

Gabelli: In 2017, Ebitda including Grand Marnier could total €470 million. The U.S. accounts for 25% of revenue. Italy is also 25%.

Next, millennials want experiences; they don't want goods. They are a sharing society. They go to concerts and other forms of live entertainment. They go to Burning Man and Coachella. Think about Las Vegas, which is undergoing a new life cycle. About 50 years ago, it attracted gamblers. Then it went into the family-entertainment business. Now Las Vegas is a big venue for sports. So, how do you play this?

Mario Gabelli: "We look for new products and new channels of distribution. The one I kick myself for is Amazon.com. If only we'd known Jeffrey Bezos back when he worked on Wall Street." *Jenna Bascom for Barron's*

We're asking you.

Gabelli: Liberty Media [LMCA], controlled by Dr. John Malone, was launched in 2001 as a spinoff of AT&T [T]. I have prepared a family tree for you, showing every company that has Malone's fingerprints. [Gabelli holds up a laminated poster illustrating Malone's corporate "family tree."] This represents $340 billion of equity value. It's not as big as Apple or Amazon, but it is significant. If you had bought a basket of everything Malone touched since 2001, it would have grown at a compound annual rate of 13.5%. That exceeds the performance of the Standard & Poor's 500. Warren Buffett and Malone are the two most tax-sensitive CEOs I have ever encountered. Their philosophy is pay less, pay later, or pay nothing. Buffett doesn't advertise it, but Malone is upfront about it. Malone has about $7 billion of his own money tied up in Liberty-related companies.

Last April, Liberty created a tracking stock called Liberty Braves Group [BATRK], which represents an investment in the Atlanta Braves. Now you can buy a baseball team at a discount. Liberty Braves also has a real estate business that owns 82 acres in Georgia. The stock began trading around $17. It now trades at $20.

Live Nation Entertainment [LYV] is another play on interest in live events. Liberty Media owns 35%. Live Nation has 201 million shares; it closed Friday [Jan. 6] at $27. The company has about $1.8 billion in net debt. It is a concert promoter and ticket seller. It owns Ticketmaster. The company could have about $700 million of Ebitda in 2017.

Is that all, Mario?

Gabelli: Mueller Water Products [MWA] has 161 million shares, and trades for $13. It has no debt.

Witmer: Do you like the management team?
Gabelli: That's why I'm recommending it. They just hired a new CEO from Textron [TXT]. He's taking over a company with $800 million of revenue; $200 million comes from fire hydrants, and $500 million from valves. Ebitda is about $275 million, and capex is $25 million to $30 million. Those are the kinds of things I like. Today, the company announced the sale of its Anvil International piping-system division.
There are so many attractive companies when you think about how a 25% tax rate would boost earnings. We expect more corporate takeovers, too. Romance is in the air.

Let's leave things there. Thanks, Mario.