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Presents: The ValuEngine View
Created by: Eric Stokes

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There seems to be a consensus forming that the stock market is going to continue to enjoy smooth sailing through the first part of this year before encountering headwinds over the summer. If you read through the Barron's Roundtable issue you'll see that forecast more than once. And we can't tell you how many times we've heard that 1200 on the S&P 500 is a foregone conclusion. From last Thursday's high that's only another 4%, so it certainly seems like a reasonable target. But the more often we hear the same script offered up the more skeptical we should become.

ValuEngine doesn't offer a market timing application but one thing we keep track of are the percentage of stocks in the entire VE universe that are undervalued and overvalued. Early in 2009 the percentage of stocks that were undervalued got as high as 94%. Since last spring the number has been dropping and it now stands at 47%. By no means is that an extreme; there have been times when it was quite a bit lower. In June, 2007 only 32% of stocks were undervalued and the market was able to move a little bit higher that year through October. But the undervalued/overvalued % is something to keep an eye on. A more conservative investor might consider overlaying a covered call strategy at this point, especially if the undervalued % continues to drop.

It was a fine month for our portfolio in December with most of our stocks outperforming the S&P. Looking ahead we'll see quite a bit of turnover for January, swapping out of 12 names. In our new configuration we continue to have a mix of growth stocks and more conservative dividend plays. The dividend yield on the January portfolio is 1.6%, with much of that coming from a couple of REIT's, a pharmaceutical firm and a food company. And there are plenty of stocks that should do very well if the market is able to sustain its advance in the weeks ahead, including some potential short squeezes.

December Results

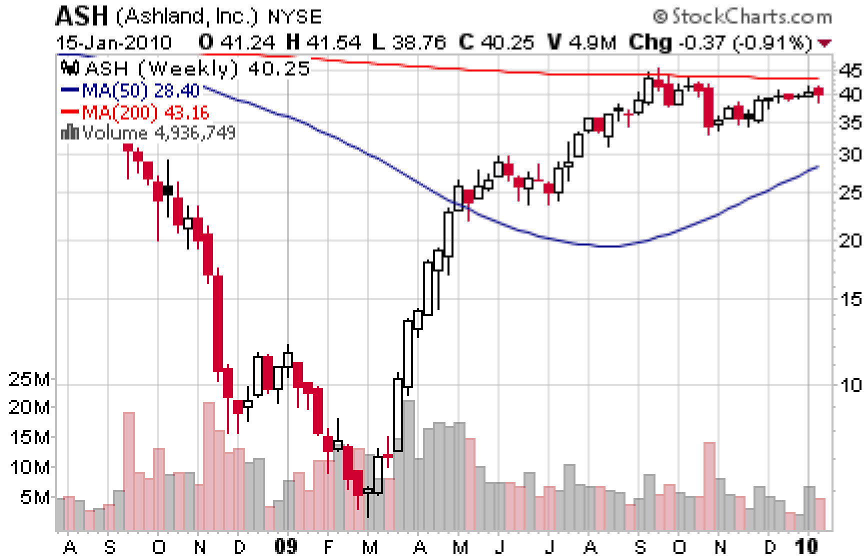
Company Name	Symbol	Opening Price	Closing Price	% Gain / Loss
AES Corp.	AES	$13.67	$14.04	+2.7
Baytex Energy Trust	BTE	$26.04	$30.22	+16.1
Chicago Bridge and Iron	CBI	$19.21	$22.71	+18.2
Cephalon	CEPH	$59.06	$63.10	+6.8
CommScope	CTV	$26.00	$28.61	+10.0
Del Monte Foods	DLM	$11.34	$11.39	+0.4
Deutsche Telekom	DT	$14.86	$14.41	-3.0
Endo Pharmaceutical	ENDP	$19.84	$20.63	+3.0
East West Bancorp	EWBC	$15.08	$16.24	+7.7
Ford Motor	F	$9.39	$11.60	+23.5
HRPT Properties Trust	HRP	$6.35	$6.47	+1.9
Huntsman Chemical	HUN	$10.65	$12.31	+15.6
Quicksilver Resources	KWK	$14.63	$15.63	+6.8
McDermott Int'l.	MDR	$23.55	$24.59	+4.4
Williams-Sonoma	WSM	$22.00	$20.50	-6.8
Portfolio Average				**+7.2**
S&P 500				**+2.5**

The model is retaining three stocks and replacing twelve. The twelve new holdings' descriptions are listed first, followed by the three we are keeping from December. The entire January portfolio is summarized in a table at the end of the newsletter.

The ValuEngine View is edited by Eric Stokes, a money manager and well-known authority on stocks and portfolio construction. He is the author of Market Neutral Investing (2004, Dearborn) and is a Principal at hedge fund Reed-Stokes Capital Partners.

New Buy

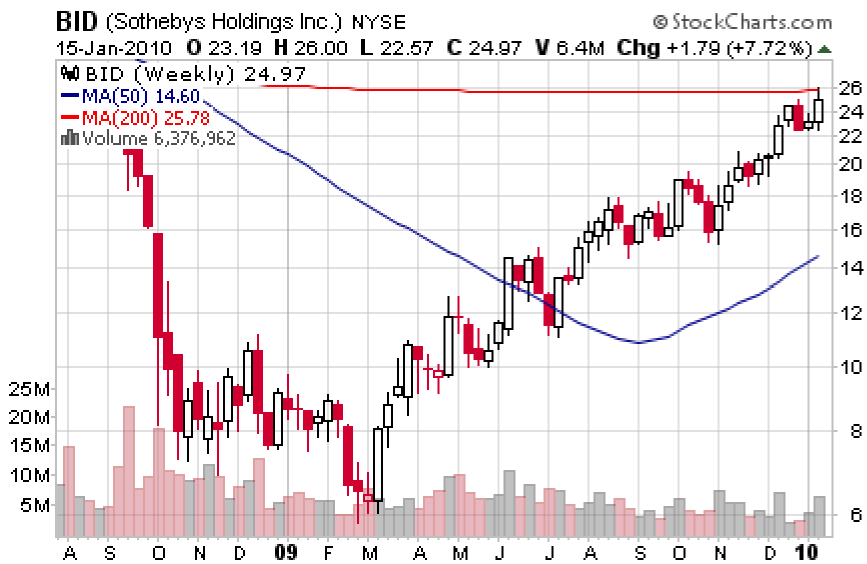
Ashland, Inc. (ASH)



Last month we scored quite well by owning shares of Huntsman Chemical, which we noted at the time was carrying a super-lofty forward PE of 70. This month we move to the other end of the spectrum by taking a position in **Ashland, Inc. (ASH)** which carries the lowest forward PE among major chemical firms. With projected earnings of $3.70/share next year (ending Sept. 2011) ASH has a forward PE of 11, considerably lower than competitors like Dow and DuPont, although a difference in fiscal years throws the comparison off slightly. ASH differs from most of its peers because it has a direct-to-consumer business here in the US under the Valvoline brand. That business is where ASH hopes to generate significant growth in the short-term and it also is one of the highest margin businesses in the ASH portfolio. Roughly one-third of profits come from there but just one-fifth of revenues. The other big opportunity within the company is specialty chemical expansion overseas, especially Asia, where only 8% of revenues are generated at present. Like most chemical firms ASH has cut expenses heavily over the past year so any uptick in demand will have an outsized impact on profits. The dividend yield is 0.7%.

New Buy

Sothebys Holdings (BID)



2009 won't exactly go down as a banner year for the collectible art market. The two biggest firms that make a market for high-end art, Christies and **Sothebys Holdings (BID)**, saw auction sales declines on the order of 50% last year. And that's not good when your business model relies on taking a cut of the proceeds. But there are signs of improvement on the horizon, especially among non-US collectors. Asian buyers in particular have started to become more active as the wealth creation taking place in China finds an outlet. And part of the appeal in owning fine art (and wine) is that it can serve as an inflation hedge. An example of early signs of strength in art was displayed at an important auction in November; the sale brought in 20 – 30% more than estimates and bidding was extremely competitive. It has been those sort of firming auction results in the last several months that has led analysts to become more bullish on BID and the consensus view today is for a 200% increase in earnings this year. That would put EPS at exactly the same level as 2008. With a forward PE of 45 or so shares of BID don't come cheap but the earnings estimate trend is clearly up. In the last two months projections have increased by over 60%. A couple of more strong auctions could force those numbers higher again. The dividend yield is 0.8%.

New Buy

Corn Products Int'l. (CPO)

There are plenty of stocks in our portfolio this month which have demonstrated remarkable price momentum in the past weeks and months, but **Corn Products International (CPO)** is not one of them. The share price isn't much changed from where it was a year ago, although there have been plenty of ups and downs in-between. We took a one-month try with CPO back in October and the stock is now down almost 10% from that original entry point. Nor has competitor Archer Daniels performed particularly well over the last several months. The lack of enthusiasm reflected in CPO's stock price belies a strong forecast for 2010. The consensus view is for 33% earnings growth this year (better growth than was predicted last October) and a forward PE of 11. That PEG ratio of 0.33 is notably low, and far more attractive than Archer Daniels' as a point of comparison. The final results for 2009 are not yet in of course but while earnings will be down by almost half from 2008, cash flow should be at an all-time high. The company has reduced debt by 30% through the 3rd quarter and will enter 2010 with a fairly low debt-to-equity ratio. Finally, we note that in the third quarter CPO attributed approximately $50M of lower sales to unfavorable foreign currency translations. Since the US dollar was notably stronger in December perhaps it will help results in the 4th quarter. CPO pays a dividend yielding 2%.

New Buy

Convergys (CVG)

As one of a number of information technology services firms (like IBM or Amdocs or Informatica) **Convergys (CVG)** probably isn't the most exciting company in our portfolio but it has some other redeeming qualities. CVG is primarily focused on customer relationship management (CRM); DirecTV, for example, contracts with CVG to handle its customer service/support. CVG is hoping to gain traction among electric utilities by providing support to the so-called smart grids being rolled out across the country. In 2008 CVG acquired Intervoice in order to beef up its automated CRM solutions as the company began moving away from the human resources technology market. The idea is that CRM will generate higher margins than HR. It is true that operating margins at CVG are among the lowest in the industry so investors are watching this metric closely to see if management can turn it around. If there are signs of improvement then the current forward earnings multiple will certainly expand from its mid-9'ish level. For CVG to achieve forward earnings parity with similar companies, where multiples typically range from 12 to 18, the stock price would have to rise to at least $14/share. There is a fairly large short interest in the stock that could also help boost the price in the event of a turnaround.

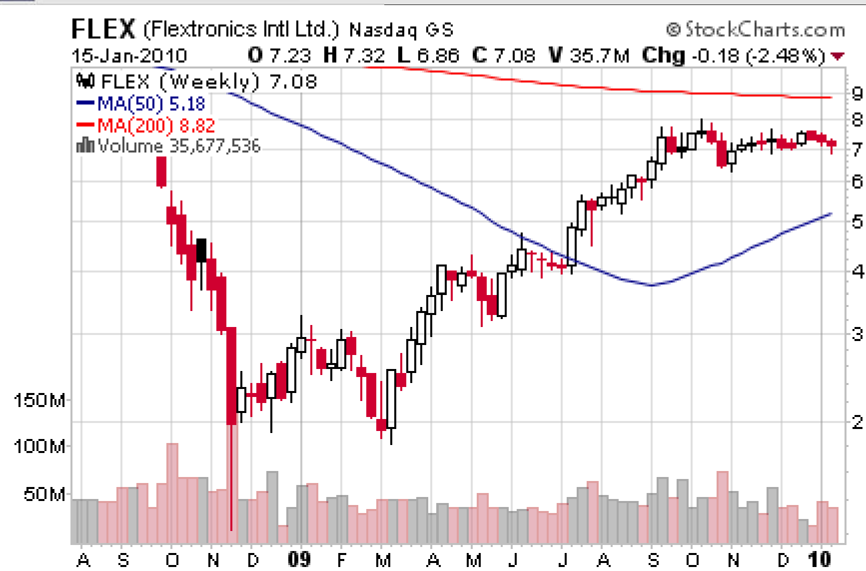
New Buy

Digital Realty Trust (DLR)

Real estate investment trusts typically come in a couple of different flavors but **Digital Realty Trust (DLR)** is unique – not vanilla, not chocolate, but perhaps the Butter Brickle of REITS. Instead of investing in retail space or office space, DLR owns and leases space for data centers. It's a nice theme because of the underlying growth trend for on-line services and computing in general. Barron's had a cover story recently that waxed on about "cloud computing", i.e., less computing taking place on the desk-top and more taking place in remote data centers with the results delivered over a network/the internet. DLR is a less well-known way to invest in that phenomena versus the technology companies one usually hears about. The health of the niche can be seen in the earnings posted by DLR, which will probably be up 10% this year and are forecast to rise 13% next year. An increase in earnings for 2009 and a forecast for one next year is an extremely rare case among REITs; indeed, we couldn't find another example. So it's not surprising that DLR carries a modest valuation premium. A number of competitors trade at 13 or 14X 2010 estimates while DLR is at 15X. That seems like a worthwhile trade-off, i.e., paying a little more for a company as well-run as DLR. The yield is 3.6%

New Buy

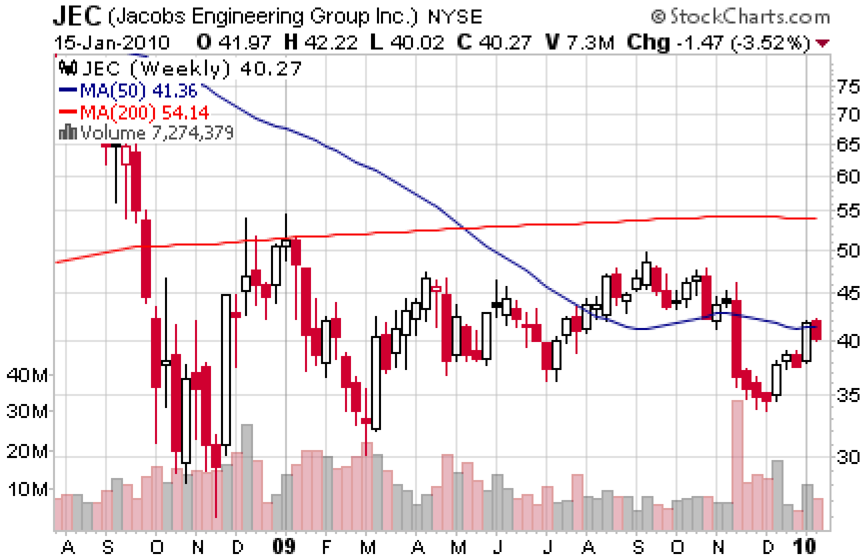
Flextronics (FLEX)



We had a brief encounter in November with **Flextronics (FLEX)**, the contract mega-manufacturer of all things electronic. The share price is almost exactly where we last left it, as there have been no catalysts to spark a move in either direction. The current year (ending March 2010) is a transitional one in that FLEX will see a shift in revenues away from telephone handsets, although that segment is still 17% of revenue, and more toward infrastructure equipment for customers like Cisco, Huawei, and others. It also marks FLEX's first material decline in revenues since the company was founded in 1994. Next year FLEX is widely expected to boost sales by 10% and earnings by 40%. Doing so would generate a PE of about 10, lower than all of its major competitors, like Sanmina, Jabil, and Plexus. That low relative valuation is also attributable to the fact that over the past six months FLEX stock may have outperformed the market but it has underperformed its peers. FLEX would like to further diversify its customer base and has taken some steps to increase its presence in the medical device market, including the recent acquisition of a Slovakian medical equipment firm: SloMedical (perhaps a name change is in order). But ultimately it will take continued improving demand for servers, televisions and handsets to see a nice upturn in the shares.

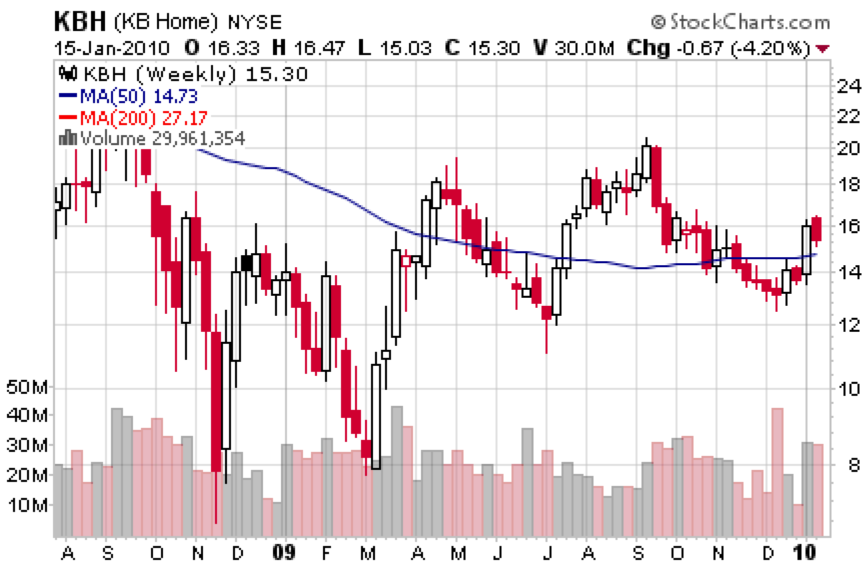
Detailed reports with quantitative stock analysis for these and other companies are available at http://www.ValuEngine.com

New Buy — Jacobs Engineering (JEC)



The heavy construction/engineering sector has been on a roll the last few weeks and we've enjoyed participating through ownership of Chicago Bridge and Iron. Now we are adding another name from the group: **Jacobs Engineering (JEC)**. This firm has broad exposure to a range of construction categories, from roadbuilding to water supply to oil and gas projects. It seems like investors have been waiting forever for proof that government-funded infrastructure money has started to flow. That may be the spark that has ignited this sector beginning in December. Indeed, one of the last contract announcements made by JEC was an award for a Los Angeles highway project that is funded by federal stimulus money. While all of these construction companies have run up recently, JEC has been lagging a bit, mostly attributable to a poor earnings announcement in mid-November. A major project cancellation reduced the backlog of work, but it still stands at $15B. With about one-third of revenue coming from the public sector JEC stands to benefit from the flow of federal dollars. Analysts expect earnings to climb 14% next year, one of the better growth numbers in the group. With over $8/share in cash it's surprising that JEC does not pay a dividend. Maybe they'll start one of these days.

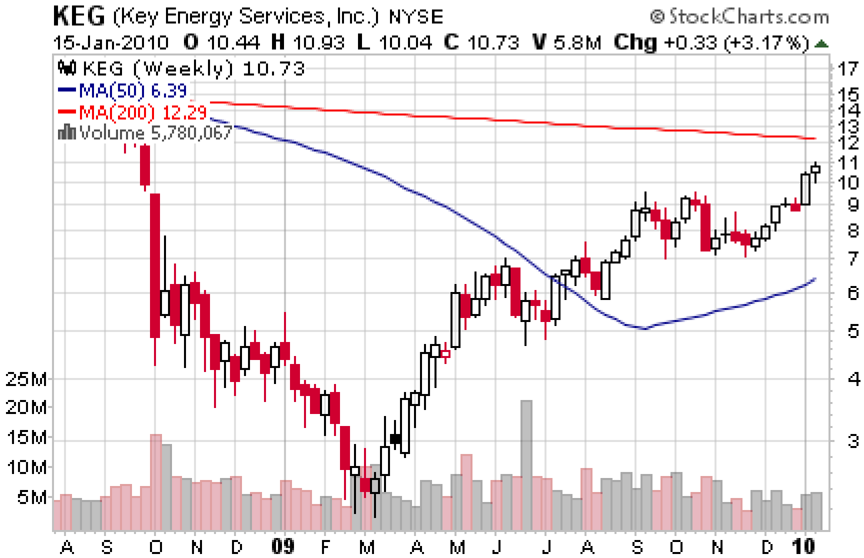
New Buy — KB Home (KBH)



Is it time to step into the home builders? Our model thinks so. Economic data on housing is mixed of late; the most recent pending home sales and new home sales releases were disappointing. But surprisingly the home builder stocks and **KB Home (KBH)** in particular have shrugged off the news. It helped that competitor Lennar announced a surprise profit earlier this month. For 2010 it's hard to describe the outlook as a recovery since KBH is still expected to lose money. But it should be a lot less money; for the quarter just ended last November the company reported a $1.31/share profit but that was because of a tax benefit. The loss for the year was -$1.34/share. Next year that could improve to a loss of -$0.64/share. Anecdotal evidence supports the thesis that new-home pricing is stable; not rising but holding steady. That combined with write-downs already taken makes KBH a candidate for upside surprises. Since the firm's strategy is to target first-time buyers KBH is in an especially good position to benefit from federal tax credit subsidies for buyers, which have now been extended through April. And the federal government is upping its largesse by offering sizable tax refunds to the builders. Finally, with a large short interest (over 20% of the float) we could see a flurry of short bets getting covered in the weeks ahead if the shares can push a little higher. The yield is 1.6%.

New Buy

Key Energy Services (KEG)



It would be an unusual month if we didn't have at least one position in the energy sector. After a great run with Quicksilver in December we are switching to a horse of a different color: **Key Energy Services (KEG)**. Rather than owning and operating wells KEG is a contractor servicing on-shore rigs. It's a smaller version of better-known Halliburton. In the US market KEG holds almost 30% of the land rig servicing business and it is expanding into Russia and Mexico. Because it's a servicer, oil/gas prices impact results less directly than for a company that owns the underlying commodity. Higher oil prices tend to generate more drilling activity but servicing contracts don't necessarily get signed or dropped in any immediate fashion. So while there is some correlation with oil prices, the relationship is a bit "stickier" with KEG. Estimates for 2010 currently call for KEG to make $0.03/share, which in itself is not so impressive. However, it also represents the highest earnings growth rate of any oil well servicer with a market cap of over $1B. In the last earnings call management was cautious but did say that in the 3rd quarter there was more customer activity at the end than at the beginning – the first time that's been true for awhile.

New Buy

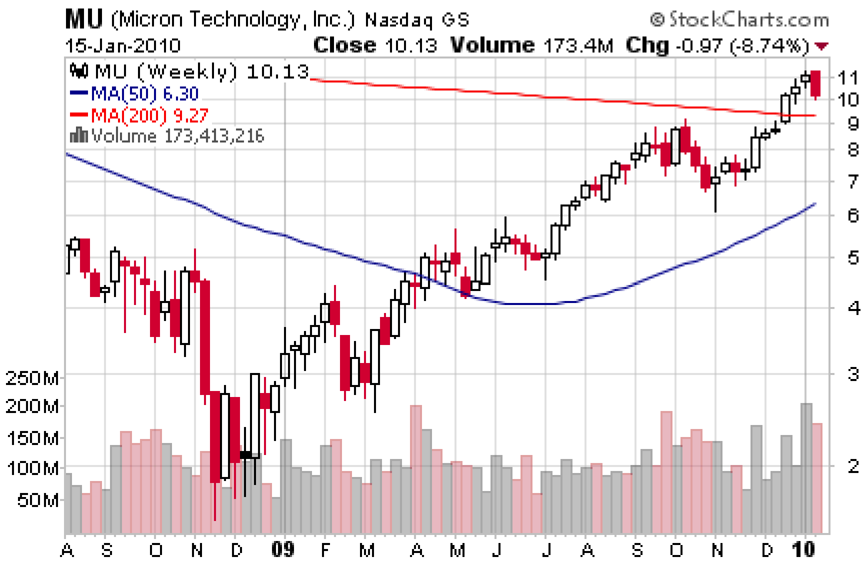
Eli Lilly (LLY)

Plenty of companies still carry eponymous names: John Deere, Procter & Gamble, Ford. Then there is **Eli Lilly (LLY)**, named after its Civil War veteran and chemist founder. In a sector dominated by companies with market caps of over $100B, LLY ranks on the smallish side, but it's a big company by any other standard at $40B. It's also big enough to not have any particular niche, with drugs ranging from schizophrenia treatment to cardiovascular disease to animal health products. In part because of its broad portfolio, LLY has demonstrated excellent stability on the earnings front. EPS should be up 10% this year and estimates are for another 7% rise in 2010. As with any pharmaceutical firm the market is always looking ahead to the next big drug and worrying about past winners coming off patent. In LLY's case the worry is about its schizophrenia drug Zyprexa but the FDA recently approved an "extended release" version that should extend the revenue stream as well. Valuation is on the low side relative to its peers. Of the top 10 US pharmas LLY has the next-to-lowest forward PE at 7.5. Competitor Johnson & Johnson for example trades at almost double that multiple at 13X 2010 earnings and has similar growth expectations. LLY pays a nice dividend yielding 5.5%.

Detailed reports with quantitative stock analysis for these and other companies are available at http://www.ValuEngine.com

New Buy

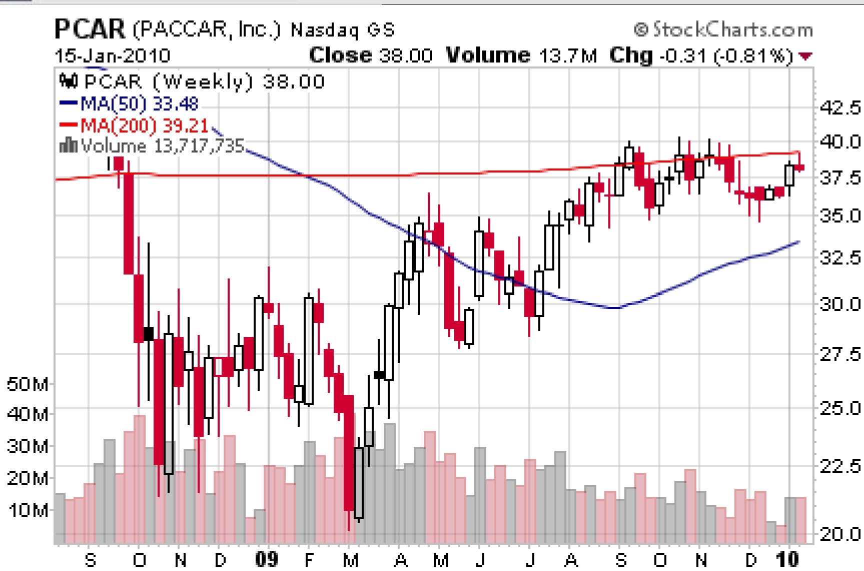
Micron Technology (MU)



Micron Technology (MU) is in a tough business: manufacturing DRAM and flash memory products for PC's and mobile devices. Since RAM tends to be a commodity product MU isn't always in control of its own destiny, but rather has to ride the waves of demand as they unfold. Earnings tend to be volatile as the demand cycle changes and it appears at the moment as though we are in a favorable period for pricing. DRAM prices were over 200% higher in November than at the beginning of the year and then pulled back some in December. Of course underlying the business is a healthy increase in application requirements for memory. In 2004 the average PC had 413MB of RAM and this year it will be over 3000MB. But from one quarter to the next earnings are extremely dependent on the supply/demand equation. Three months ago estimates for 2010 (ending in August) were calling for $0.21/share. Now that number has been pushed up to $0.89/share. The stock is (only!) about 25% higher over the same period, giving MU a lower valuation than it had in October. Just remember this is not a “widows and orphans” kind of holding. The historical beta is only slightly over 1 but last Friday's sell-off of over 5% (and down 8.7% for the week) demonstrates what can happen when traders decide to exit the train quickly.

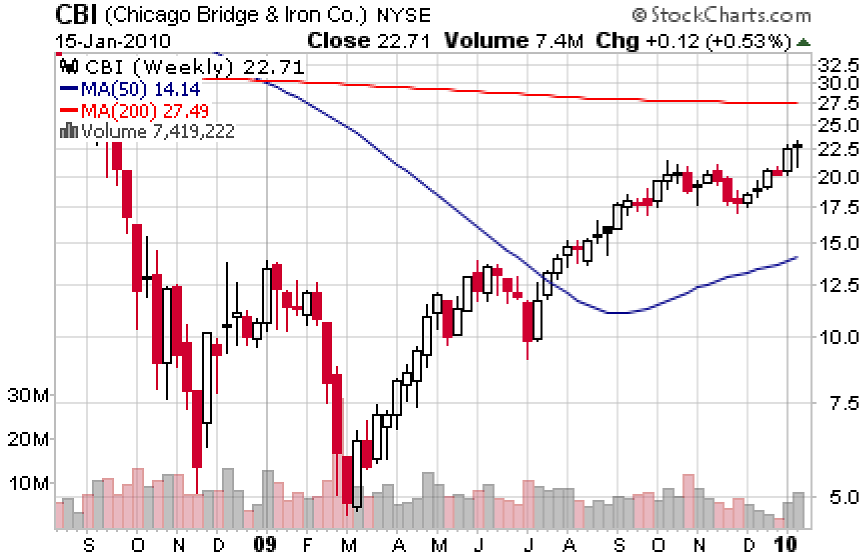
New Buy

PACCAR (PCAR)



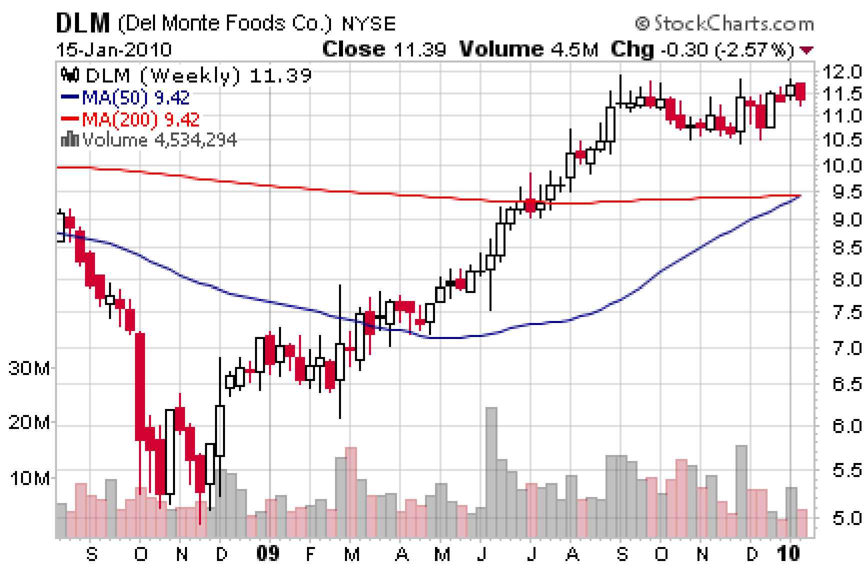
You may or may not be familiar with **PACCAR (PCAR)** but you surely know its brands: Peterbilt and Kenworth. Previously known as Pacific Car, PCAR is a leader in manufacturing heavy-duty trucks (it also has a much smaller business in industrial winches). Year-over-year sales results have been very poor, falling by 50% in the 3rd quarter of last year versus Q3 2008. With 2009 earnings expected to come in around $0.22/share the current PE is an astounding 172. Even using next year's estimates of $0.91/share the forward PE is over 40. So PCAR is hardly a value stock and is probably the most deeply cyclical of all our holdings. Our model is putting an emphasis on the earnings growth rate for next year which is projected at 300%. A high forward PE can be rationalized if the growth trajectory is sufficient, as captured in the PEG ratio. For PCAR the ratio is quite low at 0.13. However, the investment world is filled with unbelievers. As with a couple of our other stocks, the short interest on PCAR is enormous when measured by the short ratio - the number of days of normal trading it would take to cover the short positions. As of Dec. 31 the ratio stood at 12.6, the highest its been in a year. That's a big number for such a heavily traded stock. Though modest, PCAR pays a dividend of $0.36/share or 0.9%.

Retained — Chicago Bridge and Iron (CBI)



Chicago Bridge and Iron (CBI) is a global engineering and construction company with most of its work coming from outside the US. Of the last few major contracts it has been awarded, one was in China, one was in New Guinea, and one was in Colombia. And the firm does not build bridges. Instead, CBI is an infrastructure play with a specific focus on energy-related projects. The work awarded to CBI is typically along the lines of building a liquid natural gas (LNG) facility or a refinery. Near-term, LNG work is promising because it plays to one of CBI's strengths, building gas storage tanks. And while the opportunity here in the US for LNG facilities is questionable, LNG is gaining acceptance in Europe and Asia. Last year and this year have been tough for the company. In 2009 revenues are expected to be down 20% from the prior year but earnings should come in at $1.77/share (giving CBI a PE of 13 or so) versus a $0.22/share loss in 2008. In 2010 the current consensus if for a further 4% decline in revenues and no change in earnings. But it wouldn't take too many contract awards to improve the outlook, as we've seen over the last few months. On a comparative earnings valuation basis, CBI has reached parity in recent weeks with companies operating in the same space: Foster Wheeler, Fluor, KBR, and Shaw all trade at forward earnings ratios of 12 to 14.

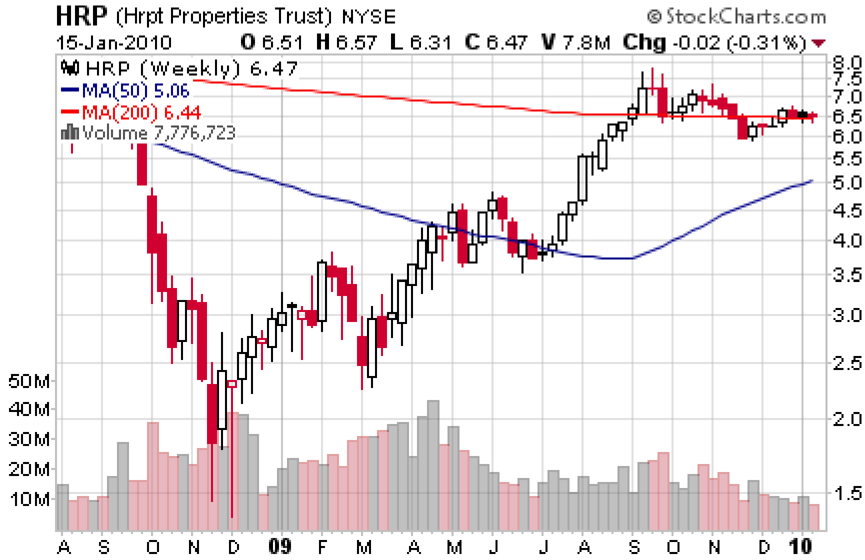
Retained — Del Monte Foods (DLM)



Our model has been bullish on **Del Monte Foods (DLM)** since last summer and with good results. Products at DLM are divided between commodity-type products, namely fruits and vegetables, and branded products like Star Kist tuna, Contadina tomato sauce, 9 Lives cat food and Milk-Bone dog treats. The company tends to dominate its categories. Every quarter since it has been in our portfolio the company has issued surprisingly good earnings reports. December 3rd was the third in a row. In addition, last summer DLM announced it was increasing its dividend to $0.20/share. All the good news really stems from the fact that DLM has been able to institute price increases for many of its products and consumers have kept buying. A quick review of the major food companies suggests that at the current valuation, DLM is priced at the low end of the spectrum even after a smart turn up in the stock price over the last few months. Certainly the stock is more fully valued than it was when we first looked at it in early summer. But shares are still selling for about 10.5X next year's earnings, below the industry range of 13 to 16, and suggestive of some price appreciation. One cautionary note: the consensus view for this year is $1.06/share, which is above the $0.98 - $1.02 range offered by management (excluding one-time items). It's possible the analysts have gotten ahead of themselves, a development worth watching prior to the next release. The dividend yield on DLM shares is 1.7%.

Retained

HRPT Properties Trust (HRP)



How many stories have you heard over the past year about the impending problems associated with commercial real estate? Probably dozens if you follow the markets very much. That backdrop makes it a bit tough to own a company like **HRPT Properties Trust (HRP)**. HRP is focused on office and industrial space, which is widely available. Lease commitments are harder to get, and rents are down. When HRP last reported its results management noted that 88% of its available space was leased versus 90.6% a year earlier. Same with rents: renewal leases averaged rates that were 3% lower than in the corresponding quarter ending September, 2008. Not a growth story. But it's also not a story of abject failure either. Earnings in 2009 will probably be about flat and the current consensus for next year, though more speculative, calls for a 4% decline. But at a forward PE of 6 and a price-to-book value of 0.55, this may be a stock that is priced for disaster. We couldn't find a REIT with a market cap over $1B and a lower price-to-book valuation, or one even close. There are a couple of things going for HRP. The company continues to generate positive cash flow, which it has been using, in part, to reduce debt (of which there is, unfortunately, plenty). And it has also been good about paying a hefty dividend to investors. The current yield is 7.4% or $0.12/share quarterly.

Detailed reports with quantitative stock analysis for these and other companies are available at http://www.ValuEngine.com

The table below summarizes all of the above holdings and reflects an equally weighted portfolio with $1,000 invested in each stock using Friday's closing prices. Stocks in **bold** letters are new positions.

January Portfolio

Company Name	Symbol	Price	Number of Shares
Ashland	**ASH**	**$40.25**	**25**
Sotheby's	**BID**	**$24.97**	**40**
Chicago Bridge and Iron	CBI	$22.71	44
Corn Products Int'l.	**CPO**	**$29.75**	**34**
Convergys	**CVG**	**$11.61**	**86**
Del Monte Foods	DLM	$11.39	88
Digital Realty Trust	**DLR**	**$50.00**	**20**
Flextronics	**FLEX**	**$7.08**	**141**
HRPT Properties Trust	HRP	$6.47	155
Jacobs Engineering	**JEC**	**$40.27**	**25**
KB Home	**KBH**	**$15.30**	**65**
Key Energy Services	**KEG**	**$10.73**	**93**
Eli Lilly	**LLY**	**$35.82**	**28**
Micron Technology	**MU**	**$10.13**	**99**
PACCAR	**PCAR**	**$38.00**	**26**

To summarize, we are selling: AES, BTE, CEPH, CTV, DT, ENDP, EWBC, F, HUN, KWK, MDR and WSM

And, we are purchasing: ASH, BID, CPO, CVG, DLR, FLEX, JEC, KBH, KEG, LLY, MU, and PCAR

VE View subscribers can have their portfolio automatically traded by the independent trading firm Ariston Advisors. Visit www.AristonAdvisors.com or call 877.776.9630 to learn more.

The ValuEngine View newsletter is the product of a sophisticated stock valuation model that was first developed by Yale Professor of Finance Zhiwu Chen and his coauthors. It utilizes a three factor approach: fundamental variables such as a company's trailing 12-month Earnings-Per-Share (EPS); analyst consensus estimate of the company's future 12-month EPS; and the 30-year Treasury yield. These elements are all combined to create a more accurate reflection of a company's fair value than is typically available. A total of eleven additional firm specific variables are also used.

The ValuEngine View portfolio is constructed by integrating this model along with some basic rules for market capitalization and industry diversification. The portfolio has 15 stocks and is balanced once each month. Note that the newsletter is published in the middle of each calendar month. An equal amount of capital is allocated to each stock. The monthly returns are calculated from the closing prices on date of publication. The performance calculation does not include any transaction costs.

ValuEngine can be contacted for any questions or membership issues by calling (800) 381-5576 or email support@ValuEngine.com