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MESSAGE TO CEOs: MARKET REWARDING MORE AGGRESSIVE CAPITAL ALLOCATION DECISIONS

Business history has shown that, given enough time, arrogance, and money, your average CEO can destroy far more shareholder value than any normal human being could think possible. This may be one reason so many of our clients in the long-only community have become so frustrated with the current penchant for companies to hoard cash rather than to come up with creative ways to grow earnings or, Ye Gods, give it back to its owners in the form of a dividend. As in most things in life, anticipation is often more intense than reality. And after a difficult decade for finance marked by scandal and crisis, investors have come to see fiscal imprudence as the default expectation in the absence of well-reasoned plans for capital allocation. This, by our lights, is one of the main reasons the market is having a tough time garnering a multiple of much greater than 13x earnings despite record low yields and the strength of corporate profits. Said another way, the low multiples reveal a sneaking suspicion that idle hands and excess cash are likely to do the devil's work; that sooner or later, somebody's going to do something stupid.

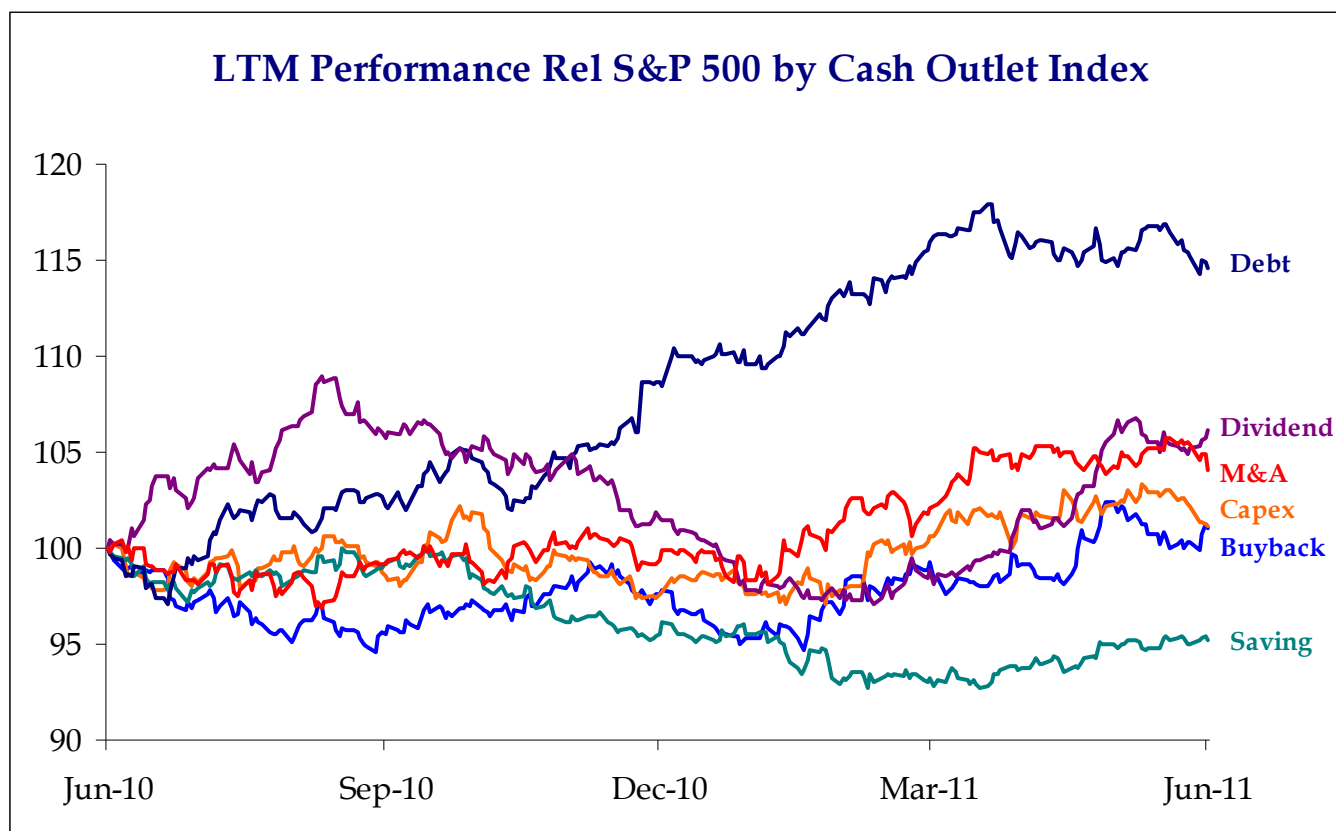
An analysis of the various potential uses for cash over the last year suggests that investors are increasingly rewarding companies who use it to pay down debt or increase dividends, bestowing little credit on those companies who buy back stock, and punishing, albeit slightly, those that simply stuff it under the mattress.

If these trends continue, we believe this is a profoundly positive development for those who believe in equities as long duration assets.

LTM Relative Performance by Cash Outlet (S&P 500 Cos. ex Fin.)

Outlet	Rel. S&P 500
Debt Reduction	14.6%
Dividends	6.2%
M&A	4.1%
Capex	1.1%
Buybacks	1.1%
Saving	-4.8%

For even the most hard-boiled world-weary portfolio manager accustomed to life's great ironies, it remains a mystery why investors will lend Wiener and Co. money for 10 years at less than 3% interest (more than 33x earnings) but are unwilling to pay more than 13.1x earnings for Apple, arguably one of the greatest and, at least for now, dominant consumer products companies in history. In a world in which Mexico can issue 100-year bonds at a 6% yield, it would make sense that more and more companies might see yield as an important component in the price investors are willing to pay for their equity. (No offense to our friends South of the Border, but we would take the under on Mexico in a hundred years.) Little by little, it seems, investors in equities are taking a somewhat more traditional view of stocks as both a source of capital gains *and* income. Eliminating the discriminatory tax treatment of dividends has greatly aided in this rediscovery, as, no doubt, has the past lost decade of equity returns. Investors buy equity for growth and yield, not to hoard cash and imitate bad banks that take deposits and make no loans or bad money market funds that take cash and then squander it. For the investor interested in such capital defenestration, there is, sadly, no shortage of other pure plays. The true investor in equities wants the company to take its capital and grow it or, in the absence of good alternatives, give it back to owners who can make their own capital allocation decisions.

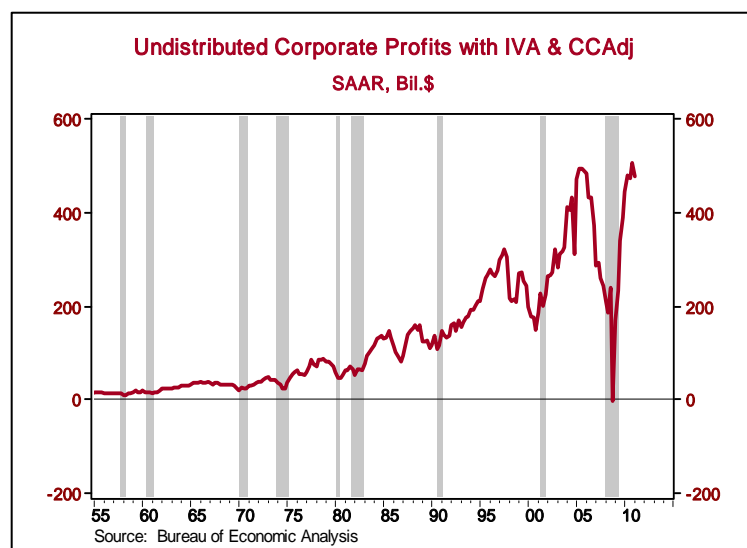
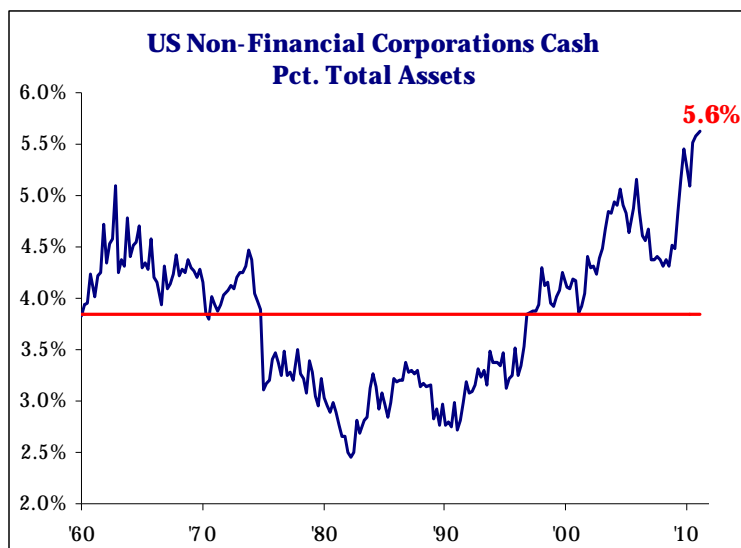


**Analysis includes S&P 500 companies, ex Financials. Indices were constructed by taking top 25 companies by LTM cash outlet as % market cap.*

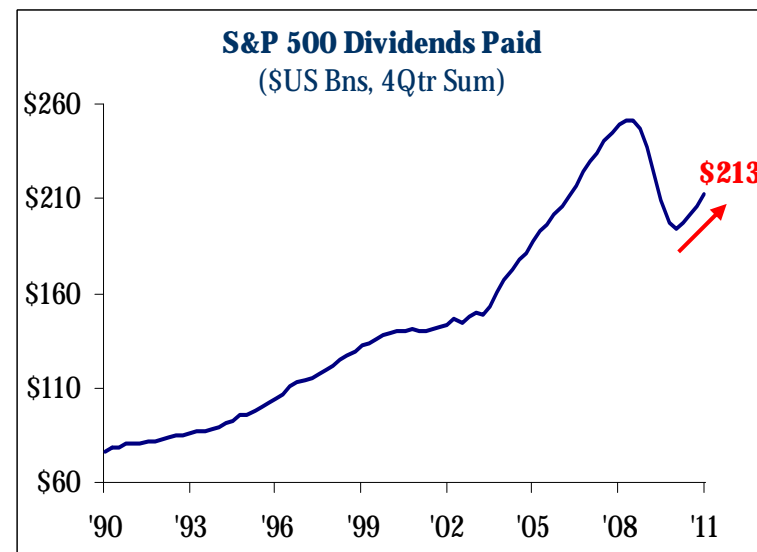
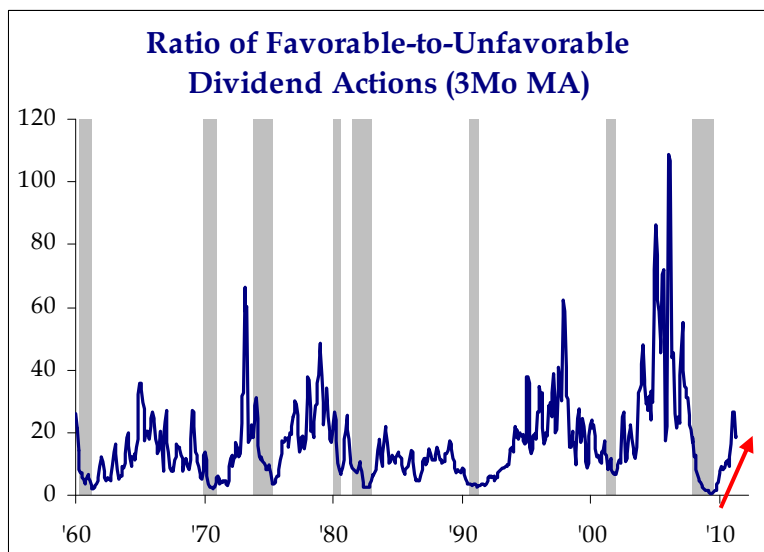
A world marked by financial repression in coming years will, in our view, only strengthen the importance of dividends in the context of total return, while buybacks will be likely to enhance the reputation of corporate treasurers as poor market timers during a period in which business cycles are likely to be shorter. M&A can, of course, be trickier. While outsized M&A transactions often destroy shareholder value, strategic acquisitions might make a lot more sense in the context of today's attractive valuations. Ultimately, the good news is that the natives are growing restless and there are signs that the Administration is interested in providing some impetus for companies to use their cash in more productive ways.

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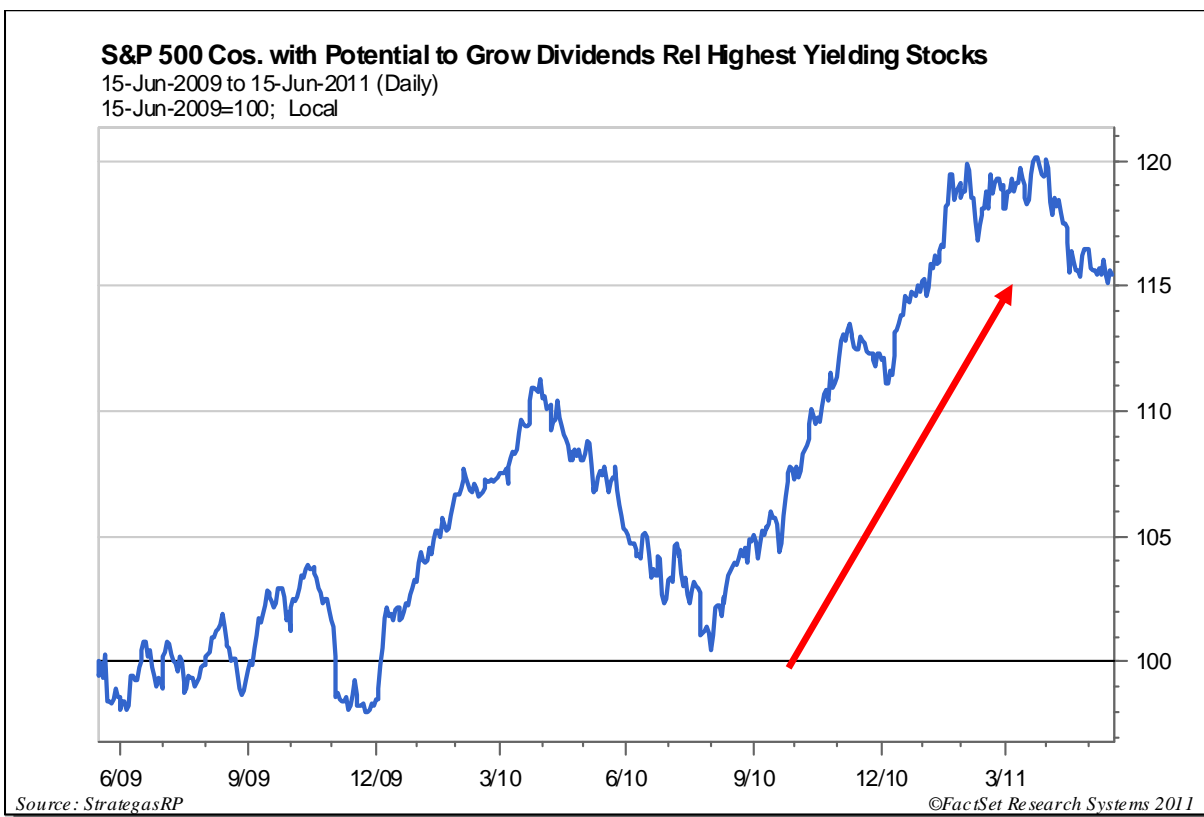
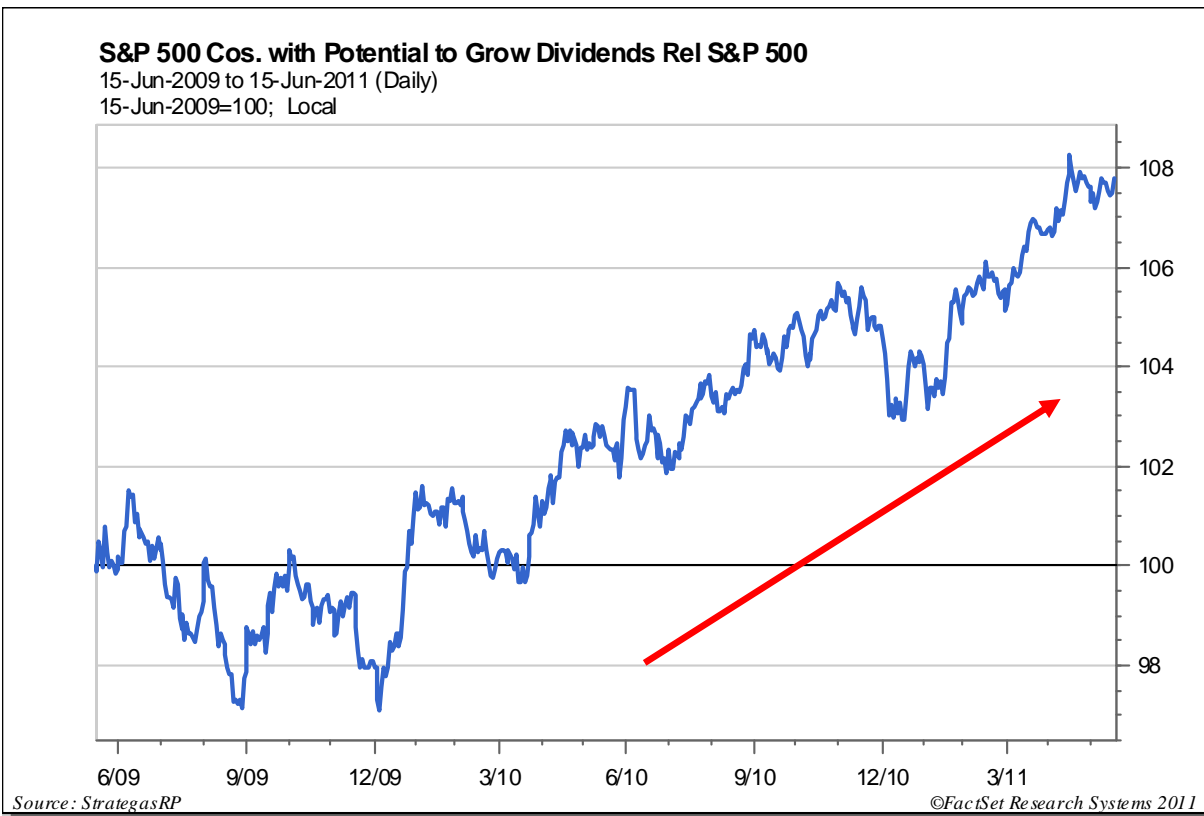
1. Saving (Hoarding)



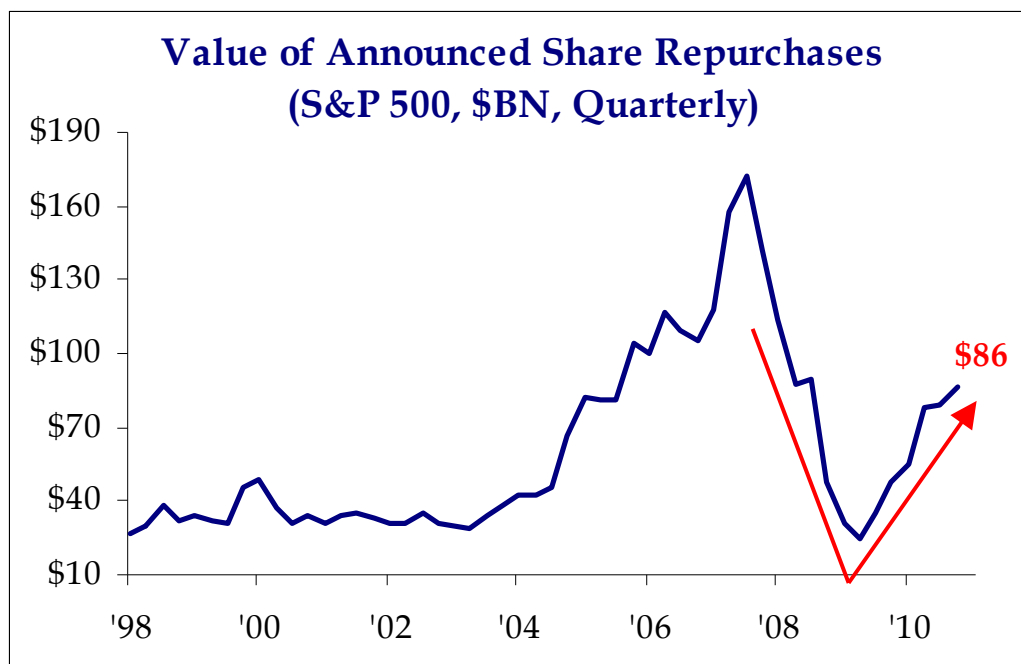
2. Pay Dividends



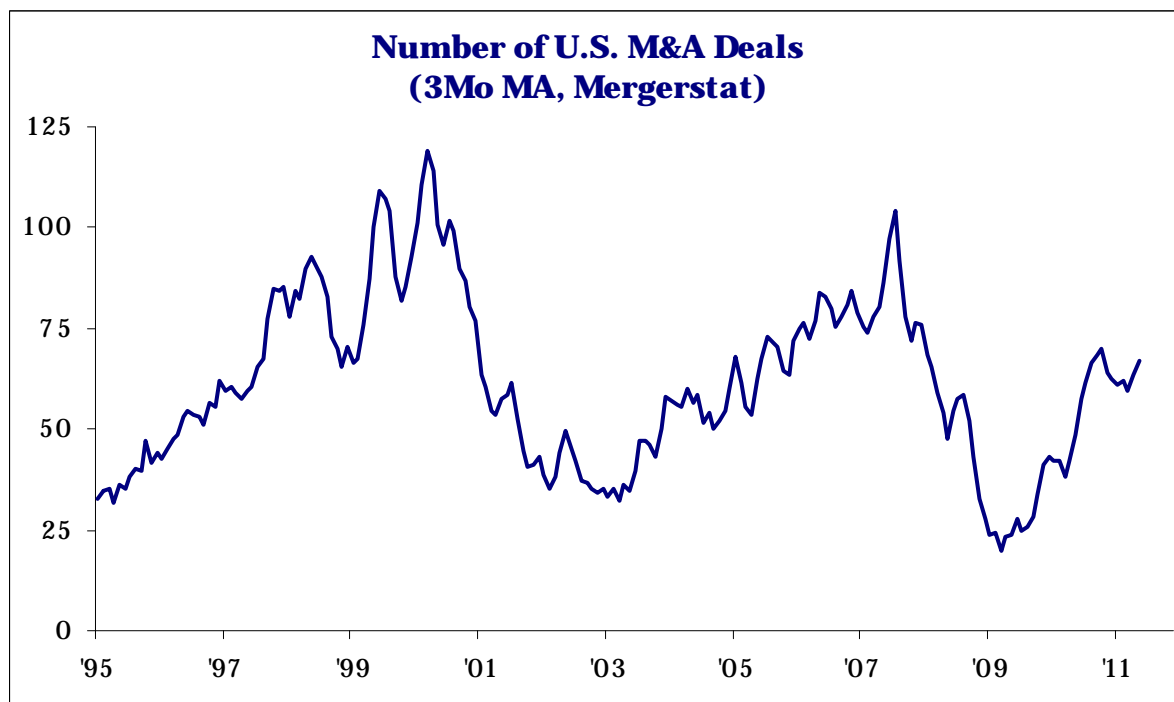
“DIVIDEND GROWERS” HAVE OUTPERFORMED BROADER MARKET AND HIGHEST-YIELDING DIVIDEND STOCKS



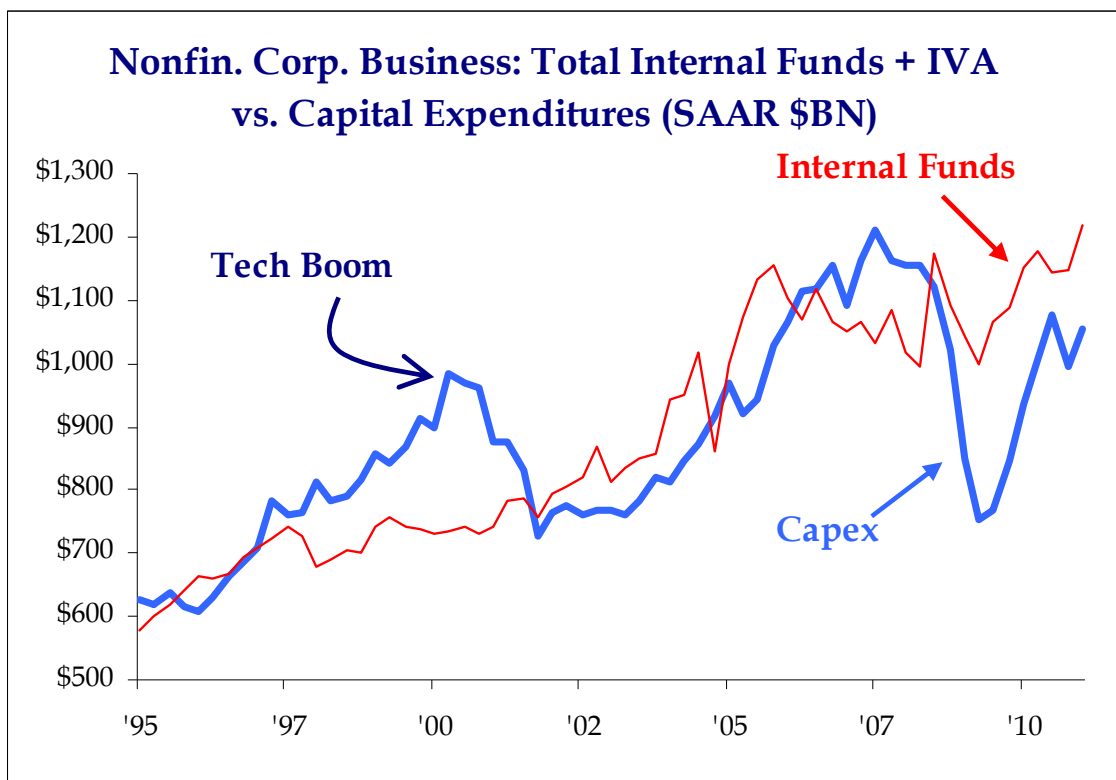
3. Share Repurchases



4. Acquisitions



5. Capex



6. Debt Reduction

