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Weakening Force Fields: Markets Drop 5%

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The S&P 500 fell through its 50-day moving average last week, a not particularly auspicious sign. Nor is the reaction to a German bond sale. Low holiday-week volume is somewhat mitigating. Next week, eyes will be on November U.S. payrolls and purchasing managers' activity.

Vital Signs

Maybe it was the passing menace of the large asteroid Nov. 8 or the more recent Leonid meteor showers. Probably, however, the widening, seemingly never-ending European-debt crisis has been a major drag on stocks, which fell again last week, big-time.

Neither were investors happy about the congressional supercommittee's failure to produce a federal debt-reduction deal, although that denouement was about as surprising as post-Thanksgiving indigestion.

Low holiday-week trading volume somewhat mitigated the blow, but a nearly 5% drop is still painful.

The Dow Jones Industrial Average fell 564 points, or 4.8%, last week, to close at 11,231.78. The Standard & Poor's 500 Index slid 57 points, or 4.7%, to end at 1158.67. And the Nasdaq Composite lost 131, closing at 2441.56, off 5.1%. The 7% market slide so far in November is beginning to make October's energizing 11% rise seem like a head-fake by Mr. Market.

Growth in U.S. third-quarter gross domestic product was revised downward last week to a 2% clip, from 2.5%. Investors, who have already marked down

European growth to zero or negative, are having trouble estimating whether the U.S. will keep its head above water, says Kimberly Forrest, senior equity analyst at Fort Pitt Capital Group. Forrest expects the U.S. to "limp along, with neither recession nor great growth....Neither [the] top line nor bottom line will move that much. It's not a great outlook, but not terrible." November data for nonfarm payrolls come out this Friday from the Labor Department; the national purchasing managers' November activity report hits Thursday.

As for Europe, eyes are on Italian bond yields, at an unsustainable 8%—but investors should fix their gaze on Germany. The 10-year bund futures sold off last week, after one of the poorest auctions in years, and yields rose sharply. While there were some technical reasons for this, it shows nascent worries about Germany's vaunted credit quality. In particular, any Europe-wide bond solution, which Berlin is against, will leave Germany paying the biggest price to save the euro. An optimistic read of this, adds Dan Greenhaus, chief global strategist of investment firm BTIG, is that maybe the bond market is sniffing out a sovereign-debt deal, one that would save the euro, but inevitably cost Germany dearly.

In the way of technical indicators, the S&P 500 fell through its 50-day moving average last Monday, a not particularly auspicious sign. Doreen Mogavero, CEO of brokerage Mogavero Lee, says the individual investor isn't much participating in the market and that the institutional investors are for the most part putting on short-term trading strategies. For the S&P, 1160 was an important support level, adds a bearish Mogavero, who says that poor sentiment means that a test of September's 1096 low is possible.

SHARES OF DIAMOND FOODS fell 25% last week, on the death—reportedly suicide—of Joseph Silveira, a director and member of the board's audit committee, which is investigating grower payments made by the walnut farmers' cooperative. Diamond's stock (ticker: DMND) has been hurt by recent skeptical stories in *Barron's* and The Wall Street Journal about those payments. *Barron's* has said that the timing of the payments artificially flattered its gross margin (**"Getting to the Nut of the Problem,"** Nov. 7).

IT'S BEEN TOUGH TIMES for some big names in the alternative-energy space lately. Solar stocks are down, and the closely held solar-panel maker Solyndra's bankruptcy has dominated headlines. Shares of **Vestas Wind**

Systems (VWSYF) have fallen all year on poor results, and are near lows. Government budget cuts here—and more so in Europe—loom large for the subsidies needed in a range of alternative-energy technologies.

So why are the shares of premium electric-car maker **Tesla Motors** (TSLA) near highs? They've outpaced the market by 18% this year, and are up nearly 60% since July. It's not as though this eight-year-old car company is showing an astounding performance. Its recently released nine-month results showed that sales did double, to $164 million, but so did the operating expenses. And the company's operating loss nearly did the same. A profit is years away. The stock trades at a price-to-sales ratio of 15 times, compared with 0.5 times or less for large car makers.

Silicon Valley-based Tesla, which ends production of its single model, the Roadster, in January, after 2,000 to 2,500 deliveries, is in a capital-intensive industry, one that, both directly and indirectly, relies heavily on government subsidies. It's exposed to fickle consumer appetites, and the second Tesla, the Model S sedan, won't be in production until mid-2012.

Then, too, there are giant global competitors that have only just begun to turn out what will likely be a flood of electric and hybrid cars—Leafs from **Nissan** (7201.Japan), Volts from **General Motors** (GM) and Focuses from **Ford** (F), to name just a few, if consumers accept them.

The fact that Tesla is at the upper end of the market won't protect it. Its roadsters sell for about $100,000; the Model S is expected to cost about half that. Porsche, Audi and Jaguar, among others, are in various stages of delivering hybrids. While Tesla stock has been climbing, so has short interest in it, now at an all-time high, at about 21%, much higher than the 3.2% average for conventional car makers, according to Data Explorers, a market-information provider.

Tesla makes some nice-looking cars, but they are fighting to get established before the big boys grab the market. At 31.66, the stock appears to be ahead of itself.

IT'S DIFFICULT TO ENDURE a love spurned. Typically, the denied suitor feels the brunt, but after **Ralcorp**'s (RAH) rejection of several offers from **Con Agra** (CAG), it is Ralcorp's own shareholders, perhaps, who are feeling sad right now.

At Friday's close of 79, the stock of Ralcorp, a mid-cap maker of Post-brand cereals as well as a wide variety of private-label foods, like cookies, crackers, sauces and pasta, has dropped by more than 16% from the $94 bid by Con Agra, whose multiple offers and assiduous pursuit of Ralcorp were rebuffed this year. That was a bit of a surprise, as management lost out on potentially many millions in change-of-control payments, says Jean-François Comte, co-president of Lutetia Capital, which holds Ralcorp shares. Even so, given the steady earnings growth and the stock's rise over many years, "it's difficult [for shareholders] to protest."

While deal fever appears to be fading, he adds, Ralcorp's recent decision to split off its Post cereals brands from the private-label foods business, make the possibility of more offers likely over the next 12 months.

"The Post spinoff can extract a better price for each of the pieces...north of the 94 total bid by Con Agra," he maintains. With all the mergers-and-acquisitions activity in food sectors in recent years, there is a strong likelihood that a premium value will be built in to the Post shares right from the start of trading. The deal is expected to be completed around year end.

Compared with bigger branded rivals like **Kraft Foods** (KFT) and **General Mills** (GIS), Ralcorp trades at a small price/earnings discount, but at a 20% discount on enterprise value (net debt plus market capitalization) to earnings before interest, depreciation and amortization. Comte argues that discount will be narrowed after the spinoff, with "a rerating of both pieces."

Splitting in two makes each piece smaller, more digestible—and attractive to more suitors.

What gives Comte comfort in Ralcorp, bid or no, is the defensive nature of its businesses and its long track record. The St. Louis company has posted steady revenue rises year after year for a decade. Meanwhile, earnings per share before extraordinary items have been up solidly in every year but one since fiscal 2003. Ralcorp's fiscal year ends in September, and annual results are expected Tuesday.

One drawback is the lack of a dividend. However, that didn't stop the shares from outstripping the S&P 500 from 2000 to 2010—up 300% versus minus 5% for the market. If the market drops sharply from here, one might expect

Ralcorp to be an outperformer on a relative basis—although in a bear market, any future bid could be lower than the current stock price.

Buying a stock simply because a deal might happen isn't a conservative investment approach. Ralcorp, however, has a proven history of revenue and earnings growth. If a deal should come, consider it gravy, but this looks like a decent entry point without it.

Being in a defensive industry like food and beverages doesn't guarantee steady results or an outperforming stock price in tough times. Case in point: **Campbell Soup** (CPB), which has been struggling.

The Camden, N.J., soup maker said Tuesday that revenue fell 1% in its fiscal first quarter, ended in October. The shares slid 5% last week, and are down 8% on the year.

And while reported earnings per share beat expectations, the quality of the beat was low. EPS was flat, versus the level in the year-earlier quarter, even though results benefited from lower marketing and selling expenses. Gross profit margins and soup volume were down.

That's just one quarter, but Campbell's vaunted soup business hasn't been growing much in recent years. The company's revenue gains have been unimpressive, and earnings per share are still down sharply from the fiscal 2008 level of $3.12.

In fiscal 2012, Campbell says, profits will come in at $2.35 to $2.42, flat with the preceding year's, as the company searches for ways to heat up soup sales through advertising and new products. Private-label soups have taken a toll, and soup sales fell 4% in the last quarter.

For the quarter ended Oct. 30, Campbell reported $265 million in net income, versus $279 million a year earlier. EPS was unchanged at 82 cents, while sales slid by 0.5%, to $2.16 billion, despite a 4% hike in prices. Gross margins were 39.5%, down from 41.2%.

Compared with Ralcorp, the much-bigger Campbell offers a nice dividend yield of 3.6%, and better-known brands. And unlike Ralcorp, Campbell stock's total return has only slightly beaten the market's in the past 11 years, all of that due to the dividend.

In a bear market, Campbell would be a relative outperformer. Short of that, the stock's not likely to do much without some evidence of a significant and sustainable turnaround in soup sales. For now, the soup's not on.

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