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Equity Research

Food Beverage & Tobacco

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Sector Strategy

Bullish On Packaged Foods, Brand-Name Soft Drinks

Our Food, Beverage & Tobacco sector strategy (BRV-FBT) demonstrates consistent outperformance when compared with a custom benchmark comprised of the Food, Beverage & Tobacco stocks in the Russell 1000, garnering an annualized return of 14.93% versus the benchmark at –0.68% over the 5-and-a-half year period ending December 31, 2008*. In addition, the BRV-FBT strategy has outperformed the benchmark in 2008 with returns of –23.77% versus the benchmark at –33.89%. At the beginning of each quarter, we select the top 10 names in the group as ranked by our BRV-FBT model and construct optimal portfolios. With respect to stock selection, we are focused on fundamental factors that we believe are key to identifying outperformers in the FBT group. We are primarily concerned with stocks in the group that exhibit accelerated near-term earnings growth, demonstrate a history of growing profitability and trade at reasonable valuations. Our strategy also places a strong emphasis on holding positions in the larger names. In any given quarter, we hold an average of 6 out of 10 stocks with market capitalizations of $10 billion or greater. The key points below highlight our positions in the current quarter:

- Relative to the custom benchmark*, we are most overweight in the Food group this quarter. Our current holdings include ConAgra Foods, Inc. (NYSE: CAG, $17.46) and Kraft Foods, Inc. (NYSE: KFT, $26.00). EPS for ConAgra and Kraft are projected to grow at more than 94% and 42%, respectively next quarter.** Forward P/E multiples for these companies are at or below the average Food, Beverage & Tobacco group multiple of 12.9x and we believe these stocks may be underpriced given near-term growth expectations.

- We are long 3 of the 5 Tobacco names in the benchmark this quarter with the exception of Philip Morris International (NYSE: PM, $37.26) for which negative EPS growth is expected in both the current quarter and the next quarter and UST, Inc. (NYSE: UST, $69.46) which experienced a sales decrease last quarter. The remaining companies trade at a forward P/E multiple that is below the group average and have current EPS growth well above the expected near-term EPS growth for the group.

* See Appendix A for a more detailed explanation of the Russell 1,000 Food, Beverage & Tobacco custom benchmark.
** First Call estimates