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LARGE GROWTH STOCK "BARGAIN BIN"

Energy stocks have been the undisputed market leaders in the S&P 500 index for the first nine months of 2005. Although they had begun to tire a bit in the third quarter, Katrina and Rita provided additional "fuel" to keep them advancing. As a group, S&P energy stocks moved up in price nearly 40% in the nine months ended September 30, while the remaining stocks in the index were actually down about -2% in the same period. Perhaps we have seen the top in energy stock prices for this cycle (they are down about 12% in October and are now the worst performing group in the S&P for the month). However, one side effect of this narrow advance is that many large, non-energy growth stocks have been left by the wayside. Tobias Levkovich, Chief U.S. Equity strategist at Citigroup, observes that a considerable number of these big, non-energy growth stocks are near twenty-year lows in valuation vs. the market (Citigroup "Strategy & Tactics;" September, 2005). The Wall Street Journal made a similar observation on September 27, 2005, noting that many of these big growth companies may be in the "Bargain Bin". In the Journal's October 9, 2005 Sunday edition, quoted in the Minneapolis Star, these companies were referred to as "Sleeping Giants". At present, we hold a number of "bargain bin", "sleeping giants" in our Compass client portfolios.* It might be of interest to look at a few to demonstrate how relatively inexpensive they seem to be and why we're pleased to hold them.

Cisco Systems, Inc. (CSCO - $17.13/share on 10/28/05)

This $114 billion (market capitalization) company is the leading supplier of products for linking local and wide-area computer system networks. After attaining $82.00/share on March 27, 2000, it fell 79% to its current price. The company has grown earnings at an annual rate of about 14%/year over the last five years, and analysts expect similar growth over the next five years as well. Business outside the U.S. represents about 45% of total revenues. The company has no debt and since 2001 has bought back more than 13% of its shares. In spite of these impressive results, "CSCO" trades at a current price/earnings (P/E) multiple of 17X (vs. 32X on average over the last five years). It is also trading at a 3% discount to the market on a relative P/E basis (vs. a 79% average premium over the last five years.)

Home Depot, Inc. (HD - $40.09/share on 10/28/05)

"HD" is the world's largest retail building supply/home improvement warehouse retailer. The company has already expanded into Canada and is opening stores in Mexico and China as well. This $86 billion (market cap.) retailer reached $70.00/share on 4/12/2000 and is now trading 43% lower. In spite of this, earnings have more than doubled over the same time period (from $1.10/share in 2000 to $2.64/share expected in 2005), as has the dividend ($.16/share in 2000 vs. $.40/share in 2005). Earnings have grown at over 20%/year on average over the last five years and are still expected to grow more than 13%/year over the next five. Home Depot appears to be a cheap stock, trading at a P/E of 14.7X (vs. 27.6X on average over the last five years) and at a 16% relative P/E discount to the market, vs. a 58% average premium over the last five years.

Microsoft Corp. (MSFT - $25.39/share on 10/28/05)

The massive, $270 billion (market cap.) company is the largest independent maker of software in the world. "MSFT" has no debt, has $37 billion in cash on hand (9/30/05) and is involved in a $19 billion share buyback program. Its "Vista" upgrade to the "Windows" operating system shows great promise as do a number of other products. In spite of growing earnings from $.85/share in 2000 to $1.16/share in 2005, the stock fell from $59.31/share on 1/3/00 to the current price, which is 57% lower. The shares now trade at a P/E of 19.2X (vs. 34.5X on average over the last five years) and at an 8% premium to the market P/E multiple (vs. a 97% average premium over the last five years.)

Obviously, no one can guarantee that these names will be big winners again. Even if they turn out to be, nobody can know for sure when, precisely, these "sleeping giants" will awaken. Nevertheless, of the relatively few Wall Street clichés which have merit, "buy low" is good advice. Perhaps the Wall Street Journal (9/27/05, "Big Names May Be in Bargain Bin"), will be proven right, that "down the road, investors might look back on today's market and bemoan that the best bargains were hiding in plain sight." If so, Compass clients won't "be moaning." They will be well-rewarded.

***Note** - - This is not a recommendation to buy or sell these names at the present time. They are already in Compass client portfolios. We are simply explaining why we hold them.

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