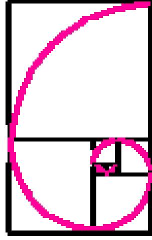


## Sand Spring Advisors LLC

# A Portfolio from Hell:

# Janus Dissected

**by**

**Barclay T. Leib**

**January 21, 2001**

Sand Spring Advisors undoubtedly made some good market calls on the major indices last year. We turned bearish the NASDAQ in late February 2000, turned neutral the stock indices in late May, and then bearish again in early September, only to recommend clients to unwind their short positions the week of December 7th and return to a neutral position.

More recently, we uncharacteristically advised clients that we were bullish January 4th and had to allow for a spike rally at least until January 22nd, and more likely a period of grinding chop all the way out to early June. We termed January 22nd as a likely pausing point however in any rally, and now, as we sit atop that date, we have to admit that the rally that did transpire in the last few weeks hasn't exactly been very impressive. On a stand-alone basis, the pattern of the Dow Jones Industrials still has an annoyingly bullish look about it, but notwithstanding, we'd now term ourselves cautiously bearish the NASDAQ once again. It's going to continue to be a market with many twists and turns by individual equities, but call us bearish overall once again. For how long and magnitude remains to be seen. There is at least a risk of a fast flush brewing now, whereas there wasn't before.

As mentioned in recent Chart du Jours, when we look at stocks like Bank of America and Morgan Stanley Dean Witter we still see much scope for another bash lower. Also, when we look through the portfolio of mutual fund manager Janus Capital, we get especially nervous.

Janus's main flagship fund ended last year down -15% -– perhaps a relative victory given the NASDAQ down –40% number. (Enron's general strength undoubtedly helped mute a lot of other stinkers.) The company doesn't regularly announce net inflows or outflows of investment funds anymore (now that the funds have experienced periods more filled with the latter), but throughout last year's decline, the Janus portfolio mix seems to have stayed pretty constant. Its main fund's top ten holdings remain heavily allocated to just a few high profile names that we list below with their current price/earnings ratio:

AOL- Time Warner (AOL -- 7.9% of the fund, up from 5.8% a year ago, p/e = 100)
Comcast Corp (CMCSA -- 4.4% of the fund, p/e =79)
Linear Technology (LLTC – p/e 54)
Boeing Co. (BA – p/e 23)
Nokia (NOK – p/e 56)
Cisco Systems (CSCO – p/e 94)

Enron (ENE -- 46)
Maxim Integrated Products (MXIM – p/e 70)
EMC Corp (EMC – p/e 117)
Charles Schwab (SCH – p/e 47)

The average price-earnings ratio, unweighted by actual dollar holdings, works out to be 69-1, and it is substantially higher if one were to take into account the relative allocation sizes.

In addition Janus has stuffed more of AOL-Time Warner into numerous of its other funds. When last reported at the end of October, the Janus Twenty Fund had an astounding 11.2% of its fund allocated to AOL-Time Warner; the Janus Worldwide Fund had more than a 2.5% allocation to AOL-Time Warner; the Janus Mercury Fund had 4.1% of its fund so allocated; the Janus Growth and Income Fund had 2.6% of its fund in Time Warner; and the Janus Special Situations Fund held approximately 5.3% of its assets in Time Warner stock.

Overall, the Janus Group controls approximately 4.6% of AOL-Time Warner worth about $9 billion. These shareholdings have not dramatically changed over the past year despite both stocks poor performance throughout 2000. Janus is clearly a behemoth in its holdings here, too big in its bet-size to even dare selling very much.

But being a nimble stock picker is what it's all about these days. Sitting on the obvious sexy names is not the way to go. Indeed if one looks carefully at the performance of individual equity sectors last year, it is amazing to discover that since the March 10th, 2000 NASDAQ high, more U.S. equities are up than are down. As recently pointed out by economic think-tank and money manager Bridgewater Associates, of the 87 sectors in the S&P 500, 68 are up since the day the NASDAQ peaked, and only 19 are lower. It's just that telecom, semiconductor, and software stocks make up such a large percentage of the NASDAQ and fell so far that they counter-balanced all the good equity performances being delivered by smaller lesser-known companies elsewhere.

Indeed, where were the best performers in 2000? Previously depressed homebuilding topped the list up 123% since last March, closely followed by the previously beat-up Tobacco and Shoe sectors. Let us call this: the revenge of the value investor. The unique attribute of equity investing has always been that among so many potential companies to choose from, there are always bound to be long equity opportunities even as the major indices head south. Go-go momentum investors like Janus just haven't caught on to this yet, nor the people still populating their funds. To still be sitting atop a bloated and overvalued portfolio of tech stocks is not where you want to be. Hence our reference to their portfolio in our title this month: the "Portfolio from Hell."

It is our strong prognostication that by the time George W. Bush leaves office, he will have faced a crisis of some sort in the mutual fund industry, this crisis to have involved at least peripherally the Janus Fund family, and likely the AIM mutual fund group as well.

So let us take a step by step look at the Janus Fund's 10 largest holdings and see if we can glean any thoughts from their chart patterns and Fibonacci rhythms.

**AOL (AOL – p/e 100)**

There has clearly been a great deal of happiness in recent days that the Time Warner merger finally went through, such that AOL management can now get on with its business instead of huddling with anti-trust lawyers all the time. Wireless and cable connectivity are clearly big growth areas this company hopes to exploit.

And yet, on an anecdotal basis and as an AOL user for the past several years, I'd say the quality of this company's service has net gone down. Connectivity over the recent holiday period was simply horrific, with the system repeatedly freezing from several different computers I use. At times it was impossible to send e-mails, and AOL was having problems handling e-mail document attachments. On

several occasions, again from different computers, I received messages that "The attached file cannot be found."

Now perhaps this all had to do with holiday traffic and system changes as the company moved to roll out AOL 6.0, but I personally was disappointed. For a premium priced service, it felt like AOL was doing a shake-rattle-and-drop-you routine again and again.

Then we turn to AOL's chart pattern and it still appears very suspect. The stock basically found support at its 200-week moving average, but is currently facing stiff overhead resistance at it's 100-week moving average and previously broken trendline that may represent the neckline of a head-and-shoulders top. The last time we saw a pattern resembling this, it was Amazon.com around $50 on its way into the high teens. Only on a weekly close above $60 would we question a bearish interpretation here.

## COMCAST (CMCSA – p/e 79)

One could make the argument, looking at the chart pattern below of Comcast, that its Fibonacci rhythm looks complete to its lows just under $28 a share last May.

But alas, there are often multiple key levels where Fibonacci bands will fit a given stock's price action. Stretching our Fibonacci bands further to the downside, look how nicely the Fibonacci retracement levels will also "fit" the recent price action from an extrapolated low near $20 ½ a share.

Combining all these Fibonacci bands from both charts together, we create a slightly complex looking chart below, but this highlights a double Fibonacci level from both measurements near 40 1/8th. It would appear to us that should Comcast start to break 40 1/8th, then 20 ½ will be in the cards. After all, one really has to wonder why a cable company in a regulated industry is worth a 79 p/e?

**LINEAR TECHNOLOGY (LLTC – p/e 54)**

The chart pictured below of Linear Technology has a certain look of an A-B-C Elliott correction given all the recent overlap and price volatility. But note as well the Fibonacci rhythm we have depicted that suggests 34 ¼ could also be a natural target for this chart to fall to over time.

Linear Technology, for those of you who don't know it, is a speciality semiconductor manufacturer and distributor, with a major exposure to the auto manufacturing industry. Now, while longer term there is little doubt that more and more semiconductor chips will go into the average car, right now the Detroit auto manufacturers face a major slowdown in demand and a backlog of cars for sale. As discussed by Fred Hickey in his latest *High Tech Strategist* newsletter: Autodata Corp estimates GM's vehicle inventories at 104 days of supply at the end of November, up from an industry target of 60-70 days, and increasing markedly from October's 80 day inventory level. Ford and DaimlerChrysler are also slashing production plans.

Is this anytime for Janus to stand blithely long LLTC? We think not.

**BOEING (BA – p/e 23)**

Next on Janus's list of holdings is Boeing, a stock that recently failed at its 100-day moving average, and then fell on disappointment that Northwest gave it less than half of its new airplane contract.

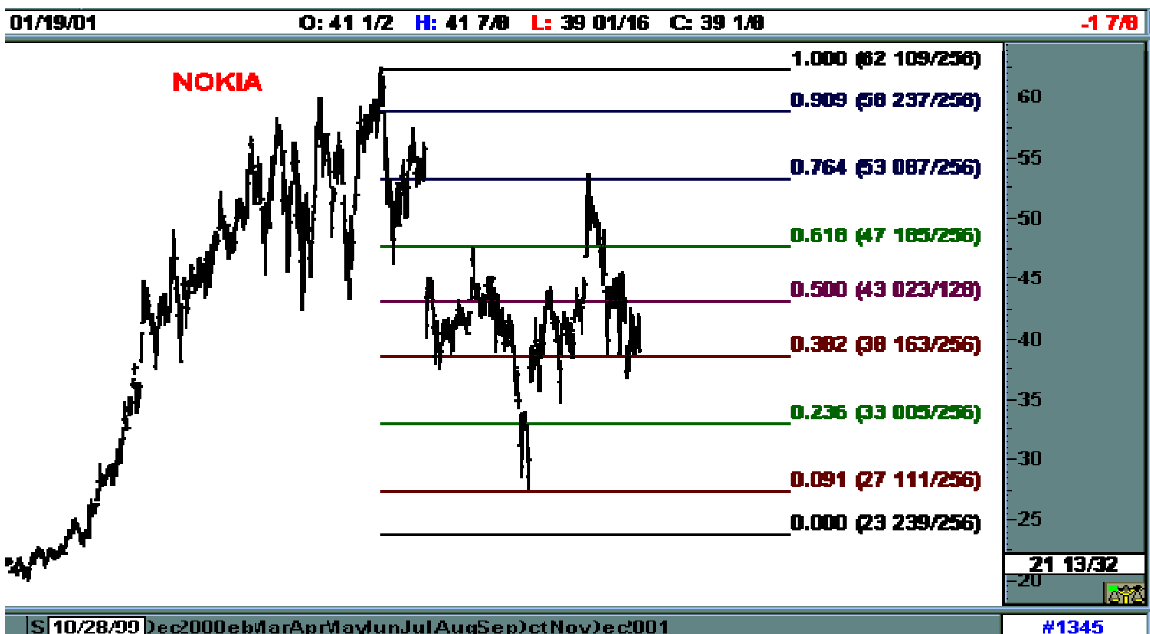
Boeing's 23 p/e is the lowest of Janus's holdings, but not exactly low for an economically sensitive cyclical stock just in front of a likely recession.

We do not have a specific downside target in mind for Boeing, but we do think its 200-day moving average near 51 will be probed.

BOEING - Daily

## NOKIA (NOK – p/e 56)

The earnings warnings of Nokia have been well publicized of late, but the market has seemed hell bent to still buy this stock on bad news. There is no doubt that consumer spending is tapering off and cell phone penetration rates in most parts of the world is now high. How many of you out there have any intention to replace your current cell phone? Until web-based functionality on cell phones becomes far more sophisticated and perfected than it is now, I certainly won't. And yet Janus feels compelled to own this stock at a 56 price-earnings ratio? It doesn't take rocket science to see how this is another Gateway-like disaster in the making. Our Fibonacci rhythm points strongly toward new lows at just under $24.



## CISCO SYSTEMS (CSCO – p/e 94)

Back when most people still considered this stock impenetrable at $60 a share, we called for it to at least reach $40. It recently did so, and then some. We show below both our original Fibonacci bands that represented a minimum target, plus the bands stretched to our actual recent low. Although this pattern could be arguably complete under an A-B-C Elliott interpretation, both sets of bands indicate strong resistance just above $44 on these shares. Unless Cisco can recover above $44, and stay there for a bit, a further cascade down may be in the cards. The next level of Fibonacci support comes in at approximately 28 ½, and 19 could represent a longer-term ultimate target.

The problem here? Imploding dot.coms and telecoms together with a 94 p/e. But I guess the folks at Janus just don't see that, or just don't care to face reality.

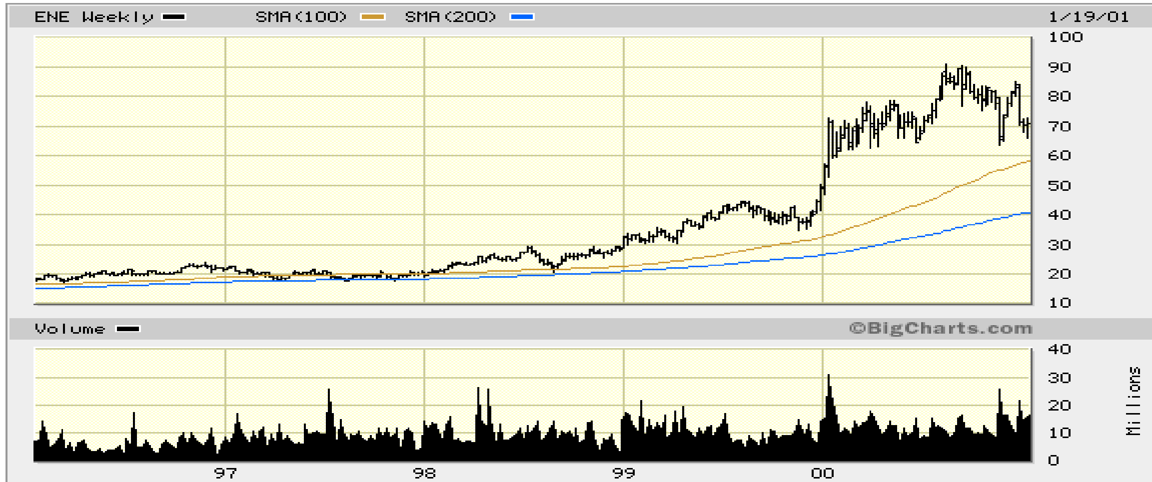
## ENRON (ENE – 46)

One of last year's darlings, Enron has the look and feel of an almost invincible company. In recent years, it has innovatively moved from a simple gas pipeline company to one of the most important and profitable secondary power marketing/distribution companies in the U.S. Last year the company took on the added cache of a lead roll in the distribution and trading of bandwidth via their Enron Online subsidiary. Arguably, the mere announcement of this new business in late 1999 added a cool $30 billion to the company's total market capitalization. The perception is that Enron gets into new businesses first, sets the standard, and then lesser companies like Williams Communications and El Paso Power come trotting along after them.

But everyone knows as well that California just entered a power crisis, and the state government has started ordering companies to keep the flow of natural gas coming into the state whether the power

utilities that are being shipped to are bankrupt or not. Is this the first backlash against de-regulated markets that Enron has so deftly profited by in recent years? Likely it can be deemed such, and hence Enron may no longer be living in such an ideal environment. They may have reaped excess profits in the short term on natural gas prices having shot higher, but longer term, more states are going to think twice now before they deregulate their utility providers.

We don't have an immediate Fibonacci objective for Enron to the downside, but the 100-week moving average near 58 or more likely the 200-week moving average near 40 certainly look possible.

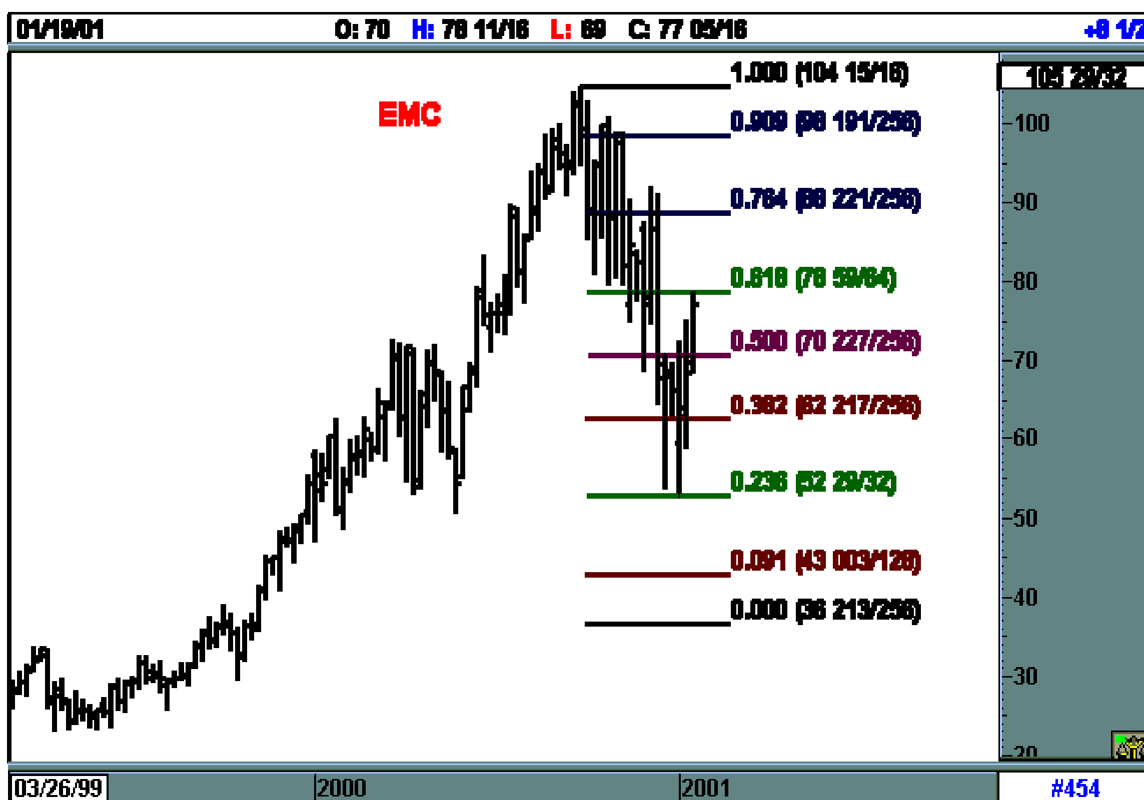



## MAXIM INTEGRATED PRODUCTS (MXIM – p/e 70)

It is bad enough Janus owns LLTC in the semiconductor space, but their compulsion to own another semiconductor equity in the form of Maxim Integrated Products seems almost duplicitous. Maxim, like Linear, has a large exposure to the auto manufacturing industry. If a recession truly hits, how many $35,000 cars will Americans be out buying? Not many, and to make matters worse, the car lease market would likely shift down into the pre-owned (used) market. We see the Fibonacci rhythm of Maxim eventually leading to a projected low near 32 ½.

## EMC Corp. (EMC – p/e 117)

A Wall Street darling in the data storage space, EMC is the holding in the Janus' portfolio with the highest price-earnings ratio: 117-1. It's hard to knock a stock that has done as fabulously as EMC in recent years in a supposedly still "hot niche" of the high tech world, but this stock has been making lower highs of late. A cascade down to a more normalized p/e level may well be in the offing. How about a price just below $37 for a projected low? That's at least what our Fibonacci bands would suggest.




## CHARLES SCHWAB (SCH – p/e 47)

Lastly, if all of the above tech exposure is not enough to sink its fund, the managers at Janus insist on holding Charles Schwab as the tenth of their core holdings. Now I think Charles Schwab is a fine company, but as a way to save costs and avoid layoffs, this company recently requested their employees to take voluntary sabbaticals without pay. That doesn't sound like their business is exactly zipping along.

How nimble can it be for Janus to be long a discount broker just as the whole financial sector is likely to turn south? What potential margin call exposures linger in the portfolios of Charles Schwab client portfolios? What sorts of lawsuits are possible when some of these clients go belly up?

I for one see no compelling reason to be long Charles Schwab at this point of the economic cycle. Instead, I'd hazard to prognosticate basis the Fibonacci rhythm here an eventual low toward $14 a share.

So all in all, Janus has accumulated a core portfolio still geared to the markets of the past, not of the future. There is no real "value" in the stocks they hold at current levels, and an inordinate amount of risk. Even if the Dow Jones and S&P 500 were to vault to new all-time highs, we doubt that this bunch of stocks would be in the lead. More obscure companies currently trading at more reasonable p/e levels would likely hold that distinction – not this bunch.

One can't of course go short a mutual fund itself. Maybe certain of you may get involved selling short a few of these stocks, but another way to play the composite picture here, is to sell the Janus Fund concept itself by selling Stilwell Financial (SV – p/e 21) – a holding company that among other businesses owns 82.5% of Janus Capital. Stilwell announced on January 2$^{nd}$ that total assets under management had fallen to $260 billion as of December 31, 2000 compared to an average level of $302 for the total year 2000. Some of this can obviously be attributed to performance, but maybe a few disappointed folks are slowly heading to the door. Certainly few are aggressively adding to this fund manager as they did once upon a time. Janus's glory days are likely over.

Stilwell, with a book value of just $3.66 a share currently pays a trivial dividend compared to some of its mutual fund competitors, and yet trades at a generally higher price multiple. Management does not have a high percentage ownership of the company, and a number of directors have recently been doing some minor insider selling.

The chart pattern is a sloppy, volatile, mess so this is not for the feint of heart, but SV is likely a stock headed lower over time. This will occur as the lightbulb slowly turns on (in other words, the realization sets in) across American households that these guys are investing their money in a cavalier and dangerous manner, and that what used to work in the go-go up-move, is unlikely to work well much longer.

Stilwell Financial (SV)

Send us your comments at info@Sandspring.com.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