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Trader Notes: April 8, 2008 **Doug Sandler, CFA**

E&P's: New highs shouldn't be ignored; *Barron's* bullish on WYE, we agree

Energy: One of the more important lessons we have learned from observing the markets over the years is that stocks eclipsing previous 52 week highs or lows should not be ignored. When a stock makes a new high it signals that sellers have either been exhausted or are no longer willing to part with their stock at prior levels. It is a very bullish message and generally a harbinger of additional upside. Therefore, we always take notice when a stock makes a new 52-week high and pay particular attention when an entire sector or sub-group is sending a similar signal. Over the past few weeks, despite all the negative rhetoric about a U.S. recession and worrisome inventory levels, many exploration and production companies have been registering new 52-week highs. While the headlines may cause consternation for some, the fundamentals, in our opinion remain strong. Energy prices are no longer driven entirely by the U.S. economy but rather the world economy and we expect the globe to remain ´recession-freeˆ (see this week˜s *Strategic View*). A falling dollar, brought on by low U.S. interest rates, is also stimulating demand for real assets like oil and gas, keeping the prices of these commodities high and allowing the E&P˜s to enjoy windfall profitability. In our portfolios we favor E&P companies and drilling and service companies over the more popular integrated energy companies. The quickest and easiest way to gain exposure to this sector is via one of several ETFs with this focus.

Drugs: Over the weekend *Barron's* had a positive article on one of our pharmaceutical holdings: Wyeth (WYE-N-$44.30). The article not only highlighted Wyeth˜s strong Alzheimer˜s franchise but noted its attractive valuation, particularly when you consider where the shares traded nearly ten-years ago. While we agree with the publications bullish view, we would note that WYE˜s situation is far from unique among the major pharmaceuticals. If Rip Van Winkle awoke in 2008 after a 10-year slumber he would also be scratching his head about the valuations of many pharma companies. In addition to Wyeth, major drug companies like Eli Lily (LLY-N-$53.06) and Merck (MRK-N-$40.28) are trading at or significantly below levels achieved in 1998. The stagnation/drop in share price has come despite earnings more than doubling for LLY and WYE and MRK˜s earnings rising nearly 75%. Simply put, sentiment regarding the drugs today versus 1998 has fallen significantly. In 1998 drug stocks were ´sure-thingsˆ and investors willingly paid 30-45x earnings for the right to participate in their growth. Today, these same companies barely hang on to double-digit P/E˜s. In the past, we have not been fans of the big drugs due to their excessive valuations, today with prices reasonable, expectations low, and dividends high they appear to be an opportunity too good to pass up. Furthermore, we think their record of steady earnings consistency will be increasingly appreciated in these volatile times. Drug companies represent between 6% and 7% of the S&P 500, we recommend at least a 5% weighting to the sector and favor companies like Wyeth, Lily and Merck.