Global Securities
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Equity Research
1 (800) 455-5778
www.globalsec.com

Market Bulletin

Issue No. 230
November 15, 2013

Summary

Recommendations

- **Nvidia –** Reduce positions as stock looks expensive, trades above our $16 target.
- **Stryker –** Sell to book 40% gains as stock trades near highest since December 2007.
- **Precision Drilling –** Sell to book gains of 55%.

Commentary – Rotate into under-performing energy and commodity sectors as broad market rally continues

Incoming Fed chair Yellen affirms commitment to easy money policy, sees no "bubble risk" yet
Sell the hot performers, buy the laggards is a strategy worth considering

Elvis Picardo, CFA

Incoming Federal Reserve chairperson Janet Yellen, who takes over from Ben Bernanke in January, affirmed during her Senate confirmation hearing on Thursday that she would continue the Fed's unprecedented monetary stimulus policy as its benefits still outweigh the costs. Market participants reacted in predictable fashion by sending equities higher, with the S&P 500 setting a record for the third straight day on Friday, closing at a new high of **1,798.18**.

The S&P 500 gained 1.6% for the week, bringing its gains for the year to 26.1% as it stays on track for its best annual gain in a decade. The breadth of this rally can be gauged by the fact that almost 90% of the S&P 500 is in positive territory for the year. In contrast, the TSX – which is up 8.4% YTD – has only about 60% of its 239 members on the plus side YTD.

Materials (-29.2%), Utilities (-7.1%), and Energy (+7.9%) constitute the bottom three performers YTD of the 10 sectors on the TSX. **In our opinion, this rising market tide – precipitated by an easy-money policy across most of the world – may start lifting all boats, including the ones that have been abandoned on the shoreline (commodity stocks, for instance)**. Accordingly, we believe this might be an opportune time to rotate out of hot sectors and stocks into high-quality laggards, which may arguably have a better risk-reward profile. **Our recommendations this week to reduce / sell positions in Nvidia, Stryker and Precision reflect our view that equity exposure should be reallocated rather than trimmed at present**.

Recommendations

(Update) Nvidia – Reduce positions as stock trades above our $16 target

With **Nvidia (Nasdaq: NVDA, $16.17)** trading above our $16 target, we are leaving our **Reduce** rating unchanged, having revised it from Hold on September 16. The stock was recommended as a Buy at $12.20 on January 14, 2013, and has advanced 33% since then. Given its recent gains, we believe it may be prudent to take some money off the table at current levels, and advise selling balance long positions on a potential downside breach of the $16 level.

Nvidia had traded at a one-month high of $16 on October 21, but then slumped 9.3% to a three-month low of $14.52 on November 7, ahead of its Q3 (of FY14) earnings report. But any concerns about weaker-than-expected results were dispelled by the Q3 numbers – which exceeded analysts' EPS estimates for the third straight quarter, while sales were in line with estimates – triggering a 7% advance in the stock the next day.

For fiscal Q3 ended October 27, Nvidia's revenues of $1.054 billion rose 25% sequentially but were down 12.5% from a year ago. GAAP net income was also up 23% sequentially but plunged 43.2% from a year ago to $118.7 million or $0.20 per share. Excluding items, adjusted EPS of $0.26 was a penny higher than analysts' average $0.25 estimate. Gross margin of 55.4% retreated slightly after rising to record levels in the previous four quarters, declining by 40 basis points sequentially from a record 55.8% in Q2, but up 250 basis points from a year earlier.

For fiscal Q4, Nvidia forecast revenues of $1.05 billion plus or minus 2%, with gross margins expected to be lower at 54.2% (GAAP) and 54.5% (non-GAAP). While the revenue forecast was a little short of analysts' average $1.08 billion estimate, any negative sentiment was offset by Nvidia's announcement of a 13% increase in the quarterly per-share dividend to $0.085 (or $0.34 annually), as well as a $1-billion expansion of its share repurchase program.

The company now has a total of $1.286 billion available for buying back shares through the end of January 2016. Nvidia is on track to achieve its goal of returning more than $1 billion to shareholders through stock repurchases and dividend payments in fiscal 2014, and said it intends to return $1 billion to shareholders in fiscal 2015 as well. The company's previously-announced $750-million accelerated share repurchase program was completed on October 22, through which Nvidia received 51.5 million shares at an average price of $14.56.

The buyback program has resulted in Nvidia's cash per share declining to $3.03 billion or $5.15 per share at end-Q3, from about $3.73 billion or $6 at the beginning of FY14. Despite Nvidia's strong balance sheet and recent performance, analysts are not optimistic about its prospects, with an average 12-month target price of $15.24. Analysts' EPS estimates have also come down significantly over the past three months, to $0.84 for FY14 and $0.87 for FY15.

With EPS forecast to grow only 3.5% next year, the stock looks expensive at current levels, as it trades at 19.3x FY14 EPS. Based on the stock's gains over the past year, its expensive valuations, and a market environment that remains challenging for its products, we reiterate our Reduce rating on the shares, which means that investors should consider trimming long positions by up to 50%. We also advise selling balance long positions on a potential downside breach of the $16 level. Note that Nvidia's revised quarterly dividend of 8.5 cents per share gives it an indicated dividend yield of 2.1%.

(Update) Stryker – Sell to book 40% gains

We recommend selling shares of Stryker Corp (NYSE: SYK, $74.21), following a 35% surge in the stock YTD as it closes in on its record high of $76.89 reached in December 2007. We had recommended Stryker, one of the world's largest medical technology companies, as a Buy for income and growth at $53.15 on February 10, 2012. Medical technology stocks have been among the best performers in the booming healthcare sector, propelled by strong earnings, attractive valuations, and a favourable long-term demographic profile for the business.

Stryker's Q3 results that were reported on October 17 confirm this growth trend. Sales rose 4.2% from a year ago to $2.15 billion. Most of this growth was organic, with an increase of 7.1% due to increased unit volume and product mix changes, and only 0.7% as a result of acquisitions. These increases were partly offset by a 0.9% decline in product prices and an unfavorable impact of 2% due to adverse foreign exchange rate changes.

Sales in the Reconstructive segment (which includes hip, knee and other implants) increased 6.5% from a year ago to $949 million. Sales in the MedSurg segment (powered instruments, endoscopic systems and emergency medical equipment) rose 1.5% to $792 million, while Neurotechnology & Spine product revenues rose 7.7% to $410 million. Reported net income plunged 70.8% from a year ago to $103 million or $0.27 per share due to a number of charges, primarily an after-tax charge of $245 million or $0.64 per share for the previously disclosed voluntary recall of certain products. Excluding charges, adjusted EPS rose 1% to $0.98.

For full-year 2013, Stryker said it expects organic sales growth of 4.5% to 5.5%, with adjusted EPS of $4.20-$4.26. On that basis, the stock trades at 17.6x FY 13 forecast EPS, which is well above the 14.7x average multiple that the stock has traded at since 2009.

Stryker should continue to benefit from its greater degree of exposure to the strengthening US economy compared to its peers. US sales accounted for 66.4% of sales YTD 2013, compared with 63.4% in 2011. **However, with the stock trading at a near six-year high (since December 2007, to be precise), we think it might be best to book 40% gains in Stryker and look for more compelling opportunities elsewhere**.

(Update) Precision Drilling – Sell to book gains of 55%

We may have been a little premature in revising our rating on **Precision Drilling Corp (TSX: PD, $10.07)** to a Sell (from Hold) on September 16. The stock had surged to a 19-month high of $11.53 last month, but has since retreated 12% from that level. Precision seems to have solid support at the $10 level, where we had introduced a stop in our July 29 update. Precision currently ranks second on the 4-member TSX Oil & Gas Drilling sub-index in terms of YTD and 12-month performance, with a gain of 23.4% and 48.9% respectively.

In its Q3 earnings reported on October 24, Precision had announced net income of $29 million or $0.10 per share, down 25% from a year ago. Revenue rose marginally (1%) from a year earlier to $488 million as increased international activity and higher average day-rates in Canadian contract drilling offset lower drilling activity in North America. Precision also hiked its quarterly dividend, which it had reinstated in December 2012, by 20% to 6 cents per share, giving the stock an indicated yield of 2.4% at present levels.

The stock now looks to be on course for an imminent re-test of support at the $10 level. While Precision could well bounce off that support level, as it has done on a couple of occasions in recent months, we recommend selling the stock to book gains of at least 55% since we recommended it as a Buy at $6.45 on June 25, 2012.

Market Snapshot

At close on Friday, November 15, 2013

S&P TSX	13482.57	+51.19	**Commodities**			**Yields (%)**	**Can.**	**US**
TSX Venture	934.07	+2.44	Canadian $ (US cents)	95.78	+0.21	90 Day T-Bill	0.92	0.07
DJIA	15961.70	+85.48	Gold (Spot)-US$	1290.20	+3.00	2-Year Bond	1.11	0.29
S&P 500	1798.18	+7.56	Oil (WTI-Dec.)	93.72	-0.04	10-Yr.Bond	2.56	2.70
NASDAQ	3985.97	+13.23	CRB Index	274.34	+0.49	30-Yr. Bond	3.12	3.79

Thought for the Day

"The men who try to do something and fail are infinitely better than those who try to do nothing and succeed." – Anonymous

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Buy: Expected total returns of 10% to 20% over the next 6 – 12 months.
Speculative Buy: Significant gains expected over the next 6 – 12 months, but entire investment may be at risk.
Hold: Expected total returns of 0% to 10% over the next 6 – 12 months.
Reduce: Expected total returns of up to -10% over the next 6 – 12 months.
Sell: Expected total returns of over -10% over the next 6 – 12 months.

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