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MONDAY, MAY 5, 2003

THE TRADER

Spring Fever Helps Stocks Extend Their Rally

By VITO J. RACANELLI

Vital Signs

ACCENTUATING THE POSITIVE, the stock market roared ahead in a week marked by plenty of mixed economic data. April consumer confidence and March factory orders were stronger than expected, for example, but manufacturing's slide deepened last month as unemployment rose to 6% from 5.8%.

Nevertheless, stocks raced ahead, fueled by improving sentiment and led by the tech-heavy Nasdaq, which jumped 5% last week to 1502.88. That topped the previous rally's high in late November, a hopeful sign to technical analysts. Not far behind was the Standard & Poor's 500, which rose 3.5% to 930.08, also closing in on its previous high. The Dow Jones Industrial Average finished at 8582.68, for a pickup of 3.3%.

A complete reversal in sentiment since the prewar gloom of March is readily apparent in UBS's recently released April investor survey, which showed the largest one-month jump in optimism in its history. Indeed, that was a pretty good month for the S&P 500, up 8%, and the Dow, up 6%.


The market clearly believes things have turned up for good, driven mainly by better-than-expected corporate earnings reported over the last few weeks, notes Francois Trahan, Bear Stearns' chief equity strategist.

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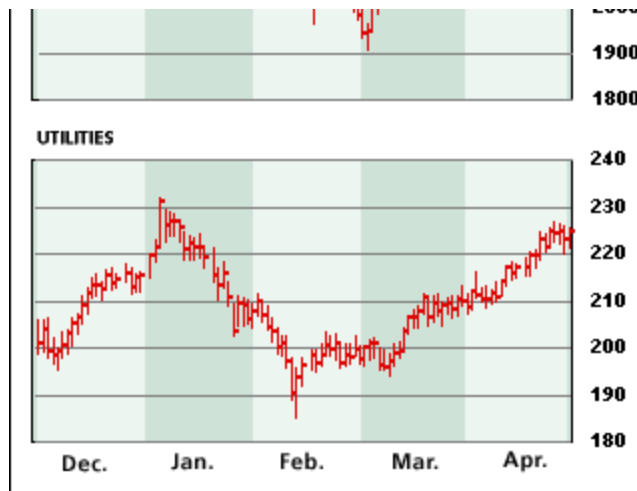
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"But this is about as good as it gets," he contends. Trahan -- who sees the S&P 500 stuck in a range bounded by 950 at the top and 800 at the lows - - thinks profit

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growth is going to be harder to come by as the year progresses, despite all the hoopla right now.

Analysts had lowered first-quarter estimates so much that they were easy to beat, he notes. Sure, there were some upbeat data last week, but more important, leading economic indicators have been decelerating for the past six months, and that doesn't bode well for the next six. In general, top-line growth is weak, pricing power is nonexistent and productivity gains will help less and less, he adds. "Fourth-quarter earnings expectations will be much harder to beat," he says, and 2003 U.S. profit growth is likely to be much lower than analyst projections of 12%. Trahan is looking for a 4% rise.

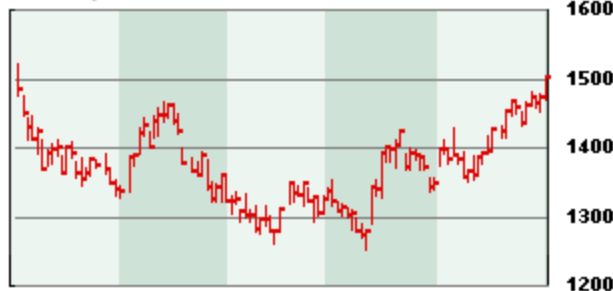
He's seconded by Jeff Knight, chief investment officer for Putnam's global asset-allocation group. By and large, the economic figures have been disappointing, so "there's a real disconnect between the data and market performance. I'm not ready to conclude from the market's activity that the economy is getting better." Knight says he's using the rally "to lighten up a little bit on equities."

As a sidelight, investors might note that high volatility on the Nasdaq 100 is typically a good measure of the market's aversion to risk. Right now, however, the volatility has reached lows last seen at previous rally tops and suggests investors are complacent.

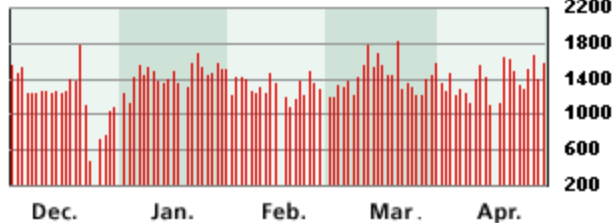
WITH THE MAJOR INDEXES HAVING RALLIED some 16% in just a few weeks since their March 11 lows, we naturally wondered if insider activity would confirm the rally. The answer is a qualified yes.

For the eight weeks ended April 30, the sell-buy ratio was 1.84 to 1, says David Coleman, editor of the Vickers Weekly Insider Report. That means there were 1.84 sales for every share bought by insiders.

NASDAQ COMPOSITE



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To put that in perspective, the historical average sell-buy ratio is 2.25 to 1; so "that's a bullish signal, though not exuberant," he adds. Other data suggest insider support, too. For example, the ratio fell from 2.28 at the start of 2003, Coleman notes. The rate of that change "is not real fast but it's significant," he adds.

That sounds like only a minor concern, but there also are indications that buying may top out soon. George Muzea, president of the Reno, Nev.-based Muzea Insider Consulting Service, also says insiders were "very bullish" in March, all the more notable because market sentiment at the time was very poor. In other words, insiders decided their stocks were cheap enough to ignore

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the market's gloom.

But things appear to be leveling off now, he says. Muzea keeps tabs on insider activity among companies in the S&P 500, the S&P 400 mid-caps, the S&P 600 small-caps and the Russell 2000 small-caps, and "all four indexes are currently neutral" in terms of insider activity. This time, the tepid measures are all the more notable in the context of market sentiment that has clearly improved since March, he adds. "The picture is better but still similar to that seen at the recent market tops in November 2002, and August 2002."

With insiders potentially quieting down despite much more bullish overall sentiment, Muzea asserts this suggests a correction could be in the offing, particularly heading toward the May-July period, historically a weak time for stocks.

Muzea also keeps particular tabs on selling and buying done by second-tier executives. These are "folks who, unlike CEOs, don't get as much scrutiny and who presumably need the money from share sales." There's been a selling pickup there recently in the technology and financial sectors, which coincidentally have led this rally, and in consumer discretionary sectors, such as autos and retailers.

Still, he adds, his data suggest October's lows should hold.

HOW HEFTY IS PACTIV'S GROWTH? it depends on what numbers you use.

In its April 23 release, the packaging company notes its first-quarter earnings rose 4% to 27 cents a share, or \$44 million, from 26 cents a share, or \$42 million, a year earlier. But then it introduces something called "core" earnings, which excludes the impact of noncash pension income and the 2002 cumulative effect of a change in accounting principles. "Core" EPS jumped a much higher 31%, to 21 cents from a 16 cents.

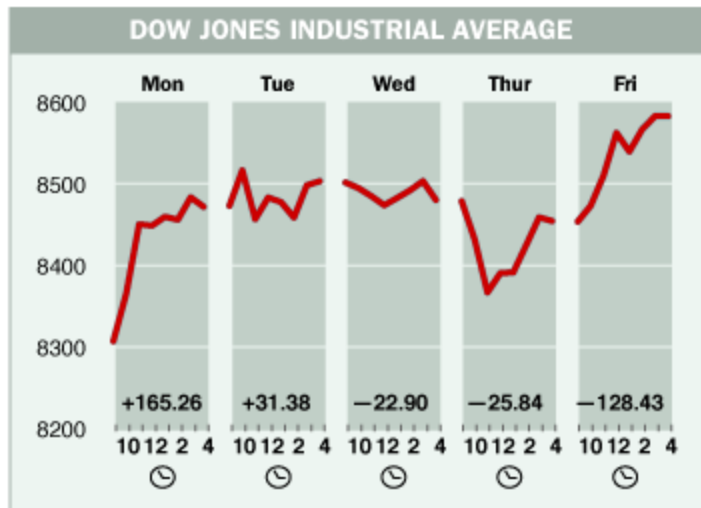
Which is right? David Hines, director of research for Avalon Research Group, asserts **Pactiv** is "confusing Wall Street by introducing a flattering new metric that didn't exist in the company's year-ago period, and by masking a dramatic \$14 million, or five cents a share (after tax), reduction in selling, general and administrative expense that wasn't in analyst models." Avalon has a Sell rating on **Pactiv**.

The confusion lies in the way **Pactiv**, which makes Hefty bags and Baggies, includes pension-fund income in SG&A but doesn't break it out separately. This is compounded by the fact that pension income is falling. For example, in this year's first-quarter release, Pactiv's SG&A fell to \$74 million from \$76 million in the first quarter of 2002, seemingly just a \$2 million drop.

But after backing out the non-SG&A items of pension income of \$15 million this quarter and \$27 million in the year-ago quarter, SG&A actually fell to \$89 million from \$103 million, a much bigger saving of \$14 million, according to Avalon. Profit gains from cost cutting, then, are far larger than it seems on their face, and happens to be equal to about a nickel a share after tax -- the increase in core earnings, which, as noted, excludes pension income.

Don't point to the 11% quarterly revenue increase to \$717 million as a source of higher profits, either. Rising prices of resin -- Pactiv's main raw material -- took gross margins down to 29% from 32%, essentially erasing the impact of higher sales. In fact, annual sales have been stuck at around \$3 billion for four years now.

And that's the point. Nobody quibbles with cost cuts to improve profits, but how long can that go on? Moreover, shouldn't it be clear where the improved profits are coming from? Indeed, soaring resin costs over the



Good Week: The Dow climbed 3.3%, borne upward on increased optimism that an economic recovery is truly under way. Some big winners: McDonalds, SBC and J.P. Morgan.

past 15 months, thanks to higher oil and natural-gas prices, as well as a price squeeze by customers like Wal-Mart, have put **Pactiv** between a rock and a hard place.

Pactiv CFO Andy Campbell denies the release is confusing. **Pactiv** traditionally notes in conference calls that there are pension-income offsets to SG&A, and it's also broken out in a reconciliation table at the end of the press release, he says. "Core" earnings, he asserts, attempts to give meaningful operational information. **Pactiv** can grow EPS 10%-12%, he maintains, adding higher sales improved earnings. But he also concedes that SG&A without pension offsets dropped a lot more than \$2 million.

But since gross margins dropped sharply, the source of higher earnings depends on what you choose to emphasize. Had **Pactiv** not slashed costs, for example, core earnings wouldn't have looked as good.

Pactiv shares trade at 14 times 2003 consensus earnings estimates, not especially cheap when you consider profits are likely to grow just 6% this year. And if it turns out that its long-term earnings growth rate actually isn't as high as Wall Street thinks, the stock likely will suffer.

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