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THE TRADER

Dow Off 1% for Week on Global Growth Jitters

Geopolitical issues weighed on stocks, but growth in Europe and Japan were the market's bigger worries. Also: why GoPro is a no-go; and Constellation Brands may go stale.

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By VITO J. FACANELLI
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Vital Signs

Stocks closed out a rough week with a buoyant Friday, but the mini-rally wasn't enough to make up for poor performances earlier. All the major indexes fell 1% or more. Like the previous week, large-cap stocks outperformed small caps, but this time they just fell less instead of rising.

While market observers blame the retreat on numerous factors, from mixed U.S. economic data out this week to continued concerns about Russian moves to drag Ukraine back into its sphere of influence, mostly there's a vague unease over the state of global economic growth.

U.S. economic expansion is proceeding apace, but the rest of the developed nations are limping along. That translated into the risk-off trade, which culminated in a big downdraft and heavy volume Thursday. Otherwise trading was quiet during the Rosh Hashanah religious holidays.

Last week, the Dow Jones Industrial Average lost 167 points, or 1%, to 17,113.15, while the Standard & Poor's 500 index gave up 1.4%, or 28, to 1982.85. The Nasdaq Composite index ended at 4512.19, down 1.5% or 68.

On Friday, the Commerce Department raised its previous estimate of second quarter U.S. gross domestic product growth to a 4.6% annual rate, about as expected, from the previous 4.2%. Earlier in the week, however, Germany's Ifo survey showed Teutonic business confidence in September dropped to its worst level in more than a year.

If there was one reason for the market drop, says Bill Stone, chief investment strategist at PNC Wealth Management, "It's worries about global growth." Investors are concerned about how much more economic pain is to come in Europe and Japan, he adds. This week's meeting of the European Central Bank governing council Thursday could be key for stocks short term, Stone says, because many are expecting details in the ECB press conference to follow. The bank has previously promised a version of quantitative easing that includes buying covered bonds and asset-back securities. Investors want to know how much, Stone adds.

At the end of October, investors will again turn their attention to the Federal Open Market Committee meeting, says Robert Pavlik, chief market strategist at Banyan Partners. While there's no press conference scheduled afterward on Oct. 29, investors are aware that "the next Fed move, whenever it comes, can't be tapering. It will be raising rates." Volatility could be introduced on rising speculation about that infamous rate hike expected in mid-2015.

Despite the losses, the market remains near all-time highs, and some bullish exhaustion shouldn't be a surprise. Bernie McGinn, president of McGinn Investment Management, says he's been "more aggressive" on the sell side in recent weeks, "even though I don't feel any more negative than before. It's just that I don't see a whole lot of stocks that say 'Buy Me! Buy Me!'" "A 10% correction "would be welcome," he adds,

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road. A large overhang of shares could hit the market in the next couple of years. GoPro's EPS is based on around 83 million shares outstanding, but there are nearly 60 million potentially dilutive stock options and awards and convertible preferred shares. Many options were struck at around \$5 per share or less, and it's hard to believe they won't hit the market as soon as they're allowed, with some exercisable later this year and next.

There are also governance issues. GoPro has A and B classes of stock. B shares have 10 votes to one for A shares, which were sold in the IPO. Class B is convertible into A at any time and holders of B control 98% of voting power, with 48% residing with CEO and founder Nicholas Woodman.

Admittedly, GoPro is a crowded short, as 8.5 million shares are sold short. Still, GoPro has only a limited track record as a publicly traded company and no clear sustainable product moat. It doesn't manufacture its products, and there's a faddish component to its popularity.

GoPro did not reply to our calls. So far, *Barron's* has been wrong on GoPro, but we still think it will end badly.

Too Much Froth

[Constellation Brands](#) shares aren't as overvalued as GoPro, but they aren't cheap.

Here, too, shareholders might be set up for disappointment after a big stock increase. The market has bid up Constellation (STZ) mainly on the \$5.2 billion acquisition of two popular Mexican beer brands, which closed June 7, 2013.



Since then the shares are up 65% compared with the market's 21% rise. The stock, which began rising even before the deal was closed, is up 167% over the past 24 month. At \$86.50, the shares trade at 20 times consensus EPS estimates of \$4.25 in the fiscal year ending February 2015. On several valuation metrics, Constellation trades at a 50% premium to its own long-term history and to the industry.

Previously, a purveyor of mass-market products, like Robert Mondavi wine and Svedka vodka, Constellation's long-term track

record showed checkered revenue and profit growth and little to justify the lofty valuation it now has. It didn't have an impressive acquisition track record.

Everything changed with the purchase of the 50% stake it didn't already own of Crown Imports. That allowed Constellation full control in the U.S. of hot imported brands like Corona and Modelo, among others, the fifth and 13th best sellers here, according to Beer Insights, an industry trade publisher. The beer segment now makes up about half of Constellation's total sales, with wine and spirits the other half.

Investors seem to be looking through rose-colored beer glasses. In fiscal 2014, which ended in February, Constellation's income statement shows total revenue jumped 74% to \$4.9 billion. But most of the rise comes courtesy of a change in the accounting method now that Constellation can consolidate 100% of Crown Imports' sales.

On an apples-to-apples basis, total fiscal 2014 sales grew 6% and the beer segment rose 10% to \$2.8 billion. In the first quarter of fiscal 2015, which ended in May, beer sales rose 14%. These are pretty good for a generally flat-lining beer industry, but the stock valuation appears to incorporate all that and more. (For more on the beer industry, see "[More Gains on Tap at Molson Coors.](#)")

Similarly, fiscal 2014 net income soared to \$1.9 billion from \$388 million in fiscal 2013, and diluted EPS to \$9.84 from \$2.04. But the Victor, N.Y.-based company added \$1.6 billion in nonoperating gains to net income in fiscal 2014. It paid a premium for the part of Crown that it didn't already own and then recorded as income the upward revaluation of its existing stake in the firm, according to a recent report from New Constructs, an independent stock-research firm. Essentially, it artificially boosted net income by

including nonoperating and "illusory" acquisition gains, **the report says.**

The beer-fueled excitement needs to be put into context. Both domestic and imported U.S. industry beer sales have been flat to down since 2010, according to the Brewers Association. Corona and Modelo have been taking market share, but Corona seems stuck at about 3.5% lately. Modelo's share is still growing fast but at just 1.8% last year, according to Beer Insights, it's still a small brand in a world of giants.

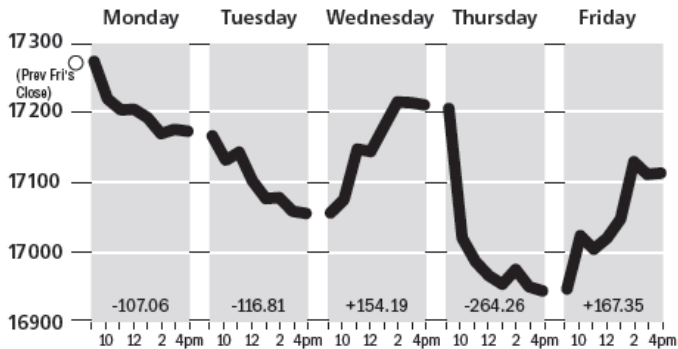
Though Constellation is now the No. 3 U.S. beer maker, its advertising capability—key for beer sales—is dwarfed by the big boys, such as [Anheuser-Busch InBev](#) (BUD).

A spokesperson said the company doesn't agree with the conclusions in **the New Construct report,** and an update on Constellation will come with fiscal second quarter results Oct. 2.

There's no reason to believe it won't make the numbers that day. However, over the next 12 months, investors might find 10% growth in beer sales is unsustainable. If Constellation misses the Street's expectations, the stock will likely fall hard.

FIVE-DAY DOW COMPOSITE

Lost Week: A good Friday didn't help last week. The Dow fell 1% on global growth worries. Nike rose 10% and Du-Pont 2%, but a dozen components fell about 2% or more.



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