BARRON'S
THE DOW JONES BUSINESS AND FINANCIAL WEEKLY www.barrons.com NOVEMBER 2, 2009

Talking With Dan Chung

Chief Executive
Fred Alger Management

This Bull Isn't Done

By Leslie P. Norton

Alger's Chung: The "terrible" yields on cash will eventually spur more investors back into the stock market.

Evan Kafka for *Barron's*

DAN CHUNG IS BULLISH—AND, DEEP INTO third-quarter earnings season, the numbers bear him out. Many of his favorite companies are beating Wall Street forecasts, buttressing his belief that the stock market still has room to run.

"We'll see more fundamental upside [earnings] surprises in the third and fourth quarters, and the wall of cash on the sidelines" that's fetching "terrible" yields will eventually spur investors back into the market, says the amiable, animated Chung, 47 years old. "A 5% reallocation from cash and short-term bonds could drive a 17% appreciation in the stock market," he adds.

Also pushing earnings higher: overseas operations. "We are at the tipping point where international business at many companies can drive growth and actually overcome weakness in the U.S.," says Chung, CEO and chief investment officer of Fred Alger Management, advisor to Alger Funds, which oversees a total of $11.5 billion.

More stock-market gains would be additional good news for Alger shareholders, many of whom already enjoy top-tier returns. At the end of the third quarter, Alger had at least one top-10 fund in each of the following categories: small-, mid- and large-cap growth; world stock; and health sciences. Among those, two funds—**Alger Spectra** (ticker: SPECX), a large-cap growth fund that has had an 11.17% return over five years, and **Alger China U.S. Growth** (CHUSX), a world stock fund up 11.98% in that time—were in the top 1% over five years. Chung personally manages the China U.S. Growth and **Alger MidCap Growth** (AMGAX) funds, and co-manages **Alger LargeCap Growth** (ALGAX) and **Alger SmidCap** (ALMAX)—a small- and mid-cap fund near-term improvement, however, could encounter some headwinds in the second half of 2010, when the "very easy" comparisons with the first half of 2009 start expiring, says Chung. That could pose a problem if the economy struggles as stimulus programs wind down, raising questions about whether the U.S. economy can grow without further federal assistance. Earnings and sector growth are likely to become bigger concerns at that time, he notes.

He expects earnings to grow 25% in 2010, but that's after "two disastrous years for the economy and financials," says Chung. So even at the recent market multiple of just 15 times 2010 earnings—less than the growth rate—stocks aren't a screaming buy. Going into 2010, Chung says, "it's very much a stock-picker's market" that may otherwise be range-bound. Even so, he believes, "investors will make money from here."

Chung and his fellow stockpickers at Alger follow the model pioneered by the firm's namesake, Fred Alger. They look for companies undergoing dynamic changes that will drive either high unit volumes or margins, or whose shift in strategy is a catalyst for profit growth.

The firm values extensive experience in its analyst team. One of Alger's researchers was chief medical resident at a major hospital; another holds a Ph.D. in material sciences. Chung himself has a law degree from Harvard. In 2001, as Alger's Internet analyst, he was dubbed an "unsung hero" by Barron's ("Super Talents," Jan. 8, 2001)—one of the little-known analysts who helped drive performance at their firms.

(over please)

Chung believes the sharp economic downturn has upended entire markets, destroying competition and allowing survivors to grow at superior rates. In retailing, that's J. Crew Group (JCG), which appeals both to people of modest means and to wealthier consumers who want to be more frugal. In banking, it's JPMorgan Chase (JPM), whose clean balance sheet allowed it to buy Washington Mutual and Bear Stearns at attractive prices. J. Crew has raised its earnings forecast due to strong sales and wider margins. And Morgan, notes Chung, "will actually exceed peak earnings" as growth in nonperforming assets slows. He sees the bank earning $5 a share for 2011; it was trading at about 44 last week.

What appeals to Chung now? The personal-computer industry, which he thinks is the subject of "a significant misperception" about demand. In March, most investors believed demand would decline or stay flat. But Alger's analysts, through checks of the supply chain and corporate customers, believe it will strengthen. Earnings estimates have since started to catch up, but are still too low, says Chung. He thinks demand will pick up next year with strong foreign growth, a new replacement cycle, the renewal of corporate demand, and more sales of Microsoft's (MSFT) new operating system.

One beneficiary: Dell (DELL). Analysts believe Dell will earn $1.27 a share next year, up from a projected $1.06 this year. But those estimates are "a little too low for an up-cycle," says Chung, given that Dell posted earnings of $1.35 last year. Dell has net cash of $6 billion, or about 20% of its market value of $28.9 billion. At a share price of 15 last week, says Chung, Dell is "well-positioned to surprise on the upside." Its forays into services—it recently bought Perot Systems—will be accretive in 2011. He thinks Dell will earn $1.35 a share next year. "More importantly," he says, "with free cash flow of $1.60, Dell trades at just 7.5 times enterprise value to free cash flow per share, excluding cash.

He's also a fan of chip makers like Atheros Communications (ATHR) that benefit from increasing wireless connectivity. Atheros makes wireless, for local-area network (LAN), chips, and 40% of its production goes into notebooks, which he sees growing at a 30% rate next year. Atheros chips also go into networking equipment. Its acquisition of Intellon will help it sell to telecom carriers serving residential customers who don't have Ethernet wiring. Chung thinks Atheros' earnings will be $1.85 this year, topping analysts' expectations of $1.25. His price target is 40; shares were trading at 25 last week.

One other pick: Skyworks Solutions (SWKS), which is gaining share in the smartphone segment owing to top-rated handsets. Chung thinks Skyworks' earnings per share, $1 in 2010, can grow 20% in 2011. His price target is 20, or about twice the shares' recent level of 10. ■