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Still Standing After Sell-Off

The biggest Minnesota companies did better than most during last week's sell-off.

Neal St. Anthony March 2007

We know that the world is flat. And that China owns a large chunk of the U.S. economy. And that when one of China's big stock markets tumble, U.S. markets will get bruised.

Gene Sit, who was born in China and actively invests there through his Sit Investments, has been one of the deans of the Twin Cities investment community for 35 years. He has watched our two economies blend in many ways. China is a huge buyer of U.S. government debt and medical and other products, purchases that recycle the dollars we use to buy China's low-cost manufactured goods.

The connections between what happened Tuesday to "Shanghai A shares" and the U.S. markets also bear close inspection, Sit said in an interview Thursday. The two

markets, albeit related, are also in fundamentally different stages.

"I think the drop in the Shanghai market was just the catalyst, triggered by

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comments from the Chinese government, concerned with speculation," Sit said. "The U.S. market had been going straight up for eight months, the volatility had been very low and there was complacency, just the time for a correction in the U.S. market.

"But the fundamentals were very different between the two. This will be a great time to buy good U.S.

companies."

On Tuesday, the Standard & Poor's 500 index dropped 3.5 percent and closed out the week down 4.4 percent. For the year, the S&P is down 2.2 percent. The U.S. sell-off followed an 8.8 percent drop in the portion of the Shanghai stock exchange that's open to ma-and-pa investors on the Chinese mainland.

Minnesota companies fared better. Although the Bloomberg Star Tribune 100 index of the state's largest public companies dropped 4.6 percent for the week, it remains up 1 percent for the year through Friday. Of the 92 companies that make up the Bloomberg Star Tribune index, only 8 finished up for the week. But 46 Minnesota companies remain in positive territory for the year.

Target Corp., a big wholesale buyer of Chinese

products, offers a good example. Down 3.3 percent for the week, the big discounter is still up 7 percent for the year. On Tuesday -- the same day the Dow tumbled 416 points -- Target reported better-than-expected earnings after a strong holiday season.

As a group, Minnesota's biggest companies tend to perform better amid market downturns than the broader U.S. indexes like the Standard & Poor's 500 and the Nasdaq. The reverse also is true: Minnesota's tortoise-like companies, tend to lag behind the national index in periods of fast -growth.

The reason? Minnesota companies in the index are dominated by large retail and service companies (Target, Best Buy); health care companies (UnitedHealth Group, Medtronic); financial services firms (Travelers, U.S. Bancorp, Ameriprise Financial), and manufacturers (3M, General Mills, Mosaic). They are a diverse group of generally solid performers that has a long track record of weathering financial storms.

The Shanghai composite index consists of more than 800 Chinese companies, including oil giant Sinopec, Bank of China and Citic Securities. The index has more than doubled in the past year as exuberant Chinese investors bid up the prices of many domestic stocks.

Chinese regulators were worried about a correction. Shares on that exchange were trading at 35 times projected 2007 earnings of the component companies vs. about 16 times for the companies of the S&P 500.

The Chinese, flush with savings and cash, have bid up the price of real estate and now stocks in their fledgling markets.

"The Shanghai exchange is not the trigger for a global economic meltdown," Sit concluded. "We see slowing growth but no recession and the world economy continuing to grow at nearly 4 percent annually.

"If you accept my premise that the underlying fundamentals are fine and that good liquidity will continue in terms of investment flows to the U.S., cushioning inflation, and stabilizing housing market, I would think a 5 to 7 percent correction in the Dow and S&P over the next month is about right," Sit said. "If we get more protectionism [from Washington lawmakers], the correction could be closer to 10 percent."

Buying opportunity

Sit said this could be a great buying opportunity for good stocks. "I still think we'll get 8 to 10 percent growth in the U.S. market this year, and growth stocks will do better, such as Target and Pepsi. From a long-term perspective, stocks are fairly priced and real estate and bonds are still overpriced."

Jim Paulsen, chief investment strategist at Wells Fargo Capital, said nervous U.S. investors used the China market dive as an excuse to take some profit from the U.S. market.

"I think what happened on Tuesday and last week has more to do with fears than fundamental economic shifts," Paulsen said. "The excessive optimism has been checked. It's still about the U.S. economy. For the next few weeks we're going to be testing lows. And then, I think, after we find a bottom, we'll go higher."

Brokers and financial planners interviewed last week reported that small investors aren't panicking.

"With such a large increase in the U.S. market in recent months, we had expected a correction," said Michael Bischoff, chief operating officer of Webb Financial Group. "We just didn't expect most of it one day on Tuesday.

"I actually thought we'd have more calls. A few people were surprised how little their accounts had turned down, based on the noise on the news about the Chinese market being down 9 percent," Bischoff said. "People grab on to it. But everybody who called into us was still up for the year."