

2010 INVESTOR'S GUIDE

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AIMING FOR
SECURE GROWTH

10

Essential
Stocks for
Next Year

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IF 2008 WAS A SOUL-CRUSHING (and wallet-depleting) year for investors, 2009 restored faith for many. After a dismal winter, most stocks rediscovered a forgotten direction: up. "In the beginning of a new bull market," observes Sam Stovall, Standard & Poor's chief investment strategist, "a rising tide lifts all boats."

Well, it's no longer the beginning of the resurgence, and of late the momentum has slowed. For starters, equities are no longer as cheap as they were a year ago. The S&P 500's trailing price/earnings ratio (P/E) is now 22, compared with a historical average of 18. Bears argue that the market recovery was artificial and temporary, a result of massive infusions of government money and rock-bottom interest rates. They point to continued weakness in the housing market, lagging corporate profits, and—worst of all—double-digit unemployment.

Those are reasons for caution, but don't give up. Consider this: Since World War II, the S&P 500 index has never fallen in the second year after a new bull market (a year in which stocks rose at least 20% after a steep loss). Stovall expects the index to climb 9% in 2010. Many economists predict a steady though perhaps lethargic recovery as federal spending helps the economy slowly get back on its feet. Revenues could bounce back next year, according to Bill Stone, chief investment strategist at PNC Wealth Management. If so, he says, profits will pack an extra punch because of all of the recent corporate cost cutting: "Revenue growth plus expanding margins gives you a sharp earnings recovery."

Think of this as the recovery's awkward phase: There may be isolated areas of vibrant growth while other areas and companies lag behind. Making judicious stock selections will be crucial in what is likely to be a topsy-turvy market.

As always, this year we've consulted top fund managers and analysts and combed through research reports to find the best candidates for 2010. Given the uncertain environment, we've picked an eclectic assortment (with an equally eclectic variety of valuations). All of them have impressive growth stories: Our selections are expected to increase earnings by more than 10% annually over the next five years. (For the record, the crop we selected a year ago beat the market. They returned an average of 42%, compared with 37% for the S&P during the same period.)

We chose our Best Stocks with 2010 in mind—but this Investor's Guide also features articles about investing for the long term. Pat Regnier explains on page 54 why index funds outperform their actively managed counterparts. We also offer a selection of technology stocks for the next 10 years (page 83), a housing-price forecast (page 101), and a 401(k) checkup (page 68). Now that China is driving global growth, our examination of that country's equities (page 77) is more relevant than ever. We've also got a roundtable with fund managers and market strategists (page 40), who explain why they're buying dividend-paying blue chips and stocks with exposure to foreign markets. Their consensus: The easy money has already been made. But like us, they still see opportunities.

signed a licensing contract with Samsung (which paid \$1.3 billion upfront to use its patents for 15 years) after years of haggling. There's another benefit to clearing up the litigation. "That had kept a cloud over the stock," says Deutsche Bank analyst Brian Modoff, who expects shares to reach \$56 in 2010. "You want a company that can control its own destiny and beat numbers even if the market doesn't improve. This is one of them."



Quanta PWR, \$20

MARKET CAP: \$4.1 BILLION

2008 REVENUE: \$3.8 BILLION

P/E RATIO: 19

DIVIDEND YIELD: NONE

THE RECESSION DELAYED countless projects intended to upgrade America's aging power grid. But now the federal government is unleashing billions for smart-grid and renewable-energy projects, and Quanta Services is positioned to benefit.

Quanta is the largest contractor in the U.S. electric power market. It specializes in constructing and maintaining high-voltage electrical transmission lines. As utilities with shrinking workforces increasingly outsource projects, Quanta's revenue more than doubled in the past four years. "Quanta is a play on the reliability of the system," says Charles Ober, longtime manager of T. Rowe Price's New Era Fund, which bought Quanta shares this year.

J.P. Morgan analyst Scott Levine says now is a buying opportunity. Spending on transmission projects is forecast to nearly double from 2008 to 2012, and many of those deals are being negotiated in 2010. "Transmission is the best bet in the near-term," says Levine, who thinks Quanta is positioned to win big contracts in 2010.

Shares fell to \$16 in February after utilities delayed spending amid the credit crisis and have since rebounded to \$20. But at 19 times forward earnings, the stock trades well below its five-year average of 27 times earnings, since investors still worry that Quanta's work might be delayed even longer. Analysts predict earnings per share will increase by 30% next year.

The long-term future looks even more promising. In addition to grid spending, which the Brattle Group, a research firm, estimates will total \$1.5 trillion to \$2 trillion between now and 2030, Quanta will prosper as its transmission lines carry electricity from renewable energy projects like wind and solar farms. Buoyed by the government's stimulus loan guarantee program for renewable projects, Quanta expects such sales to nearly triple to \$300 million in 2010. CEO John Colson also figures Quanta's recent acquisition of Price Gregory, the country's largest gas pipeline builder, will drive profits in two to three years as natural gas in remote shale formations increasingly needs to be moved across the U.S. "We haven't been as bullish on the natural-gas market as we are today," he says. "That's going to spur growth over the next several years."