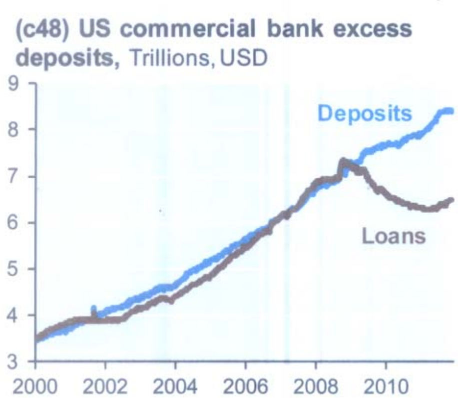
Joseph Jekyll Advisers LLC recommendation

February 9, 2012

Top-Down Strategy for Apple (AAPL)

I attended Tuesday in New York, a meeting for Michael Cembalest, Chief Investment Officer of J.P. Morgan Chase & Co. in New York where he leads analyses of global markets for $1.8 trillion in client assets worldwide.

One of the big questions influencing investment policy is the large cash holdings of corporations and the high deposit/loan ratio of U.S. banks. As this topic was discussed, I found this to be a very profitable meeting. Below is Mr. Cembalest's chart on the deposit/loan ratio:



Source: J. P. Morgan Chase & Co.

Two questions:

- **Why is this money not being deployed into risk assets and**
- **What are the implications for this buildup of liquidity both in the banking and corporate sectors?**

We know that capital spending and bank borrowings are logical events when companies are looking at either unsatisfied customer demand or when companies are building additional infrastructure for new products or services with a bright outlook. So why not look for companies that are redeploying their cash into capital spending rather than retaining it as cash?

Apple said in its January conference call with analysts that in the most recent quarter:

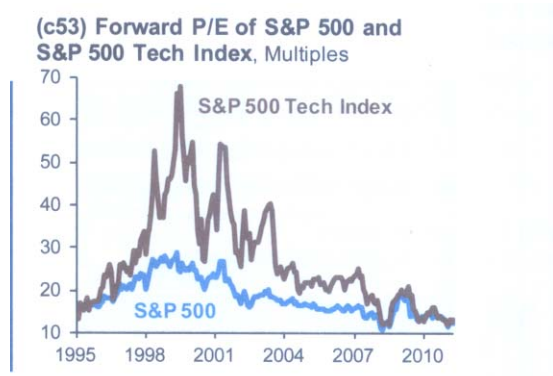
> ***"We opened 4 new stores in the quarter, including our spectacular new store at Grand Central, as well as 3 stores in Europe, bringing us to a total of 361 stores. With an average of 358 stores open, average revenue per store was $17.1 million compared to $12 million in the year-ago quarter, an increase of 43%."***

Notice that average revenue per store was up 43% over year-ago quarter. This statistic must be music to the ears of officials in the company, which want to roll out more stores.

After the meeting for the Chief Investment Officer of J.P. Morgan Chase & Co., I visited Apple's flagship store on Fifth Avenue. I have never seen anything like it before. There was an army of customer service personnel in the store. The key feature is that these people know their product and are superior to personnel in a large big-box store, which has to sell numerous brands, and are not sufficiently trained in all the details of fast moving technology. Apple's flagship store was packed with customers in midafternoon. There were foreigners from Asia and I heard foreign languages spoken by the visitors/customers.

High revenue per store growth is a good logic for Apple's directors to approve redeployment of Apple's large cash position (see our January 25, 2012 report) into more stores and new products. This is a speculation at this point, but the logic is compelling. The foundation of the innovation concept at Joseph Jekyll Advisers is to base investment strategy on expecting more stores and newer products.

I can hear the first reaction: the stock has moved up $73 per share since the January last quarterly release. Well a stock going from $420 to $493 in percentage terms is the same as a $42 stock going to $49.30 and less of detraction. In either case, the stock is up 17.4%. However, remember the stock gains are related to the gain in sales and profits. As long as these gains continue, then the stock should do well. Finally, do not forget that Apple is cheap on a price earnings ratio basis and does not have the vulnerability of being at a large premium to the whole market. Mr. Cembalest displayed a great chart to drive home this point. His chart compared over time the forward Price Earnings Ratio of the tech sector versus the entire S & P 500 index:



Source: J. P. Morgan Chase & Co.

I asked Mr. Cambalest to address this chart and he replied in my paraphasing:

> ***There is no premium at all for large cap tech stocks and secondly the Federal Reserve is forcing investors to redeploy investments from sterile bank deposits/money market funds into risk assets.***

Hence, in my opinion the outlook for Apple is bright. Standard & Poors has just raised its price objective to $650 per share and this makes sense to me based on the above reasoning. This target is 32% above the current market of $492.67 per share as I write.

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Disclosure:

Thomas H. Wilkins jointly with his wife and his Wilkins Foundation, Inc. own Apple stock.