TheStreet.com
Technology Report
by Richard Suttmeier

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Investors Begin to Rotate Money Into Tech Sector

By Richard Suttmeier

The **Nasdaq** began showing its leadership qualities after the April employment figures were released May 6. The better-than-expected expansion in nonfarm payrolls and upward revisions for February and March indicated that any economic soft patch ended in April. With the economy back on track, investors' focus returned to earnings and guidance from technology bellwethers. And indeed, we weren't disappointed. Three model portfolio members -- **Intel** (INTC:Nasdaq), **Texas Instruments** (TXN:NYSE) and **Cisco** (CSCO:Nasdaq) -- as well as **Dell** (DELL:Nasdaq) gave positive guidance for the remainder of 2005.

As May progressed, it looked like a clear rotation into technology shares was under way. In addition, upbeat CEOs appear to be getting comfortable with the reporting requirements under Sarbanes-Oxley, the legislation passed by Congress to make chief executives more accountable in a post-Enron climate.

Another potential positive for technology companies was Cisco's proposed security that would track the expensing of options, a popular form of compensation for emerging tech companies. If regulators approve the new security, it would account for the issuance, redemptions and cancellations of employee stock options. This would reduce the negative impact expensing of options could have on earnings per share in future quarters and relieve one cloud overhanging the tech sector.

May Scorecard for the Technology Sector

Date	Dow	S&P 500	Nasdaq	Utilities	Transports	Russell
April 29, 2005	10,193	1158.50	1922.00	371.47	3426.00	579.50
May 31, 2005	10,467	1192.50	2068.00	365.13	3600.00	614.75
May Change	2.69%	2.93%	7.60%	-1.71%	5.08%	6.08%

Market Performance Stats: Year to date the Nasdaq is down 4.92%, not as bad as the Dow Transports, down 5.21%; or the Russell 2000 futures, down 5.71%. What's significant is that the Dow Transports reached a new all-time high at 3889 on March 8 and is down 7.4% since then -- another sign of the rotation into tech stocks.

May's turnaround in equities was led by the Nasdaq, up 7.60% for the month and ahead 9.4% from its April 29 low of 1890. What's also significant is that the Dow Utilities declined 1.71% in May after testing a 52-week high of 374.28 on May 2. The year-to-date highs on the Utilities and Transports were failed tests of my annual risky levels -- a price where my models forecast that investors are likely to reduce holdings -- for each average, and in my judgment are leading the rotation into technology.

This second issue of the monthly report takes an in-depth look at my three focus industries and summarizes a month of Trading Alerts and Weekly Summaries. I hope you find it helpful and look forward to your feedback.

Semiconductors: The SOX Sets Up to Lead Stocks

At the end of May, my model showed technology 20.0% undervalued, with the semiconductor industry 27.1% undervalued. The weekly chart for the Philadelphia Semiconductor Index (SOX) clearly shows that attempts to break out above the 200-week simple moving average failed four times in 2004 -- in January, April, July and December -- and then in March 2005. What's different now?

After the first three breakout attempts failed, the SOX declined to a lower low at 350.91 in September 2004, and since then has made two more failed tests of the 200-week simple moving average. The main difference now is that we are not dealing with a pattern of lower lows for the SOX but rather sideways action. This increases the probability that the sixth time will be the charm.

Philadelphia Semiconductor Index (SOX) -- Weekly

Source: Athena Graphics On Telerate Plus

In anticipation of this potential move upward, *TheStreet.com Technology Report* model portfolio has been long two chip leaders, Intel and Texas Instruments. During May, I also traded **Applied Materials** (AMAT:Nasdaq) for a gain of 7.6%, and **Teradyne** (TER:NYSE) for a gain of 17%. On May 23, I added **Micron Technology** (MU:NYSE), which has lagged the SOX.

The model portfolio also remains heavily weighted in semiconductor-related shares with holdings in **Brooks Automation** (BRKS:Nasdaq), **Helix Technology** (HELX:Nasdaq) and **QLogic** (QLGC:Nasdaq). **Rudolph Technologies** (RTEC:Nasdaq) was another chip-related company that I traded in May for a gain of 11.6%.

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Promising Stories for Semis and Hence Tech Stocks

Intel's CEO Craig Barrett set a positive tone for chipmakers in a *CNBC* interview on May 3, saying the semiconductor industry is as exciting as ever with tremendous growth potential in wireless, broadband and content. The buildup in Asia's infrastructure, an expanding broadband market in the U.S., Intel factories running near capacity, no signs of an inventory surplus among customers, and initiatives in Wi-Fi and WiMax all look promising for the chipmaker, according to Barrett.

Texas Instruments marked its 75th anniversary in May, a milestone worth mentioning again. During the Great Depression, TI used new technologies to explore for oil; today, its technology puts it in the sweet spot to benefit from growth in a number of areas, according to CEO Rich Templeton.

In the 1980s and '90s, the PC had driven technology growth, but now communications and entertainment are driving growth -- a trend that should last for the next 10 to 15 years, the CEO said in a *CNBC* interview. VoIP growth is strong, TI sees steady business conditions across its entire customer base, inventories have cleared out and margins are improving, according to Templeton. Moreover, he said that cell-phone subscribers are expected to grow from 1.7 billion subscribers today to 3 billion to 5 billion within five years, and DSPs, or digital screen processors used in high-definition TVs, are set for growth again.

In addition, the semiconductor capital equipment group's longer-term cycle is bottoming, according to Richard Bernstein, CEO of Future Technology Today, a full-service IT consulting firm.

May Scorecard for the Semiconductor Industry

Date	SOX	Intel (INTC)	Texas Instruments (TXN)	Micron (MU)	Applied Materials (AMAT)	Teradyne (TER)
April 29, 2005	385.65	23.53	24.96	9.71	14.87	11.02
May 31, 2005	428.95	26.96	27.64	10.98	16.42	13.01
May Change	11.23%	14.58%	10.74%	13.08%	10.42%	18.06%

Growth Drivers for the Remainder of the Year: New Products and Innovations

Intel, the leader in laptop computers with its Centrino technology, has launched a new desktop PC geared to business users. The Professional Business Platform consists of a Pentium 4 processor and includes applications to simplify system management and enhance security. Intel also launched a new home-PC microprocessor that features two computing engines on a single chip. These Pentium D processors should be installed in new PCs and laptops by year-end, and allow home computer users to more efficiently run multiple programs simultaneously. This dual-core capability will enhance what's called a "digital home" platform that gives users improved graphics, sound, storage and security.

Micron joined the announcement parade in May with its launch of a family of mobile semiconductor devices designed to deliver superior bandwidth performance with extended battery life in standby mode. Two of the technology factors I have been focusing on in semiconductors are cooler chips and longer battery life. Micron's new product group satisfies these criteria and targets feature-rich smartphones, digital still cameras and MP3 players.

PC Makers: Sun Spotlights Its Turnaround Progress

Sun Microsystems (SUNW:Nasdaq) captured the headlines both early in the month and again last week. The May 9 issue of *BusinessWeek* reported that CEO Scott McNealy was considering taking the company private. But McNealy denied the story in a *CNBC* interview and instead discussed how the company is redefining itself. Sun is gaining customers among major Wall Street firms and seeking to do business with governments around the world, McNealy said. Plus, the company continues to cut costs by converting old legacy applications to new technologies, and will be offering some new free and fee-based services such as leasing CPU hours on Sun Grid services, which include storage and security offerings.

A few days later, Sun announced it was buying Tarantella, a software maker, for about $25 million in cash to bolster its remote-access software segment. Tarantella's software helps users manage information, data and applications across all platforms, including networks and devices. Sun expects to complete the deal by its fiscal first-quarter 2006. Then last week, Sun said it was acquiring **Storage Technology** (STK:NYSE) for $4.1 billion in cash. The move, expected to close in late summer or early fall, would combine Sun's storage and networking products with StorageTek's security and archival offerings.

Helping Sun's turnaround was a deal with former archrival **Microsoft** (MSFT:Nasdaq). The companies unveiled measures to better integrate their products over common networks, with features that include a single sign-on for both .net windows and Solaris/Java environments. IT managers had been seeking to integrate both platforms on their corporate networks, and this alliance gets that done. Ending years of legal wrangling with Microsoft marks another positive for Sun in its turnaround.

May Scorecard for the PC Makers

Date	Apple (AAPL)	Dell (DELL)	Hewlett-Packard (HPQ)	IBM (IBM)	PalmOne (PLMO)	Sun Microsystems (SUNW)
April 29, 2005	36.06	34.83	20.47	76.38	21.43	3.62
May 31, 2005	39.76	39.93	22.51	75.55	28.42	3.81
May Change	10.26%	14.64%	9.97%	-1.09%	32.62%	5.25%

The computer manufacturers ended May 29.1% undervalued as the stocks I have been tracking rebounded nicely after underperforming significantly in April. Dell contributed to the turnaround for computer makers, raising its earnings guidance for the current quarter. **Hewlett-Packard** (HPQ:NYSE) continued to perform better than expected, showing that a turnaround under new CEO Mark Hurd was indeed feasible.

However, former highflier **Apple Computer** (AAPL:Nasdaq) bottomed on May 11, holding my annual value level at $34.33 a share -- a level at which my model suggested that longer-term buyers would show interest. At that price, Apple shares were 12.5% undervalued. This was a major revaluation as Apple was 77.8% overvalued on March 1 with the stock trading around $44.50. Apple shares have been quite volatile of late on the possibility that there could be an inventory glut of iPods, and on the recently announced plan to shift from IBM chips to Intel chips a year from now. Apple shares are currently trading around $37 a share on these uncertainties.

Software: Retooling the Internet With Security in Mind

Cisco Systems, in my judgment, remains the leader in retooling the Internet. The company's quarterly earnings in May did not disappoint. The usually conservative CEO John Chambers gave positive guidance, saying that Cisco's success includes growth in its Internet telephony, storage, wireless and security segments. It appears to me that Cisco is returning to growth through acquisitions at a pace similar to six years ago. To this point, Cisco announced it was acquiring privately held FineGround Networks, a provider of network appliances used to minimize bandwidth usage and maximize infrastructure capacity in a data center. The integration of FineGround's technology into Cisco's applications should help customers improve delivery of Web-based applications in a more secure environment.

To include security software in the model portfolio, I added **Symantec** (SYMC:Nasdaq) May 11 at $18.31 after the stock held my semiannual value level at $18.03 and had become more than 40% undervalued. Symantec had been on my watch list for quite a while. In December 2004 when the company announced its decision to buy **Veritas** (VRTS:Nasdaq), I liked Veritas as it was more than 40% undervalued. But my screen of Symantec at that time showed it to be more than 40% *overvalued*. As a result, I took Veritas off my focus list and decided to review Symantec when it became 40% undervalued.

In December, Symantec was trading around $34 a share, with Veritas around $25, so my models worked well in timing when Symantec had a more favorable risk/reward profile. The company's June 24 merger with Veritas should end the uncertainty that contributed to Symantec’s 47% price decline from early December to mid-May.

Software ended May 19.9% undervalued, and in June I will be looking for new stocks for the model portfolio that are at least 40.0% undervalued.

May Scorecard for Internet and Security Companies

Date	Cisco (CSCO)	Symantec (SYMC)	Time Warner (TWX)	Microsoft (MSFT)	Take Two (TTWO)	Autodesk (ADSK)
April 29, 2005	17.27	18.76	16.81	25.30	23.53	31.83
May 31, 2005	19.4	22.51	17.40	25.80	25.76	39.58
May Change	12.33%	19.99%	3.51%	1.98%	9.48%	24.35%

In news from portfolio member **Time Warner** (TWX:NYSE), CEO Dick Parsons indicated that the company may eventually spin off AOL. This is not a good idea. I believe that Time Warner management is on track to turn AOL around and investors should take notice, which is the reason I added this one to the portfolio. It's true that dial-up subscriptions are down to 21.7 million from 27 million four years ago, but part of that loss is the transition to high-speed access.

AOL has settled its accounting issues with the **Securities and Exchange Commission** concerning the overstatement of advertising revenue, and I consider AOL a portal, an ISP and a search engine. The division should gain advertising dollars, grow as a commerce site and generate new optional services revenue. In its quarterly earnings report, Time Warner reported that AOL's advertising revenue rose a solid 45%, year over year.

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I am also looking for more cooperation among Time Warner units to help the turnaround. AOL for Broadband can be combined with RoadRunner, Time Warner's high-speed Internet offering for cable TV subscribers, and the new platform acquired from Adelphia. Other initiatives, including a redesign of AOL's instant messaging (AIM) service, called Triton, and the ability for AOL subscribers soon to multitask on a PC and other mobile devices, should also help Time Warner increase revenue in this division.

Finally, a story in the *New York Post* said that AOL was close to a deal with Sony BMG for the sole rights to its music videos made available over AOL. According to the *Post* story, some 22 million users visit AOL Music each month and about 5 million are not AOL subscribers. If closed, this deal should result in AOL gaining a bigger slice of online advertising dollars. I am keeping track of this plus any other content agreements that will lead to additional subscribers.

Tech Hotspot: Music Downloading and Satellite Radio

● **Music Downloading:** I continue to watch the music download segment. **Yahoo!'s** (YHOO:Nasdaq) May 11 announcement of its new music download service, priced at $6.99 per month or $60 annually, crushed shares of **Napster** (NAPS:Nasdaq) and **RealNetworks** (RNWK:Nasdaq). Both Napster and RealNetworks depend on music downloading as their major source of revenue, and charge $14.95 per month, or $179.40 annually, for subscriptions.

Since the May 10 close of $6.35, Napster's stock is down 33.9% to $4.20, but still does not merit buying according to my model. Napster is 63.3% overvalued and depends on music downloading more than RealNetworks, which has declined 29.2% from $7.30 to $5.17 over this same period. Before Yahoo!'s announcement my models showed RealNetworks extremely *overvalued* by more than 100%, but now it's 33.6% undervalued. Because RealNetworks is less dependent upon music downloads than Napster, I have the stock on my radar screen if and when it nears my annual value level of $4.23.

In keeping with my theme of understanding how products work, my son and assistant, Jason Suttmeier, a Napster To Go user, gave RealNetworks' Rhapsody To Go a try. According to Jason, it was more difficult to set up a Rhapsody To Go account and get it running properly than a Napster account. As an already-existing Real customer, it should have been easy. Here are his results:

When Jason set up Rhapsody on his office computer, he was able to browse and download music immediately. However, when he later downloaded Rhapsody on his home PC, he could not access Rhapsody To Go at all. Inputting his correct user name and password gave him access only to Rhapsody's free "Rhapsody 25" service, which prompted him to purchase any song that he wanted to download. His efforts to fix this problem failed; he couldn't even change membership status without repurchasing the service, so he called customer service. Once the agent reset Jason's password, he was ready to download from Rhapsody's million-plus songs.

Another difficulty occurred when Jason tried to transfer songs to his iRiver H10 (a Rhapsody-compatible MP3 player). He received an error message, "unsupported media type," and so checked all the settings. They were all correct. Both his Rhapsody and iRiver were set to allow 160 bitrate WMV (Windows Media Video) files, so this didn't make too much sense. He tried to call tech support again, but it was already closed at 8 p.m. EDT. However, a visit to iRiver's Web site provided the solution. Once Jason

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downloaded the firmware update for his iRiver H10, he was in business. It would've been nice for Rhapsody to mention something about that in its online support area.

One positive thing Jason has noticed thus far is that Rhapsody actually puts the album songs in the proper order on his MP3 player.

In contrast, Napster was simple to use out of the box, but it would put album songs in alphabetical order. To listen to the songs in album order, Jason had to play them from his folders and not from the artists' albums. Clearing his MP3 player and retransferring the songs from Napster to his iRiver using the initial firmware update did not fix this issue. It actually made things worse. The songs were now in random order within the artists' album folders.

Ease of use and compatibility are important issues, and this is a continuing story.

● **Satellite Radio:** This is my favorite segment for growth of consumer dollars. In my judgment there is plenty of room for growth among both satellite radio companies, **XM Satellite Radio** (XMSR:Nasdaq) and **Sirius Satellite Radio** (SIRI:Nasdaq). I prefer Sirius because it has raised its subscriber growth rate while XM has not. Sirius is gaining ground and closing the subscriber gap. My model shows Sirius is 48.2% undervalued compared with 13.5% for XM Satellite.

During May I talked about a Sirius story that projected only 10% of new-car buyers annually would opt for satellite radio over the next five years, along with 20% of boat owners, 10% of those with late-model cars and only 2% of households annually. I think that demand is underestimated. There should be a much higher percentage of factory-installed components in the 2006 and 2007 model years. I also see a much larger market for home users. I listen to my Sirius Satellite Radio at home, as I no longer have to search through piles of albums and CDs to find what I want to listen to. Would you like to buy a jukebox?

Plus, Sirius leads in content and has new products on the drawing board. Content additions include the all-Jimmy-Buffett-all-the-time music channel and Podcasting, which is the ability to publish audio files to the Internet. Sirius also plans to launch a wearable radio in the second half of the year. New devices are important as Sirius pushes to close the subscription gap.

Technology Report Model Portfolio

Long Holdings

Company Name	Current Quote	Initial Purchase Date	Most Recent Trade Date	# Shares	Cost Basis per Share	Current Value	$ Gain/ Loss	% Gain/ Loss
Brooks Automation BRKS	$ 15.19	05/11/2005	05/11/2005	300	$ 13.55	$ 4,557.00	$ 492.00	12.10%
Cisco Systems CSCO	$ 19.41	04/04/2005	04/04/2005	225	$ 17.66	$ 4,367.25	$ 393.75	9.91%
Helix Technology HELX	$ 13.17	05/23/2005	05/23/2005	325	$ 12.04	$ 4,280.25	$ 367.25	9.39%
Intel INTC	$ 26.86	04/04/2005	04/04/2005	175	$ 23.10	$ 4,700.50	$ 658.00	16.28%
Micron Technology MU	$ 10.49	05/23/2005	05/23/2005	375	$ 10.78	$ 3,933.75	$ -108.75	-2.69%
QLogic QLGC	$ 33.33	05/11/2005	05/11/2005	150	$ 29.39	$ 4,999.50	$ 591.00	13.41%
Nasdaq-100 Trust 1 QQQQ	$ 37.79	04/14/2005	04/14/2005	100	$ 35.67	$ 3,779.00	$ 212.00	5.94%
Sirius Satellite SIRI	$ 5.84	04/28/2005	04/28/2005	1000	$ 4.81	$ 5,840.00	$ 1,030.00	21.41%
Sun Microsystems SUNW	$ 3.61	04/21/2005	06/02/2005	3000	$ 3.65	$ 10,830.00	$ -120.00	-1.10%
Symantec SYMC	$ 21.98	05/11/2005	05/11/2005	225	$ 18.31	$ 4,945.50	$ 825.75	20.04%
Time Warner TWX	$ 17.05	04/04/2005	04/20/2005	450	$ 17.32	$ 7,672.50	$ -119.25	-1.53%
Texas Instruments TXN	$ 27.28	04/07/2005	04/18/2005	300	$ 23.75	$ 8,184.00	$ 1,059.00	14.86%

Short Sales

Company Name	Current Quote	Initial Purchase Date	Most Recent Trade Date	# Shares	Cost Basis per Share	Current Value	$ Gain/ Loss	% Gain/ Loss
Autodesk ADSK	$ 38.58	05/27/2005	06/07/2005	(200)	$ 38.94	$ 72.00	$ 72.00	0.92%

Performance

Total Average Return (including cash)	3.33%
Total Average Return on Dollars Invested (excluding cash)	8.57%
2005 YTD Return	3.33%

Performance results listed here reflect values of stocks as of the close of the most recently completed trading day, and do NOT take into account dividends paid, interest earned or commissions. Results are updated overnight and posted prior to the market open the following business day. The 2005 Year-to-Date Return figure reflects changes since inception at the market open April 4, 2005. The Total Average Return figure reflects changes since inception at the market open April 4, 2005.

	Date of Portfolio Inception	Open Price	Current Price	% Gain/Loss Since Portfolio Inception	2005 YTD Return
Tech SPDR (XLK)	4/4/2005	$ 19.35	$ 20.14	4.08%	-4.78%

	Date of Portfolio Inception	Open Price	Current Price	% Gain/Loss Since Portfolio Inception	2005 YTD Return
S&P 500 Index (SPX)	4/4/2005	$ 1,172.79	$1,197.26	2.09%	-1.37%

Reader Feedback

Question: I noticed you sold Teradyne (TER:NYSE) last Friday. On *CNBC* you had a higher price target of $19 plus. Is this target still valid? -- K.M.

Suttmeier: On *CNBC* I decided to post a longer-term target **for investors just entering a position** because the stock was too close to the target posted in the newsletter. I derive my value and risky levels from a model I was developed in 1984. The model inputs are the past nine weekly, monthly, quarterly, semiannual and annual closes. My theory is simple: The evaluation of nine years of a stock closes is the summation of all bullish and bearish events for that stock. Bearish fundamentals may cause a stock to have weakness toward a weekly, monthly, quarterly, semiannual or annual value level, where buyers should emerge. Weekly is for this week only, monthly for this month only, and so on. Bullish fundamentals may cause a stock to rally toward a weekly, monthly, quarterly, semiannual or annual risky level, where investors are likely to book profits. If a value or risky level is violated during its time horizon, I call that level a pivot, which has a high probability of being tested at least once more in its time horizon. June 30 is the next key longer-term date as the closes in June will be new inputs to the formulas that derive new monthly, quarterly and semiannual value and risky levels.

Question: How would a new 30- year Treasury bond change your overvalued or undervalued calculation?

Suttmeier: In its May quarterly refunding announcement, the U.S. Treasury announced it is considering issuing 30-year bonds again, beginning February 2006. This is a significant event for my model as the yield on the 30-year is an input in the ValuEngine fair value calculation I use. For this I have been using the old 30-year Treasury bond (USTB 5.375 02/13/31), which was originally auctioned in February 2001 and reopened in August 2001. With a new series of 30-year bond issue, the general level of the 30-year yield could be higher than without this change. Overly simplified, when the yield on the 30-year Treasury is declining, the model price of the stock increases. When the yield on the 30-year is rising, the model price decreases.

Question: In reading your weekend summary I noticed that your cash position was 79%. Is there any reason for this high level of cash? -- S.M.

Suttmeier: We are just beginning a long-term portfolio of technology stocks, and I thought it be prudent to pick stocks using approximately $4,000 for each initial investment. I do not view the level of cash as any indication of asset allocation. I think it's more important to focus on my stock-picking ability.

Question: Congratulations to success! … Seems all your picks have made great moves, but I am a new subscriber and missed most of your alerts. Will you be sending out alerts when there is a pullback? -- P.

Suttmeier: My objective is to have a portfolio of 20 to 25 stocks, both longs and shorts, and I will send an alert whenever action is taken to add or remove a position, or to increase or decrease the size of an existing postion.

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