February 2016 Vol. 2 Issue 2

Investors Alley
Blue Chip Gems

Investing in the Strength of the American Consumer

Fellow Investor,

The market continues to be rocky but has a recent relief rally that has recaptured approximately one-third of the losses in the S&P 500. A bounce after deep declines was overdue. Whether this is the start of a larger rise will largely depend on two of the factors that have helped stocks stabilize recently. First, oil has climbed back over $30.00 a barrel on talks of a production freeze within OPEC and Russia and continued falling rig counts in the United States. The crude complex is not likely to be solved just yet as this is just the beginning of “negotiations” to freeze production levels. These discussions will be heated given the contentious and adversarial nature of the main energy producers. There will be many false starts before any agreement is possibly complete. Whether this might eventually lead to the cuts needed for oil to stage a significant rally is anyone’s guess.

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Second, the spate of bad news out of China has ebbed recently. After going deep into a bear market, Chinese equities have recently found better support and are almost exactly flat over the past month. If this floor holds it should be beneficial to our market as it eliminates a sore spot investors have been worrying about.

The rest of Asia continues to be troubled. Japan is in a contraction again despite a negative interest rate policy from the Japanese Central Bank. Its exports just had their worst monthly fall since 2009 as the Yen has perversely risen despite authorities best efforts to weaken the currency. Europe is bumping along and auto sales there are improving nicely. Unfortunately, the possibility that the United Kingdom could vote to leave the European Union in June is likely to be a headwind for bourses there until resolved.

I am deeply concerned about the commodity complex. Simply, the pain in the commodity sector will get worse before it gets better. The Baltic Dry Index is at its lowest level in its over thirty year history. All the shippers are hemorrhaging money at these levels and there will be myriad bankruptcies across the sector before all is said and done.

The large global miners are finally starting to face the reality of the current environment. All the major mining firms like Anglo American are trading at multi-year and in many cases multi-decade lows. They are slashing dividends, capital expenditures and instituting massive layoffs and divestures.

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Commodity based economies will continue to face increasing distress. This includes our largest trading partner, Canada. Their currency has fallen markedly against the dollar and their economy is in a mild recession. This will not be good for our trade volumes heading north.

At least Canada is in good shape compared to the other commodity based emerging markets like Russia and Brazil. Both countries' currencies are down over 60% against the greenback over the past two years. Their sovereign debt ratings continue to get downgraded and are now in junk territory. Foreign reserves are falling rapidly and both countries are running huge deficits compared with their GDP. If oil and commodity prices stay at these levels through 2017, it is hard to see how either country avoids a default.

Closer to home, the presidential election looks like it could turn out to be one of the nastiest in memory as the candidates with the highest negative ratings are leading the nominating race for each of their parties. Politics will play an increasing role in stock market direction as we get closer to voting in November.

Ending on a more positive note, it appears GDP is ready to post at least two percent growth for the first quarter after a fourth quarter level below one percent. Auto sales and housing activity are still solid as is job and wage growth. Hopefully our economy can continue to muddle along as it has throughout this weakest post-war recovery on record despite the anemic global outlook at the moment.

If you ever have a question or comment you can reach me at bret.jensen@investorsalley.com.

Thank you and Happy Hunting.

Bret Jensen
Editor
Bret Jensen's Blue Chip Gems

P.S. The returns in my other newsletter *Biotech Gems* are positioned to heat up in the coming months. With 20 recommendations in one of the hottest sectors of the market we are well on our way to building a complete biotech portfolio that should trounce the market for years to come. Right now most of the stocks are way undervalued and are representing great long-term values not seen in the sector since 2011.

In fact, I am giving away three of my favorite tickers in the sector for free right now, just click here.

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Synchrony Financial: Cheap Consumer Growth Investment

It is getting easier to find value in this market after the steep declines in recent months. The challenge, especially among large cap names, is finding businesses that are not going to have significant impacts from the anemic global economy or the fallout from the collapse in energy and commodity complexes.

Worldwide economic activity posted its lowest levels in 2015 since 2009. 2016 has seen the world economy continue to deteriorate especially in regards to global trade. The Baltic Dry Index, a gauge used to measure shipping demand, is at its lowest levels in its over 30-year history. Cargo ships are being scrapped at twice the rate as 1986. This was, up until now, the hardest year for shippers as oil dropped to $10.00 a barrel.

Japan is in contraction, China's growth is slowing, and Europe is barely muddling along as it deals with its largest migration wave since WWII. There are substantial concerns around its banking system as well, especially in the Southern European countries of Italy and Greece.

The United States is the best house in a very bad neighborhood right now despite being mired in the weakest post-war recovery on record. The consumer, outside those employed in the energy sector, is holding up well as job and wage growth are decent if not spectacular. The energy "tax cut" is also putting an extra $1,000 per capita or so in shoppers' pockets.

This is why our next Blue Chip Gem comes from an area that should continue to benefit from the slowly improving environment for the American consumer. The name of the company is **Synchrony Financial (NYSE: SYF)** which is the largest private label credit card issuer in the country.

Company Overview:

Synchrony has a market capitalization north of $20 billion, but most investors have never heard of it. However, most know of its main competitor **Discover Financial Services (NYSE: DFS)** despite the latter's smaller market capitalization. There are two reasons for this. First, until 2014 when it was spun off as a public company, Synchrony was a part of **General Electric's (NYSE: GE)** vast financial services empire. Second, the company provides private label cards which make up some 80% of its business. These are the card that can only be used at that retail establishment. If you have an **Amazon (NASDAQ: AMZN)** or **Walmart (NASDAQ: WMT)** card, you are probably a Synchrony customer even if you do not know it. The remaining 20% of Synchrony's business is in dual cards which can be used and receive perks at the core retailer and also can be used on the main card networks like Visa or Mastercard.

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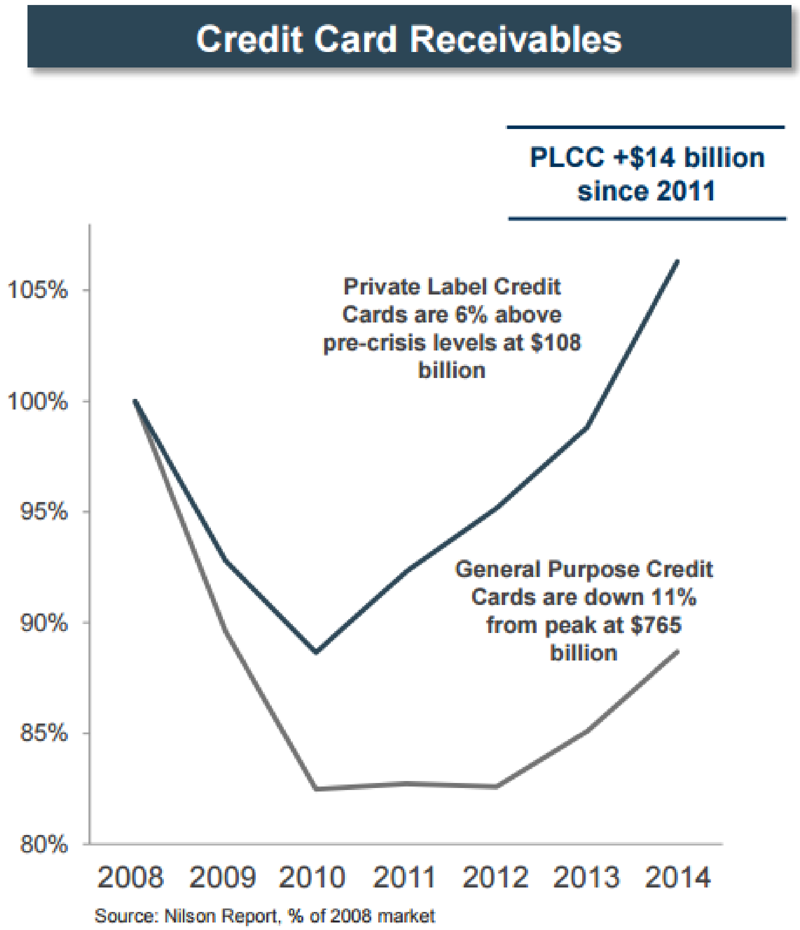

Merchants can benefit from co-issuing private label credit cards in several ways. First, they don't have to pay the transaction credit card fee which averages approximately 1.5% of the transaction total. Second, private label cards can provide much more granular level data on the retailer's customers and their purchase habits as they are integrated into the store's inventory management systems. This provides the merchant with advanced data analytics and targeted marketing capabilities. This is a key to allow the retailer to leverage digital, loyalty, and analytics capabilities to augment growth.

In addition, the merchant can customize their offering such as 5% cash back on purchases or other specific company promotions. Finally, they can receive revenue sharing income. Last year, Synchrony paid out more than $2.5 billion in this revenue to the 22 retail partners it has private label cards with. For Synchrony, the money is made from the loan portfolio consisting of carried balance behind these cards.

Loan Portfolio:

Private label card receivable growth is increasing significantly faster than regular credit card growth. The total amount of credit card receivables is actually still down some 10% from pre-financial crisis levels. Private label card receivables are up just a tad more than five percent over the same time period. Currently, private label card receivables are growing at approximately three percent a year.

Synchrony is experiencing a much faster rate as it is not only a "best of breed" company in this space, it is also by far the market share leader. Synchrony has seen its loan portfolio grow at an average rate of 9% annually over the past several years and benefits from having long standing relationships with the likes of **Lowes (NYSE:LOW)** where it has been a private label partner for over 35 years. Less than 10% of Synchrony's loan book comes up for contract renewal between now through year-end 2018.

In 2015, loan growth came in at 11% after the company guided to begin the year in a range of six to eight percent. This year Synchrony is guiding seven to nine percent growth in its loan portfolio but should do better as management is known for setting conservative guidance at the beginning of the year.

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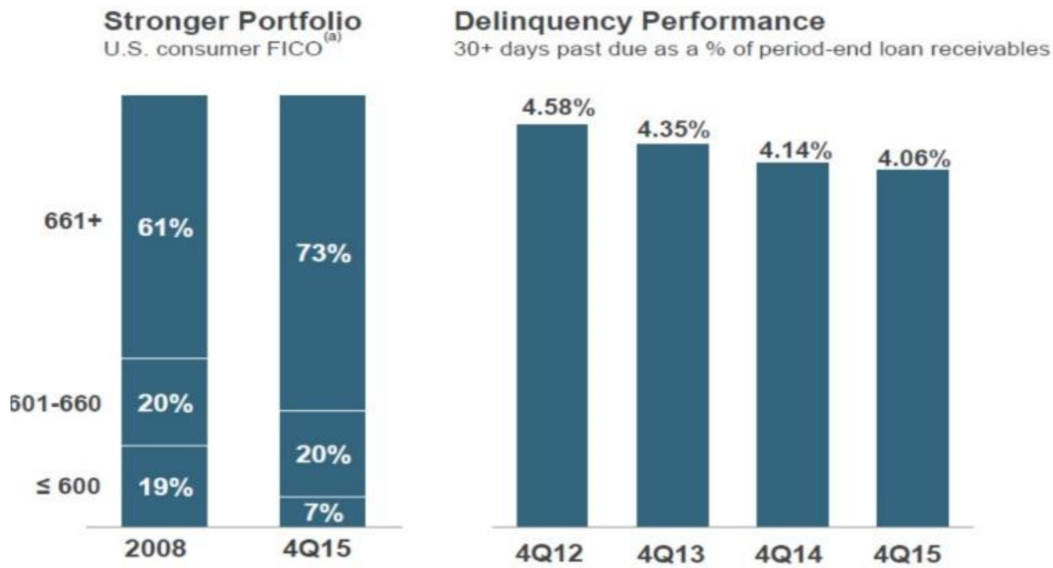

The company serves the lower-end consumer and the average credit card balance per card which grew some 4% in 2015 is approximately $1,000. Because Synchrony's customer base tends to have poorer credit scores than major credit card companies, it can charge a higher rate of interest which averaged just under 22% in 2015.

This consumer is benefiting greatly from lower energy prices as well as steady job growth as the unemployment rate is now nicely below five percent again. The company is a solid risk manager and has been strengthening its credit book in recent years. 73% of loan portfolio now has a FICO score of 660 or higher. The 30+ past due rate was 4.58% of receivables in the fourth quarter of 2012 and this has consistently and slowly improved every year and currently stands at 4.06%. The company has guided this number will drop an estimated 18 basis points in 2016.

Funding and Balance Sheet:

As one would expect of an entity spun out of General Electric, the company's balance sheet and efficiency are impressive. Based on Risk Adjusted Yield, Liquidity % of Assets, and Efficiency Ratio Synchrony scores significantly higher than better known credit card concerns such as Discover**, Capital One (NYSE: COF)** for **American Express (NYSE: AXP).**

Almost two thirds of it the funding comes from low-cost deposits and the rest is provided by both securitized and unsecurtized debt. Its assets are highly liquid and has over $6 billion in undrawn lending capacity.

Outlook and Valuation:

The company should continue to churn out revenue and earnings growth in the high single digits in coming years as Synchrony continues to gain market share in the private label space. The current consensus has Synchrony earning some $2.80 a share in FY2016 and $3.10 a share in FY2017. The stock currently goes for just over $27.00 a share so is priced at under 10 times forward earnings, a large discount to the overall market.

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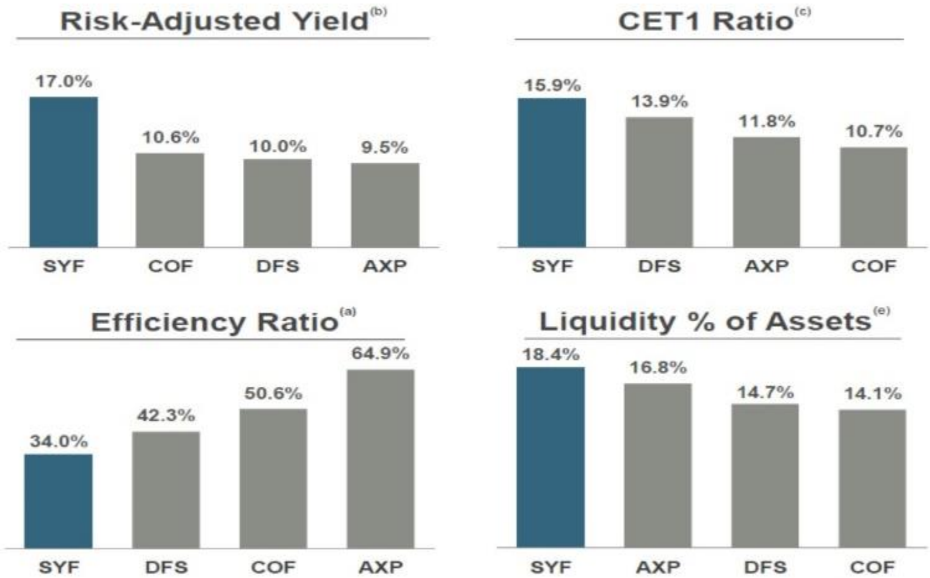


Like most financials, the stock has been hurt by falling interest rates. Synchrony also has been hit by falling earnings estimates at competitors like American Express. However, the consensus earnings estimate has not budged in three months on Synchrony and the company has a habit of consistently beating the consensus earnings expectations by a penny or two a share.

Given the company's continued improving loan portfolio and balance sheet, an initiation of a dividend payout and/or a significant stock repurchase program seems a likely future event that should bolster these cheap shares. The 20 analysts that cover the company have a $37.00 median price target on SYF, which is right at its 52-week highs. That would represent approximately 35% upside from current levels and still only value the stock at less than 12 times next year's like earnings per share. This is a discount that should erode quickly once interest rates start to rise again and investors get some more confidence that the economy will continue to bump along.

Recommendation: BUY SYF up $30.00 a share.

Position: Long SYF

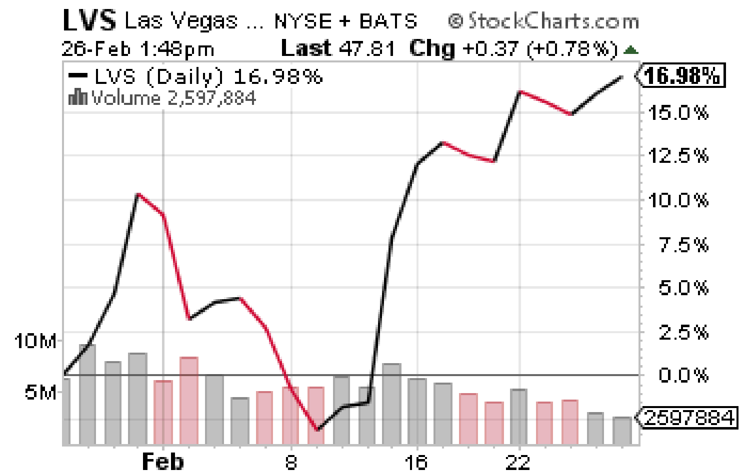
Portfolio Update

February treated investors somewhat better than the rocky month of January where the S&P 500 lost over five percent in that first month. Volatility continues to see occasional spikes as worries about global growth, fallout from the collapse in oil and commodities, and the Federal Reserve's next move will be proliferate. Many areas of equities continue to be in bear markets. These include the energy and commodity sectors but also emerging markets, biotech, and small cap stocks.

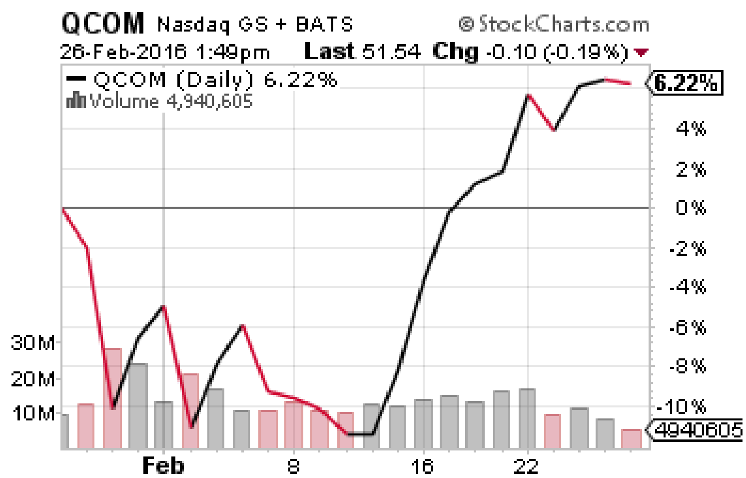
Blue Chip stocks are holding up much better than the rest of the market as one would expect given the "risk off" environment for equities right now. We saw some solid performance from several names in our portfolio over the last month despite a challenging market.

Macy's (NYSE: M) continues to add to its gains since being put in the portfolio late in 2015. The retailer easily beat on the top and bottom line expectations when it reported quarterly results earlier this week. The company also noted it is seeing "high interest" as it begins to contact parties regarding real estate deals. **Foot Locker (NYSE: FL)** also had a very nice month as retail has been quite strong overall in recent weeks.

Two of our stocks with high exposure to China also had very solid months. **Las Vegas Sands (NYSE: LVS)** is up some 15% since our last update. Traffic on Macau was strong and up from last year for the long Lunar Day holiday period. The company should also face easier comps in 2016 compared with 2015. **Qualcomm (NASDAQ: QCOM)** also had a strong February. It continues to make progress signing 3G/4G license deals with major carriers in the Middle Kingdom. Even analyst firm and longtime bear Bernstein changed its rating to a Buy this month.



Valero (NYSE: VLO) pulled back this month primarily to challenges in ethanol pricing (~1/8th of sales) and its request to bring oil to California via rail was not unexpectedly rejected. Our positions in the financial sector continue to struggle to find traction early in 2016. The predicted interest rate rise that was projected to see a gradual rise in rates all year has just not kicked in yet. In fact, as we go to press, the ten year treasury yield is under 1.75%. **Capital One (NYSE: COF)** did have a nice snap back rally over the past month from oversold levels despite this.



Our addition this month, Synchrony Financial, will replace Allergan (NYSE: AGN) which posted a nice gain for the portfolio since its inclusion but has an upcoming merger with Pfizer (NYSE: PFE) which could cause some hiccups for the share price before it is completed. Our AGN position closes with a solid 16% gain, no easy feat in current market conditions.

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Current Portfolio

Company	Entry Date	Entry Price	Recent Price	Yield	Returns	S&P 500 Comp.
Synchrony Financial (SYF)	02/25/16	$27.78	$27.78	-	N/A	N/A
Wells Fargo (WFC)	01/25/16	$47.66	$47.75	3.1%	0.2%	4.0%
Alphabet (GOOGL)	12/28/15	$782.24	$729.12	-	-6.8%	-5.1%
Macy's (M)	11/24/15	$39.63	$43.37	3.5%	9.4%	-6.6%
Merck (MRK)	10/27/15	$53.47	$51.00	3.6%	-4.6%	-5.5%
Amgen (AMGN)	08/28/15	$155.89	$146.75	2.7%	-5.9%	-1.9%
Celgene Corp. (CELG)	06/26/15	$117.92	$102.35	-	-13.2%	-7.1%
Blackstone Group (BX)	05/18/15	$43.64	$25.48	9.2%	-41.6%	-8.3%
Qualcomm (QCOM)	04/15/15	$68.46	$51.64	3.7%	-24.6%	-7.4%
Capital One (COF)	04/15/15	$82.82	$66.42	2.4%	-19.8%	-7.4%
Express Scripts (ESRX)	03/18/15	$83.29	$69.69	-	-16.3%	-7.0%
Foot Locker (FL)	03/18/15	$61.17	$67.03	1.6%	9.6%	-7.0%
AbbVie (ABBV)	02/13/15	$58.05	$56.20	4.1%	-3.2%	-6.9%
Valero Energy (VLO)	02/13/15	$58.60	$60.69	4.1%	3.6%	-6.9%
Gilead Science Inc. (GILD)	01/16/15	$100.71	$90.16	1.9%	-10.5%	-3.4%
Apple Inc. (AAPL)	01/16/15	$105.99	$96.76	2.2%	-8.7%	-3.4%
JPMorgan Chase & Co. (JPM)	01/16/15	$55.93	$57.01	3.0%	1.9%	-3.4%
Las Vegas Sands Corp. (LVS)	01/16/15	$54.89	$47.44	6.1%	-13.6%	-3.4%

Recent Price is updated from stock closings on 02/25/16

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Closed Positions

Company	Entry Date	Entry Price	Close Price	Returns	Close Date
Allergan (AGN)	09/29/15	$254.87	$296.34	16.3%	02/25/16
Bank of America (BAC)	07/28/15	$17.88	$12.96	-27.5%	01/15/16
Micron Technologies (MU)	1/16/15	$28.99	$14.19	-51.1%	12/28/15

Notes:

Entry price is determined by the last "Close" price at the closing of the market on the day before publication. Recent price is determined by the last "Close" price at the closing of the market on the day before publication; most recent update: 01/25/16. Returns is share price appreciation or depreciation between entry price and recent price. S&P Comp. represents the returns on the S&P 500 Index from the point of entry of a stock listed above through the recent price and is meant to provide a comparison to the overall small cap stock market as comprises that index.

This is not real-time data and should not be interpreted as such.