Investors Alley

January 2015 Vol. 1 Issue 1

Bret Jensen's Blue Chip Gems

Welcome

Fellow Investor,

My favorite things to write about and invest in are promising small cap stocks and emerging turnaround stories. Getting one or two of these right in any given year can turbocharge one's portfolio as many can double, triple, or even quadruple if everything goes well over a 12 or 18 months' time span

Unfortunately, these are very volatile areas of the market and for every "home run" an investor is likely to have at least one "strike out". This is why the majority of my own personal portfolio is in stocks of large cap growth companies. These are firms like **Apple (NASDAQ: AAPL)** and **Chipotle Mexican Grill (NYSE: CMG)** that deliver outperformance to the overall markets for years if not decades. They may not double, triple, or quadruple in a year like catching a turnaround play at the right time or finding the right small biotech firm just before it announces the successful trials of a potential blockbuster drug, but they can deliver this sort of return over a decade without the failure rate or big blow-ups of these other more volatile spaces.

In This Issue

Since the majority of my own portfolio has been in these attractively and reasonably priced large cap growth stars for the majority of my three decades of investing, it seemed inevitable and prudent to launch a monthly service dedicated to these Blue Chip Gems to pair with the more volatile Small Cap Gems and Turnaround Stock Report to offer more choices and ways to diversify one's portfolio to mitigate risk.

There are several things I look for when selecting a company for inclusion into my large cap growth portfolio. Obviously the stock must have an attractive valuation compared to its long term growth prospects. Good management as well as sustainable and defensible market positions are also requirements as well.

I also will not put companies dependent on pricing of an underlying commodity within this portfolio. No energy exploration and production companies or miners therefore will be selected for the Blue Chip Gems portfolio of my top 20 large cap growth plays in the market. This is also true for cyclical plays like automakers. These are the type of stocks that investors should be comfortable holding within their portfolio for a half-decade or more.

We will kick off Blue Chip Gems with two great large cap growth plays in our inaugural issue in mid-January. From there we will add two to three new positions a month until we have a diversified portfolio of my top 20 names currently in the large cap growth space.

Every month thereafter we will modify the portfolio as needed to take profits on some positions that hit our price targets and/or better values become available elsewhere. I very much look forward to launching this service and start to build an optimized Blue Chip Gem portfolio.

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

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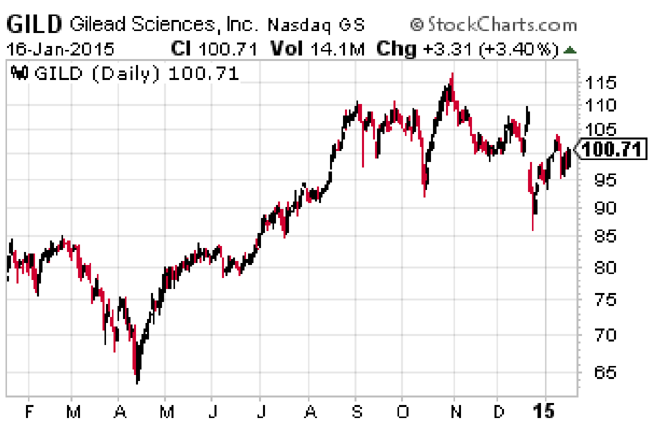
Gilead Science: A Cheap Biotech Juggernaut that Just Keeps Giving

Our first position in the Blue Chip Gems portfolio is biotech juggernaut **Gilead Sciences (NASDAQ: GILD).** My regular readers on Real Money Pro, SeekingAlpha, and Investors Alley know that I have been an unreconstructed bull on this core biotech concern since they traded at $40 a share two years ago. The stock has more than doubled since then and I have not sold a single share despite the fact this is by far the largest position in my own personal portfolio.



The stock has declined some 20% recently on concerns around new competition in the hepatitis C space from new products from **AbbVie (ABBV: NYSE).** I think the pullback caused by this possibility is much overblown and have increased my long exposure in the recent decline.

Gilead had the biggest drug launch in history – based on first year revenues – in history in 2014. The company continues to dominate the HIV space which is still seeing sales growth of some 10% annually. Gilead also has a deep and promising pipeline focusing on various diseases with a particular focus on oncology which investors are putting no value on at current stock levels. Let's break down each of these value drivers in building a very attractive investment case for this biotech giant.

HIV Franchise:

Anyone that came of age in the 80s and early 90s remember what a scourge AIDS was. The epidemic made Ebola look like a walk in the park as far as the numbers infected. This is the space that Gilead first made its bones in the 90s beating major pharma firms in developing the most effective drugs to make this dreaded and lethal disease manageable.

Gilead continues to build upon its market leading franchise consistently running out more effective, easier to use drugs with fewer side effects. This business is still seeing revenue growth of approximately 10% annually as the disease has been made manageable but not eradicated. The company just signed an agreement with Janssen, **Johnson & Johnson's (NYSE: JNJ)** biotech unit to expand their partnership in the HIV space.

These partners are working on the next iteration of HIV drugs. A development and commercialization of the once-daily regimen treatment for HIV infection is in Phase III trials using a combination of drugs from both partners. Gilead will see combination through to approval and Janssen will then distribute in at least 17 major countries. Gilead's HIV franchise consisting both of its own propriety drugs and those used in combination with drugs from other pharmaceutical companies to treat this disease make up the majority of the approximate $12 billion in annual sales the company will see when FY2014 numbers are final outside of its blockbuster hepatitis C drug launches.

Hepatitis C:

Gilead's hepatitis C drug Sovaldi is tracking to being the biggest drug launch in history based on first year sales. Harvoni, which is a just approved hepatitis C combo drug, was recently approved and racking up impressive sales as well. Harvoni replaces a couple previous hepatitis C combos using Sovaldi and drugs from other partners. Harvoni has a much lower cost to insurers and patients, have much less side effects and in some cases can be effective in eight week once a day regimens instead of 12 weeks. Sovaldi and Harvoni should see sales in FY2014 of approximately $12 billion.

The stock of Gilead has been racked recently as **Express Scripts (NASDAQ: ESRX)** decided to offer only new hepatitis C products from competitor AbbVie to the 25 million individuals in its network for the most prevalent type of hepatitis C.

This so called Viekira Pack is inferior to Sovaldi/Harvoni in several key traits. Unlike the one pill regimen from Gilead, Viekira consists of several pills that have be taken at different times twice a day, lowering compliance. In addition, the drug pack can have some of the same side effects of the previous hepatitis C combo drugs Harvoni replace including flu like symptons. It also cannot be used with certain other medications a patient might be on or with certain medical conditions like anemia.

Sovaldi/Harvoni have none of the these issues. Nor is Viekira that much cheaper than Sovaldi/Harvoni on a percentage basis. Express Scripts covers less than 10% of the domestic population and I don't see this as the threat the market is pricing in with the recent 20% decline in Gilead shares. Morgan Stanley recently came out with comments saying this development might reduce Gilead's market share in this space from 90% to 75% over time.

Given there are over 150 million people infected with hepatitis C worldwide and Sovaldi/Harvoni has been used to cure less than on quarter of one percent of infected individuals globally, this franchise has a huge growth ramp. Sales are just getting started in Europe and should be approved in Japan soon, which has one million infected individuals. After posting sales of ~$12 billion in FY2014, estimates range from $14 billion to $20 billion for Sovaldi/Harvoni in FY2015.

Pipeline:

Gilead is not a one or even two trick pony. It has one compound "Viread" that is doing approximately $1 billion in sales to treat hepatitis B, a less deadly but more prevalent version of hepatitis. It is also doing trials on the active ingredient in Sovaldi to treat hepatitis B and other diseases of the liver. Not to mention numerous compounds in various trials to targeting the respiratory, oncology, and hematology spaces.

Besides the drugs from its core HIV and hepatitis C franchises, Gilead's other products include AmBisome (treatment of fungal infection) and Letairis (treatment of pulmonary arterial hypertension) as well as Cayston (improvement of respiratory symptoms in patients suffering from cystic fibrosis with pseudomonas aeruginosa) and Ranexa (chronic angina). The FDA recently gave approval to Gilead's new drug Zydelig for treating three cancer forms has further boosted Gilead's product portfolio.

Gilead also has a lot more "shots on goal" in development. Given Gilead's increasing free cash flow I would not be surprised if the company becomes more active via acquisitions. After all it was Gilead's $11 billion acquisition of Pharmasset in 2011 that brought it Sovaldi/Harvoni, a purchase that will eventually be a Harvard Case Study of an acquisition that created massive shareholder value.

Balance Sheet & Valuation:

The company has a pristine balance sheet and rapidly increasing free cash flow thanks to the blockbuster success of Sovaldi and Harvoni. It is using a greater portion of free cash flow – which should total between $10 billion to $15 billion in FY2015 – to increasingly buy back its own cheap shares. In the last completed quarter the company bought back $1.7 billion in its own stock. RBC Capital recently speculated the company could and should do a $10 billion accelerated buyback in 2015 which would retire approximately six percent of its outstanding float at current prices boosting earnings by a similar amount.

The company earned just over $2.00 a share in FY2013 but is tracking towards nearly $8.00 a share of profit in

FY2014. The current consensus shows that exponential earnings growth slowing with $10.00 a share of earnings expected in FY2015, “only” a 25% year-over-year increase in profits. This means the stock, despite its huge growth prospects, is going for 10 time forward earnings in a market that currently fetches 16 times forward earnings.

Summary:

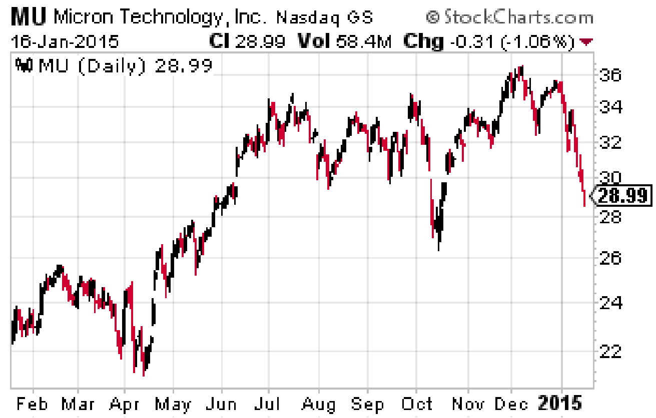
Gilead has everything a large cap growth investor should want in a long term core investment in the biotech space. It has a cheap valuation, impressive earnings and revenue growth, a deep pipeline and expanding free cash flow. The company is extremely profitable averaging between 86% to 88% gross margins and operating margins north of 60%. It is hard to see how the company does not continue to reward its shareholders just like it has for two decades. Thanks to a recent unwarranted decline, investors are getting a great entry point to pick up this biotech juggernaut.

Recommendation: Anything under $110 a share is a gift as this is a long term core holding that I expect to be in the Blue Chip Gems portfolio for many years.

Position: Long GILD

Micron: A Cheap Tech Stock

Beginning our diversification process, our second selection for our Blue Chip Gems portfolio is a chipmaker named **Micron Technologies (NYSE: MU).** About two thirds of Micron’s revenues come from Dynamic Random Access Memory (DRAM) chipsets. DRAM shipments have had and will continue to have strong demand primarily driven by the explosion in mobile devices where DRAM is used in smartphones, tablets and a variety of mobile and other devices. This type of memory is also used in service, solid state drives (SSDs) and a variety of other computer devices. Most of the rest of Micron’s sales come from NAND chips, also known as “flash” memory.



Micron had a very strong first half of 2014 but the stock has spent most of the last six months consolidating in a relatively narrow trading range. I accumulated a significant stake when the entire chip sector sold off on a warning from **Microchip Technology (NASDAQ: MCHP)** in early October. This effectively pushed Micron’s stock down to under $30 a share briefly before it became apparent that Microchip’s take on the chip market was not a “canary in a coal mine”.

Now new worries on rumors that Samsung is going to be expanding DRAM capacity, concerns about global growth and just general volatility in the market have brought the shares down below $30 a share once again as we go to print.

The company reported earnings on January 6th. Micron beat earnings expectations by a nickel a share on a 13% year-over-year increase in revenue. Still sales were a bit light and the company issued conservative guidance even as gross margins increased to 36% from 33% in the previous quarter. I am not surprised guidance was tepid given the first quarter after the holidays is always seasonally weak. Combined with the sell-off in the overall market the shares are going for under $30 a share, a great entry point for long term investors.

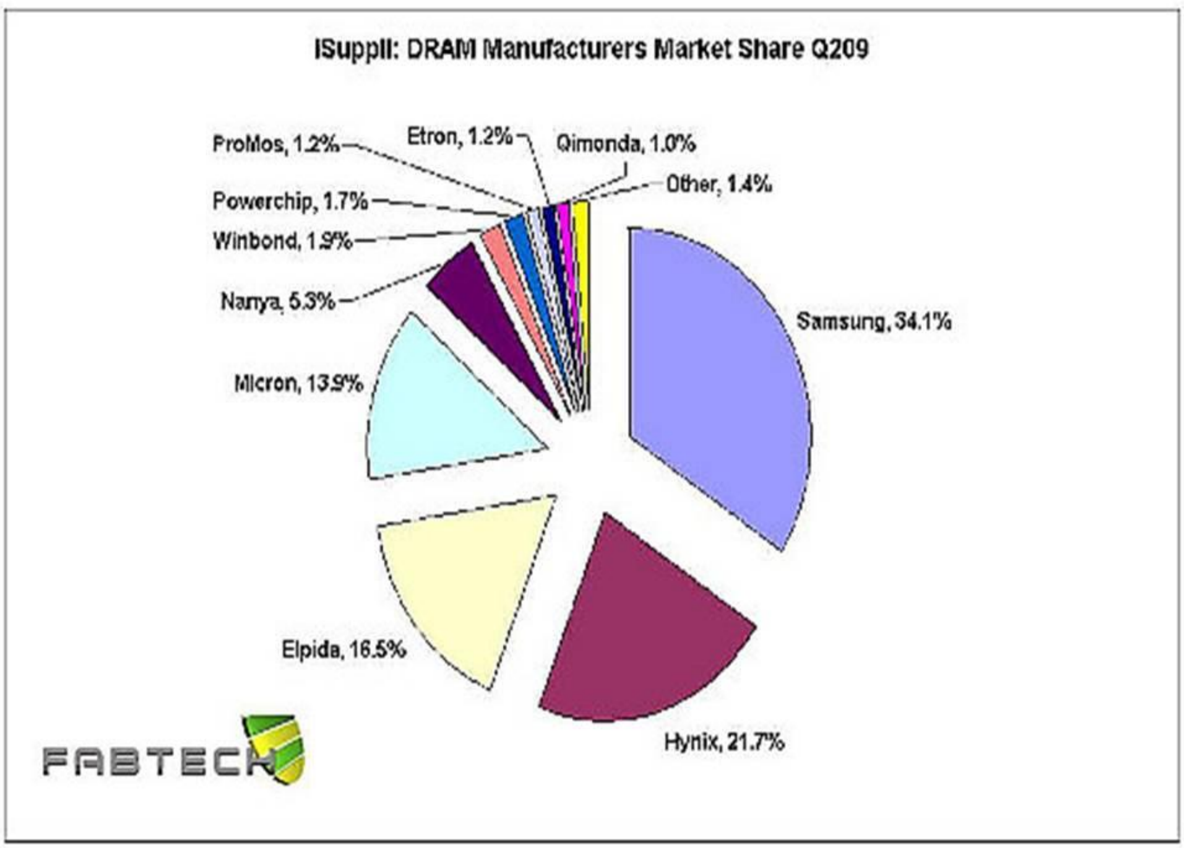
Valuation:

Micron is one of the cheapest large cap growth stocks I own currently. The chip sector is broken down into two basic segments. Chip stocks that are deemed to supply "commodity" chips or in fragmented parts of the market generally are valued at eight to 10 times forward earnings currently. Chip manufacturers that are deemed to dominate their spaces and have pricing power such as **Intel (NASDAQ: INTC)**, **Avago Technologies (NASDAQ: AVGO)**, and **Qualcomm (NASDAQ: QCOM)** typically go for 12-16 times forward earnings in the stock market right now.

This is an anomaly that should correct over time for Micron and this undeserved discount should narrow in the months and the years ahead. The main reason that this chip giant trades at such a discount to the overall market is that most investors have not factored in how much the DRAM market has consolidated over the past five years. Investors are putting a very conservative cyclical based valuation on the stock when it deserves a premium to commodity chip producers.

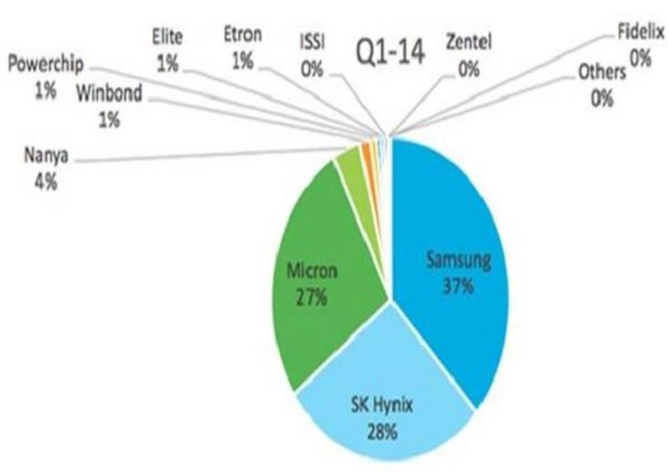
This dirt cheap valuation might have been appropriate five years ago when the DRAM manufacturing space was much more fragmented than it is today which can be seen above. However, over the past few years the market has consolidated into three main manufacturers. Micron has been the biggest driver of this consolidation wave through its purchase of bankrupt Japanese manufacturer Elipda in 2013. This event greatly enhanced Micron's market share and provided a coup de grace to industry consolidation.

Thanks to the market narrowing to much fewer players, the DRAM space is now an oligopoly with the three main players controlling roughly 90% of the overall market. This greatly lessens the possibility of the prices wars that played havoc with the space in the past and greatly lowers earnings volatility which has not be rewarded with higher multiples yet the way it should. You can see the impact of Micron's integration of Elipda within its recent earnings trajectory. After posting a



*Source: FabTech

small loss in FY2013, Micron made more than $3 a share in profit in the just completed FY2014. The consensus analyst forecast currently has this chip manufacturer posting $3.75 a share in earnings this fiscal year and $4.20 a share in FY2016.



Source: Company Investor Presentation

This is an earnings ramp up that is currently unappreciated and undervalued by the street. A previous announcement by Samsung that it is building a huge facility for DRAM manufacturing also had provided a headwind to the stock of Micron in the back half of 2014. However, this plant will not be online until sometime in 2017. In addition, Samsung's CEO has stated this capacity is only being built to meet new demand and the company has no desire to engage in a price war in an effort to gain market share. I take him at his word given Samsung has enough problems with its recent challenges and eroding position in the smartphone space, especially in China.

Rewarding Shareholders:

Micron is starting to do more to promote its value and reward investors which over time should result in a higher multiple in the market. The company attended a Credit Suisse technology conference and its CEO had the following to say about the outlook for the DRAM business "it is fair to characterize our view of the DRAM business over the next year as continuing to be very, very positive. We see really a very strong demand profile out in the market place for the foreseeable future with strong demand growth in the mobile segment as well as an enterprise".

The company has used approximately 85% of its free cash flow to eliminate convertible notes, improving its balance sheet and the potential for dilution at some point in the future. It also recently announced an additional $1 billion to its stock repurchase program which would retire three percent of its float at current prices. I would not be surprised if at some point in the foreseeable future the company uses its increasing free cash flow to initiate a dividend to further reward shareholders.

Analyst Commentary:

One thing I have noticed and I think bodes well for the stock in 2015 is that the company is starting to pick up increasingly positive commentary. Here is just a sampling from the past couple of weeks.

Three weeks ago Nomura raised its price target to $45 a share from $40 a share previously. The analyst noted even this price target assumed "consensus revenue and margin expectations that remain conservative."

A few days later Summit Research Partners reiterated its Buy rating and $50 a share price target on Micron. Summit noted "Micron's forward P/E hovers around 8 when both the underlying markets DRAM and NAND are likely to grow 15 percent and 10 percent at least per industry sources (notwithstanding MU's specific sub-segments of focus exhibiting higher growth such as mobile and server DRAM and Enterprise SSD)."

Not to be outdone Needham slapped a Strong Buy rating and a whopping $60 a share price target on Micron around the same time. It is the top pick in the chip sector for Needham's analyst in 2015 who noted that the company threw off record free cash flow of $2.6 billion in FY2014 and still has growth drivers ahead of it.

Finally, in the last analyst rating change on Micron one week ago before we go to print was that of Piper Jaffray. Their analyst initiated the stock as a Buy with a $44 a share price target.

Summary:

In summary, Micron is significantly undervalued given its growth prospects, strong fundamentals in its core DRAM and NAND businesses and the changing nature of the DRAM market. I feel this Blue Chip Gem has plenty of capital appreciation ahead of it as earnings continue to increase and as investors start to give the company some credit for the consolidation that has gone on in the DRAM space over the past few years.

This should narrow the discount between where commodity chip players are valued and where Micron deserves to be. We plan to hold the stock until it achieves a valuation of 12 times forward earnings which is the bottom end of the range where more premium chip makers are currently valued in this market. When the stock reaches that bogey we will reassess Micron's future prospects from a much higher share price level and determine whether it still belongs in the Blue Chip Gems portfolio or whether to take our gains.

Position: Long MU

Apple: The easiest single stock decision in the current market

It would almost seem comical to kick off a large cap growth monthly newsletter without having **Apple (NASDAQ: APPL)** as a core inaugural position. Not only because I have been a huge "bull" on the stock over the last 18 months within pieces in Seeking Alpha, Real Money Pro, and Investors Alley, but also because it is probably the easiest one decision stock in the tumultuous market as we go to print.

This tech juggernaut is not the "screaming buy" it was in the summer of 2013 when I was in "pound the table" mode when pundits were routinely questioning whether the Cupertino based tech giant had lost its "mojo" after the passing of Steve Jobs. However, the shares still offer unquestionable if slightly less exciting value in what I consider a slightly overvalued market to begin 2015.

Let's take a look at a couple of core reasons I believe Apple's winning ways will continue into the New Year and the stock will continue to outperform the overall market in 2015 and beyond.

Last Man Standing:

One of the sillier arguments for when Apple fell out of investors' good graces a year and a half ago was that the smartphone space was increasingly tilting to market share leader Samsung. The theory went that Apple's market leading margins would have to come down to the Asian giant's 20% level from the almost 40% they currently commanded.

First, Apple never intended on the capturing the "mass market" like Samsung. It is and will continue to be focused on the upper end of the smartphone space which has higher margins. Second, Apple was in one of weakest points within its product line cycle in quite some time when the shares went under $400 a share (split adjusted) in June of 2013. With the launch of the iPhone 5S/5C, the larger screen iPhone 6 line as well as Apple Pay the company is in the middle of its strongest product line ups in at least four years. This bodes well for continued strong margins. Finally, investors were not giving Apple credit for its massive and expanding ecosystem. We will cover that in detail in the next section as it is important part of the stock's continuing value story.

As we go into 2015, it is Samsung that has lost its way with a declining stock price and surrendering its top position in China's smartphone market as it loses ground in the mass market Apple has prudently chosen to avoid in the low end of the space. Samsung's recent troubles should not be any surprise. Apple has taken on and vanquished all comers since it created the smart phone space with the launch of the original iPhone.

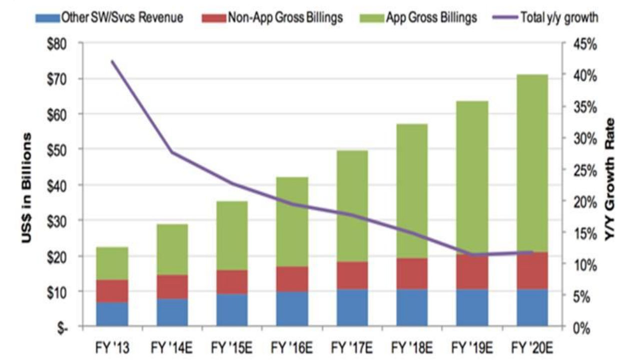
Palm is long gone, **Nokia (NYSE: NOK)** sold its handset business to **Microsoft (NASDAQ: MSFT)** last year which continues to struggle to get any traction in the space. Even once mighty **Blackberry (NASDAQ: BBRY)** is trying to migrate to being an enterprise software provider as it continues to post losses and cede market share on the hardware side. Nothing on the horizon seems remotely imminent to knock Apple off its perch as the dominant and by far most profitable player in the smartphone sector.

Massive Ecosystem:

One of the core reasons for Apple can maintain and expand its dominant position in the smart phone and other tertiary spaces is that it has simply the best ecosystem going right now. Even though sales for iTunes are declining, the company has over 750 million unique accounts with credit card numbers on file. This is one reason Apple Pay has gained such traction in mobile payments soon after launch where others like Google Wallet have failed for years to gain critical mass.

The appeal of Apple Pay also powers additional iPhone 6 and iPad sales as this desired functionality is only available on new Apple devices. These new users then widen Apple network effects further. This is a virtuous circle no competitor can match. Apple gets about $20 billion annually from software and services currently, driven mainly by the expanding revenues coming from downloads from the company's App Store. The company gets a 30% slice of every sale from this channel, a very high margin business indeed. As can be seen below, these revenues in this expanding segment are projected to have very impressive growth over the next half-decade and are one of the core reasons to believe the company's overall margins and earnings should continue to be strong in the years ahead.

Fig 6 Apps are the main growth driver within iTunes/SW/Services



Source: Company data, Macquarie Capital (USA), March 2014

Free Cash Flow:

Simply put, Apple is just a free cash flow beast. The company bought back over $55 billion of its own shares in the just completed 2014. It also shelled out more than $10 billion in dividends during the year. A lot of *countries* wish they had that sort of spending ability. Despite this, the company ended 2014 with over $120 billion of net cash and marketable securities on the balance sheet.

I don't believe the company will buy another $50 billion plus in stock in 2015. However, given the company has never done big acquisitions, I would expect Apple to continue to return a good portion of free cash flow to shareholders in 2015. A target of $20 billion to $30 billion in additional buybacks as well as another 10% to 15% dividend hike appears to be reasonable expectations in the New Year.

Other Factors:

Falling energy prices across the globe is good for additional discretionary income and spending. Some of that extra cash will find its way to additional mobile device sales and App Store downloads which should be at least marginally positive for growth prospects.

The strengthening US dollar will crimp overseas profits. However, most of the company's manufacturing is done in Asia where a stronger dollar will improve margins. I see this currency trend as mostly a wash for Apple unlike a lot of other American multi-nationals where it is decidedly negative.

The new iWatch should launch by spring. The roll out should generate considerable positive buzz for the company. In addition, it is one more product that will raise the overall gross margins for Apple as it is in a sweet part of its product cycle right now. Finally, if successful the iWatch could be the first in a long line of devices aimed at the new market category “wearable technology”.

Outlook & Valuation:

I don’t expect Apple to provide the same approximate 80% return to shareholders the stock has done since its recent bottom in the early summer of 2013. However, I do expect the shares to continue outperform the market.

The stock trades at around 12.5 times forward earnings, an approximate 20% discount to the overall market multiple even though Apple should provide higher rates of revenue and earnings growth in the foreseeable future. If one equates for the net cash on the balance sheet, the shares go for right around 10 times forward earnings.

In addition, after its next dividend hike the stock should provide around a two percent yield at these levels making it also somewhat attractive to more income orientated investors. The hard start to 2015 for the overall market has clipped some 10% off Apple’s recent highs providing a solid entry point for long term investors in what looks destined to be the first trillion dollar company by market capitalization in history.

Position: Long AAPL

J.P. Morgan: Brighter days ahead for this blue chip bank

The last couple of years have been very challenging for investors in major banks. After popping off pre-crisis lows in the first couple of years after the recession officially ended in June 2009, the past couple of years have been a Ying & Yang environment for TBTF (Too big to fail) financial institutions.

Historically low interest rates have pressured net interest margins and an anemic recovery has kept loan growth to a minimum. Most importantly, the major banks have paid more in fines and settlements to various state and federal governmental agencies than they ever booked in credit losses during the financial crisis and its immediate aftermath. It seems every time it appeared the skies were clearing on this front another multibillion dollar fine would be leveled against one of these banks while Fannie Mae and Freddie Mac remain wards of the state and untouched by any reforms.

However, 2015 might finally be the year that the industry returns to some level of pre-crisis normalcy. My pick in this space is **J.P. Morgan (NYSE: JPM).** The bank was one of the few major financial institutions that could have navigated the financial crisis without federal largesse and it remains one of the best managed banks in the sector.

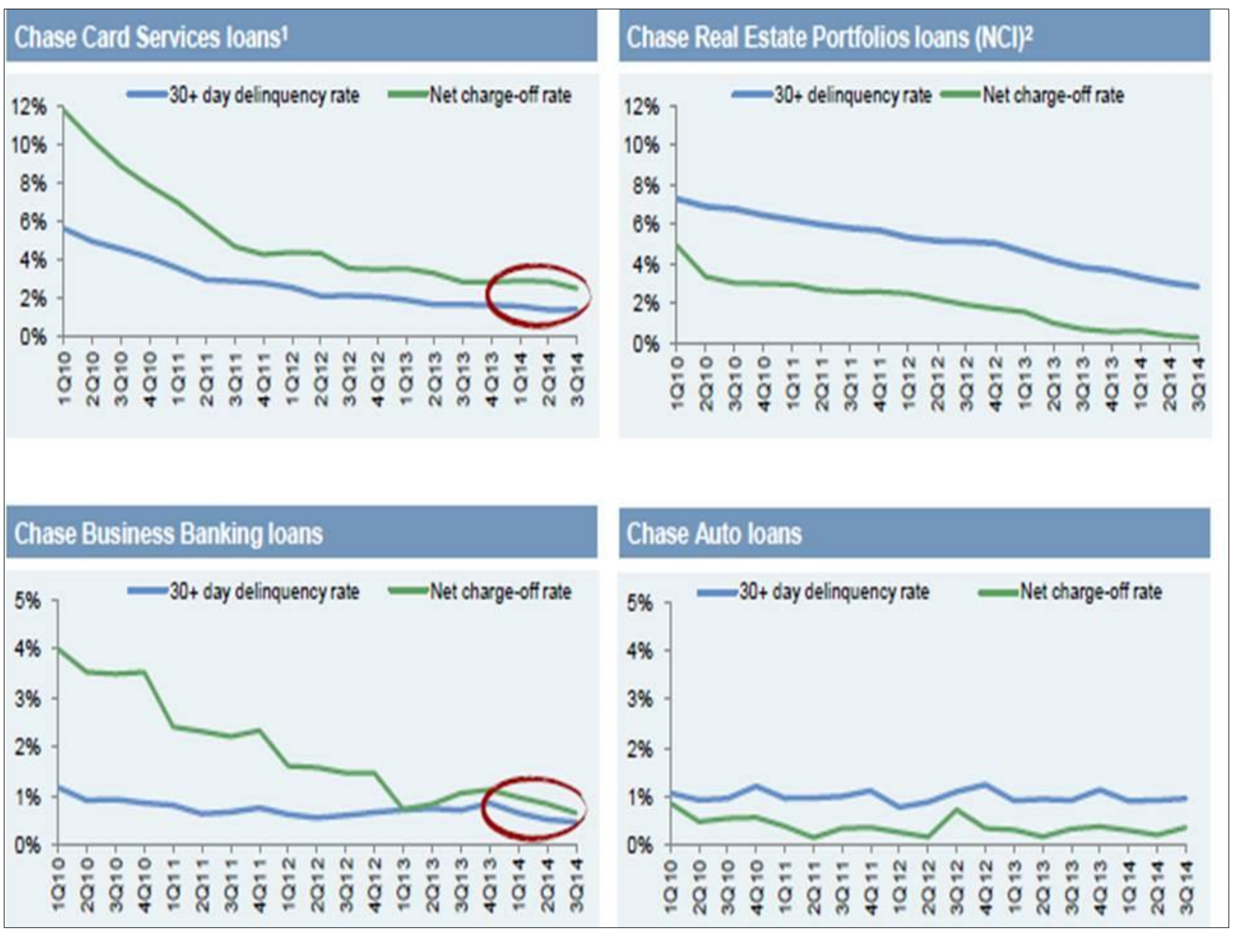
There are several reasons I like J.P. Morgan as our bellwether in this space. Among them is I believe the majority of its litigation woes are behind it, the economy should post its best growth in 2015 since the weakest post war recovery "officially" ended in June 2009 and the stock's valuation and dividend yield are enticing at current levels.

Litigation Gauntlet Ebbing:

Other than **Bank of America (NYSE: BAC)** it is hard to find a bank that has been singled out more for punishment than JP Morgan in the past five years. Although it had about half the amount of subprime loans as **Citigroup (NYSE: C)** it has paid roughly twice the fines and settlements. JP Morgan has offered up more than $20 billion in total to various state and federal agencies covering a range of alleged transgressions. Some 70% of the settlements have originated from the Bear Stearns and Washington Mutual businesses before they were acquired at the very strong urging of the federal government during the financial crisis. Such is the capriciousness of regulators.

You can see the impact of these litigation costs in the company's latest earnings report that came out on January 14th. The results included $990 million in after tax costs for various legal charges during the quarter. Without those charges, headline earnings per share would have been $1.54 vs. $1.19 reported and estimates for $1.31 a share. The stock dropped just over five percent on the news creating a nice buying additional buying opportunity for long term investors.

However, it now appears this financial institution has offered up its "pound of flesh" and banks can look forward to fewer headwinds from state and federal agencies going forward. The attorney general announced his resignation recently and the deputy AG that was spearheading the jihad against the banks has already left for private practice.



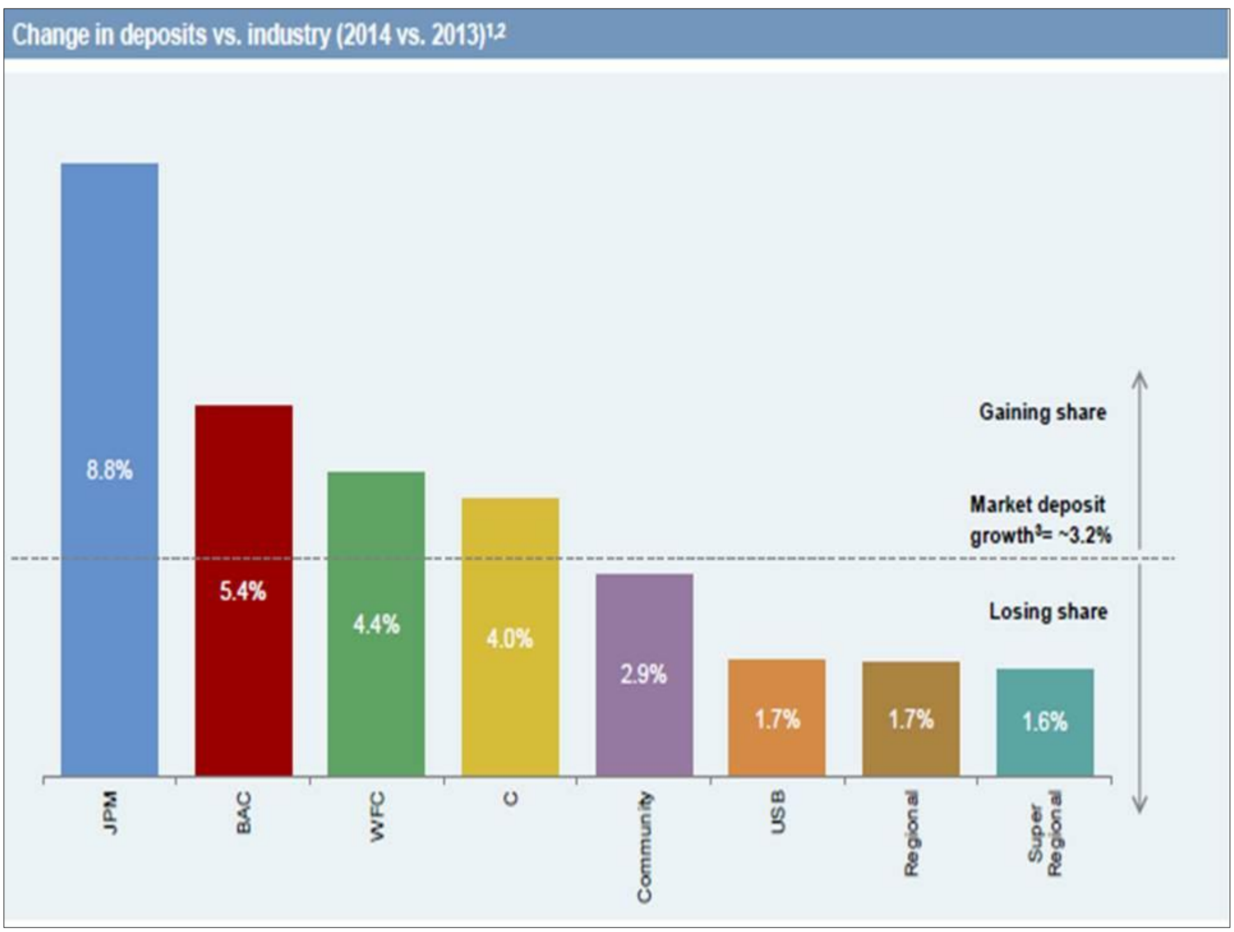
In addition, the midterm elections brought Republicans control of the Senate as well as furthering their numbers in the House. Government agencies such as the E.P.A, F.C.C., and even the Justice Department can be expected to see more scrutiny around their actions which should add an additional check on any excessive regulatory actions. More importantly, the economy has shifted to a more robust growth level in 2014 which hopefully will allow us to move on from reliving the financial crisis and scapegoating major banks as there was plenty of blame to go around for the housing debacle and its associated aftermath.

Economic Catalysts:

Obviously a more robust economy would bode well for banks and JP Morgan on a variety of levels. Credit losses should continue to shrink as consumers have bigger paychecks and more income to pay their bills in a timely manner. Loan growth to business, which has been anemic throughout the recovery, should pick up and bolster revenues.

The bank is already seeing an increase in consumer and small business loans and few financial institutions are more tied to an improving economy. JP Morgan is the leading credit card issuer by loans outstanding, is number two in mortgage origination and servicing, and is the third leading non-captive auto loan originator in the country as well.

If we do start seeing three percent or better GDP growth on a regular quarterly basis, one thing to expect is that interest rates should start to rise off their current anemic levels. Even a little boost this year would be a major help to banks as it would expand their net interest margins and profits. If interest rates do rise in 2015 look for banks and insurers to be the beneficiaries

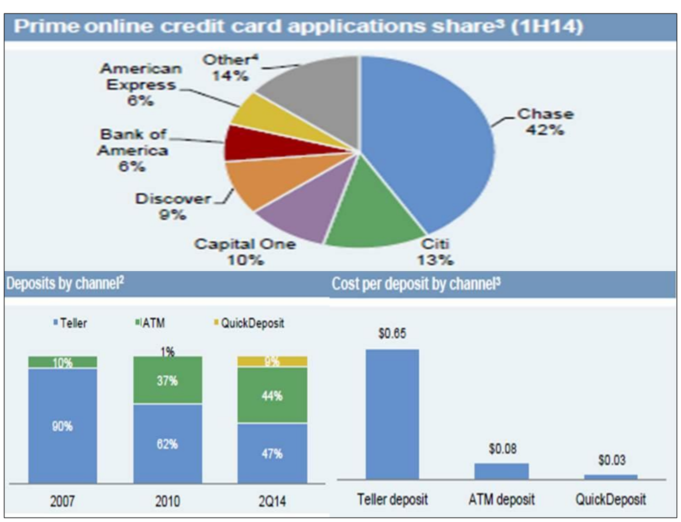


of improving sentiment from investors and one of the better performing sectors in the market. I put a high probability of this occurring sometime in the next few months, especially given the Federal Reserve has ended quantitative easing and the economy does seem like it has moved to a higher growth trajectory.

Management & Other Factors:

JP Morgan is winning in the marketplace. The bank saw deposit growth of over eight percent year-over-year in 2014, easily the best among the major banks. It was the third straight year it has led in this category. The bank is also rapidly gaining market share in fast growing cities it is expanding into like Miami. Impressively it also saw market share gains in slower growing cities where it is consolidating branches.

One thing I like about the bank's management team is it is not resting on its laurels. Expenses should be $2 billion lower in 2016 than their base level in 2014 as the company continues to consolidate real estate and better utilize technology to serve their consumers. The company reduced expenses from ongoing operations by $2 billion as well in the just completed year. JP Morgan has the most visited online banking portal and is without peers in acquiring prime customers via the internet. It has also been very successful in driving customers to make deposits outside using an ATM which radically drives down the cost per transaction.



JP Morgan is also nicely positioned as it does little overseas business especially in emerging markets which are having major problems due to plunging commodity prices like Brazil. In addition, most of the build out of the energy sector over the past few years was financed via the high yield markets or small to mid-size banks in the oil patch. This means JP Morgan should not be impacted to any significant degree if we start to see bankruptcies in that space due to the steep plunge in crude oil prices.

Any pickup in Europe would be a nice tailwind for its capital markets business and a rise in interest rates should also benefit its fixed income trading revenues. The main driver of the bank's fortunes in the years ahead however will be an improving domestic economy.

Valuation & Summary:

Despite the economic aftermath of the financial crisis, the weakest post war recovery on record and serving as a piñata for numerous state and federal regulators JP Morgan has continued to drive its business forward. Profits after non-recurring items surged better than 20% in 2014 with another 10% seems in the cards for this year.

In a market that currently goes for approximately 16 times forward earnings, the stock of JP Morgan stands at under 10 times FY2015 consensus earnings per share projections. Some discount to the overall market is warranted but this seems excessive and should narrow as the economy continues to improve and as regulatory actions and related fines ebb as well.

Add in a 2.6% dividend yield which should continue to move up nicely as JP Morgan puts the aftermath of the financial crisis behind it and the bank is a compelling value play.

The shares are not going to double overnight but could easily do so over the next 4-6 years. I expect the stock to deliver annual returns in the low to mid-teens for the foreseeable future. This easily beats my outlook for equities overall and is why JP Morgan is included on our inaugural list of Blue Chip Gems.

Position: Long JPM

Las Vegas Sands: Blue Chip Gem Is On Sale

"I'm shocked, shocked to find that gambling is going on in here!" – Casablanca (1942)

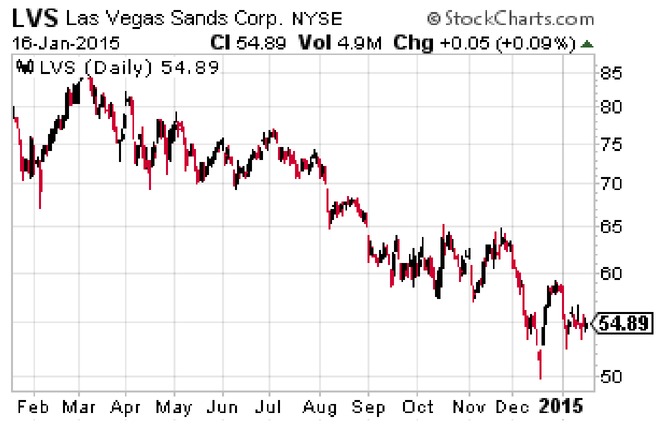
Our last inaugural pick might be the most controversial and I advise subscribers to build up a position in this Blue Chip Gem over time and incrementally as the company's core market is going through a bit of a "hiccup" right now. However, over time this is a solid growth play that is offering an attractive entry point for long term growth investors.

The stock is that of casino AND hotel concern **Las Vegas Sands (NYSE: LVS).** The name of the company probably should be changed as little of its revenues or profits come from the Las Vegas strip anymore. Over 80% of its revenue comes via Asia with the gambling mecca of Macau making up roughly two thirds of "Las Vegas" Sands overall sales.

Macau has exploded over the past decade and now dwarfs Las Vegas as the biggest gambling market by sales and the gap continues to grow. This has been very good for the shares of Las Vegas Sands (below) for most of that time period until recently.

Recent Events:

The company is one of the few that have a concession to operate gambling activities on this enclave and constantly vies for market share leader with just under 25% of overall gaming revenues in Macau. 2014 was the most challenging year in a decade as new leadership in China cracked down hard on corruption and high end gambling junkets that can be used for alleged money laundering. They even netted a former defense minister that had somehow accumulated over $10 billion in assets while on a government salary – nice work if you can get it.



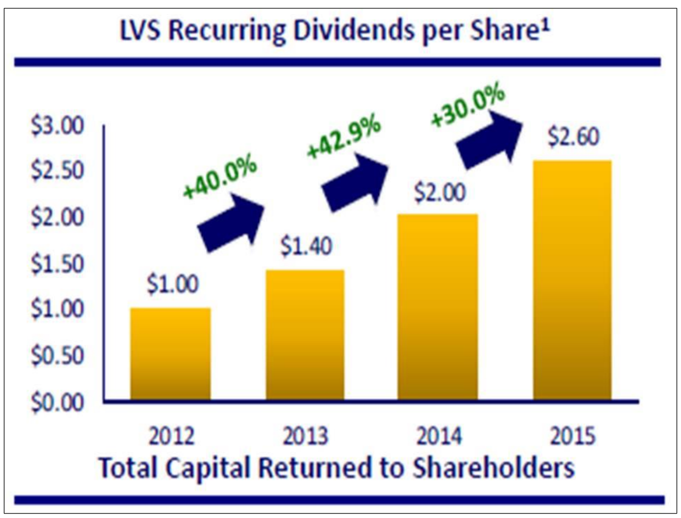
A new regime cracking down on corruption as it assumes power is nothing new in the Middle Kingdom as has been going on for decades. Corruption remains rampant as once new leadership is firmly installed things have a way of going back to normal. The stock has fallen more than $30 a share from highs earlier in the year, providing an attractive time to start to pick up shares and build a position.

The new leadership in China seems to be intent on starting to open up the economy which bodes well for Macau and Las Vegas Sands over the long run. The country announced late last year a Hong Kong mainland stock link which will allow global retail investors access to Shanghai-listed stocks for the first time ever, and mainland investors will be able to trade Hong Kong-listed shares.

The crackdown on corruption and "discouraging" of luxury has had some interesting and disparate impacts in 2014 especially in two of China's favorite pastimes, drinking and gambling. Scotch exports to China were down one third this year and traffic to the gambling mecca to Macau has dried up.

Long Term Outlook & Rewarding Shareholders:

Once the country gets back to "normal", growth should return to Macau boosting the fortunes of Las Vegas Sands and the other casino operators on the island. Even as Macau has weighed heavily on the stock over the past six to nine months, the company has continued to reward shareholders. In its last reported quarter, the company gave shareholders approximately $400 million in dividends and bought back $300 million in stock. The company also just raised its dividend payout 30% starting in its first payout in 2015 and added $2 billion to its stock buyback authorization program. Las Vegas Sands has said it will buy at least $75 million every month under this repurchase program. The latest dividend hike is just the latest bump to reward investors over the years.

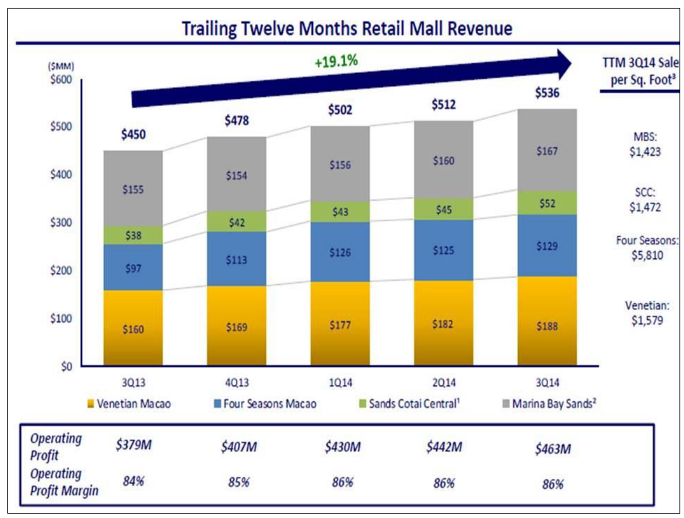


With the new dividend increase, the shares will yield almost four percent (4.75%) which should attract income orientated investors and help put a floor under the stock at current levels. The company has increased its dividend by more than 150% since FY2012 and I look for the company to continue rewarding shareholders by using its free cash flow to increase dividends and buy back stock.

Las Vegas Sands is the best positioned gaming concern to continue to benefit from the growth of gambling in Asia. It has a major casino complex in Singapore, continues to add facilities in Macau and should be a major beneficiary should Japan ever allow full scale gambling. Given the state of the country's finances and huge debt levels it is hard to imagine this will not happen over time.

A Hidden Gem:

The most underappreciated part of the growth story and value of Las Vegas Sands' is its very high end retail properties in within its hotel and casino complexes. As can be seen below these retail sales sport extremely high gross margins, are growing rapidly and these stores have huge sales per square foot metrics. I have seen several valuations on these high end properties that generally fall into the $10 billion to $12 billion range. At current levels this little recognized part of Las Vegas Sands' operations are worth 20% to 25% of the company's overall market capitalization:



Focusing on Mass Market:

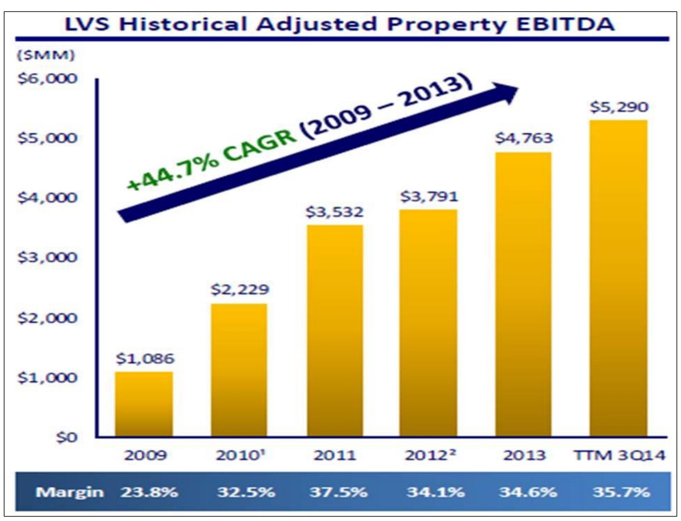
Another part of Las Vegas Sands that I like that is poorly understood by the market is how it has expanded its exposure to the mass market part of the gambling population over the past few years. It is becoming less dependent on those "whales" brought in on high end junkets that the current Chinese government is putting significant scrutiny on over the past half year or so. It has by far the most hotel rooms in Macau.

This bodes well for more stable growth over the long run. I also expect the recent collapse in energy prices will act in the same way as a "tax cut" in Asia just like it has in the United States. This could be a tailwind for visits to Macau at some point in 2015. This should also help its properties in Las Vegas as well. As things currently stand the amount of Chinese expected to travel outside China is projected to double the roughly 100 million that do so now.

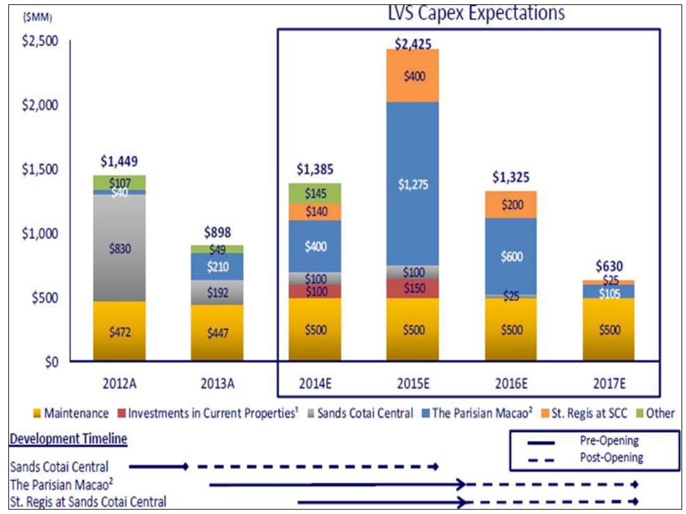
This appeal to the mass market will accelerate in the back half of 2015 as the company's $2.7 billion 3000+ room hotel and casino named the Parisian Macau comes on line with 450 table games, 2,500 slots and substantial new high end retailing facilities.

Balance Sheet & Valuation:

The company has a strong balance sheet with ample flexibility. As can be seen below, Las Vegas Sands has done an impressive job growing EBITDA over the past half-decade. At current levels, the stock is selling at around eight times EBITDA, significantly lower than its valuation in the past.



Even better, 2015 will mark the peak year for capital expenditures as the Parisian Macau gets completed. Combined with new revenue and earnings streams from the new property the amount of money generated that can continue to be returned to shareholders should increase substantially in the years ahead.



Summary:

I think the stock, after already experiencing a deep slide, is in the process of bottoming and will start to move higher in 2015. I have been accumulating shares incrementally recently and will continue to do so during any additional significant dip in the market.

Comps will start to get much easier in the second half of the year as well boosting sentiment in front of the opening of the Parisian Macau. Las Vegas Sands is a great proxy for the long term growth in one of the fastest growing regions in the world.

In addition, the stock is currently on sale. The shares go for 14.5 times forward earnings approximately a 10% discount to the overall market multiple. The company has traditionally traded at a premium to the overall market and will once it gets past this latest blip in the Macau market. In the meantime, the almost five percent dividend yield pays one amply to wait for brighter skies ahead.

Portfolio Update

Normally this would be the section where I would update you on the portfolio holdings and alert you to coming market and economic events and trends that might affect our stocks. But this is the first issue, so there are no updates.

What we do have however is the baseline at the market conditions that influenced my initial stock selections for the portfolio.

2015 has opened up the year with plenty of volatility to start the New Year for investors. The S&P 500 declined some four percent to start January only to make it all back in two sessions in the second week of the year. The second week of trading was just as volatile with an over 500 point swing in Dow Jones Industrial Average during just Tuesday and Wednesday of last week.

Some themes that drove the markets in the last half of the year are still firmly in place. The US dollar continues to strengthen against major currencies and has gained more than ten percent against both the Euro and the Yen since June. This will start to impact earnings for American multi-nationals that derive a good portion of their revenues from overseas.

Crude oil also continues to struggle to find a floor; this continues to provide a major headwind to the energy sector while bolstering transports and consumer discretionary plays like retailers and restaurants.

Europe appears on the edge of recession and worries that Greece could leave the European Union are once again roiling the markets. Despite the ending of quantitative easing by our Federal Reserve and robust GDP growth in the back half of 2014, ten year treasury yields are below two percent. The United States continues to benefit from a flight to quality and remains the best house in a bad global neighborhood for the time being.

Deflation, or the worries about it, is shaping up to be a major new theme for the New Year with Japan in contraction, Europe teetering on entering its third recession in the past six years and the economic situation in China that is murky at best. Commodities should continue to be under pressure especially with a strengthening dollar. Both oil and copper are hovering at 5 ½ year lows.

On a brighter note, falling gasoline prices are a key factor behind consumer confidence being at eight year highs. Domestic vehicle sales are at 2006 levels and job growth just posted its best year since 1999. Unfortunately, the improving job market has not shown up in wage growth and this could continue given the layoffs that seem inevitable in the high paying oil and gas sector.

Hopefully 2015 will finally be the year we see consistent growth of at least three percent on a GDP basis in what remains the weakest post war recovery on record. In order to achieve this, we are going to need to see increased activity from a housing market that is still at tepid levels more than five years since the recession officially ended.

The New Year should be a good one for healthcare, technology, and also hopefully the financial sector. That last one should see regulatory and litigation actions start to recede and hopefully benefit from somewhat higher interest rates and better loan growth in an improving economy. It is in these areas a majority of our selections will come from as we start to build our Blue Chips Gems portfolio.

Current Portfolio

Company	Entry Date	Entry Price	Recent Price	Returns	S&P 500 Comp.
Gilead Science Inc. (GILD)	01/16/15	$100.71	$100.71	N/A	N/A
Micron Technologies, Inc. (MU)	01/16/15	$28.99	$28.99	N/A	N/A
Apple Inc. (AAPL)	01/16/15	$105.99	$105.99	N/A	N/A
JPMorgan Chase & Co. (JPM)	01/16/15	$55.93	$55.93	N/A	N/A
Las Vegas Sands Corp. (LVS)	01/16/15	$54.89	$54.89	N/A	N/A

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: 12/30/14. 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.