Investors Alley

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Bret Jensen's Blue Chip Gems

Caution is the Word Going into Summer

In This Issue

Fellow Investor,

The market continues to trend higher over the past month although it remains in a relatively tight trading range during the past several months. This is a fairly impressive performance given first quarter earnings for the S&P 500 came in flat year-over-year thanks mainly to the strong dollar, tepid global demand and the collapse in profits in the energy sector thanks to much lower oil prices than the same period a year ago.

In addition, earnings could have easily been negative had it not been for the huge amounts of stock buybacks currently being done. In April, companies announced $141 billion of new stock repurchase authorizations; an all-time record. Although a tailwind for earnings, this kind of activity usually occurs near market tops. It also is not encouraging given business investment levels remain very tepid; hardly a vote of confidence by the business sector in the economy.

Not that you can blame corporations. First quarter GDP growth came in with an initial estimate of just 0.2% which will probably be revised lower when all is said and done. Second quarter growth will be better but will not see the four percent plus growth we saw in the second and third quarters of last year as the economy rebounded from a horrid winter. Retail sales have been down or flat for four of the past five months. Consumer sentiment and industrial production recently declined coming in significantly below consensus. Add in the huge amount of regulations added to the Federal Register over the past few years and the current political dysfunction, it is little wonder that “animal spirits” are hardly robust in the economy right now.

I am also watching the sovereign credit markets right now. The ten year treasury yield has backed up some 60 basis points since it lows of the year. German Bunds have also sold off recently. With the Federal Reserve set to raise rates now for the first time since 2006 most likely in September or December of this year I worry that the markets could go through a “taper tantrum” like that in 2013. This was the last real pull back in equities, and a similar occurrence can’t be ruled out.

Finally, Greece is once again on the verge of defaulting and being pushed out of the Eurozone. Although yet another last minute deal to kick the can down the road is the most likely outcome, both sides seem closer to acknowledging what in the end looks like destiny. The continent is much more insulated from this possibility that in was in 2010 or 2011, however, such an event will still bring turmoil to the global markets.

With the markets trading at 18 times trading earnings, interest rates moving up and flat earnings and economic growth so far in 2015 it is hard to be optimistic about the market at current levels. This is about as cautious as I have been since the recession ended in June of 2009. I am up to 15% cash in my portfolio.

It is also hard to find much value in a good portion of the market outside of some financials and some other corners of the market. For this reason, we are only adding one new selection to the Blue Chip Gems portfolio this month. I think that lower entry points will present themselves at some point before the end of summer and want to have a decent amount of "dry powder" to take advantage of any potential bargains.

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. In June I plan to officially launch my new *Biotech Gems* service to the public. Last week we beta published our first issue and took on subscribers. There have been a few requests to open up the service to *Blue Chip Gems* subcribers before going fully public with it. If you're interested in being a beta tester and early subscriber **just click here for a short description of the service and a link to sign up**.

Blackstone Group: High Yield, Value, Sector Dominance

As I said in the opening of this month's issue I am not currently sanguine on equities with the S&P 500 being at all-time highs even as earnings growth was flat year-over-year in the first quarter. I think the most likely scenario over the next few months is that the stock market stays in the trading range it has been over the past few months with a distinct possibility of a decent size pull back should an event boost volatility in the global markets. Possible triggers could be an eventual Greek exit from the Eurozone or a "taper tantrum" should the Federal Reserve raise interest rates for the first time since 2006 sometime in our lifetimes.

This is the key reason we are only adding one new stock to the Blue Chip Gems portfolio this month. I don't think the market is going to run away from us here and a pullback of some sort is at least a decent possibility. Patience is a virtue here and hopefully we will get some lower entry points in the months ahead. It seems like a prudent way to play what is at least a slightly overbought market.

That being said, our current portfolio has performed well overall and stocks have meandered to the top end of their current trading range. There are also still some bargains left in the market for patient long term investors. This is especially true in the unloved financial sector which is performing much better recently as interest rates across the globe have started to rise. Our positions in **JP Morgan (NYSE: JPM)** and **Capital One (NYSE: COF)** have borne fruit and this month we tip our toe further into this part of the market by adding **Blackstone Group (NYSE: BX)** to our portfolio. The stock offers a solid trifecta of growth, value and yield at current levels.

Company Overview:

Blackstone was started in 1985 by Steven Schwarzman together with former Lehman Brothers Holdings Inc. chairman Peter Peterson as a mergers-advisory firm. It went public in a 2007 stock offering organized as a partnership and the founders have built a powerhouse that is the largest publicly owned alternative investment manager in the world with a market capitalization of approximately $30 billion.

The firm manages separate client focused portfolios. It launches and manages private equity funds, real estate funds, funds of hedge funds, and credit-focused funds for its clients which include corporate pension funds, endowments as well as charitable organizations. The company invests in private equity, public equity, fixed income, and alternative investment markets.

Weathering the Financial Crisis:

Unlike firms such as Bear Sterns, Lehman Brothers and others that were sunk in the financial crisis or the banks that have had to completely retrench over the past half dozen years, Blackstone just continues to keep on growing and performing admirably. Blackstone invested most heavily during the period 2009-2013 as in the aftermath of the financial crisis deal valuations were more reasonable than they are currently. Private Equity funds like Blackstone that made substantial investments after the financial crisis are now better placed to generate strong returns. The firm currently has just north of $270 billion under management.

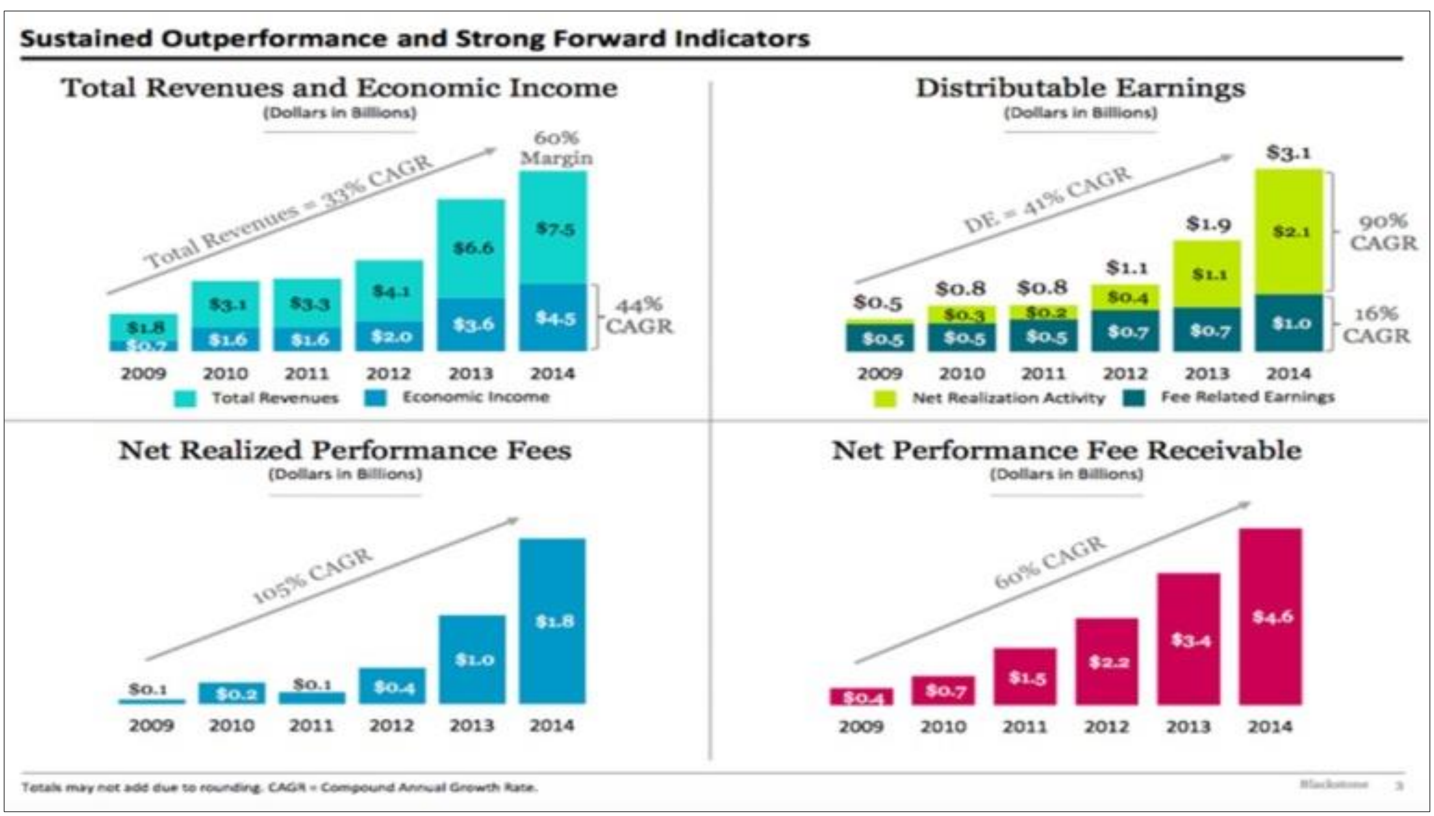
Blackstone is also the largest real estate private equity firm in the world with over $80 billion of assets under management. Half of the firm's unrealized investments are in the real estate area which has done very well over the years thanks partly to the liquidity provided by the Federal Reserve's liquidity efforts which have been a significant tail wind to real estate values.

They say a picture is worth a thousand words and the graphic below visibly shows how these opportunistic investments during this time period has impressively driven significant growth across all of Blackstone's core metrics including performance fees, overall revenues and distributable earnings to shareholders. Rarely do you see this sort of growth over a five period especially in a market starving for it right now. In 2014 Blackstone followed the strategy of selling assets when the valuations were at their peak. Blackstone distributed $45 billion back to its investors through realizations last year.

New Opportunities:

Blackstone continues to use its reputation to raise a remarkable amount of money for new investments even as it opportunistically prunes gains from earlier investments that yielded significant profits. In 2014 the company raised more than $55 billion which is more than the combined total of Blackstone's three top competitors. The company recently announced it has raised another $17 billion over the past seven months for its latest private equity global fund.

Blackstone can use its size and expertise to look outside of domestic opportunities where valuations are much dearer than they were just a few years ago. The investment manager has been busy actioning new investments in Europe where asset values, both stocks and real estate, should be bolstered by the large quantitative easing program initiated by the European Central Bank. Both the bank and Blackstone are executing the same game plan that work so well in the United States, at least in regards to boosting asset values if not successfully getting the economy to deliver above trend growth.



Blackstone has picked up numerous properties in beaten down areas of the Eurozone recently including shopping centers in Spain and Portugal as well as picking up some industrial warehouses in United Kingdom. The company has opportunistically picked up some of GE Capital's prime real estate assets as **General Electric (NYSE: GE)** tries to divest most of its exposure to the financial sector to focus on its industrial businesses. It is also looking at new investments in Australia, Brazil, Israel and other worldwide opportunities.

Valuation and Performance:

In mid-April the company reported economic net income of $1.37 a share; 33 cents a share above the consensus. Q1 economic net income came in at $1.6 billion, up 99% from a year ago. Blackstone also upped its quarterly distribution by 14% to 89 cents a share, giving the stock a forward yield of over eight percent. Based on the last four quarterly distributions Blackstone yields just north of six percent.

Blackstone currently trades at approximately $44.00 a share. The current consensus calls for economic net income per share (the term used for earnings in this space) of $4.07 a share in FY2015 which would be up just under 10% from the previous year. This may prove to be a conservative estimate as Blackstone has crushed earnings expectations three of the last four quarters and estimates have moved up over 30 cents a share since the company reported quarterly results.

Blackstone does not have the upside potential of some of the other stocks in our portfolio like **Gilead Sciences (NASDAQ: GILD)**. However, the six to eight percent yield it should deliver over the next year is at or above the return I expect for the overall market during the next 12 months. Add in 5% to 15% capital appreciation potential, this Blue Chip Gem should easily deliver superior return to equities overall which merits inclusion into the portfolio. The high dividend and relatively low beta of the stock should also reduce volatility of the overall portfolio as well.

Recommendation: Buy BX up to $46.00 a share, collect quarterly dividend payouts; we will re-evaluate if stock hit $55.00 a share.

Position: Long BX

Portfolio Update

Despite mounting worries about the economy and earningsstocks posted a decent gain over the past month. The Blue Chip Gems portfolio also had its share of winners for the month. **Apple (NASDAQ: AAPL)** continues to be the star of the portfolio and moved up more than five percent for the month. China is becoming a huge driver of growth for the tech giant from Cupertino. In its last quarterly report, revenues were up better than 70% year-over-year thanks to the iPhone 6 and its distribution deal from **China Mobile (NYSE:CHL).**

We also got good performance from our healthcare selections. **Gilead Sciences (NASDAQ: GILD)** was up more than 10% over the past month. The company might have been the only large cap growth stock that reported a quarter that was better than Apple. Gilead reported earnings of $2.94 a share, more than 60 cents a share over estimates. Revenue also easily beat expectations with Sovaldi and Harvoni posting quarterly sales of $4.55 billion, one billion over the consensus. Management also raised guidance for FY2015 sales by a cool $2 billion.

Both **Express Scripts (NASDAQ: ESRX)** and **AbbVie (NYSE: ABBV)** posted solid gains over the month and should continue to do well if the market moves to a defensive stance.

Our two financial picks, **JP Morgan (NYSE: JPM)** and **Capital One (NYSE: COF)** had strong months after posting better than expected earnings. The recent rise in interest rates was also a positive. This month we add another financial selection to our portfolio as financials are one of the few sectors where I continue to find good value.

Foot Locker (NYSE: FL) and **Qualcomm (NASDAQ: QCOM)** marched ahead in line with the overall market during the month while **Valero (NYSE: VLO)** pulled back some but is still above our entry point. Our two disappointments this month were **Micron Technologies (NYSE: MU)** and **Las Vegas Sands (NYSE: LVS).** Micron has become a battleground stock with analysts with different views on DRAM pricing. However, the stock is still cheap even in the pessimistic scenario and should do better as approach the seasonally strong back half of 2015. I have added a few shares to my stake recently on the dip.

The Chinese crackdown on corruption continues to impact traffic and gambling revenue in Macau. However, comps should get easier in the second half of the year. In addition, the stock's five percent yield should continue to provide a floor under the shares and pays investors to wait for brighter skies. Free cash flow will increase substantially when the 3,000 room Parisian Macao hotel and casino opens in the first quarter of 2016 which will boost revenues and lower capital expenditure needs.

As always, if you have a question about our portfolio holdings or how they fit the strategy just send me an email at bret.jensen@investorsalley.com.

Current Portfolio

Company	Entry Date	Entry Price	Recent Price	Yield	Returns	S&P 500 Comp.
Blackstone Group (BX)	05/18/15	$43.64	$43.64	8.3%	N/A	N/A
Qualcomm (QCOM)	04/15/15	$68.46	$69.62	2.8%	1.7%	1.0%
Capital One (COF)	04/15/15	$82.82	$85.41	1.9%	3.1%	1.0%
Express Scripts (ESRX)	03/18/15	$83.29	$88.75	-	6.6%	1.3%
Foot Locker (FL)	03/18/15	$61.17	$63.45	1.6%	3.7%	1.3%
AbbVie (ABBV)	02/13/15	$58.05	$65.73	3.1%	13.2%	1.5%
Valero Energy (VLO)	02/13/15	$58.60	$59.88	2.7%	2.2%	1.5%
Gilead Science Inc. (GILD)	01/16/15	$100.71	$110.56	-	9.8%	5.4%
Micron Technologies, Inc. (MU)	01/16/15	$28.99	$26.31	-	-9.2%	5.4%
Apple Inc. (AAPL)	01/16/15	$105.99	$130.07	1.6%	22.7%	5.4%
JPMorgan Chase & Co. (JPM)	01/16/15	$55.93	$67.01	2.7%	19.8%	5.4%
Las Vegas Sands Corp. (LVS)	01/16/15	$54.89	$50.46	5.0%	-8.1%	5.4%

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: 05/18/15. 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.