March 2017 Vol. 2 Issue 1

Investors Alley
Automatic Income Machine

# Volatility Comes Creeping In

The post-election, low volatility stock market rally has given up. It is almost a shock to have a couple of back to back down days for the Automatic Income Machine model portfolio. The post-election rally was unique in its ability to just climb steadily higher for four straight months without anything close to a significant down day in the market.

## In This Issue



That type of steady climb is not typical for stock prices, but we'll take it. From the end of October through the end of February, the Automatic Income Machine model portfolio gained over 12%, slightly more than the S&P 500.

Market pundits start to talk about volatility when the major indexes experience declines. Either big declines or a series of down days. In these cases, the "volatility" is just a code word for falling stock prices.

Our long-term total return goals should force us to ignore the short-term "volatility" in the market. The focus is on the companies behind the stocks we own and the growth they report in revenues and free cash flow. There will always be short-term "news" stories that drive stock prices in one direction or the other. By next week, this week’s important news items will be forgotten.

Currently, there are two events going on that affect the types of stocks owned in the Automatic Income Machine model portfolio. On the REIT side, next week the Fed is expected to again increase short-term interest rates. The accepted, but mostly wrong, wisdom is that higher rates are bad for REITs.

However, a look at history shows that out of 16 periods of significantly rising interest rates since 1995, REITs gained value during 12 of them or 75% of the time. Growth-focused REITs, the kind we own, should continue to grow their businesses and announce dividend increases.

The energy sector has hit an abrupt but short period of falling crude oil prices. The price of WTI crude had been stable at around $53 a barrel for several months. That type of stability has to eventually break one way or the other. While the number of barrels in storage has been climbing for weeks, the market just noticed, and crude has really sold off over just a few days.

I don't think the crude supply numbers are going to slow down the resurgence in U.S. shale production. The onshore producers will continue to ramp up production, which is good for the types of energy infrastructure companies we own in the portfolio. I also find this chart of WTI for the past year interesting.

I am watching to see if the current pull back ends up looking like the two previous short-term declines in the price of a barrel of oil.


*One-year WTI crude oil chart. I will be watching to see if the most recent decline resembles the last two in July and November of 2016*

We launched the Automatic Income Machine just over a year ago, and the model portfolio is up over 25%. I would chalk that up as a good start. More importantly, the strategy I use should produce above average ongoing total returns. In investing, its not so much about where you have been but where you are going. I think we will continue to go to very good places with our investment portfolios.

Our next live session is tonight, March 14.

If you have not already registered you will need to do so before the start time which is 9:00 p.m. eastern.

Here is the link to sign up: https://attendee.gotowebinar.com/register/3704724546386120961

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If you are not able to attend and would like to send in a question, you can always email me at tim.plaehn@investorsalley.com.

Best Regards,

Tim Plaehn
Editor
*Automatic Income Machine*

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# My Thoughts on Tanger Factor Outlet Center

Out of the fourth quarter and yearend earnings reports from the different Automatic Income Machine portfolio companies, I was least impressed by the 2017 guidance from **Tanger Factory Outlet Centers Inc. (NYSE:SKT)**. At this point, continued investment in SKT is really a matter of weighing the pros and cons.

**Let’s Start with the Cons**

Let's get the big negative out of the way first. The focus of the Automatic Income Machine strategy is to find and invest in stocks with high annual dividend growth rates. That dividend growth, in most cases, is supported by free cash flow per share growth – which makes sense.

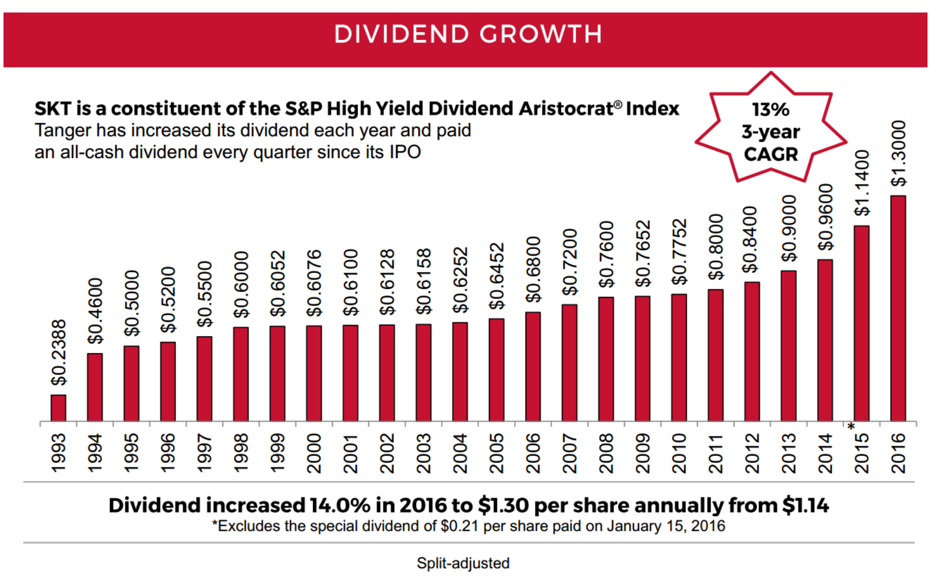
In it's earnings release and presentation, Tanger Factor Outlet gave 2017 AFFO (funds from operations as adjusted) guidance at the midpoint of $2.44 per share. This would be just a 3% increase compared to the reported 2016 AFFO of $2.37 per share. The slow rate of cash flow growth makes it hard to expect that Tanger will continue its string of double-digit annual dividend increases.

I took a look back at last year's guidance. The midpoint was AFFO of $2.32 per share, up 4.5% from the 2015 results. The actual 2016 AFFO per share added another 5 cents or 2.25% on the year-over-year cash flow increase. Overall in 2016, Tanger increased AFFO per share by 7%.

**And Now the Pros**

The biggest positives about Tanger Factory Outlets are that this is financially strong and conservatively managed company with a solid business model that has a deep moat guarding against competition. This is a company with a two decade record of assets, revenue, cash flow and dividend growth.

The company is very proud of its 21 year record of dividend increases, and unless there is a significant reversal in the company's financial success, we can expect that dividend to continue to be increased once a year. The question becomes how big will the increase be?



Due to fears concerning brick and mortar stores and the competition from online retailers, shares of the shopping center and mall REITs have sold off. SKT is down about 25%. This drop is similar to the declines experienced by other shopping center REITs.

However, the Tanger business model of outlet type shopping centers has not been affected and is currently not threatened by online retail competition. The company's outlet malls continue to attract plenty of foot traffic, and sales at the mall stores continue to grow.

At this point, the SKT share value has been pulled down by its more at-risk peers. At around $31 a share, I view SKT as significantly undervalued. Here is one metric that illustrates that contention. The average yield of SKT over the last four years has been 2.92%. The stock currently yields 4.15%. To yield 3.0%, SKT would need to climb back into the low $40's.

**Investment Considerations**

Tanger Factory Outlets will announce a new, higher dividend rate in early April – next month. I am currently not sure what to expect concerning the dividend hike. A 7% increase would match last year's AFFO growth. However, last year the dividend was boosted by 14% even though 2016 AFFO was just 7% higher than in 2015.

The current $1.30 annual dividend is just 54% of the 2016 AFFO. I think there is a good probability of another double-digit increase just to keep the recent string alive. Tanger has been very vocal about trumpeting its 13% three-year dividend CAGR. A 10% dividend boost would be just 13 cents out of the $0.90 of current excess cash flow above the dividend rate.

In spite of the low AFFO growth, I view SKT as undervalued based on its strong financials and continued growth prospects. A double-digit dividend increase is still possible, even though cash flow is not growing that fast. If the Fed announces an interest rate increase and the SKT price falls further, I will recommend we add to our position in the stock. Stay tuned for an email.

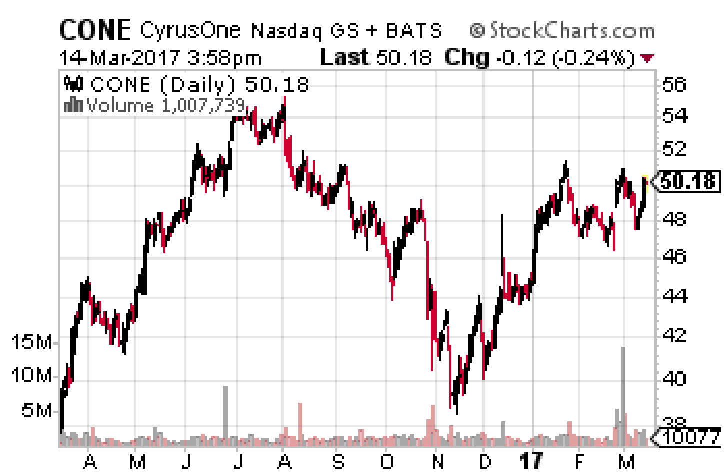
## Portfolio Update:

In February, the Automatic Income Machine model portfolio gained 3.0% for its fourth straight monthly gain. At the end of the month, the portfolio was up 28% from the starting value in February 2016. Not a bad first year. There has been some pull back in the first two weeks of March, which looks to me like normal stock market action. I will discuss what events have affected our stock prices in the live session.

The recent stock market run up began with the national elections in early November. For the period from October 31 to February 28, the model portfolio was up 12.2%. That's with almost 30% of the portfolio in cash. The S&P 500 gained 11.1% over the same period.

Earnings Call Notes:

**CyrusOne Inc. (Nasdaq:CONE)** reported 23% normalized FFO growth in 2016 over 2015. The Q4 FFO was up 11% year-over-year. The company announced a $0.42 per share dividend to be paid in April, up 11%.



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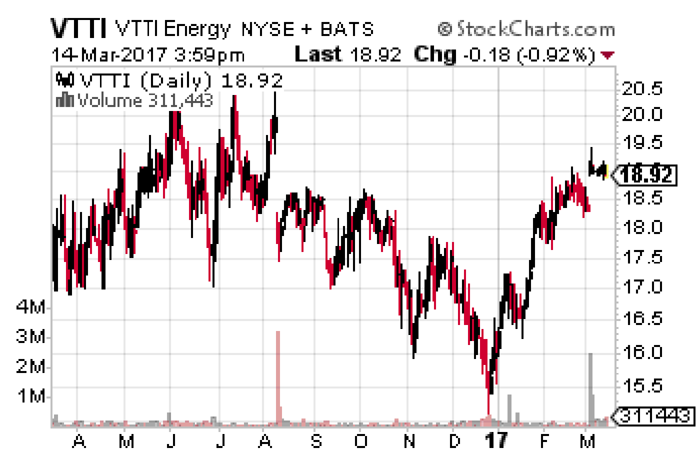
**Colony Starwood Homes (NYSE:SFR)** reported a very good 2016, which was a year focused on completing the merger announced early in the year and selling the company's portfolio of non-performing real estate loans.

For 2017, SFR issued FFO guidance of $1.85 - $1.95 per share. For 2016, FFO exceeded the high end of guidance at $1.69 per share. The guidance midpoint gives us 12.5% AFFO growth. The growth story for Colony Starwood Homes is just getting started. I plan to focus more on this company in the live session.


**Other news:**

The sponsor of **VTTI Energy Partners LP (NYSE:VTTI)** announced an $18.75 buyout offer to reabsorb the MLP less than three years after its spin-off IPO. I think the offer is an initial low ball. It did help the share price, but I believe we will see another offer above $20.




## Current Portfolio

To view our most up to date portfolio, please use the link below which will take you to the Investors Alley home page. From there, click :Member Login" at the top left and follow the prompts.

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We make no guarantee that any company in the portfolio will continue dividend payments. For a more detailed look at the portfolio, log on at www.investorsalley.com.