March 2016 Vol. 2 Issue 3

Investors Alley

Blue Chip Gems

Dividends and Value Remain a Top Priority

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.

In This Issue

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.

Stocks continued to make headway in erasing their deep losses from the first two months of the year during March. The S&P 500 had five straight weeks of gains before suffering a slight pullback during the holiday shortened week before Easter.

There have been several major factors behind the recent uptick in sentiment on equities and the recent rally in the stock market. After declining sharply early in the year, oil has staged an approximate 40% rally and is now up for the year. Last week, crude touched its highs for 2016 at around $41 a barrel before pulling back slightly.

This in turn has improved the stability in the high-yield credit markets whose spike in volatility was a huge factor in the big early equity declines of the year. Emerging markets have also surged thanks to the improvement in prices for oil and commodities. I still remain cautious around energy and commodities. Even $40 oil will not save a myriad of small and mid-tier shale producers from heading to bankruptcy in 2016, especially since natural gas prices have not rallied at all. In addition, talks about production "freezes" are miles away from production "cuts" that are probably needed to see a sustained rally from these levels. This is especially true given the anemic world economy and the glut of oil and natural gas in storage.

Investors Alley
Blue Chip Gems

In addition, the recent rally in energy and commodity prices will do nothing to end the "profit recession" in the market. Year-over-year earnings have declined for three straight quarters in the S&P 500 and the first quarter when reported should make it four in a row. On a brighter note, the Federal Reserve has finally bowed to reality and backed off its forecast that it will raise interest rates by a quarter point four times in 2016. Two quarter point hikes this year is the new forecast. Even this might be difficult to accomplish without roiling the global markets with both the Japanese and European Central Banks initiating negative interest rate policies.

The United States still remains the best house in a bad neighborhood despite our tepid two percent GDP growth in what is enduring as the weakest post war recovery in history. Job growth does remain solid and the housing market continues to slowly improve, albeit in fits and starts.

Given the current conditions in the global economy and the makings of one of the most negative presidential elections in recent memory, it is hard to see major upside for the markets in 2016. My current outlook is that the domestic economy will continue to bump along and markets will continue to churn in a trading range with equities being flat or slightly down for the year when all is said and done.

Ending on a brighter note, it is in this type of environment that large cap concerns with attractive long-term valuations and solid dividend yields, like those that represent the majority of the Blue Chip Gems portfolio, should continue to outperform the overall market.

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 most lucrative 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.

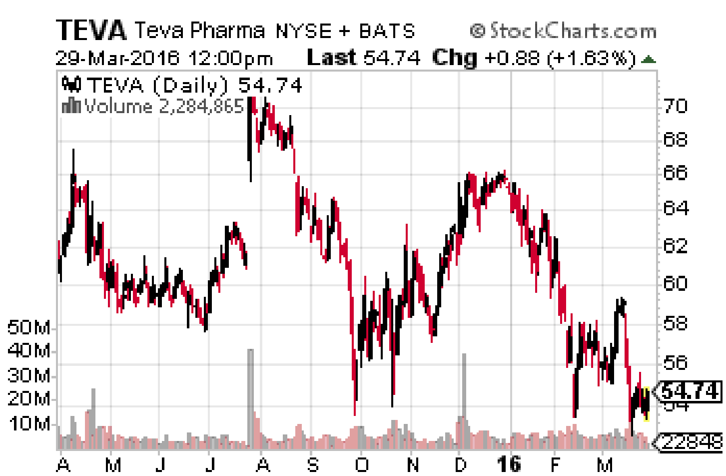
P.P.S. Join me and my colleague Tim Plaehn live and in person at the Las Vegas MoneyShow where we're each giving several presentations. The conference is May 9th through 12th. Click here for details.

Investors Alley
Blue Chip Gems

The Bull Thesis for Teva Pharmaceuticals

Valeant Pharmaceuticals (NYSE: VRX) has been one of the biggest stories of the last six months involving an individual company in the market. The one-time market darling has descended into what can be only be described as one of the biggest soap operas that has emanated around a large cap equity in years. The shares are down some 90% from their highs this summer. The stock has now lost more market value from its peak than Enron did as it plunged into bankruptcy. The latest news that caused the stock to decline over seven percent to begin this trading week was that the company's just ousted CEO was subpoenaed to testify before a congressional committee in late April.

I have no dog in this fight and it would not surprise me if the stock was $10.00 or $100.00 a share a year from now depending on how all the moving pieces play out. More important to me is how the cascading drip of one negative story after another around this drug pariah has knocked down other competitors in this space. These entities have been stung by the taint of association but do not employ the same tactics such as constant and substantial yearly price hikes on existing drugs as a core port of their business model.

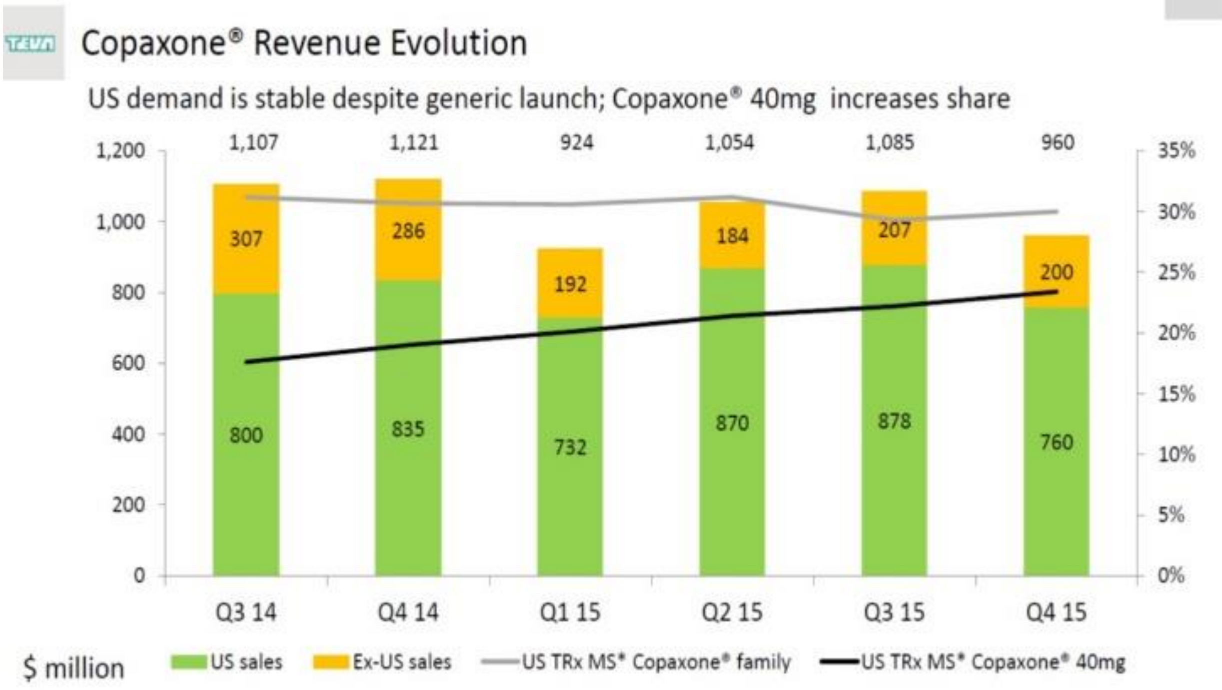


One of the stocks that has suffered at least in part to the debacle that Valeant has become is **Teva Pharmaceuticals (NASDAQ: TEVA)**, the largest generic drug maker in the world. Teva also has an expanding specialty drug business focused on a few core areas. The stock is down some 30% from its 52-week highs and is selling at a significant discount to how fast free cash flow should increase in the next few years. 2016 is shaping up to be one of the most transitional in the company's long history as it integrates its largest acquisition ever made, a deal which will cement its market leading position in the industry. So, let's take a look at the investment case on Teva and why it deserves a place within the Blue Chip Gems portfolio.

The company's business by revenue consists of just over 45% of total sales from generics, 20% from its specialty Multiple Sclerosis business, 24% comes from other specialty drugs focused primarily in the pain, migraine, movement disorders, and respiratory categories. The remaining 10% comes from over the counter medications. Approximately 55% of Teva's overall revenue comes from the United States, 25% from Europe and 20% from the rest of the world.

Copaxone which is the core of its multiple sclerosis franchise is by far the company's most important drug as far as revenue goes. It provides some $1 billion a quarter in sales. Despite now facing competition from generics, its market share and revenue contribution is holding up well. The compound makes up some 20% of overall sales but with the big acquisition Teva just made that percentage will be dropping significantly in 2016.

Investors Alley
Blue Chip Gems



Actavis Acquisition:

Early in 2015, Teva made a play to acquire **Mylan (NYSE: MYL)** which is the third largest generic drug maker in the world. It was rebuffed and instead bought **Allegan's (NYSE: AGN)** huge generic drug business that is known as Actavis for just over $40 billion. This deal, when completed later in the first half of 2016, will cement Teva's hold as the market share leader in generic drug space along with its growing specialty drug business. Allergan was focused on ridding itself of this unit primarily as it is looking to merge with **Pfizer (NYSE: PFE)** in one of the biggest mergers in history. Teva got a solid price and there should be significant synergies as Teva integrates its biggest purchase to date as a company.

Balance Sheet and Debt:

One of the main factors that has collapsed the stock of Valeant is its huge debt load. This debt was taken on to make a huge series of acquisitions over the past five years. At the present time, the company has less than a $10 billion market capitalization to support over $30 billion in debt. Given its business model of significantly raising prices of acquired drugs looks no longer viable, paying off that debt looks more than challenging which is why Valeant's credit rating is in the "junk" category.

Teva's situation could not be more than opposite. It has not been the target nor should it be of attacks from politicians on drug price "gouging." In addition, the company has a very manageable debt load. In the last reported quarter, the debt/EBITDA ratio stood at 1.51, down from 1.65 in the same period a year ago. Even the huge Actavis deal when it closes is easily managed given the company's current free cash flow as well as the consistent revenue and earnings emanating from that acquired portfolio.

Growth, Valuation, and Dividend:

2016 will obviously be a transition year for Teva as the company integrates Actavis into its overall business and gets through an election year that has seen the industry under siege, but probably will result in little new legislation or regulation once the smoke has cleared in early November. The same basic trading action took

Investors Alley
Blue Chip Gems

place in 1992 when Mrs. Clinton's husband was running and winning national office. It turned out to be a great time to buy the pharma sector in retrospect.

Revenues should surge some 25% year-over-year thanks to the acquisition and organic growth. Earnings should only be up approximately five percent according to the current consensus as the company takes associated charges and makes strategic divestitures associated with the integration and closing of the Actavis purchase. Next year, earnings growth should be up some 10% on sales growth in the high mid-single digits, which looks like a solid baseline for Teva's projected growth trajectory going forward. The company should deliver more than $6.00 a share in earnings in FY2017, which means the stock is going for less than nine times that conservative figure (The consensus has Teva earning $6.16 a share currently in FY2017)

More importantly, the company has guided that it believes it can deliver 20% average annual free cash flow over the FY2015 through FY2018 timeframe. This indeed would be extremely strong growth and with the nearly $5 billion in free cash flow the company threw off in 2015, its free cash flow yield is near 10%, a rarity in the S&P 500 at the current time. Some of that increasing free cash flow will find its way to additional dividend hikes. The company has made frequent increases to its dividend payout and has more than doubled its dividend over the past half dozen years. The stock currently yields 2.5%

Outlook:

Teva is a great combination of value and yield at its current price of under $55.00 a share. In March, three analyst firms have issued ratings on this drug giant. Citigroup called the company a "preferred" name when it reiterated its Buy rating and $75.00 a share price target on March 9th. BTIG assigned a Buy rating and $77.00 a share price target on TEVA on March 21st saying any weakness ahead of the closing of Actavis acquisition is a buying opportunity. Finally, on March 23rd Morgan Stanley maintained its Buy rating and $71.00 a share price target on the stock.

These price targets would get Teva back where it traded early last summer before Valeant started to dominate headlines and the pharma and biotech sectors went into a deep funk and their biggest bear markets since the financial crisis. Even at $72.00 a share, TEVA would trade at just 13 times forward earnings. This is a significant discount to not only the overall market multiple but is not warranted given the company's long-term growth prospects and 2.5% dividend yield.

Recommendation: Buy TEVA up to $57.50 a share

Position: Long TEVA

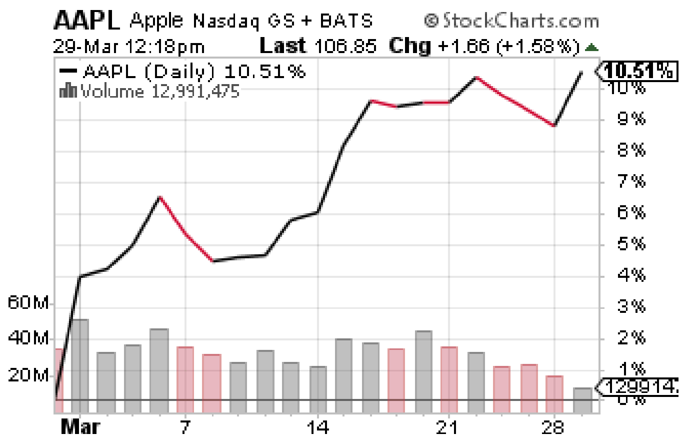
Portfolio Update

Overall, there was a slight rise across the majority of holdings within the Blue Chip Gems portfolio during March. The Federal Reserve reduced their projection of how many quarter-point interest rate hikes they see initiating in 2016 from four to two. The financials in our portfolio held up well despite an admission from the central bank that interest rates will rise more slowly than they envisioned to start the year which was a major plank for improved performance from the financial sector. **Blackstone (NYSE: BX), Wells Fargo (NYSE: WFC), JP Morgan (NYSE: JPM)** and **Capital One (NYSE: COF**) are all up decently since our last update.

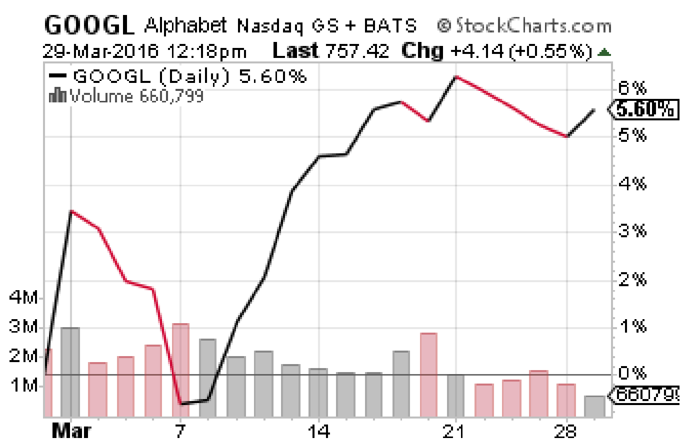
The biotech and pharma sectors continue to be challenged by the political driven rhetoric about drug price "gouging" and the soap opera and tragedy that one-time market darling **Valeant Pharmaceuticals (NYSE: VRX)** has become. This previous "hedge fund hotel" has now lost more market value in the last six months than did Enron. Hopefully, the ouster of the company's CEO last week is the first step to stabilizing

Investors Alley
Blue Chip Gems

the overhang in this sector. Despite this, our pharma and biotech holdings were largely up during March led by the performance of **Merck (NYSE: MRK)** which is up some five percent since our last update.



Apple (NASDAQ: AAPL) was up some 10% on the month as it introduced a smaller and faster version of its 5S smartphone.



Alphabet (NASDAQ: GOOGL) had one of the strongest months of our holdings as it continues to dominate the search market, YouTube continues to grow exponentially and its cloud business garnered recent contracts with some high profile clients like **Home Depot (NYSE: HD)** and **Disney (NYSE: DIS)**.

Las Vegas Sands (NYSE: LVS) also had another strong month rising nearly 10% since our last update as the outlook and comparisons in Macau continue to improve.

Foot Locker (NYSE: FL) looks like it is our biggest down holding this month. The main reason for the decline during the month was slightly under expectations guidance from **Nike (NYSE: NKE)**, which of course is a major supplier to the retailing firm. I have to agree with Jim Cramer on his outlook that Foot Locker is a buy on the decline.

Finally, we are ejecting **Express Scripts (NASDAQ: ESRX)** from the portfolio this month. The largest PBM in the world has become embroiled in a lawsuit with one of its biggest customers, health care insurer **Anthem (NYSE: ANTM).** This is likely to take some time to settle on favorable terms and is likely to remain a headwind until it is resolved. In its place and staying in the industry we are adding **Teva Pharmaceuticals (NASDAQ: TEVA),** the largest generic drug manufacturer in the world. The shares are cheap, near 52-week lows and also pay a 2.5% dividend yield to boot.

Our addition this month, Teva Pharmaceuticals, will replace Express Scripts (NASDAQ: ESRX) in the portfolio. ESRX will no longer be convered and can now be found in the 'Closed Positions' portfolio.

Investors Alley
Blue Chip Gems

Current Portfolio

Company	Entry Date	Entry Price	Recent Price	Yield	Returns	S&P 500 Comp.
Teva Pharmaceuticals (TEVA)	03/28/16	$53.85	$53.85	2.5%	N/A	N/A
Synchrony Financial (SYF)	02/25/16	$27.78	$28.38	-	2.2%	4.4%
Wells Fargo (WFC)	01/25/16	$47.66	$48.70	3.1%	2.2%	8.5%
Alphabet (GOOGL)	12/28/15	$782.24	$753.28	-	-3.7%	-0.9%
Macy’s (M)	11/24/15	$39.63	$44.38	3.3%	12.0%	-2.5%
Merck (MRK)	10/27/15	$53.47	$52.83	3.5%	-1.2%	-1.4%
Amgen (AMGN)	08/28/15	$155.89	$148.37	2.7%	-4.8%	2.4%
Celgene Corp. (CELG)	06/26/15	$117.92	$99.22	-	-15.9%	-3.1%
Blackstone Group (BX)	05/18/15	$43.64	$26.31	9.2%	-39.7%	-4.3%
Qualcomm (QCOM)	04/15/15	$68.46	$50.19	4.2%	-26.7%	-3.3%
Capital One (COF)	04/15/15	$82.82	$69.20	2.3%	-16.4%	-3.3%
Foot Locker (FL)	03/18/15	$61.17	$65.20	1.7%	6.6%	-3.0%
AbbVie (ABBV)	02/13/15	$58.05	$56.11	4.1%	-3.3%	-2.9%
Valero Energy (VLO)	02/13/15	$58.60	$65.24	3.7%	11.3%	-2.9%
Gilead Science Inc. (GILD)	01/16/15	$100.71	$92.46	1.9%	-8.2%	0.9%
Apple Inc. (AAPL)	01/16/15	$105.99	$105.19	2.0%	-0.8%	0.9%
JPMorgan Chase & Co. (JPM)	01/16/15	$55.93	$59.40	3.0%	6.2%	0.9%
Las Vegas Sands Corp. (LVS)	01/16/15	$54.89	$51.94	5.5%	-5.4%	0.9%

Recent Price is updated from stock closings on 03/28/16

Investors Alley
Blue Chip Gems

Closed Positions

Company	Entry Date	Entry Price	Close Price	Returns	Close Date
Express Scripts (ESRX)	03/18/15	$83.29	$67.67	-18.8%	03/28/16
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: 03/28/16. 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.