April 2016 Vol. 2 Issue 4

Investors Alley
Blue Chip Gems

Blue Chips Will Continue to Outperform in 2016

Fellow Investor,

The market has continued to grind higher since our last update. The S&P 500 hit its apex of the year at, not coincidentally, the same time that crude oil saw its highest levels of 2016. This tailwind for the market could be challenged in coming weeks as talks over this weekend at Doha failed to reach an agreement for production freezes. Given the enmity between the Saudis and the Iranians this should not have been a surprise. Oil began this week falling once again to under $40 a barrel.

In This Issue

The collapse in oil and other commodities is starting to take an increasing toll on the credit markets. Corporate borrowers across the world have defaulted on $50 billion of debt so far this year as the number of delinquent companies accelerates at its fastest pace since the financial crisis in 2009. This is a definite watch out item.

Nearly 50% of the defaults have happened in the oil/gas and mining industries, spurred by the sharp decline in commodity prices, slowing global growth, and lackluster demand for base metals and crude. I am watching closely to see if this trend spikes the volatility in the high-yield markets, as that was a big trigger for the substantial decline in equities we saw as 2016 opened on a huge down note.

I am also watching as first quarter earnings reports roll in. Most are coming in better than expected, as is usually the case given the lowered bar provided by analysts leading up to quarterly results. However, profits year-over-year look like they will decline this quarter at their fastest pace since 2009. A good portion of this is due to collapsing earnings in the energy sector. However, even with energy taken out of the equation, earnings should be down two to four percent from the same period a year ago within the S&P 500.

This will mark the fourth quarter in a row that profits have declined across the S&P and the fifth quarter in a row that revenues will have fallen. Tepid world demand and, until recently, a U.S. strong dollar have been steady headwinds to profit and sales growth. The lack of global demand is also one key reason business investment continues to lag from levels usually associated with this point in the business cycle. Companies are using their cash flow to buy back stock and increase dividends rather than build new plants and capacity.

Increasing regulations are also playing their part to put a cap on business investment and are a key reason we continue to limp along with two percent GDP growth almost seven years into the "recovery." This lack of growth is also forcing central banks across the globe to enter into uncharted territory with both Europe and Japan

Investors Alley
Blue Chip Gems

pursuing negative interest rate policies at the moment. This may well have unintended consequences once all is said and done.

One thing these rock bottom interest rate levels are doing is created a significant headwind for the financial sector. It is very hard for banks and insurers to post any sort of profit growth at these yields.

Ending on a more optimistic note, it is exactly this type of environment that should continue to see the type of high quality blue chips that we invest in continue to outperform the overall market thanks to their strong balance sheets, dividends, and continued ability to grow as we travel further into this "profit recession".

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. P.S. Come meet me in person in May at the Las Vegas Money Show when I present on "How to Invest in Biotech for Maximum Gains with Minimal Risk." The conference takes place from May 9th to the 12th, and if you are interested at all I invite you to click the link below and register. It's free!

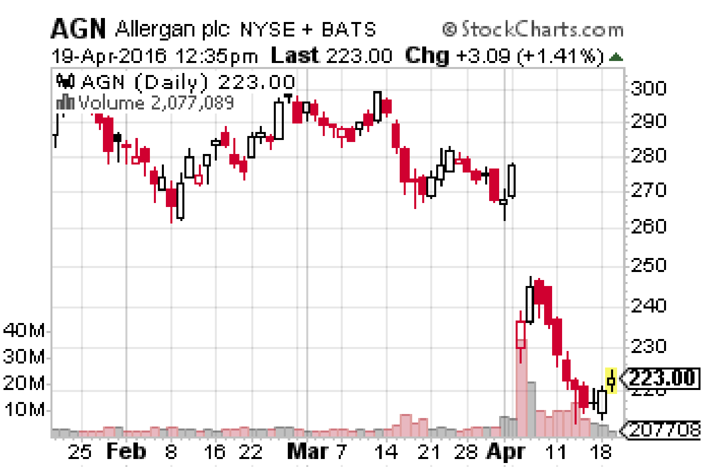
Click here to register for my in-person presentation on investing in the biotech sector.

Investors Alley
Blue Chip Gems

The Decline is Temporary for Allergan

This month, we are adding another name in the recovering pharma and biotech industry. It is a name that has been in the news recently and offers good value after a recent decline. We are adding our old friend **Allergan (NYSE: AGN)** back into the portfolio. We had exited out of the position previously earlier this year for a decent profit as we felt the shares were getting close to being fully valued and there were better opportunities in the market. It also was about to be subsumed into a much larger entity which we did not want to be a part of at that time. However, thanks to its recent sell-off, the company and stock are compelling once again as it is back to being a standalone entity. This is because the company recently had its mega-merger plans with **Pfizer (NYSE: PFE)** derailed after the Treasury Department on the third try was successful in bypassing Congress to make rules so onerous both companies realized they were playing against a stacked deck and threw in the towel.

The stock has declined some 20% since this news was announced earlier this month which presents a more than solid entry point for long-term investors on this solid growth play. The shares have also been weighed down by the overhang **Valeant Pharmaceuticals (NYSE: VRX)** cast over the entire industry as well as some doubts that a large transaction will be kyboshed by regulators, which is unlikely. Once these concerns ebb, investors will start to see the value of Allergan's underlying business and the stock should move up. So let's discuss the investment case on the company as well as upcoming catalysts that could power the stock forward.



Deal With Teva Pharmaceuticals:

In the second half of 2015, the company agreed to sell its generics business to **Teva Pharmaceuticals (NASDAQ: TEVA)** for just over $40 billion. Selling this low-margin business was a strategic step on its way to merging with Pfizer. Although concerns as to whether this deal will go through have escalated recently due to the government stepping in to kill the Pfizer merger as well as the **Halliburton (NYSE: HAL)** and **Baker Hughes (NYSE: BHI)** merger**,** these worries are overstated.

This is a much smaller deal, does not restrict competition in a way that should be worrisome to regulators and the company already received regulatory approval from the EU Commission for this proposed deal in March. Teva will definitely be motivated to get the deal done given it will owe Allergan a $1 billion breakup fee if for any reason the transaction does not close.

When this deal closes in June, as expected, Allergan will get $33.75 billion in cash and $6.75 billion in Teva stock, which is also undervalued in my opinion and a holding in my own portfolio. When this transaction is approved, I would expect a decent relief rally in this beaten down stock. More importantly, the funds can be put to good use by Allergan.

Investors Alley
Blue Chip Gems

After the deal completes, the remaining part of Allergan will be focused on higher margin and faster growing branded drugs. I will highlight a couple of the key parts of this new business development in an upcoming section. At the current stock price, the company should have an enterprise value of just under $100 billion. The company will have $42 billion in debt before the cash for the deal with Teva goes through, and I would expect the company to use a good portion of this windfall to pay down that debt which will de-lever their balance sheet and maintain or enhance their credit rating.

The rest of the money will be used to make smaller bolt on acquisitions to build out the company's pipeline and bolster growth prospects. Given that the biotech and biopharma sectors are just emerging from their deepest and longest bear market since the financial crisis, it is opportune time to get some "dry powder" to do some bargain shopping, especially in the smaller cap names that bore the brunt of that brutal decline.

I think one focus area the company will be eager to expand is in the gastrointestinal space. This could mean a couple of companies in the Small Cap and Biotech Gems portfolios like **Synergy Pharmaceuticals (NASDAQ: SGYP)** and **Progenics Pharmaceuticals (NASDAQ: PGNX)** could receive some interest and perhaps a buyout offer with a significant premium.

In addition, I expect Allergan to opportunistically look over the assets of Valeant Pharmaceuticals as that company has brought in investment bankers to make recommendations on what divestures the company should make to pay down its massive debt load. There could be several cheap products Allergan could be interested in there.

Product Portfolio:

The remaining part of the business, once the sale of the generics side of the company is officially sold to Teva, produces just over $15 billion in sales per year. It has a well-diversified product lineup with major contributors that include Botox and Anda, and its distribution business makes up 15% of sales and is of course never subject to patent expirations. Even with the divesture of

its generic business, the company is projecting that sales should grow 10% this year and analysts see just under $17 billion in sales for FY2016 as the current consensus. This points to the fact that Allergan did not lose much by selling its generic business and got a good price for it.

The company continues to find new uses for its fast selling Botox product including for migraines and overactive bladders. These new indications are patentable and there is no significant patent cliff across the portfolio in the foreseeable future. Unlike Valeant, the company does spend on R&D (some $1.5 billion in 2015) and does on rely inclusively on making serial acquisitions to power growth. As can be seen below the company has numerous new products coming to market over the next two years, not to mention any products it strategically acquires over that time span.

Analyst Commentary & Outlook:

Earnings growth will be slowed somewhat this year from the company getting through its generic sale and all the time that was put in on the Pfizer merger. Earnings per share should be up five to 10% this year. Next year, earnings should again resume a more normal pace of increases in the mid-teens. In addition, just because "tax inversion" has been turned into an ugly word this election year, the company's headquarters in Ireland continues to produce a much lower tax rate. This translates into higher retained earnings, improved cash flow, and attractiveness either as a purchaser or at some point a buyout target itself.

Given recent events, the analyst community understandably has a divergent view on Allergan at the moment. The median price target on the stock by the 18 analysts that cover the firm is $286.00 a share, close to where the stock was trading before the merger with Pfizer fell through and some 30% above the current level of $220.00 a share. Evercore is the most bullish on the stock with a recently reiterated $400.00 a share price target. JP Morgan and Morgan Stanley have also reiterated Buy ratings with price targets in the low $300s since the merger with Pfizer fell through.

The company pays a small dividend that could be boosted significantly by the proceeds from the sale to Teva when complete. The bottom line on this new holding is that we are getting a company that should be able to grow revenues at approximately 10% annually going forward with earnings growth in the mid-teens. After the sale to Teva, Allergan's debt profile and growth prospects will be improved, and this is not reflected in a stock that goes for under 13 times the consensus FY2017's earnings per share estimates, a discount to the overall market multiple despite the company's superior growth profile.

Recommendation: Buy AGN up to $240.00 a share.

Position: Long AGN

Portfolio Update

All in all, it was quite the solid month for the Blue Chip Gems portfolio. Our biotech names have been particularly strong in recent weeks, and all of our holdings in this space were up five percent or better since out last update. It does appear the bear market in the biotech sector is officially over.

After declining more than 40% from its peak in July to its trough in February, the sector has put together an almost 15% rally off its lows and is one of the strongest performing sectors of the market so far in the second quarter. This makes sense especially among the larger names as this is one of the few areas of the market that can deliver both revenue and earnings growth in this environment. We will see if this momentum can continue as stalwarts like **AbbVie (NYSE: ABBV), Amgen (NASDAQ: AMGN) Celgene (NASDAQ: CELG)** and **Gilead Sciences (NASDAQ: GILD)** provide quarterly updates

Investors Alley
Blue Chip Gems

next week. If they deliver as expected, I think the rally in the sector could go on.

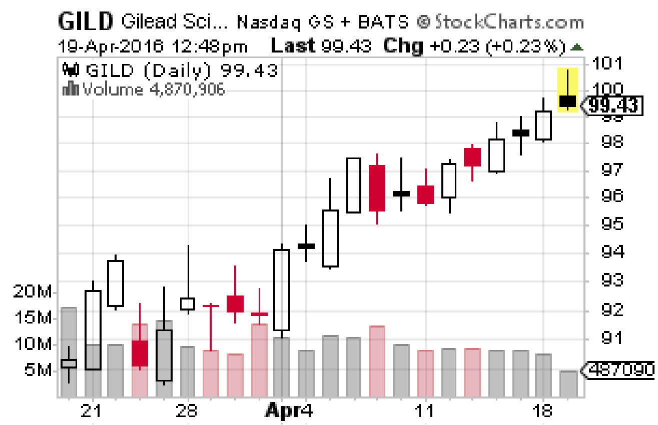
Our financial holdings have posted solid performance since we last visited them. This is despite a very difficult current environment for this sector. Regulators continue to take their pound of flesh, as legislation implemented after the financial crisis has limited opportunities for growth and the interest rate policies of the Federal Reserve and other major central banks have put a lid of much if any improvement on their net interest margins. On an optimistic side, this is reflected in their low valuations and any change in the environment is likely to be a positive given the current low expectations.

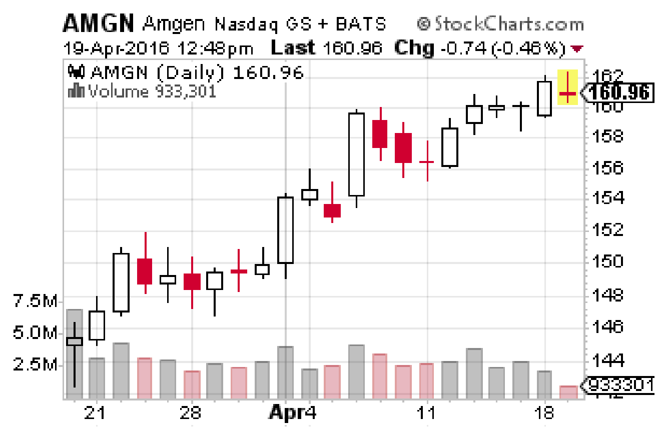
Alphabet (NASDAQ: GOOGL) is up some five percent since our last update and reports earnings later this week. Retail continues to be a challenging environment and both **Macy's (NYSE: M)** and **Foot Locker (NYSE: FL)** declined some since we last updated the portfolio. Despite low energy prices and decent job growth, the consumer is still reluctant to spend for the most part.

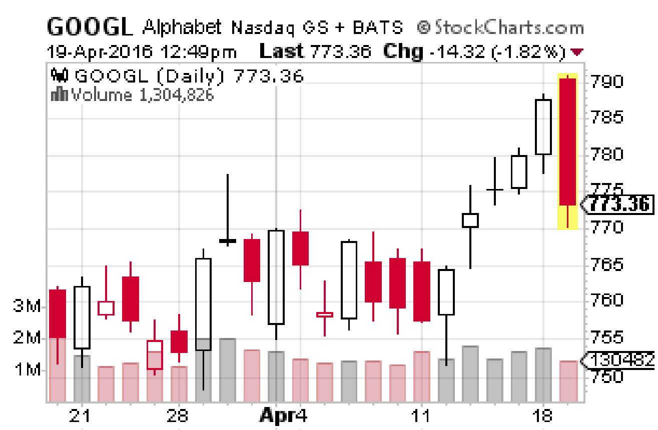
Macy's has hired executives and board members with real estate experience of late which falls squarely in line with a top-priority goal to explore strategic real estate options. Given the company's real estate holdings, including an entire city block at its flagship Manhattan location, is worth the retailer's entire market capitalization, any movement here could trigger some significant capital appreciation. In the meantime, the stock is cheap on earnings and pays a nice dividend.

The only other disappointment since our last update is **Valero (NYSE: VLO).** Crude spreads have deteriorated recently and the sector has been hit by a rash of analyst downgrades. I think it is time to take our small gain on this position along with our dividend payments and go elsewhere. This month our Valero holding will be replaced by Allergan, another leader in the pharma and biotech field.

Our addition this month, Allergan, will replace Valero in the portfolio. VLO will no longer be covered 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.
Allergan (AGN)	04/19/16	$225.67	$225.67	-	N/A	N/A
Teva Pharmaceuticals (TEVA)	03/28/16	$53.85	$56.66	2.5%	5.2%	2.8%
Synchrony Financial (SYF)	02/25/16	$27.78	$29.82	-	7.3%	7.3%
Wells Fargo (WFC)	01/25/16	$47.66	$49.88	3.1%	4.7%	11.6%
Alphabet (GOOGL)	12/28/15	$782.24	$776.25	-	-0.8%	1.8%
Macy's (M)	11/24/15	$39.63	$41.15	3.3%	3.8%	0.2%
Merck (MRK)	10/27/15	$53.47	$56.86	3.5%	6.3%	1.4%
Amgen (AMGN)	08/28/15	$155.89	$162.10	2.7%	4.0%	5.3%
Celgene Corp. (CELG)	06/26/15	$117.92	$106.53	-	-9.7%	-0.3%
Blackstone Group (BX)	05/18/15	$43.64	$29.39	9.2%	-32.7%	-1.6%
Qualcomm (QCOM)	04/15/15	$68.46	$51.83	4.2%	-24.3%	-0.6%
Capital One (COF)	04/15/15	$82.82	$72.80	2.3%	-12.1%	-0.6%
Foot Locker (FL)	03/18/15	$61.17	$61.76	1.7%	1.0%	-0.2%
AbbVie (ABBV)	02/13/15	$58.05	$60.17	4.1%	3.7%	-0.1%
Gilead Science Inc. (GILD)	01/16/15	$100.71	$99.44	1.9%	-1.3%	3.7%
Apple Inc. (AAPL)	01/16/15	$105.99	$106.91	2.0%	0.9%	3.7%
JPMorgan Chase & Co. (JPM)	01/16/15	$55.93	$63.32	3.0%	13.2%	3.7%
Las Vegas Sands Corp. (LVS)	01/16/15	$54.89	$52.50	5.5%	-4.4%	3.7%

Recent Price is updated from stock closings on 04/19/16

Investors Alley
Blue Chip Gems

Closed Positions

Company	Entry Date	Entry Price	Close Price	Returns	Close Date
Valero Energy (VLO)	02/13/15	$58.60	$60.71	3.6%	04/18/16
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: 04/19/16. 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.