

Top Ten Picks For 2015

By David G. Dietze, JD, CFA, CFP™
Founder, President and Chief Investment Strategist
Point View Wealth Management, Inc.
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Making money in stocks will be trickier in 2015. With stocks now up three fold since the 2009 bottom, and on the cusp of finishing another double digit return year, the low hanging fruit is, well, picked.

Valuations are now richer than the ten year average, and the market's dividend yield has dipped below 2%. Investors are bracing for rate hikes from the Federal Reserve, as a near six year period of rates set close to zero seems to be coming to an end.

The US Dollar has soared to a five year high, making our exports and business activities abroad, which constitute nearly 50% of the revenues of the S&P 500 companies, less profitable when translated back into our currency.

Overseas economies are struggling to stay out of recession, as weak demand threatens deflation. In Japan, more aggressive monetary assistance seems to do little, while in Europe the desire for a greater financial stimulus is fanning the flames of nationalism and may threaten the very existences of the monetary union.

Yet, despite all the concerns, interest rates remain low; the conundrum of how to improve on the paltry yield of just 2.3% on the US Treasury or 0.65% or even 0.42% on the ten years of Germany and Japan remains. Corporate earnings keep chugging along and employment indicators keep improving.

Bottom Line

Because fixed income offers so little return, investors will continue to seek out pockets of stock market value. Areas of excessive valuation will be shunned in favor of companies that return worthwhile profits, dividends, and growth relative to their shares' cost.

The most attractive areas include mature tech companies, international stocks, emerging market stocks, energy plays, commodity oriented investments, and vice stocks. But, above all, be sure to stay diversified, don't overpay, and maintain an adequately long investment horizon.

A Resurgent Japan

Japan's been mired in an over 20 year slump. It's determined to move past that. Monetary policy is actually more aggressive than the US'. Plus, its mandate to buy up securities

and lever up its balance sheet isn't just limited to sovereign debt and mortgages; it's targeting Japanese stocks, Japanese real estate investment trusts, and even US stocks.

If the rationale to invest in stocks here is that their prospective returns are better than bonds, then stocks are really compelling in Japan, with the Japanese government ten year bond yielding less than ½ of one percent.

Other factors are starting to work in Japan's favor. A weakening Yen makes their exports more attractive. The precipitous fall in the cost of fossil fuels is manna from Heaven for this island nation, with little in the way of their own energy resources. Given how large the US market is for Japan, an improving economy here is a big boost.

Toyota Motors (TM) makes our top ten list for 2015. This is the gold standard for auto makers; it's the biggest and the perception of quality is such that it has to offer fewer incentives to buyers. As the largest company in Japan, it's a proxy for the entire Japanese market.

Financially, the Japanese car makers have outperformed their peers. Their conservatism allowed them to avoid cutting their dividends in the last downturn. Fellow vehicle maker **Honda (HMC)** sports uninterrupted payments going back to 1949.

Valuations are attractive; Toyota is at just 11 times earnings. While more expensive than the US automakers, that's a pretty attractive discount to the US market, now at 17 times earnings. Toyota's dividend at 2.5% is superior to the S&P 500's at 1.92%; indeed, Toyota's payout is more than five times the payout on the Japanese ten year bond.

Profit margins are more attractive than their US peers because their pension and healthcare obligations are far lower than the Big Three.

It's a good time to be an automaker, as 2015 sales should be the highest since 2001; any improvement in the global economy will provide further tailwind. This bodes well for Toyota.

Nippon Telephone (NTT) is our other Japanese choice, and gives good exposure to the dynamic telecom and wireless industry. NTT is essentially **AT&T (T)** and **Verizon (VZ)** wrapped into one, such is its dominant market share.

NTT's crown jewel is its 67% ownership of **NTT DoCoMo (DCM)**, the dominant wireless carrier in Japan. While the non-wireless business is slow growth, the wireless holdings helps NTT generate close to a 10% free cash flow yield, buy back shares, and pay a 3.2% dividend, nearly 8 times the rate of Japanese 10 year bonds.

In sum, we think large cap, large franchise Japanese stocks can make sense for the well diversified portfolio.

Energy Rebounds

It was a tale of two markets in 2014, at least in the second half, when crude oil dropped nearly 40%. No one's quite sure what triggered it; while some attribute it to North America's surging production, but that didn't just start in July 2014, when the collapse started.

In any events, investing 101 says buy when stocks are cheap. Economics 101 says the best cure for low prices is, well, low prices. The current low price for fossil fuels spurs consumption, reduces supply, and gives pause to those who would transition to non-fossil fuel energy sources.

Given that no one knows how long the commodity sell off will continue, a focus on franchise companies, with very low debt and long experience in volatile markets, makes sense. While you are waiting, many energy stocks sport attractive dividend yields.

Dow component **Chevron (CVX)** fits the bill. The second largest integrated energy company in the country, it's got the diversity to ride out this crude oil sell off.

The company is globally diversified, with new production coming from the Gulf of Mexico, Thailand, Australia, and West Africa. Its operations cover the gamut from "upstream" exploration operations to "downstream" refining operations, as well as chemical operations.

The valuation is attractive, with the stock down 20% since last summer; there's a 4%+ dividend yield and it trades at just 10 times earnings.

Helmerich & Payne (HP) is narrowly focused, supplying drilling rigs to larger companies. Its financial strength (no debt) and technological acumen has allowed it to double its market share, returning on average 44% annually to shareholders over the last decade.

With the stock now cut in half since last summer on the back of the oil downturn, it's exceptionally cheap at less than 10 times earnings, with a 4.4% yield.

Legacy Large Cap Tech

This sector had a wonderful 2014, with such stalwarts as **Microsoft (MSFT)**, **Intel (INTC)**, and **Cisco (CSCO)** rising as we close the year 30%, 46%, and 26%. But, one of the biggest of all was left in the dust, **IBM (IBM)**, down 11%, and that's one reason we think it offers opportunity in 2015.

IBM's biggest focus is IT consulting and services, a wonderful business that's insulated from the cyclicity of product boom and bust, with strong recurring revenue. Further, the other portions of its business, including hardware, software, even the much maligned mainframes, are industry leaders themselves and pose high transition costs to any would be customer defections.

Valuations are quite attractive for this industry leader, at less than ten times earnings, 1.7 times sales, and with an above average 2.6% dividend. Add it to your portfolio for 2015.

Financials

The combination of rising interest rates and an improving economy can prove to be a real tailwind for this sector. An uptick in borrowing rates allows them to charge more for their loans and earn more on their portfolio, while greater economic activity will spur loan growth and business.

We recommend **MetLife (MET)**. It's the largest life insurer in the country and benefits mightily from economies of scale. It also boasts solid overseas exposure, with operations in 50 countries.

Trading below book value, at under 10 times earnings, together with a 2.4% payout, MetLife could benefit from rising rates. This would allow them to earn more on their investment portfolio, plus expand the insurance market.

Commodity Play

Commodities were banged up in 2014, down over 14% as the year draws to a close. A surging US Dollar and weakening global demand, particularly from China, a voracious consumer of metals in the previous cycle, weighed.

As a result, the stocks of commodity companies tumbled. **Fidelity's Global Commodity Stock Fund (FFGCX)** typified the action, sliding nearly 11% by the close of year end 2014.

The strategy is to buy a very well-managed, market dominating, commodity stock to play the inevitable rebound. **Rio Tinto (RIO)** fits the bill.

Down by a quarter from its 52 week high, RIO operates mines well diversified both by type of commodity extracted and by geographic location. Its resources in Australia are well positioned to benefit from Chinese growth.

It's a smart buy for 2015, at just 10 times earnings and a 4.6% dividend.

Consumer Staples

These stocks are core portfolio holdings, as demand tends to be constant through thick or thin. If there's a strong brand name involved, premium margins are available. Those products are sticky; who's going to switch from their favorite gum or chocolate to save a quarter?

Philip Morris (PM) fits the bill. It represents the international holdings of the storied tobacco purveyor, while **Altria (MO)** holds the domestic operations.

PM has lagged recently; the international outlook has clouded due to the distaste for all stocks non-domestic, plus an invigorated push overseas to discourage smoking. The flip side is

the stock now sports a more attractive valuation, down 5% since last summer, with a dividend yield over 4.6%.

This stock could do well regardless of the price of oil or the path of the global economy!

Healthcare Continues Strong

Healthcare stocks had a phenomenal 2014. As we conclude the year the **Healthcare Select SPDR (XLV)**, an exchange traded fund, was up 27%. The Affordable Care Act is bringing in lots of new customers, while imposing neither regulations nor price controls as onerous as feared.

Many healthcare stocks are richly priced, but we believe **Teva (TEVA)** can still do well. It's the largest generic maker in the world, plus it has extensive operations in the emerging world.

Its size gives it the ability to turn very complex drugs into generics, and should benefit from growth in this area. It's a buy at 11 times earnings, a 2% dividend yield, and at 2.7 times sales, thus at least a third cheaper than **Pfizer (PFE)**.

Utilities Still Offer Yield

Utilities had an excellent year in 2014, up over 22% as the year comes to a close. Utilities rode a tail wind of lower interest rates; these good yielding steady eddie companies are seen as bond surrogates.

Opinions differ as to the future; those who see interest rates rising are wary of the group. To be truly diversified you can't build your portfolio geared only to higher rates; what happens if you're wrong?

Exelon (EXC) is our utility pick. It's the largest power retailer in America, serving millions through its regulated subsidiaries throughout the East and Midwest. It generates 4% of the country's power.

What could give it material upside is its nuclear fleet, the largest in the country, producing 22% of the country's nuclear power. Tightened EPA emission standards now wending their way through the courts could become effective next summer, which could give it a significant advantage versus utilities more reliant of fossil fuels.

2015 Investment Picks

<u>Investment</u>	<u>Symbol</u>	<u>Sector</u>	<u>12.5.14</u>	<u>Yield %</u>
IBM	IBM	Technology	\$163.27	2.7%
Toyota	TM	Consumer Cyclical	\$129.03	2.6%

Nippon	NTT	Communication Services	\$25.85	3.1%
MetLife	MET	Financial Services	\$56.35	2.5%
		Basic		
Rio Tinto	RIO	Materials	\$45.29	4.2%
Helmerich & Payne	HP	Energy	\$67.44	4.1%
Teva	TEVA	Healthcare	\$57.88	2.4%
Philip Morris	PM	Consumer Defensive	\$87.14	4.6%
Chevron	CVX	Energy	\$110.87	3.9%
Exelon	EXC	Utilities	\$35.59	3.5%
Average Yield				3.3%
S&P500			2,075	1.9%
Dow			17,959	2.2%