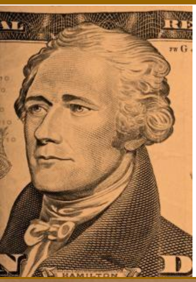


Top 3 Buy and Hold Forever Stocks

Investors Alley

Macy's: Little Downside with Big Opportunity

My first buy and hold forever stock, and perhaps one of my current favorites, is Macy's, widely acknowledged as the best run department store chain in the market. The shares have had a recent blip that have took the stock from over $70.00 a share to around $38.00 a share, which is more than excessive. The trigger for the decline was the lowering of full-year earnings guidance for 2016 and worse-than-expected comparable sales.

The retailer is being hit at the moment with uncertain direction of consumer spending despite low gasoline prices as well as a slowdown from foreign visitors as a result of a strong dollar and tepid overseas growth.

These factors are likely to turn out to be temporary and start to fade over the next 6-12 months.

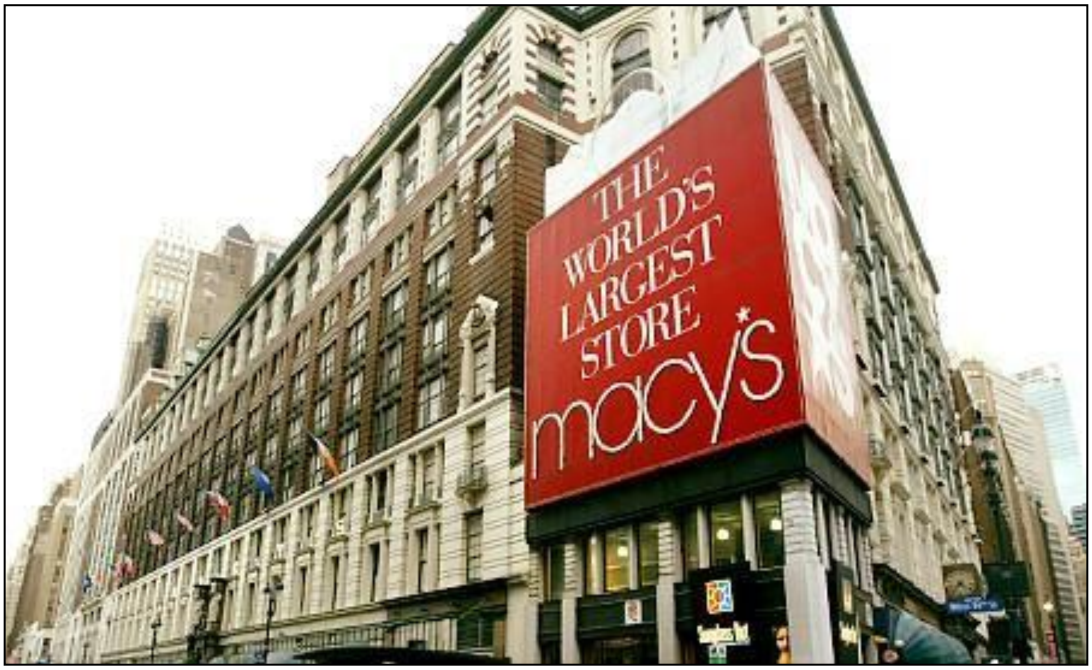
Indeed, even during the broad market rout we saw at the tail end of 2015 and into 2016 as the major indexes were flirting with correction territory, Macy's was putting up double digit gains, however, it has since given those back.

I see little risk to the downside here given the value of the company's real estate holdings and their high dividend yield. Shareholders should benefit greatly as consumer demand eventually returns and the stock is lifted from its current dirt cheap valuation on an earnings basis.

Company Overview:

Macy's (NYSE: M) operates some 800 stores in 45 states, the District of Columbia, Guam and Puerto Rico under the names of Macy's, Bloomingdale's, Bloomingdale's Outlet, Macy's Backstage, Bluemercury, and their related websites. The company has 175so ,000 employees and has a market capitalization of approximately $10 billion.

The company has been around since 1858 and is still recognized as one of the most powerful retail brands. It also has a growing online presence and is probably the best in the industry of melding the two channels. It also runs its own credit card operation.



Two Floors:

One of the main reasons I like the stock at these levels is it hard to see much downside outside a recession for the shares given two factors.

Real Estate:

The company owns the vast majority of real estate its locations occupy. This includes its iconic Herald Square location in New York which sits on an entire city block and where the famous Macy's Thanksgiving Day Parade runs by. This location alone is worth several billion dollars given the value of land in the Big Apple. Starboard Value put a valuation on this one holding at $4 billion, more than 30% of the company's current market capitalization. Including debt this one location would be worth 20% of Macy's enterprise value.

More than one activist fund has pushed Macy's to convert its valuable real estate holdings into a real estate investment trust (REIT) to unlock shareholder value. The numbers funds have thrown out there indicate Macy's real estate holdings are worth $40.00 to $60.00 a share spun off in this structure. Even if they are worth half of those projections, a good portion of the company's recent stock price is represented just by Macy's properties which does not even touch on its brand value or what its operations are worth. The company, is after all, churning out earnings and is not a version of downtrodden Sears.

The company has looked at a REIT structure but has passed for the current time as it does not want to give up the financial flexibility it enjoys under the current asset structure. It may work with brokers to rent out some of its underutilized space, but for the moment will not pursue a grander strategy.

Dividend:

The other big floor under the stock at current levels is its robust dividend yield. Macy's yields over 3.9% at its current price of approximately $38.00 a share. That is in line with a lot of so called "income" sectors of the market like Utilities.

Macy's can be had for a much lower valuation and has better prospects for longer-term growth. Since emerging from the financial crisis in 2009 the company has more than sextupled its dividend payout from a nickel a share to 38 cents a share. It has done this with frequent raises to payout including earlier this year when it raised its dividend by a little less than a nickel a share. The company has a conservative payout ratio of approximately 35%, and combined with earnings growth this dividend trajectory should continue albeit at a slightly lesser pace.

Valuation:

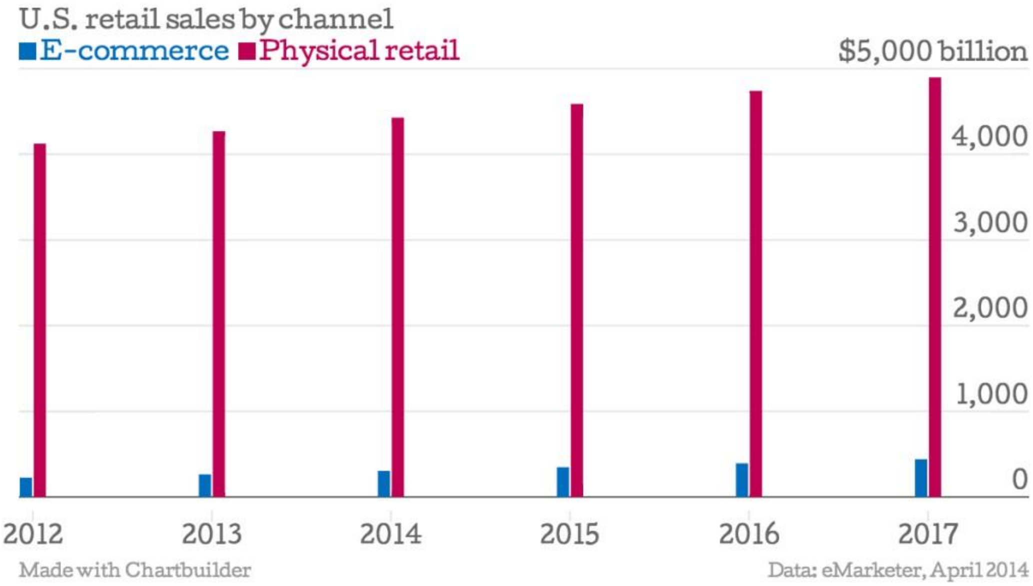
Earnings are going to be slightly down this year unless the U.S. dollar weakens and/or foreign visitor traffic picks up significantly in the year ahead. I don't see either happening currently but eventually things usually return to the underlying trend. Until recently, Macy's was a huge benefactor from overseas traffic.

After its recent decline the stock is going for 9 times the $4.40 a share the company made in FY2015. Over the past five years, the stock has traded with a trailing PE ratio of 14.4 times earnings. If we put a conservative earnings multiple of 12 times the $4.20 to $4.30 a share the company just guided profits to in FY2015, Macy's should be trading at over $50.00 a share. This would give it just two thirds of the current overall market multiple and seems more than warranted given its large dividend yield and the current challenges in retail. A return to its previous valuation multiple would fetch more than $60.00 a share based on current earnings.

Outlook:

Every retailer has to worry about being "Amazoned" with few exceptions. However, it is important to keep in mind that over 90% of U.S retail sales still come from physical stores. In other words, less than 10% of sales currently happen on the internet. Internet sales are still growing faster than those from physical stores but that growth is slowing and is currently in the low teens.

It is also very important for department stores and other retailers to provide different ways for consumers who like their brand to purchase items. This is why Macy's has spent so much focus on its e-commerce efforts and even **Amazon (NASDAQ: AMZN)** is rumored to be thinking about opening a physical location in New York City.



The company's president recently stated around its e-commerce channel "Macy's is already one of the largest and fastest-growing digital platforms in the country. Our fast-growing digital offering, including robust apps and mobile-enhanced websites, integrate with our stores to provide an unparalleled omnichannel shopping experience for customers... as a result, we are able to attract new customers and grow sales profitability."

Macy's is not sitting on its laurels. The company recently announced plans to close 100 underperforming stores which together represent about 1% of the company's total sales over the next few years. This should help reduce operating costs by some $500 million by 2018.

Macy's is also experimenting with "the store within a store" concept to boost foot traffic. It will set up ten Best Buy operations within specific Macy's locations and it looks like 500 LensCrafter stores will soon be in over half of Macy's current retail locations as well as the company just signed a deal to integrate these stores within its operational footprint.

The company already has 16 of its own branded Bluemercury cosmetic stores within it larger retail operations. These take 1,000 to 1,500 square feet within the store and have high sales per square foot. The company plans to open another 40 of these concept "stores within a store" locations over the next two years. It acquired Bluemercury for just over $200 million in the first quarter of 2015.

Summary:

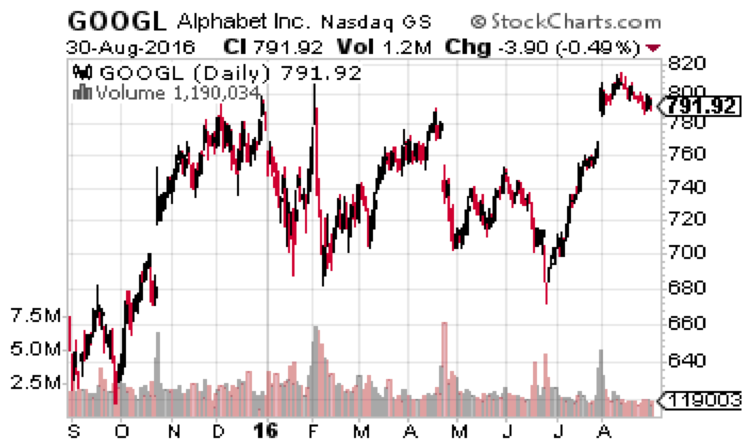
It is harder to get more "Blue Chip" than a retailer with a well-known brand name that has been around for more than a century and a half, and the company has certainly navigated much more dire circumstances than it currently faces. Macy's has also taken actions to reduce operational costs, boost sales and return to its previous growth trajectory. While we await for management to turn around its undervalued assets, we get to collect an almost four percent dividend yield while waiting for the market to properly value Macy's holdings.

Position: Long M

Alphabet: Changed Name but Still Highly Profitable

Our next buy and hold forever stock is a bit unusual but a name you're no doubt familiar with. Or at least you were. It is unusual only because it is priced at north of 20 times forward earnings and does not yet pay a dividend. In that way it is similar to **Celgene (NASDAQ: CELG)**, another Blue Chip Gems holding. However, the long term growth prospects of this tech giant warrant paying a premium to the overall market multiple even after the stock's solid gains in 2015.

The name of the company is **Alphabet (NASDAQ: GOOGL)** which until recently was known formerly by the moniker that has become a verb in our vocabulary, Google. This is one of the notorious FANG (Facebook, Apple, Netflix, Google) stocks whose acronyms appeared throughout the financial press in 2015 as this area was one of the few that delivered outsized performance to investors in a year that yielded very little else.



The stock is cheapest by valuation of the so call FANG stocks at roughly 17.5 times forward earnings, which is a tad less more than the 20 times forward earnings multiple they started 2015 with. However, the company did several things in 2015 that merit a higher multiple.

In addition, if you take out the huge gobs of net cash that sit on Alphabet's balance sheet, the multiple is really more like 13-14 times forward earnings. This is a slight premium to the overall market which on average does not have this company's long term growth prospects.

I expect this stock to occupy a slot in the Blue Chip Gems portfolio for a long term horizon as it should be able to deliver earnings and revenue increases in the mid-teens for the foreseeable future. It has all the traits, outside a dividend yield, that one should look for in a true "buy and hold" position.

Main Business:

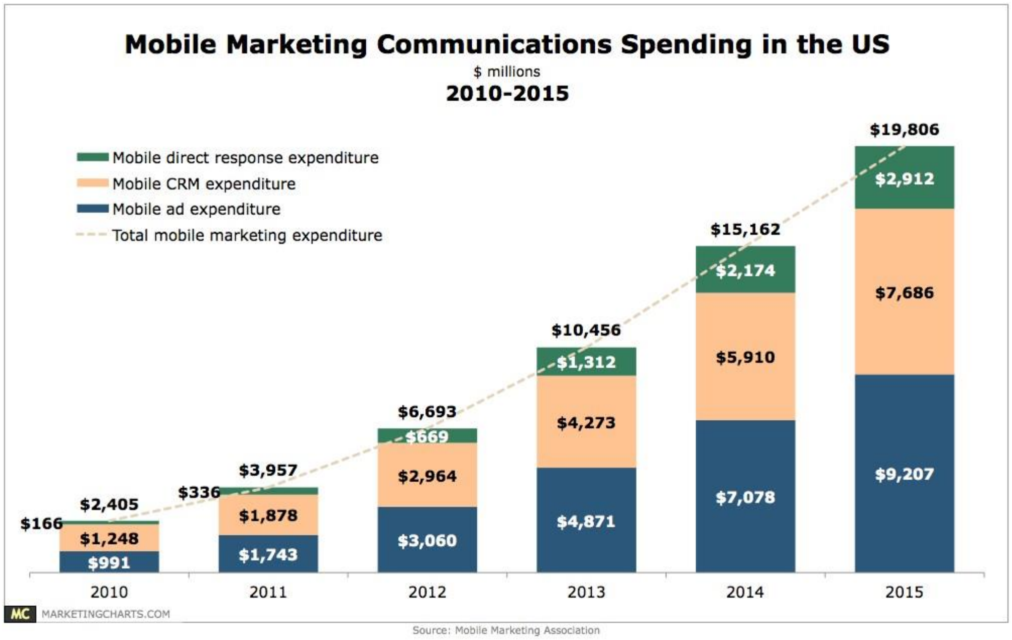
Let's start with the fact that Google totally dominates the domestic search market both here, Europe and many other countries and regions. It has roughly two thirds of online search market both here and in Europe. It has an even higher (>80%) of the mobile search market in both regions, which of course has drawn the ire of European regulators who have grown frustrated by a lack of a Eurocentric "champion" emerging in this space.

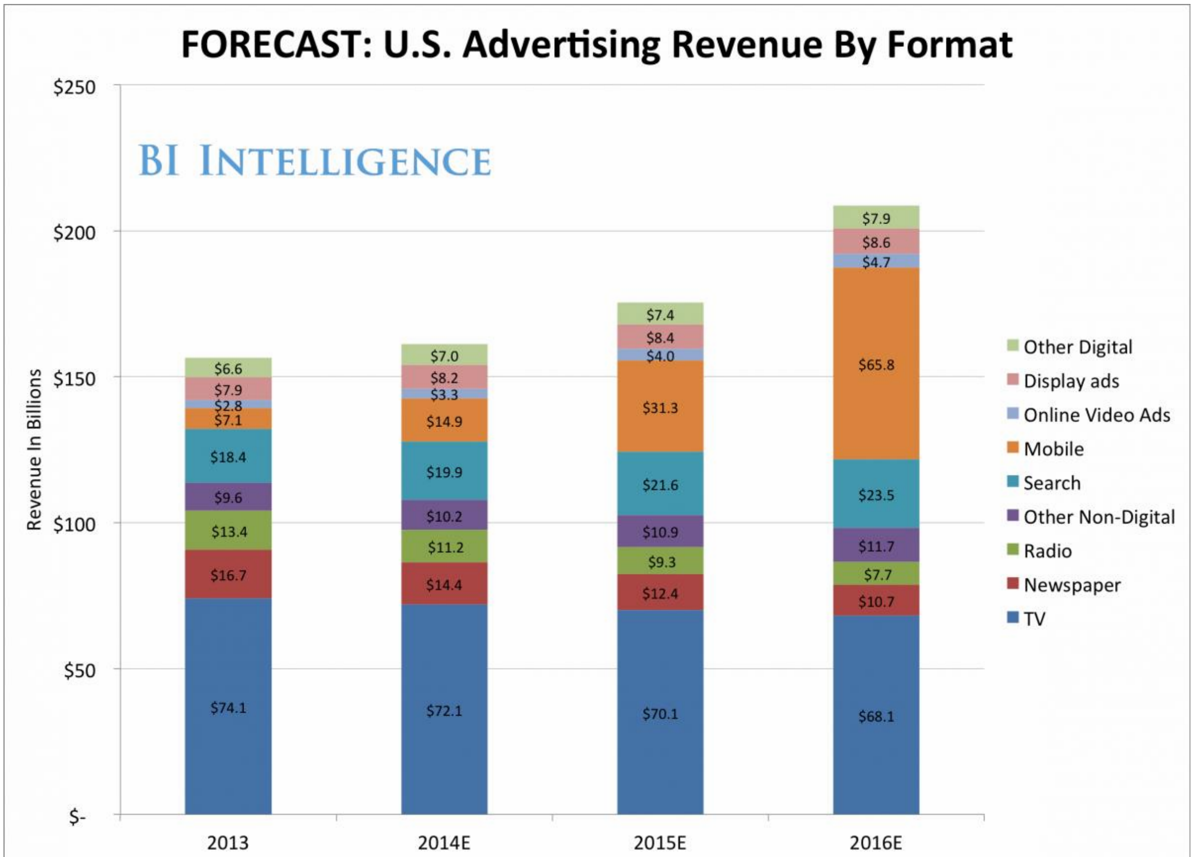
This dominance in the search market and the migration of internet traffic more and more to the mobile medium which Google dominates has led to a dramatic increase in mobile and online ad revenue. **Facebook (NYSE: FB)** and Google are the two heavyweights in these areas and are the beneficiaries of more and more of the overall ad dollar moving from television & radio to online & mobile channels. This is a trend that is firmly established and should continue to play out for the foreseeable future.

comScore Explicit Core Search Share Report* (Desktop Only) May 2015 vs. April 2015 Total U.S. – Desktop Home & Work Locations Source: comScore qSearch			
Core Search Entity	Explicit Core Search Share (%)		
	Apr-15	May-15	Point Change
Total Explicit Core Search	*100.0%*	*100.0%*	*N/A*
Google Sites	64.2%	64.1%	-0.1
Microsoft Sites	20.2%	20.3%	0.1
Yahoo Sites	12.7%	12.7%	0.0
Ask Network	1.8%	1.8%	0.0
AOL, Inc.	1.1%	1.2%	0.1

As can be seen from the chart, mobile advertising has exploded onto the scene over the past five years. Almost the entire growth in advertising since the recession ended in 2009 has gone to these two components of digital advertising. The chart below clearly demonstrates that this channel is capturing more and more of the overall advertising dollar. This is a trend that will continue to play out in the years ahead.

This type of advertising is growing at such a clip as it gives marketers many advantages over traditional TV & radio spots. The marketer knows much more about its potential customer such as demographics, what sites the customer previous viewed, etc… which is not available via traditional mediums. This allows the marketer to better customize more effective and niche advertising campaigns. In addition, a customer can click on an ad and instantly be able to order the advertised good in most cases. Obviously this is a capability that TV and radio can't match.





Source: Interactive Advertising Bureau, BI Intelligence Estimates

This is a space that Google and Facebook have dominated as it has grown. Due to the network effect, it is hard to imagine another entrant being able to displace either firm from its dominant position. While this is the main reason we want to have Alphabet in our portfolio, it is not the only one.

Other Assets:

The company brought in a new and experienced CFO from Morgan Stanley into the firm last year which has imposed some adult supervision to what has also been a startup culture. The changes she has already made have created shareholder value and will continue to do so in the future. She helped lead the charge to split off Google more speculative businesses into separate company for greater transparency. Both companies are under Alphabet which is now a holding company.

In addition, the new CFO has gotten expenses under control. In the last reported quarter expenses grew nine percent year-over-year down from 28% in the same period the prior year. Starting with this year the company will start to break out revenues from the main parts of the company. This should create shareholder value and a greater multiple for the stock just as it did when **Amazon (NASDAQ: AMZN)** started to break out the contribution from its web services division.

YouTube:

The company's YouTube ownership is a very undervalued asset. Only Facebook as more than the 1.3 billion active users that YouTube can claim. This compares favorably to the 70 million subscribers that **Netflix (NASDAQ: NFLX)** can claim. Youtube is also seeing faster growth than either noting early last year that viewing time had increased 60% year-over-year while mobile viewership had doubled.

Youtube brings in some 15% of the company's overall revenue which is approaching $75 billion this fiscal year. That number could grow to 25% of overall revenue five years hence if the company can double revenue per Youtube user over that timeframe which seem eminently possible given how fast advertising dollars are migrating to digital channels especially video.

Think about this, YouTube is producing nearly $9 billion in revenue, more than $2 billion more than Netflix which has a market capitalization of $50 billion. Assigning a per user value along the lines of **Twitter (NASDAQ: TWTR)**, which seems conservative, to Youtube puts a $100 billion value on this part of the company's business or about 20% of the Alphabet's overall market capitalization. Not bad given Youtube was purchased for less than $1.7 billion over nine years ago.

Driverless Cars and Web Services:

I could write a whole article on the potential for these nascent businesses but will do a quick summary. How fast driverless cars are rolled out and embraced by the market is the subject to much debate. Huge strides are being made and whether this happens a few years from now or a decade from now, it is pretty clear that a quarter century from now; very few of us will actually be driving a car the "old fashioned" way. Google will be one of the key players in this potentially massive market given its early investments, patent trove and technical edge.

Google internal data server farms would amount to the fourth largest web services business in the world if it was treated as a standalone entity. The company is just getting into supplying webs services to other businesses. It recently assigned a director of its board to lead this business who has extensive experience developing cloud based businesses. Web services is what powered huge gains in the stocks of **Microsoft (NASDAQ: MSFT)** and Amazon this year. As the company builds out its offerings, it has the same potential to power growth and shareholder value in the years ahead.

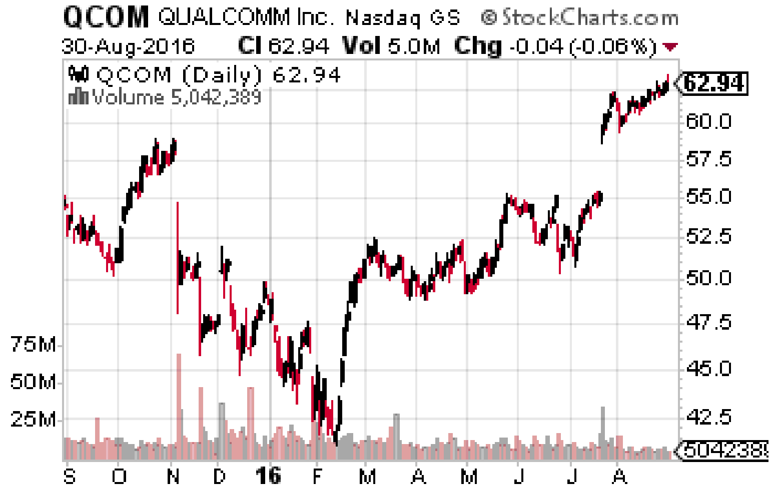
Summary:

The newly christened Alphabet as outlined above has many different growth drivers that bode well for continued creation of shareholder value in the years ahead. The company has also discovered financial discipline in 2015. Although not cheap, the stock is not expensive given its long-term growth trajectory, unassailable position in search, rock solid balance sheet and the continued migration of the advertising dollar to the digital domain.

Position: Long GOOGL

Qualcomm: Cheap and Starting to Rally

Our last buy and hold forever stock also comes from the technology sector. **Qualcomm (NASDAQ: QCOM),** the giant chipmaker that basically is to the smart phone industry what Intel (**NASDAQ: INTC)** is to the personal computer and server businesses. This company has been under pressure of late for several reasons.



The stock has seen significant headwinds recently as have most chipmakers. The stock is gaining traction lately with a price of $63. The company was left out from the build of the Galaxy 6 smart phone and had some issues with Chinese regulators in 2015.

Its success has made the company very attractive to investors. The company is returning a great deal of free cash flow to investors in the form of dividends and increased buybacks. The company also has a great balance sheet.

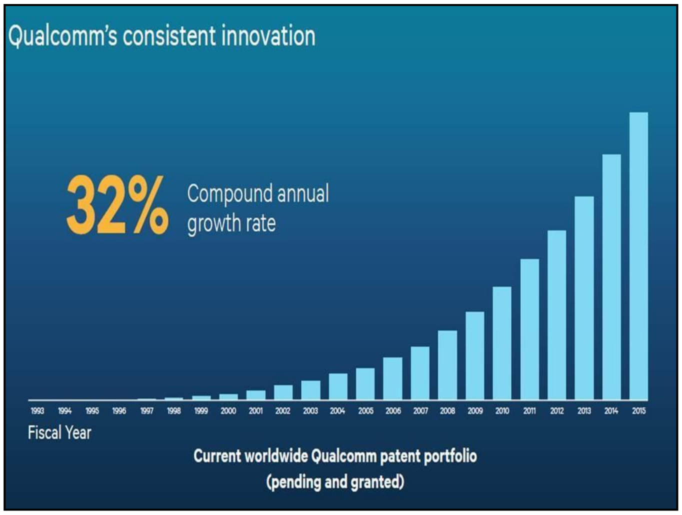
Let's take a look at the investment case for Qualcomm.

Company Overview:

Qualcomm consists of two main businesses. First it develops and supplies integrated circuits and system software based on code division multiple access (CDMA), orthogonal frequency division multiple access (OFDMA), and other technologies for use in voice and data communications, networking, application processing, multimedia, and global positioning system products. Qualcomm is the world's largest maker of chips used in mobile phones.

The second core part of Qualcomm's business makes use of the company's huge store of patents thanks to its hugely successful research and development (R&D) efforts over the years. This segment grants licenses or rights to use portions of its intellectual property portfolio, which includes patent rights useful in the manufacture and sale of various wireless products, such as products implementing CDMA2000, WCDMA, CDMA TDD, GSM/GPRS/EDGE, and/or OFDMA standards, as well as their derivatives. Approximately two thirds of the company's revenues come from this licensing and royalty business which requires much less capital expenditures than the manufacturing side of the business.

Recent Challenges:



In recent months, the stock has been dogged because of problems with Chinese regulators, slower revenue growth, and its new chipset called "Snapdragon" not being a part of the Samsung Galaxy 6. The company recently settled the antitrust investigation by agreeing to pay $1 billion in fines and modifying its royalty rates on handsets sold in the country.

Unfortunately, this sort of "shakedown" is part of doing business in the Middle Kingdom for technology firms. The settlement puts the matter behind Qualcomm and hopefully will lead to more accurate license royalties by Chinese firms that use Qualcomm's products and patents.

Revenue growth has slowed into the low single digits year-over-year recently but the company has longer term opportunities that should boost sales back into the high single digits in the near future. I view the Snapdragon loss due to Samsung wanting to use a chip it manufacturers internally that is unlikely to affect other smart phone makers' decision to include Snapdragon in the future.

Longer Term Opportunities:

While growth in its core smart phone market has slowed recently, the market is far from saturated. Thanks to emerging markets, the smart phone market should still see solid unit growth for years to come. In addition, the world is becoming more and more "interconnected". Qualcomm's expertise in LTE and other mobile technologies should play well as homes and autos connect directly to the internet and become "smart". The company believes these new areas of growth will be key drivers to its goals to deliver average annual revenue growth of 8% to 10% over the next five years. It believes combined with stock buybacks and other operational improvements this will lead to annual earnings per share growth in the low teens over that same time span.

Valuation:

Qualcomm has a market capitalization of approximately $92 billion. The company has a fortress balance sheet with over $7 billion in cash and cash equivalents as of the most recent reporting at the time of this report. The stock goes for 15 times fiscal 2016 earnings-per-share estimates of $4.17 and looks even better from a valuation basis when one equates for the net cash the company has on its books and considers its substantial dividend yield.

Summary:

Qualcomm is the classic Blue Chip Gem stock that has temporarily hit some rough waters over the past year. The shares are cheap, the stock pays a substantial dividend, Qualcomm should boost growth in the years ahead, and has a big activist fund pushing it to create additional shareholder value.

Position: Long QCOM

All data, including equity prices and yields current as of when this report was published.

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