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Economy & Market Valuation

The S&P 500 Index was up by approx. 4.4% in first quarter of 2017. The market is still waiting for big-ticket economic policy reform actions from the Trump administration. We see tax reform as a big-ticket item. If it happens, it will have a positive impact on the US economy and the stock market. One would think that with the Republican party controlling the Senate, the House of Representatives and the White house, it would be easy to pass tax reform. But with push and pull from different factions within the Republican party, it will take time to have a plan that is acceptable to all factions. Lowering of the corporate tax rate will be a big positive for US based companies. Various companies especially the software companies can simplify the tax structure with less emphasis on creating subsidiaries and offices in low tax countries. It could also result in a substantial reduction in tax for US based companies who have current tax rate over 30%, such as, banks, finance companies and retailers.

The US economy is expected to grow between 2% and 2.5% in 2017. Tax reforms can boost the growth rate in 2018 and years afterwards, providing a positive momentum to the stock market. We see very low probability of a recession in 2017. Interest rates are still very low and the Federal Reserve is expected to be very cautious in raising rates given the tepid growth rate of the economy.

Investment philosophy and Examples

Visa is one of the picks in our portfolio and we will try to explain the rationale of investing in Visa. Visa is a global payment processing company for Visa cards. It collects money for every transaction happening on a Visa card but does not take credit risk for the cards. The estimated amount that Visa collects for every transaction in US is \$0.078. In return, Visa provides services such as payment processing, authorization, clearing, payment collection and fraud detection and so on. We think that Visa meets three of the key parameters that we look for in any company that we invest in. These are – 1) competitive edge, 2) organic growth rate and 3) high free cash flow. Visa has a very strong moat and it would be very difficult for somebody to come in and build a payment network from scratch. It has shown consistent growth and there is more growth to come as more people worldwide move from cash to credit/debit card . Even Apple Pay uses the payment processing network of Visa at the backend. The operating margin is very high (>60%) with very high free cashflow. It has been consistently buying back shares. The risk is that there could be a new technology that comes in and makes a company like Visa obsolete, but we still place a low probability of that happening. Visa has done quite well for our clients and we expect it to continue to do so in the coming years.