

## **Economy & Market Valuation**

2014 was a remarkable year for the US economy and the stock market. The US stock market touched an all time high and the S&P index provided returns of around 13%. The Federal Reserve ended its QE program. The US economy has been improving in 2014 and has added more than 200,000 jobs/ month for the last 12 months. The US economy is strong despite the global headwinds like slowdown in Chinese and European economies. We are expecting to see the first interest rate hike in almost 10 years in 2015. Some people think that interest rate hikes are not good for the stock market. We are of the opinion that interest rates start hurting the economy only when they cross a certain threshold. The interest rate is right now at 0% and it will take around 2 years to reach a high level of 3-4%. Meanwhile low inflation will make sure that the rate hikes will be slow and could end at a level that is lower by historical standards. We are staying invested in the stock market for now and will be watching Federal Reserve moves and other economic parameters including inflation. We also consider the QE initiation by ECB as a positive move for the European economy which is positive for the global economy.

## **Investment philosophy and Examples**

We will talk about two of our new positions that we invested in Q4'2014. The positions are Valeant (VRX) and Tower Jazz Semiconductor (TSEM). We initiated a position in Valeant when it was bidding to buy Allergan. Our thesis of investment was that VRX was a buy with low downside risk in both the scenarios i.e. whether VRX was able to buy Allergan or not. Valeant stock has gone up 20 times since Mike Pearson took over as CEO of the company. Valeant's pharma products are not paid by insurance

companies and are benefitting from ageing population. Valeant has been a constant acquirer of pharma companies and has cut down R&D costs of the acquired firms. Valeant's R&D costs are on the lower end for the whole pharma industry. Its philosophy is not to take risks in R&D and buy companies with successful drugs. It has been working so far as it is mainly in the business of generic drugs. We believe that Mike Pearson will continue to add value for shareholders.

The second position that we want to talk about is Tower Jazz Semiconductor (TSEM). We recently initiated a position in TSEM and have already seen handsome gains. TSEM bought semiconductor fabs from Panasonic with replacement value of Billions of Dollars for almost nothing. It has assured revenue from Panasonic and in addition it is putting underutilized capacity to work. The profits do not show up in GAAP results because of depreciation impact from the fabs purchase. We looked at the Free Cash Flow (FCF) and initiated position in TSEM at almost 3 times projected FCF, which is a great (low) price.