



**Boulegeris
Investments, Inc.**

Discontinuities, Dividends and Two Little Engines That Could

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The heightened systemic risk that accompanied the rise in the debt ceiling coincident with a government shutdown had a short shelf life. Credit the Federal Reserve which continued to amply supply the economy with liquidity. Investors refocused on equities to participate in buoyant markets. Yet, the probability of the Fed eventually curtailing its \$85 billion monthly infusion, and anticipated higher interest rates have resulted in discontinuities that challenge investors.

For the most part third quarter corporate earnings have met profit estimates but lacked convincing revenue growth. Bottom line results have benefited from tight fiscal controls, reduced tax rates, and onetime non-recurring events. As the Q3 reporting season winds down, investors will unavoidably grapple with the outcome of budget talks in late December, followed by the fiscal requirement to raise the US debt ceiling in February. The transition of Janet Yellen (the nominee to head the US central bank) along with repair of a flawed rollout of the Affordable Health Care website should further crowd business headlines.

Paradoxically, the S&P 500 and the Dow recently reached new highs, and the NASDAQ touched a thirteen year high. We anticipate that the US debt ceiling will be raised and an incremental budget compromise will be forged. Along with tame energy prices, better than expected employment data and signs of economic recovery firming in Europe and China, we expect continuation of the great meltup in US equities. Further reinforcing this unrelenting market advance is the rotation of money flows from fixed income investments into equities.

With forward price earnings multiples approaching the upper end of the historic range and market indices setting new all-time highs, unquestionably the Federal Reserve's program of quantitative easing (QE3) is the propellant extending financial assets. Aggressive monetary accommodation by the European Central Bank (ECB) and the Bank of Japan has kindled additional foreign investment in US markets. Signaling curtailment of artificial expansion of valuation parameters, interest rate-sensitive industry groups such as Utilities and Real Estate Investment Trusts (REITs) have been marked down in anticipation of Fed tapering and the reality of rising interest rates. When the Fed begins to rein in QE3, a market correction of 10% - 15% might be reasonably expected. While it is uncertain precisely when the Fed will initiate the unwinding of QE3, what is clear is that interim market speculation is alive and well.

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We note momentum investing is accelerating into areas of the Technology sector and IPOs. Investor appetite for developmental companies with paltry earnings, anemic revenues and no dividends is on the rise. This undisciplined approach to investing underscores one unintended consequence of QE3: investor desensitization to risk. We remember March 2009 when our *Azimuth North* commentary summoned faith and hope that one day markets would once again experience an upswing. Conversely, now mavens ask when the equity markets will experience a meaningful downtick.

Though we remain constructive in the near term, internal discontinuities will surface during market advances as the ambiguous timing of the Fed's tapering will lead to investor overreactions. Investment opportunities will be created as evidenced in the REIT industry where the correction has been overdone - in stark contrast to pockets of twitter-like exuberance manifest in some portions of the tech sector. This dynamic unevenness is the consequence of pending deleveraging related to the Federal Reserve's four trillion dollar balance sheet and collateral damage from unbridled global monetary accommodation.

Ever vigilant of macro events, our primary focus remains on the advancing fundamentals of core portfolio positions; specifically, their strengthening balance sheets and durable income streams that fortify total returns. Despite the aforementioned lackluster Q3 results, many of our key large-cap holdings distinguished themselves.

PPG Industries, the world's leading coating and specialty products company, posted 23% growth in aggregate coatings segment earnings. In addition to strong operating performance, the impressive balance sheet of PPG continues to advance with \$2.2 billion cash and short-term investments on hand at quarter's end.

PepsiCo, a premier global consumer-oriented company focused on convenience foods and beverages, reported earnings that exceeded analyst estimates. With 22 iconic brands that each garnered more than \$1 billion in retail sales in 2012; Pepsi is not resting on its laurels. Of 25 new food and beverage innovations introduced in 2013, seven are on track to achieve \$100 million in annual sales. More recently, Pepsi announced plans to invest \$5.2 billion in India through 2020. This strategic initiative will enable Pepsi to double manufacturing capacity and bring new snack products to this developing market.

Meanwhile global payments industry leader, *MasterCard* reported strong growth in all geographic regions. Third quarter diluted earnings per share advanced 18% to \$7.27 while revenues increased to \$2.2 billion, a 16% jump from the year ago period.

Health care leader *Johnson & Johnson* (JNJ) raised earnings guidance for the full year 2013 to \$5.44 - \$5.49 per share. Led by an impressive 9.9% increase in worldwide pharmaceutical sales to \$7 billion, the outlook for balanced growth at JNJ is bright. Growth drivers at JNJ include improved integration of the Synthes acquisition, enhanced fundamentals in the consumer health care products division and the potential for new blockbuster drug approvals. Capably led by Joaquin Duarte, JNJ's worldwide pharmaceutical division is poised to launch ten new major drugs in 2013-2017 with differentiated therapies in oncology, infectious diseases, diabetes and central nervous system pathologies.

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Though large capitalization securities are representative of the firm's top holdings, occasionally an unorthodox and overlooked mid-cap or small-cap name complements portfolios, enhances income streams and augments portfolio performance. Clients may recall how *Kos Pharmaceuticals*, *MAP Pharmaceuticals* and *Kramont Real Estate* contributed meaningfully to capital appreciation as they were acquired at healthy premiums.

National Retail Properties (NNN) is illustrative of a small-cap company that has grown into a mid-cap core holding while raising annual distributions. Along the way NNN achieved an investment grade debt rating (1998), reached total assets of \$1 billion (2001) and joined the S&P 600 Small-Cap Index (2004). More recently it was added to the S&P 400 Mid-Cap Index (2011) and the S&P High Yield Dividend Aristocrats Index (2012) as well. With total assets that now exceed \$4 billion, Orlando-based NNN is one of only four public REITs to have increased its annual dividend for 24 consecutive years.

As of September 30, 2013 National Retail's portfolio occupancy was a robust 98.1%. Consistently high portfolio occupancy has dampened earnings volatility. Management refined earnings guidance in November and now forecasts 8% growth in Funds From Operations (FFO) per share for 2013 to a range of \$1.88 to \$1.90. This year NNN has raised \$877 million of attractive long-term capital to fund future acquisitions. In Q2 NNN paid off its \$174 million outstanding debt balance and now has full availability on its \$500 million credit facility. We note that 99% of assets are unencumbered.

The company's 2014 guidance fell just short of analyst estimates which accounts for near term pressure on the stock. The conservative approach to the balance sheet that may constrain short-term results nevertheless positions National Retail for long-term growth. Locking in low cost capital well in advance of the anticipated tapering (and higher interest rates) demonstrates the stewardship of the company, led by CEO Craig Macnab. Recognizing solid operating performance and citing management's "continued commitment to conservative financial management," Moody's Investors Service upgraded the ratings on \$2.3 billion of NNN debt in October to stable.

National Retail Properties is a well-diversified REIT that invests in long-term, net lease, retail properties. It owns 1,850 properties in 47 states with gross leasable area (GLA) of over 20 million square feet. Emphasis on steady, safe and growing dividends has enabled average shareholder annual total return for the past twenty years of 12.5%.

In May 2013 NNN hit an all time high of \$41.98. In the aftermath of the Fed's summer tapering notice, interest rate sensitive securities tumbled. Trading 26% off its 52-week high, NNN shares are being accumulated. With the advent of meaningful tapering already substantially discounted, the prospect for NNN shares appreciating to \$34 is reasonable. This represents a projected annualized total return of approximately 15%.

Like NNN, another conservative REIT we identified early in its growth curve is *Monmouth Real Estate Investment Corporation* (MNR). Our investment thesis for MNR is simple and direct: Monmouth provides stakeholders an annuity-like income stream derived from blue chip US and foreign corporations coupled with qualitative growth.

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Organized in 1968, NYSE-listed Monmouth Real Estate, with a relatively small capitalization (\$412 million), has an enduring history. Monmouth's portfolio specializes in net-leased industrial properties subject to long-term leases primarily to investment grade tenants. The company has a presence in 27 states, with a portfolio consisting of 80 industrial properties and one shopping center. This blue chip portfolio is comprised of tenants that include *Coca Cola, Anheuser-Busch, Home Depot, Watson Pharmaceuticals, Siemens, Caterpillar, Sherwin Williams, United Technologies, National Oil Varco* and *FedEx*.

Market aversion to anticipated Fed tapering enhances our investment thesis predicated on both qualitative yield and growth. Unlike large cap REITs whose dividend yields become less attractive should the 10-year Treasury yield rise to 3%, Monmouth's 6.6% yield remains compelling. This market discontinuity indiscriminately pressuring all REIT securities provides opportunity for long-term investment in Monmouth, enabling an attractive entry point.

In the past three months Monmouth reached a milestone adding 11% GLA, which now totals 10.7 million square feet. Recent additions to the MNR stable of blue chip tenants include *Dr. Pepper Snapple, ConAgra Foods, and International Paper*. These most recent additions, with a weighted-average lease term of 15.8 years, provide added certainty that the current dividend can be met solely from FFO. We estimate that the above acquisitions should raise forward annualized 12-month FFO to \$0.60. Occupancy should rise from 96% at the end of FY 2013 to 97.2% in FY 2014. Weighted-average portfolio net lease should extend from 6.3 years to 7 years further solidifying MNR's resilient dividend.

At its mid-December fiscal year-end conference call Monmouth will update investors regarding its pipeline, FY 2014 lease expirations and ongoing lucrative FedEx industrial warehouse expansions. Given Monmouth's enviable track record of lease renewals and its recent strong execution of the previously announced pipeline, we believe that FYs 2014-2015 will be banner years. Looking further ahead, Monmouth is well-situated on the east coast to benefit from the Panama Canal's expansion in 2015. Moreover Monmouth is strategically positioned as a preferred player in the industrial warehouse e-commerce space as evidenced by its longstanding relationship with FedEx Ground.

Unlike many non-public REITs, insiders at Monmouth have significant personal ownership (8% of outstanding shares). Inspection of 2013 insider purchases might also confirm a positive long-term outlook for the Freehold, NJ based REIT. Especially noteworthy are the 2013 exercise of options and retention of nearly all underlying shares by Chairman Eugene Landy, CEO Michael Landy and Treasurer Anna Chew.

As equities advance it is prudent for investors to stay grounded and invest in proven, conservative business models. In the midst of the market meltdown in 2008 Muhtar Kent, the CEO of Coca-Cola, extolled the virtue of having "respect for cash" and its central disciplined role in securing entrepreneurial growth and value. Both National Retail Properties and Monmouth Real Estate embody this principle in their vision and focus, and thus merit ownership in our mission to responsibly create and sustain wealth.

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