April 1, 2015

Hello Friends:

I have many ideas and thoughts swirling around in my mind that I could write about for this 2nd quarter newsletter. After reflecting on several different topics, I thought that I would write about one of my favorite stocks, Lockheed Martin.

For a quick review, Lockheed provides a broad range of products and services to the world's governments and commercial customers. Areas of concentration include space and missile systems, electronics, aeronautics, and information systems. The program base includes F-16, F-22, F-35 aircraft, ballistic and other missile systems, C-130 military transport, and Titan launch vehicles. In 2014, 79% of sales were to the U. S. Government.

Before I buy any stock, I always carefully evaluate how the stock performed during the market selloff in 2008 and 2009. By peering back into time, history provides a clue as to the risk and volatility that is inherent in all financial assets. At the time of the market peak in 2007, Lockheed reached a high of $120.30 and at the market trough in 2009 the low was $57.4. That works out to be about a 50% decline from the high to the low. No doubt, holding this stock throughout that period would have been quite painful. Most investors would have been challenged to hold their ground and resist the urge to follow the path of the masses and dump the stock.

However, taking a closer at the company's sales, earnings and dividend reveal a different story. At the market peak, the company had earnings of $6.86 for each outstanding share of common stock. And at the trough in 2009, the company earned $7.78. So despite the fact that the stock price declined 50%, the company's profits increased 13% over the same period.

The second measure of valuation is the amount of cash dividend paid to shareholders. A holder of 100 shares received $147.00 in 2007 and the same shares paid $234.00 in 2009. The dividend income increased by over 50% from top to trough.

How does an investor justify the 50% decline in the stock price when earnings went up 13% and the dividend income went up 50%? The answer is, I don't know. I can only reason that the market can become overwhelmed by fear, and investors make an emotional decision to sell stocks regardless of the underlying financial strength of a company.

This brings me to a brief discussion about risk. In my opinion, all stocks are volatile but volatility is different than risk. I view risk as a stock that is losing market share, or cutting its dividend, or facing serious competitive challenges. Stocks like Radio Shack, Blackberry and Sears are risky, but stocks like Lockheed, Apple and Google are just volatile.

And one more comment about Lockheed. Looking at the dividend income over the last 16 years, the average yield for all of those years is 2.4%. And at today's price, the yield is actually higher at 2.9%. At the current price of $202.96, the stock would have to appreciate to $250 to have the same 2.4% dividend yield as the 16 year historical average.

I certainly don't know if the stock will move from $202 to $250, but I don't believe that the problems in Iran, Russia, Ukraine, Iraq, North Korea, Yemen, and Syria are going away anytime soon. Our government will have no choice but to keep spending more for defense. It is my belief that the company will continue to raise the dividend each and every year that will be supported by more sales and more profits. If I'm wrong, and everyone's hope and dream of World Peace come to fruition, then I'll sell the stock and move on to the next idea.

And in the interest of full disclosure, I've taken my figures from sources that I deem to be reliable. If you would like more detail on any of the figures, or view a research reports, I will gladly send it your way.

Happy Easter.

Sincerely,

Jim

Jim Aljian