BARRON'S COVER

Barron’s Roundtable, Part 2: 31 Savvy Investment Ideas

Abby Cohen, Felix Zulauf, Mario Gabelli, and Jeffrey Gundlach offer their best bets for 2016 in this week’s Roundtable installment.

By LAUREN R. RUBLIN
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Barron’s 2016 Roundtable: Part 1

Mario Gabelli, Jeffrey Gundlach, Felix Zulauf, Abby Joseph Cohen *Photo: Brad Trent for Barron’s*

A funny thing happened last week at the local Trader Joe’s. Your hungry Roundtable editor popped in for some dinner provisions, and got an unbidden earful of market talk from a cheerfully bearish cashier. Stocks will fall a lot further, he predicted. The Baltic Dry Index, which measures the cost to ship stuff like grain and steel around the world, has collapsed. Inventories are piling up, deflation is looming, and the Federal Reserve might weigh a fourth round of quantitative easing.

It was like déjà vu all over again: The 2016 *Barron’s* Roundtable, convened Jan. 11 in New York, was heavy on the same worrisome talk, and last week’s frequently dismal stock action only confirmed the prescience of our assembled market seers.

While big-picture prognostications dominated the first Roundtable issue, published Jan. 18, they also feature prominently in this week’s installment, the second of three. But, happily, the four experts showcased in the pages ahead also have plenty to say about specific investments that could yield rich returns in the year ahead, notwithstanding the troublesome backdrop.

Sharing the bear’s lair this year are Roundtable veteran Felix Zulauf, the sagacious Swiss investor who helms Zulauf Asset Management, and newcomer Jeffrey Gundlach, co-founder of DoubleLine Capital, a mostly bond-focused shop whose returns have dazzled since its formation in 2009. Both riff at length on the potential calamity facing emerging markets due to China’s cooling economy, and think U.S. stocks haven’t seen their lows yet. Felix offers a bevy of short-selling ideas to profit from the pain, while Jeffrey combs the fixed-income universe for mispriced assets, such as closed-end funds and a mortgage REIT, that could reward investors in multiple ways. A consummate contrarian, he also sees opportunity in Puerto Rico’s distressed debt.

Abby Cohen: “We are optimistic about the housing market. Demographics favor a pickup in household formation, which will help Lowe’s.” *Photo: Jenna Bascom for Barron's*

Abby Joseph Cohen, a standout strategist and public policy guru at Goldman Sachs, also shares her best bets for the new year, in the form of seven stocks favored by the firm's analysts that amplify her current investment themes. Cautious about the industrial economy, she is tilting toward health care, retailing, and housing plays that could benefit from the consumer's improved finances.

Mario Gabelli, the master of Gamco Investors and a shrewd guide to corporate deal-making, rounds out this week's quartet with a look at media companies that could enrich shareholders by buying, selling, or rearranging valuable assets. There is a lot to chew on in his calculations and commentary—and in the rest of this meaty Roundtable segment.

ABBY JOSEPH COHEN

Barron's: *Abby, what are you recommending today?*

ABBY JOSEPH COHEN'S PICKS

Company/Ticker	Price 1/8/16
Philips/PHG	$24.04
AbbVie/ABBV	55.65
Mylan/MYL	49.42
Signet Jewelers/SIG	126.93
Lowe's/LOW	70.88
Bharti Airtel/BHARTI.India	INR 323.85
Ocado Group/OCDO.UK	295 pence

Source: Bloomberg

2015 Roundtable Report Card

2015 Mid-Year Roundtable Report Card

Cohen: As we discussed earlier in this session, capex [capital spending] has weakened among U.S. companies. But there has been a great deal of capex in some industries. While spending is weak in energy and chemicals, and among some heavily industrial companies, it is quite robust in industries such as digital technology and medical technology. Philips, based in the Netherlands, is a capex beneficiary, but not in the usual cyclical sense. Philips is selling for 10 times 2016 estimated earnings, below the sector P/E [price/earnings ratio] of 12.5 times. Its European shares have fallen 7% in the past 12 months, to 22.15 euros [closing price on Jan. 8] and yield 3.6%. Our analyst expects Philips to earn €2.21 a share [$2.39] this year, well above the consensus estimate of €1.64.

I started looking at Philips after thinking about one of my picks from last year's Roundtable— Acuity Brands [ticker: AYI], a maker of LED lighting. New energy-efficient technologies, like lighting, have a long road ahead in terms of growth. Philips has been around since 1891 but is always reinventing itself, and has a history of innovation in many categories, from traditional lightbulbs to Blu-ray discs. While the company is typically viewed as an industrial, it has a robust consumer business. It also has a robust lighting business.

2016 Roundtable Panelists

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Philips has a first-mover advantage in providing equipment such as lighting and ultrasound services to its customers. Philips' lighting is used in public and industrial spaces, but the area that intrigues me is health care.

How so?

Cohen: The company makes CT scanners and MRI scanners. It has used its digital expertise to build a pretty robust business in hospital management and information management in the health-care industry. The stock trades in Amsterdam [PHIA.Netherlands] and via American depositary receipts [PHG].

Which security do you recommend buying?

Cohen: If you are dollar-based, buy the ADR.

Zulauf: Would you hedge the currency?

Schafer: The company does a lot of business outside the European Union. If the stock is going to work, it will go up 50%. The currency isn't going down 50%, so you can afford to be wrong on the currency.

Cohen: My next two names are in the health-care sector, which performed well last year, but ran into hard times toward the end of 2015. There were significant outflows in the fourth quarter from health-care mutual funds, and from many stocks, particularly pharmaceuticals. AbbVie [ABBV] was one. It has a yield of 4%. In the 12 months ended Friday, the stock was down 18%.

Jeffrey Gundlach: How to Get a 12% Yield

The chief concern has been the high concentration of Humira, a treatment for arthritis, in its total business model. Humira has dominated AbbVie's revenue, and investors are concerned that a biosimilar drug will be launched, posing competition. Our analyst believes the launch of a biosimilar probably won't happen until 2020, and, if that is the case, AbbVie still has good earnings growth ahead. Earnings could grow at a compound annual rate of 13% from 2015 through 2020. [Subsequent to the Roundtable, AbbVie had a major patent win on Humira.]

AbbVie has some promising things in its product pipeline. It is working on a number of vaccines for HIV and hepatitis C, although the hepatitis product is off to a slow launch.

The CEO of Doubleline Capital and newest member of the Barron’s Roundtable likes closed end funds and other ways to buy oversold assets at an even bigger discount. His first pick: Annaly Capital.

Priest: Abby, we own AbbVie. It has been in a negative trend for a few weeks, and I can’t explain its significant underperformance versus many other names. Maybe it is concern about potential competition to Humira.

Black: The Food and Drug Administration has warned that the company’s hepatitis C treatments could cause liver toxicity in people with cirrhosis. This is a big plus for Gilead Sciences [GILD], which makes the leading hepatitis C treatments. The news took down AbbVie’s stock.

Cohen: Our second name is Mylan [MYL] which was hurt because of its failed bid last fall for Perrigo [PRGO]. Both are makers of generic drugs. Mylan’s stock fell 13% in the past 12 months. It is trading for 9.8 times 2016 estimated earnings, below the rest of the industry.

Although investors are upset about the failed bid, more consolidation is likely in the generic-drug industry. Mylan is likely to be an acquirer, and seems to be benefiting from previous deals. The company bought some generic products from Abbott Laboratories [ABT], and is working them through its sales and distribution system. Also, a competitor had a problem with its own version of Mylan’s EpiPen [an epinephrine auto-injector used to treat life-threatening allergic reactions], so Mylan is benefiting from that.

Cohen: While spending is weak in energy and chemicals, it is “quite robust” in digital technology and medical technology. *Photo: Jenna Bascom for Barrons*

How large is the EpiPen market?

Cohen: It could be as big as 24 million people, larger than Mylan previously thought. Mylan’s application to sell a generic version of Copaxone [a multiple sclerosis treatment] is now before the Food and Drug Administration; it doesn’t seem to have any problems. The company also has a generic version of Advair [an asthma treatment] on track, and has built a new manufacturing facility to produce it. Mylan has some temporary issues, but our analyst sees good value in the stock.

Next, the U.S. consumer had a tough time for a while, but is doing far better now. That brings me to Signet Jewelers [SIG], which operates stores in the U.S., the U.K., and Canada under a variety of names. Signet acquired Zale in 2014. In the U.S., Signet operates 1,400 stores under the Kay Jewelers and Jared the Galleria of Jewelry brands. The Zale division has 1,600 stores in the U.S. and Canada. The company had a good holiday season. Maybe people weren’t buying a lot of coats, but they were buying jewelry.

Felix Zulauf: Global Stock Selloff Will Continue

The Barron’s Roundtable veteran says economic conditions — especially in China and emerging markets — are worse than most people realize, and he is shorting, or betting against, U.S. stocks.

How has the stock done?

Cohen: In the past 12 months Signet’s shares have been flat. The stock closed Friday at $126.93, and yields 0.6%. For the fiscal year ending in January 2017, our analyst has an earnings estimate of $8.07 a share, roughly in line with the consensus. The company has had some issues: It was sued for gender discrimination. But Signet is held in high esteem by customers, and has a good distribution network.

Zulauf: Are they selling upscale products, or a range of products?

Cohen: They cater to middle- and upper-middle-income buyers, and sell a lot of diamonds.

Lowe’s [LOW] also could benefit from a stronger consumer, and a strong housing market. It benefits from the renovation market, in particular. The stock was flat in the past 12 months, and yields 1.5%. We are optimistic about the housing market. Demographics favor a pickup in household formation, which will help Lowe’s.

Why do you prefer Lowe’s to Home Depot [HD], another housing beneficiary?

Cohen: Lowe’s has a cheaper valuation. It sells for 18 times this year’s expected earnings.

Bharti Airtel, based in India, provides mobile telecom services in India and elsewhere. It trades on the Bombay Stock Exchange [BHARTI.India]. The company is spending to expand its 3G and 4G telecom networks. The stock was down about 10% in the year ended Jan. 8, but our analyst, based in India, has an earnings forecast for this year that is dramatically above consensus. He expects the company to earn 19.89 rupees [29 cents] versus the consensus forecast of INR16.91. The stock is trading for 16 times expected earnings for the fiscal year ending in March 2017, and yields 1.4%.

Lastly, Ocado Group is an online supermarket company based in the U.K. The shares trade in London [OCDO.UK]. The stock did poorly in the past 12 months, falling 29%. The company was

Felix Zulauf: “I am not saying the S&P 500 will fall 50%, but 1600 is my minimum downside target.” *Photo: Jenna Bascom for Barron's*

formed in 2000 and has invested heavily in distribution and inventory-control systems. There have been concerns that Amazon.com [AMZN], which has launched in the U.K., will hurt them. But Amazon is based in London, which is J Sainsbury ’s [SBRY.UK] territory more than Ocado’s.

Rogers: Does the company do business as Ocado?

Cohen: Yes. It also provides deliveries for Morrisons, a well-known supermarket chain in the U.K. Ocado has a lower-cost model than other supermarkets in the U.K. It has very little product waste, which keeps its costs down. Here, too, our analyst has above-consensus estimates—3.43 pence [five cents] for the fiscal year ending in November, versus the consensus estimate of 2.98p.

This isn’t a new industry, but an example of an old industry trying to take advantage of some newer technologies. Macy’s [M], which Brian recommended today [Rogers’ picks were featured in last week’s Roundtable issue] is also building a significant Internet platform. To the extent that old-line retailers can adapt successfully to the Internet, they should do well.

Thank you, Abby. Let’s hear from Felix.

FELIX ZULAUF

Zulauf: As most of you know, I am a macro guy. I invest based on my analysis of macroeconomic trends, and try to figure out where we are in the economic and financial cycle. My base case is this: The developed economies have had a disappointing recovery since the financial crisis, but the emerging economies had a big boom until a few years ago. That boom went bust in 2012-’13. Now we are in a down cycle that will end with crisis and calamity. China’s troubled economy is to the global financial market what the U.S. housing market was in the prior cycle. Many people don’t understand this. While the U.S. is widely analyzed, China often is misunderstood, as the economic data published by the Chinese government are of poor quality.

FELIX ZULAUF’S PICKS

Investment/Ticker	Price 1/8/2016
BUY	
CME 90 Day Eurodollar Future (Dec. 16)	$98.94
CURRENCY TRADES	
Buy U.S. Dollar/Short offshore Chinese yuan	$1=CNH6.68
Buy U.S. Dollar /Short Singapore dollar	$1=S$1.44
Buy U.S. Dollar /Short Korean won	$1=KRW1,198
Buy U.S. Dollar/Short Taiwan dollar	$1=TWD33.34
SHORT	
iShares MSCI Emerging Markets ETF / EEM	$29.51
CME S&P 500 Index Future	1,911.50
IBEX 35 Index Future (Spain)	€8,890.80
iShares MSCI Singapore ETF / EWS	$9.58
German Stock Index Future	€9,859.50
Euro STOXX 50 Future	3,029.00

Source: Bloomberg

Gabelli: "If I were running Millicom, I would first sell off the African business. Then I would consolidate Latin American operations with those of John Malone.” *Photo: Jenna Bascom for Barron's*

In the past 12 months, China tried to reignite its economy. Debt has risen dramatically, to more than twice gross national product, with almost no impact on the real economy. China has reported annual growth of nearly 7%, but the industrial complex is in a recession, and I estimate the service sector is growing by only 4% a year. In reality, then, growth is probably around 2%, and slowing.

Priest: Doesn’t China have a huge percentage of the world’s debt?

Zulauf: It does. China has doubled its debt in a few years’ time. In boom times, the corporate sector in China and other emerging markets made all sorts of mistakes. Companies overexpanded, took on too much debt and staff, and raised labor costs excessively. Officially, Chinese corporations have issued $1 trillion in dollar-denominated debt. Unofficially, it could be as high as $3 trillion.

When wealth is created during a boom, there is no need to diversify into other economies. Once the boom is over, however, the wealthy want to diversify outside the country. By looking at what happened in other economies when boom times ended, we can estimate that about $3 trillion in wealth wants to leave China. That is a huge amount, and outflows have been increasing.

MARIO GABELLI’S PICKS

Company/Ticker	Price 1/8/16
Madison Square Garden / MSG	$153.84
Griffon / GFF	16.60
Kaman / KAMN	38.40

Most economists and strategists think China is growing by 5% or 6%. They look at the country’s current-account surplus of $300 billion and think everything is fine. But China is running a capital account deficit of $1 trillion. It doesn’t publish that number, although you can figure it out.

How did you figure it out?

Genuine Parts / GPC	78.56
Millicom Intl Cellular / MIICF	51.90
CBS / CBS	46.46
Discovery Communications / DISCA	26.01

Source: Bloomberg

Zulauf: Foreign-exchange reserves fell to $3.3 trillion last year from $4 trillion. The current-account surplus is $300 billion, so that means $700 billion has flowed out of the country on a net basis. The gross outflow is about $1 trillion. If we assume $1.3 trillion of China’s reserves are illiquid, only $2 trillion remains. If money continues to leave the country at the current rate, China could lose all its foreign-exchange reserves in a little more than a year.

To prevent that from happening, China eventually will stop intervening in the currency markets to prop up the value of its currency, the yuan, and let it fall. The government has other options: It could raise interest rates, which would be dreadful for the Chinese economy, or tighten capital controls, which would postpone the problem of capital flight, but cause bigger problems in the future. That is why China will have to let the currency fall. China has a balance-of-payments crisis, which usually ends with a recession in the real economy. The currency overshoots on the downside, and interest rates rise to extreme levels. That is what lies ahead.

That is some base case. What are the implications for the rest of the world?

Zulauf: China’s Asian trading partners will also let their currencies fall. It is conceivable that Singapore, which has attracted a lot of foreign capital over the years because of its image as a strong-currency state, will be extremely exposed to the situation in China. Singapore’s banking-sector loans have grown dramatically in the past five or six years. Singapore is now losing capital, which means the banking industry is losing deposits. When that happens, carry trades go awry, which is usually a prescription for disaster. I expect a banking crisis to develop in Singapore and to spread eventually to Hong Kong.

What will happen to the Hong Kong dollar?

Zulauf: The Hong Kong Monetary Authority has said it will defend the Hong Kong dollar. During the first stage of the crisis, capital flowed from mainland China to Hong Kong, which depressed interest rates in Hong Kong. In the past few days, the reverse has happened; capital has flowed out of Hong Kong and shorter rates [interest rates on shorter-term government debt] have gone up. The Hong Kong dollar is pegged to the U.S. dollar.

Rising interest rates will be deadly for the Hong Kong stock market and real-estate market. Eventually, as their currencies lose value, China and the emerging-market countries will reduce their imports, which will exert a contractionary force on the world economy. They will try to export more by cutting prices, which will influence the pricing mechanism throughout the industrialized world.

Are you talking here about a currency war?

Zulauf: Some call it a currency war.

Gabelli: Government-owned enterprises in China are already dumping steel.

Jeffrey Gundlach: “Based on the deterioration in stock prices, commodities, and junk bonds, I have been waiting for the Fed to start dialing back its rate-hike rhetoric.” *Photo: Jenna Bascom for Barron's*

Zulauf: In Asia, as well as the U.S., there has been a large buildup of inventories, and inventory levels are too high. The corporate sector in both regions overestimated final demand. Now it has to cut production. Companies also overestimated their debt-carrying ability. Remember that cutting costs is cutting someone else’s revenue. Thus, the global economy will continue to weaken.

Investors are pretty fully invested in equities around the world, because equities have been the only game in town. The slogan was TINA: There is no alternative to stocks. Among U.S. households and institutional investors, equity allocations are approaching the 2000 and 2007 peaks. Investors are extended and vulnerable, and don’t have a lot of cash.

At the same time, the monetary backdrop is changing. The U.S. Federal Reserve hiked interest rates in December, and at the margin is shrinking its balance sheet. The People’s Bank of China has shrunk its balance sheet dramatically because it is losing foreign-exchange reserves. The European Central Bank won’t engage in further quantitative easing [buying assets to drive down interest rates] beyond its current round, which means QE is finished as a policy tool for now. [Mario Draghi, president of the European Central Bank, suggested Thursday that the ECB might ease monetary policy further in March.] The Bank of Japan will continue with QE reluctantly, but is unhappy with the government of Prime Minister Shinzo Abe because it isn’t delivering on reforms. The BOJ will increase QE when bond yields rise, buying more bonds to push yields down. In sum, the big monetary push we have seen in years past is over. Global liquidity is deteriorating. To complete the picture, the geopolitical backdrop will deteriorate further.

JEFFREY GUNDLACH’S PICKS

Investment/Ticker	Price /Yield 1/8/16

Is there any hope for investors under your scenario?

SHORT	
iShares MSCI Emerging Markets / EEM	$29.51/2.8%
BUY	
Brookfield Total Return Fund / HTR	$21.77/10.5%
Annaly Capital Management / NLY	9.41/12.8
Puerto Rico GO Bonds (8%, due 2035)	72.25/11.6
SPDR Barclays Intl Treasury Bond ETF / BWX	51.77
iPath MSCI India Index ETN / INP	60.29

Source: Bloomberg

Zulauf: Investors should stay as defensive as possible. If you have to stay invested, stick with sectors such as consumer staples and utilities. My first recommendation is in money markets. I don’t expect the Fed to hike rates further this year. Instead, Fed officials will bring their dots down. [Members of the Fed’s policy-making committee publish their expectations for the federal- funds rate on a chart called the dot plot.] The Eurodollar futures market is predicting two more rate hikes. They won’t be executed because the world economy will turn much softer. The U.S. dollar remains too strong versus emerging-market currencies. It doesn’t make sense to hike rates and make the dollar even stronger.

The U.S. economy will surprise on the downside. I recommend buying December 2016 Eurodollar futures. [Eurodollars are timed dollar-denominated deposits held outside the U.S. The futures contracts are traded on the CME.] Friday’s closing price was $98.94. The implied yield is 1.06%, or 100 minus the price. The actual yield is 0.62%, which means a further rate increase of 44 basis points [hundredths of a percentage point] is priced in. That won’t happen. If the Fed hikes one more time by 25 basis points, you would still earn 19 basis points on the contract, or 44 minus 25. The notional size of the contract is $1 million, and the term is three months. If you buy one contract and earn 44 basis points, that’s $1,100. You can buy 100 or 1,000 contracts, and make your money that way.

Gundlach: “Either the credit market has to improve or stocks have to fall further, because there has been a yawning gap in the performance of these markets in recent months.” *Photo: Jenna Bascom for Barron's*

How would you lose money on this?

Zulauf: You would lose money if the Fed hikes rates by 25 basis points more than twice.

Do you buy the futures or options on the futures?

Zulauf: We buy both, but I like the futures. In equities, I would short the EEM, or iShares MSCI Emerging Markets exchange-traded fund. [Short sellers sell borrowed shares in the expectation of repurchasing them later at a lower price.]

I recommended this in the June Midyear Roundtable, as well [“2015 Midyear Roundtable–Top Stock Picks,” June 15, 2015]. The ETF is selling for $29.50. The 2008 low was $18.24. I expect it to hit that low again.

Second, I recommend shorting S&P 500 futures. The U.S. corporate sector has a relatively weak balance sheet. Companies have loaded up on debt. The stock market is vulnerable, and prices could go much lower. The average bear-market decline is 22%-23% for U.S. indexes. I am prepared for a decline of more than 20%. People will be surprised by how low the market goes.

Cohen: *What is the timing of your projected decline?*

Zulauf: It started last spring with a stealth bear market. The first leg down occurred last summer, and a recovery attempt failed. Now the second leg down has begun. There might be a bounce, but then the selling will resume. I expect three down legs from last year’s highs. I am not saying the S&P 500 will fall 50%, but 1600 is my minimum downside target, and I expect the market to hit it this year. This is a global affair; European markets will fall, as well. I would short the weakest market in Europe—Spain, via IBEX 35 index futures. Spanish companies have a lot of exposure to Latin America, Brazil in particular, and Spanish banks will suffer badly.

I mentioned the potential for a banking crisis in Singapore. I don’t recommend shorting Singapore bank stocks, but rather the EWS, or iShares MSCI Singapore ETF. In this case, an investor will benefit from both declining local stock prices and a decline in the Singapore dollar against the U.S. dollar. Finally, in Europe, I recommend shorting the German DAX index and the Euro Stoxx 50, both via futures. My minimum downside target for the DAX is 7500.

Schafer: Where is the DAX trading now?

Zulauf: It is around 9000. I also would short emerging-market currencies, particularly Asian currencies. I would buy the dollar against the CNH, the Chinese yuan offshore. The yuan offshore is priced at about $6.60, and could shoot up to $8.

Cohen: What is your time frame for that?

Zulauf: I expect it to happen this year. This will be an extremely bad year for investors. Hopefully, it will yield many investment opportunities in 2017. You will hear me sounding bullish then.

We don’t believe you.

Zulauf: I would buy the U.S. dollar against the Singapore dollar, which is trading for $1.43-$1.44. I would also buy the dollar against the Korean won and Taiwan dollar. South Korea is the most highly leveraged industrial economy in Asia.

Schafer: *Where does gold fit into your investment portfolio?*

Zulauf: Gold will be a tremendous trade at some point this year, but we are in a deflationary environment, which isn’t good for gold. When systemic risk thrives, gold could become an important investment, but gold isn’t entering a new bull-market cycle. The price could break below $1,000 an ounce first, and then run to $1,400, so I don’t want to recommend it today. You’ll have to time your entry during the year.

The same is true for bonds. There will be a safe-haven run into U.S. Treasuries, pushing the yield on the 30-year Treasury bond down to 2.50% or so from 2.91%. Then yields will rise again, as the markets assume the authorities will expand the deficit once the economy turns sour. Governments will try to support the system, but we need a calamity to occur first.

Thanks for your thoughts, Felix. Mario, you’re next.

MARIO GABELLI

Gabelli: We have talked today about the impact of China’s weakening economy on the commodities market, and how problems in the industrial sector will hurt Standard & Poor’s 500 earnings. I am going to discuss something unrelated: a company I have followed for some time that has grown more exciting [puts on New York Knicks cap]. I am referring to Madison Square Garden [MSG], which owns the greatest sports arena in the world—Madison Square Garden, in New York. The company has 25 million shares outstanding, selling at $154 each, for a market capitalization of $3.8 billion. It has $1.5 billion of net cash, and has committed to buying back $500 million worth of stock.

Madison Square Garden owns several sports franchises, including the New York Knicks, New York Rangers, and New York Liberty women’s basketball team. As a group, its sports franchises could be worth $1.7 billion. In addition to the Garden, the company owns properties such as the Forum in L.A., and the Chicago Theatre. It leases Radio City Music Hall and the Beacon Theatre in New York.

And it is a real-estate play.

Gabelli: That’s right. From Manhattan’s West 34th Street south along the High Line, there has been a construction renaissance. There have been many discussions about renovating Penn Station. The air rights over Madison Square Garden, which sits atop Penn Station, could be worth as much as $500 million, and the company is starting to look at ways to monetize that asset. The combination of cash flow, asset values, and stock buybacks allows me to put a value on the stock of $200 to $300 per share. Another way to look at it is, if you buy the stock, you get the Knicks for free.

Through its 4.5 million B shares, the Dolan family controls the company. There are a lot of ways to make money here by monetizing the company’s assets.

Next, Griffon [GFF] is a small-cap stock. The company has 48 million shares. The stock sells for $16.60. Griffon is involved in several industries. Through its home and building-products division, the company is involved in the U.S. garage-door business. It is a $1.8 billion market, and Griffon’s Clopay unit has a 25% market share. It competes with Overhead Door, and others. It sells mostly through Home Depot. This is a good business, and it is improving. The company has added a few product lines in its home division, including True Temper garden and snow-removal tools.

What are Griffon’s other businesses?

Gabelli: The company is a component supplier for diapers. Procter & Gamble [PG] accounts for half of Griffon’s diaper business, and is gaining share. Griffon’s costs have fallen as resin prices have come down, and these cost savings are passed on to customers. But, on balance, this too is a good business for the company.

Griffon also develops and sells equipment for the military through its Telephonics unit. It makes submarine-monitoring hardware for helicopters, and is a first-tier supplier to Lockheed Martin [LMT]. Military spending will increase in 2016, ’17, and ’18, given China’s more aggressive posture in the South China Sea, North Korea’s reported test of a hydrogen bomb, and the events in the Middle East. The U.S. has underspent on its military, and we’ll have a new president next year, which means spending will rise.

Here are the numbers. Griffon generated revenue of about $2 billion for the fiscal year ended Sept. 30. Ebitda, or earnings before interest, taxes, depreciation, and amortization, was about $171 million. In the current fiscal year revenue could rise to $2.05 billion, and Ebitda, to $180 million. Griffon earned 73 cents a share in its latest fiscal year. It could earn 85 cents a share this year, and $1 in fiscal 2017. Goldman Sachs owns more than five million shares.

Is there any chance Griffon might break itself up or spin off businesses?

Gabelli: We would prefer that they don’t break things up. We’d like management to focus on using the company’s cash flow to grow the businesses it is in, and make a few tuck-in acquisitions. To me, Griffon is in the right businesses.

Kaman [KAMN], based in Connecticut, ties into two themes: higher military spending, and the struggles of the energy, metals, and mining industries. Kaman has about 30 million fully diluted shares. The stock is trading for $38. Pro forma, with two acquisitions, net debt is $435 million. Kaman acquired Timken Alcor Aerospace Technologies from Timken [TKR] for $45 million.

Kaman sells JPFs, or joint programmable fuzes, used to program precision-guided bombs aboard military planes. The U.S. Air Force has placed orders for Kaman’s JPFs, as have other nations. One small but important concern is that the U.S. Navy just awarded a fuze contract to another company, which will be phased in starting in 2021.

Witmer: Which company is that?

Gabelli: It’s Orbital ATK [OA]. Kaman also is a subcontractor to Lockheed Martin for cockpits for the Black Hawk helicopter. It has an aerospace-structures business. But the crown jewel is a business that manufactures tapered rolled bearings for commercial aircraft. As the ramp rate rises on new planes from Boeing [BA] and Airbus Group [AIR.France], Kaman benefits. This business has been particularly strong. Including recent acquisitions, bearings revenue could reach about $300 million this year, and $320 million in 2017. Ebitda could rise from $105 million in 2016 to $120 million in 2017. The JPF business is operating at capacity. Growth can be accommodated by machinery and labor.

What is happening on the industrial side of the company?

Gabelli: That business faces challenges. Kaman generates about $1.2 billion in annual revenue from its distribution segment, which mainly includes the sale of MRO [maintenance, repair, and overhaul] supplies. About 20% of distribution revenue is tied to EMM—energy, mining, and metals. The company acquired a business with operations in Pennsylvania, near the Marcellus Shale. That has become an air pocket: Revenue in the distribution segment declined at an accelerating rate in the fourth quarter, as energy prices fell, and will probably continue deteriorating.

Kaman generates a lot of cash. It is reasonably well-managed, and the defense side of the company will get more traction in coming years. Charles “Chuck” Kaman founded the company in the 1940s. As an aside, the first time I visited his office, the guy’s dog, Otto, came over and put his head on my lap. I didn’t ask any aggressive questions after that.

Chuck Kaman was a smart man.

Gabelli: I expect Kaman to earn $2.90 a share this year and $3.10 in 2017.

Auto-parts stocks were a tale of two cities last year. O’Reilly Automotive [ORLY] was up 31%. Pep Boys—Manny, Moe & Jack [PBY] was up 87%. Genuine Parts [GPC] was down about 20%. Genuine Parts is trading for $78 and has 150.8 million shares. The company has raised the dividend annually for the past 59 years. It has four operating segments. The automotive business, conducted under the Napa name, contributed $8 billion out of a total $15 billion in 2015 revenue. We expect revenue of closer to $16 billion this year and $16.5 billion in 2017.

Why has the stock underperformed peers?

Gabelli: About 25% of automotive revenue comes from Canada, Australia, New Zealand, and Mexico. Revenue was up nicely in local currency last year, but down significantly when translated into dollars. At some point, the currency head wind will flatten out and the negative impact will disappear.

Genuine Parts also has an MRO business, which sells repair parts. It competes with Fastenal [FAST] and W.W. Grainger [GWW]. Annual revenue for this business is about $4.5 billion. It has been declining sequentially in the past few months, but the business is OK. I expect Genuine Parts to earn $4.50 a share for 2015, $5 this year, and $5.50 next year. The company pays an annual dividend of $2.46 a share, which it is likely to raise again this year.

Shifting gears [everyone groans], people are uncomfortable with the outlook for emerging markets, but I like Kinnevik [KINVB.Sweden], a Swedish company that has several emerging-market subsidiaries. I recommended it last January. If you give $1 billion to a private-equity fund, they take fees and 20% of profits, and you have no liquidity. In Kinnevik’s case, you can invest in a basket of companies selling at a discount to net asset value; management doesn’t take two-and-20 [2% in fees and 20% of profits], and you can get your money out.

What is the stock price?

Gabelli: Kinnevik has 277 million A- and B-class shares. The stock was priced at 238 Swedish kronor [$28] last Friday. Kinnevik has investments in e-commerce operations. The business I am focused on is Millicom International Cellular [MIICF].

Millicom has 60 million wireless customers in Africa and Latin America. In Africa, it is cash break-even. At some point, Millicom will be able to monetize its African business. The Latin America business operates in Costa Rica, Honduras, Guatemala, El Salvador, Bolivia, Colombia, and Paraguay. The company already has sold off its Asian operations.

How will it monetize the Latin American portion?

Gabelli: John Malone [chairman of Liberty Media /LMCA] recently merged Columbus International, a telecom provider in the Caribbean and Central and South America, into Cable & Wireless Communications [CWC.UK], in which he has a stake. Last summer Liberty Global [LBTYA], which he controls, created a tracking stock called Liberty LiLAC Group [LILAK] to track its operations in Latin America and the Caribbean. Next, Malone is likely to use Liberty LiLAC to further consolidate operations in that part of the world. Millicom is likely to be sold at the right price. The current CEO of Millicom previously ran the Chilean operations of Liberty LiLAC.

What could Millicom be worth in a break-up and sale?

Gabelli: Let me put it this way: If I were running Millicom, I would first sell off the African business for a couple of billion dollars. It has about $200 million in annual Ebitda. Then I would consolidate Latin American operations with Malone’s. This is going to be a big winner. Here’s the math: Millicom has 100 million shares. The U.S. shares are trading for $52. The company could generate $7 billion in revenue this year, and $2.3 billion in Ebitda. Next year revenue could hit $7.4 billion, and Ebitda, $2.4 billion. Annual capex is $1.2 billion, so the business is cash-flow positive.

Next, CBS [CBS] has 38 million class A shares, of which Sumner Redstone’s National Amusements owns 30 million. There are eight million in public hands. Our clients own about four million of the A shares. The A shares are selling around $50, and the B shares, at $46. There are 474 million shares in all. CBS has an equity-market capitalization of $22 billion; $8 billion of debt, and an enterprise value of $30 billion. The company operates television stations and produces content for TV.

CBS had $13.8 billion in revenue last year, going up to $14.6 billion this year. Election-related and Super Bowl 50 advertising will bolster revenue in 2016. Ebitda was $3.1 billion, and could rise to $3.4 billion. The company might be harvesting assets through the spectrum auction later this year. The prior spectrum auction generated proceeds of more than $40 billion, although this auction won’t generate close to that, due to buyer exhaustion.

What is CBS likely to generate in earnings?

Gabelli: The company earned $3.30 a share last year, and could earn $3.90 this year and $4.25 next year. The stock is selling for 11 times next year’s estimate. The broadcasting business accounts for almost $9 billion of revenue. On the programming side, I like *Ray Donovan* better than *Downton Abbey*, and I like *The Walking Dead*.

Gundlach: That’s a lot of TV.

Gabelli: In addition to big sources of advertising and the spectrum sale, there is CBS All Access, the company’s “over-the-top” or streaming service.

Black: The stock is cheap statistically, but [CBS CEO] Leslie Moonves makes north of $50 million a year and hasn’t delivered much top-line growth.

Gabelli: Come on, hedge-fund managers make a lot of money. This guy [points to Gundlach, sitting to his right] runs $63 billion in fixed-income portfolios, and makes a lot.

Give us the range of outcomes at CBS.

Gabelli: Redstone is 92. When he passes from the scene, will his family hang on to Viacom [VIAB], which he also controls, and sell CBS? A lot of organizations and individuals might like CBS.

Lastly, Discovery Communications [DISCA] has 645 million shares outstanding: 223 million A shares have one vote, seven million B shares have 10 votes, and 415 million C shares don’t get a vote. Malone is involved with this company, too; he owns about six million of the B shares. Discovery has $7.3 billion of debt, and a $25 stock price. It has a market cap of $16 billion and an enterprise value of $23.7 billion. The company’s various cable-TV channels generated $6.4 billion of revenue in the latest year, about half outside the U.S.

Revenue could climb to $6.8 billion this year and $7.2 billion next year. We forecast Ebitda of $2.6 billion for 2016, and $2.9 billion for 2017. The company earned $1.80 last year. It could earn $2.15 this year and $2.55 next year. Neither CBS nor Discovery has much capex. They are great cash generators. The big issue for Discovery is how to migrate its content to global platforms, including smartphones. The CEO, David Zaslav, is terrific. Discovery won the non-U.S. broadcast rights for the Olympic Games from 2018 through 2024. That’s it.

In that case, thank you. Jeffrey, it’s your turn at bat.

JEFFREY GUNDLACH

Gundlach: Felix laid out a lot of facts that I have also been observing. I agree that the Fed won’t be able to raise interest rates according to its dots, particularly if you follow the dot plot to the end of 2017. It suggests the Fed will hike rates eight times, by 200 basis points in all. Based on the deterioration in stock prices, commodities, and junk bonds, I have been waiting for the Fed to start dialing back its rate-hike rhetoric. We got a little of that today, when Dennis Lockhart [president of the Federal Reserve Bank of Atlanta] said the Fed might not have enough data to move rates up in March.

According to some fixed-income managers, the step-function decline in junk-bond prices has created an overwhelmingly attractive opportunity. At DoubleLine, we are not of that opinion. While junk bonds tied to the commodities complex are due for a rally, it will be a rally within a correction. Like Felix, we believe China is growing at a much slower rate than the government claims and people want to believe. The World Bank recently dropped its global growth estimate for 2016 to 2.9% from 3.3%. Since China is 16% of the world economy, global growth might be only 2%.

In this environment, currency devaluation becomes the only tool to spur growth for many countries experiencing negative GDP. In Brazil, the largest economy in South America, GDP growth is negative 4%, even if the country’s finance minister says it is negative 2%. Again, like Felix, I recommend shorting the iShares Emerging Markets ETF.

We allow doubles.

Gundlach: The correlation between the emerging-markets ETF and commodity prices is incredibly high, and the gap today between commodity prices and the ETF price is remarkably wide. This suggests further downside in emerging-market stocks. The MSCI Emerging Markets Index, which the ETF tracks, is now around 700. If commodities prices stay at current levels, history suggests the index should be around 450. It would probably overshoot to the downside, so you could be looking at a 40%, or possibly 50% decline.

How much worse could things get in the junk-bond market?

Gundlach: I expect it to remain challenged. It would require a big rally in commodities prices to avoid a debt-default cycle. However, a portion of the credit market has a safety cushion large enough to absorb another 200- or 300-basis-point widening in junk-bond spreads versus Treasuries. I’m referring to closed-end bond funds, which trade on the New York Stock Exchange. Closed-ends are one of the best plays on the Fed not raising interest rates. I like them better than the Eurodollar futures idea Felix discussed.

Closed-end funds are leveraged, and investors have been afraid to own them because they fear that the Fed has launched a tightening cycle. Also, based on daily data going back 20 years, they have traded at a 2% discount, on average, to net asset value. Recently, however, the sector traded at a 10% to 12% discount to NAV. It has traded at such a steep discount only 5% of the time. In the past 20 years, the discount has been wider than that only during the financial crisis in 2008-’09.

Rogers: Are you referring only to fixed-income closed-ends?

Gundlach: Yes. If history is any guide, discounts would widen further only in a 2008-type scenario, which is possible, although doubtful so soon after the prior crisis. Under current circumstances, you have about two percentage points of downside, and 10 points of upside to return to the historical discount. That makes a basket of closed-ends attractive. If you bought a junk-bond-oriented closed-end trading at a 12% discount to NAV, some of the bonds would be trading at a 15% discount. This isn’t a bad idea, but I prefer Brookfield Total Return fund [HTR]. It is trading just as poorly as some other closed-ends, but is vastly safer.

Brookfield’s NAV is $25.75 a share. It is trading at $21.77, for about a 12% discount to NAV. It pays a monthly dividend of 19 cents, which it hasn’t changed for more than seven years. While investors have been crushing anything that is interest rate-exposed, there is also little ability in the closed-end fund market for institutional investors to arbitrage the discounts. For example, at DoubleLine, we manage $85 billion. You thought it was $65, huh? $85, bro.

Gabelli: I said $63. My estimates are always low.

Gundlach: There is no way I could buy these institutionally without the discounts instantly disappearing, because the volume is so low, relative to the amount I would have to buy to make a difference on DoubleLine's $85 billion in assets. Closed-ends are a good opportunity for the retail investor.

Brookfield Total Return yields 10.47%. It is leveraged 35%; hence, the worry about interest-rate risk. Junk bonds and commodities are Ground Zero of the bond market's and the economy's problem, but only 8% of this fund's portfolio is corporate credits. Another 2% is preferred stocks, and the rest is mortgage-backed securities. MBS are immune to the problem of lower commodities prices. Lower oil prices actually help homeowners put extra cash in their pockets. That makes it more likely they will make mortgage payments.

Gabelli: Having seen *The Big Short*, I'm nervous about MBS.

Gundlach: Trust me, there aren't a lot of MBS from North Dakota [a major shale-oil region]. The MBS are non-government-guaranteed, so defaults could be an issue. Yet with housing prices having risen for four years and consumers getting a break on oil prices, the fundamentals are favorable. While I like HTR, an investor could put together a basket of closed-ends yielding 10% and 12% and selling at a 10% to 15% discount to NAV.

Priest: With respect to closed-end funds, if you assume that the management fee is a perpetual claim on net asset value, the present value of that stream of future claims will almost always lead to a market price below the funds' NAV. Historically, that discount can vary, but 8% to 10% is not uncommon.

Gundlach: Your argument makes mathematical sense, but historically that discount has been 2%. A reversion to the mean isn't unheard of; based on recent discounts, it would amount to a 10% gain in the price.

Witmer: With the yield, the return would be 20%.

Gundlach: I was getting to that. The S&P 500 yields 2%. Either the credit market has to improve, or stocks have to fall further, because there has been a yawning gap in the performance of these markets in recent months. If the S&P rises 10%, closed-ends could return 20%. If the stock market falls 30%, a decline is already priced into these funds. I look at closed-end funds as a good place to put your risk money.

What is the best way to assemble a basket of quality closed-ends?

Gundlach: You have to decide which sectors you are interested in, and look up the discounts to NAV because they aren't homogenous. [*Barron's* publishes weekly data on closed-end funds; or the Market Data section of Barrons.com.]

Priest: In my prior life, we ran many closed-end funds. We decided to adopt a novel policy: Charge investors based on market value, rather than the net asset value. Yet the discount to net asset value didn't change at all.

Gundlach: I'm not surprised. Closed-end funds aren't well understood.

Priest: It seems logical to invest in liquid fixed-income closed-ends, rather than those equity closed-ends with a preponderance of illiquid private placements, where values aren't determined by the market or an independent third party. Moreover, for some funds, frequent rebalancing of the portfolio may cause large capital gains. Low-turnover equity closed-end funds make sense.

Witmer: Who lends closed-ends money?

Gundlach: A fund manager can establish a bank line of credit or do a reverse repo [reverse repurchase agreement].

Black: What happens to the mortgage portfolio if interest rates rise?

Gundlach: It is a bond portfolio, so it will go down. But priced at a 12% discount to NAV, it is trading at what it would be worth if rates were 150 basis points higher. That's the cushion of safety. You have to ask yourself, in what context would rates rise? The economy would be doing OK, and the backdrop would be less deflationary. The discount would absorb some of the impact of higher rates. The discount is the secret sauce here. If you can acquire a $100 bill for $85, I recommend that you do so, assuming you consider a $100 bill attractive to begin with.

It wasn't so long ago that people would do just about anything to get a 7% yield. Those who bought master limited partnerships lost a lot of money. Now there is plenty of yield out there, and people say they're afraid of the Fed. Fears that the Fed will raise rates significantly are overblown. This brings me to Annaly Capital Management [NLY], one of the largest mortgage REITs [real-estate investment trust]. It has an $8 billion market cap and has been trading at a 25% discount to book value for some time. It is probably riskier than HTR because it is leveraged about six times, so there is significant exposure to borrowing costs that could rise over time.

Schafer: What is the stock price?

Gundlach: It is selling for $9.41. A few years back, it sold for $18. These sorts of stocks have step-function moves. They don't move by a few percent; they go from $18 to $12 and from $12 to $9, and if the yield curve is inverted, and they have to cut their dividends, things get really bad. But a discount of 30% to book value is the widest ever for Annaly, and historically very wide for a mortgage REIT. Annaly is paying a dividend of 30 cents per quarter. It yields 12.75%. The environment for Annaly has improved.

Schafer: Didn't Annaly cut its dividend?

Gundlach: Management cut it in 2013, but it has been at this level for a while. When rates rose sharply during the "taper tantrum" in 2013, after the Fed hinted it was going to reduce asset purchases, Annaly appropriately got scared and reduced its leverage. When you reduce leverage, you reduce your earnings power, and then you have to cut your dividend. Annaly primarily owns government-guaranteed mortgages and tries to hedge the interest-rate risk. This is challenging, but they survived the credit crisis by doing so. You have to give them credit for that. The discount to net asset value got as wide as 30% back then, in a far more challenging environment. At today's discount, a lot of bad things are priced in. If the Fed doesn't raise interest rates much, the stock should go higher.

3 Stock Picks from Mario Gabelli

Black: At Annaly, there used to be a mismatch between funding the assets and liabilities.

Gundlach: That is always a challenge. They are buying mortgages with an instability aspect to them, as they don’t know exactly when the mortgage holders will pay them off. The hedges are largely Treasury- or swaps-based [interest-rate swaps], and they don’t have the same instability. That is why these stocks can be volatile. But there are a lot of ways for this to go right, and if it doesn’t, you’ll just have to cry your way to the bank, clipping a 12.75% yield.

Why buy Annaly, as opposed to another mortgage REIT?

The legendary value investor makes the case for Madison Square Garden Co., Griffon Corporation, and a broadcaster that could become the ESPN of Europe.

Gundlach: It is highly liquid. I have even been able to buy some shares in our institutional business. Also, I know the company and have talked to management several times.

A third way of getting income is pretty risky, but I like it a lot. I’m talking about Puerto Rico GOs [general-obligation bonds]—the 8% GOs due in 2035. The general-obligation bonds have the highest constitutional protections, which means borrowers must be paid first, ahead of other commonwealth debt holders. Puerto Rico has shown a willingness to default on some of its debt, but defaulting on this would be tough.

My thesis for owning Puerto Rico debt has a lot to do with Florida. There are many voters in Florida with ties to Puerto Rico, and Florida is a critical state to win in the presidential election. I started buying the bonds around 80, and bought more at 71. The bonds are triple tax-exempt, meaning interest payments to U.S. citizens aren’t taxed at the federal, state or local level. In a high-tax state such as California, an 11% or 12% yield is equivalent to 23%, taxed. Maybe I won’t get back 100 cents on the dollar. Maybe the government will let Puerto Rico go. But President Obama spoke in the Puerto Rico statehouse with the U.S. flag sewn together with the flag of Puerto Rico. It doesn’t guarantee anything, but it is a reason to take a flyer. Even if the debt is restructured, you might get 70 cents on the dollar, and you’re getting eight points of coupon per year. This particular issue is a few billion dollars.

Gabelli: If you were running the country, what would you do to help Puerto Rico?

Gundlach: I would extend them the ability to file for bankruptcy protection, and restructure what they can. I might extend them some sort of lifeline economically. I am not advocating this, and I don’t care what shape a restructuring takes. But at 73 cents on the dollar, you’re going to make decent money, particularly if you’re a taxable investor. It is a speculative investment.

Abby Joseph Cohen: Goldman’s 2016 Outlook

The senior investment strategist at Goldman Sachs, interviewed at the Barron’s Roundtable, is optimistic about some technology and healthcare stocks.

Next, investors often use diversification to justify buying things that are up a lot, but bond investors who haven’t diversified beyond the U.S. might consider doing so. The DoubleLine Core Fixed Income fund [DBLFX] was 100% dollar-denominated since 2011, when the dollar was at a low. For the first time ever last week, I started to buy a diversified basket of non-dollar-denominated fixed-income assets of developed countries. The dollar is overvalued. It rose 25% in a year. People think a stronger dollar accompanies the start of a Fed tightening cycle, but history suggests otherwise. It is possible, even likely, that the Fed wants to dial back some of its rate-hike rhetoric. If that is the case, the dollar could weaken about 10% against a basket of currencies.

Schafer: Being long the dollar is a crowded trade.

Gundlach: Everyone is on one side of the boat, and they justify it by saying the Fed is going to tighten.

Zulauf: So you are buying the currencies of other industrialized economies?

Gundlach: Yes—even the Canadian dollar, which looks like death because of the drop in oil prices. We are overdue for a commodity rally.

What is the best way to execute this investment?

Gundlach: BWX [SPDR Barclays International Treasury Bonds ETF] would do the job. One reason Treasury yields bottomed in July 2012 was because Europeans were buying dollars like crazy. They did that by buying bonds. You had a monstrous move in the U.S. bond market that took the 10-year Treasury yield down to 1.38%. Now it is nearly 100 basis points higher. I am advocating diversification into developed-country currencies.

Finally, while I regard U.S. equities as a much better bet than emerging markets, I recommend buying the India stock market through the iPath MSCI India exchange-traded note [INP]. Indian equities could have a hard time as emerging markets sell off, but the labor force is growing. India will be the China of the next generation, in terms of equity returns. Things are bad. India has a lot of corruption. That means things might get better.

You made a high-profile negative call on Apple [AAPL] a few years ago. What are your thoughts now?

Gundlach: I recommended shorting Apple in April 2012 at $600 a share [prior to the company’s 7-for-1 stock split]. The stock rose to $700. That’s when everyone mocks you. But I insisted it would fall below $425. It did, and we bought it at $405. Then we sold it too soon. I don’t have a position or a strong view now. The stock isn’t expensive, but I have an allergy to high-market-cap stocks in general, because I don’t understand how they can compound when they are already so big. [Apple’s market cap is $533.9 billion.]

Fair enough. Thanks for joining us, Jeffrey.

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