Valuentum Securities, Inc.

"The 12 Most Important Steps To Understand The Stock Market"

www.valuentum.com

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About the Speakers

RJ Towner

RJ is director of research development for Valuentum Securities, leading the firm's qualitative research. He also assists in managing Valuentum's Best Ideas Newsletter portfolio and Dividend Growth Newsletter portfolio. Prior to joining Valuentum in 2012, Mr. Towner worked in equity research and advisor software at Morningstar. He graduated with a Bachelor's degree in economics from DePaul University's Driehaus School of Business.

Brian Nelson, CFA

Brian is the President of Equity Research and ETF Analysis at Valuentum Securities. Before founding Valuentum in early 2011, Mr. Nelson worked as a director at Morningstar, where he was responsible for training and methodology development within the firm's equity and credit research department. Prior to that position, he served as a senior industrials securities analyst, covering aerospace, airlines, construction and environmental services companies. Before joining Morningstar in February 2006, Mr. Nelson worked for a small capitalization fund covering a variety of sectors for an aggressive growth investment management firm in Chicago. He holds a Bachelor's degree in finance and a minor in mathematics, magna cum laude, from Benedictine University. Mr. Nelson has an MBA from the University of Chicago Booth School of Business and also holds the Chartered Financial Analyst (CFA) designation.

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Agenda

- What Is Valuentum Investing?
- Are You A Valuentum Investor?
- Performance of Our Best Ideas Newsletter Portfolio
- The 12 Most Important Steps to Understand the Stock Market
- Valuentum's Dividend Analysis
- Valuentum's Investment Research Services

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What Is Valuentum Investing

But how, you will ask, does one decide what [stocks are] "attractive"? Most analysts feel they must choose between two approaches customarily thought to be in opposition: "value" and "growth,"...We view that as fuzzy thinking...Growth is always a component of value [and] the very term "value investing" is redundant.

-- Warren Buffett, Berkshire Hathaway annual report, 1993

At Valuentum, we take Buffett's thoughts one step further. We think the best opportunities arise from a complete understanding of all investing disciplines in order to identify the most attractive stocks at any given time. Valuentum therefore analyzes each stock across a wide spectrum of philosophies, from deep value through momentum investing. We think companies that are attractive from a number of investment perspectives--whether it be growth, value, income, momentum, etc.--have the greatest probability of capital appreciation and relative outperformance.

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But Why Do We Think This?

- Stock prices are determined by deep-pocketed institutional money-managers and corporations
- These buyers/sellers use a variety of tools to make a decision
- Understanding all of the tools that these buyers and sellers use to make decisions is vital to anticipating future stock prices
- Their tools center on:
  - Value (growth is a component of value)
  - Competitive Analysis (Buffett's moat, ROIC)
  - Momentum (including technical analysis)

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The Valuentum Investor

- Not Value Investing – Benjamin Graham
- Not Growth Investing – T. Rowe Price, Jr.
- Not GARP Investing – Peter Lynch
- Not Momentum Investing – Richard Driehaus

- But “Valuentum” Investing
  - Finding technically-attractive growth stocks that are trading at deep discounts to intrinsic value and their peers.

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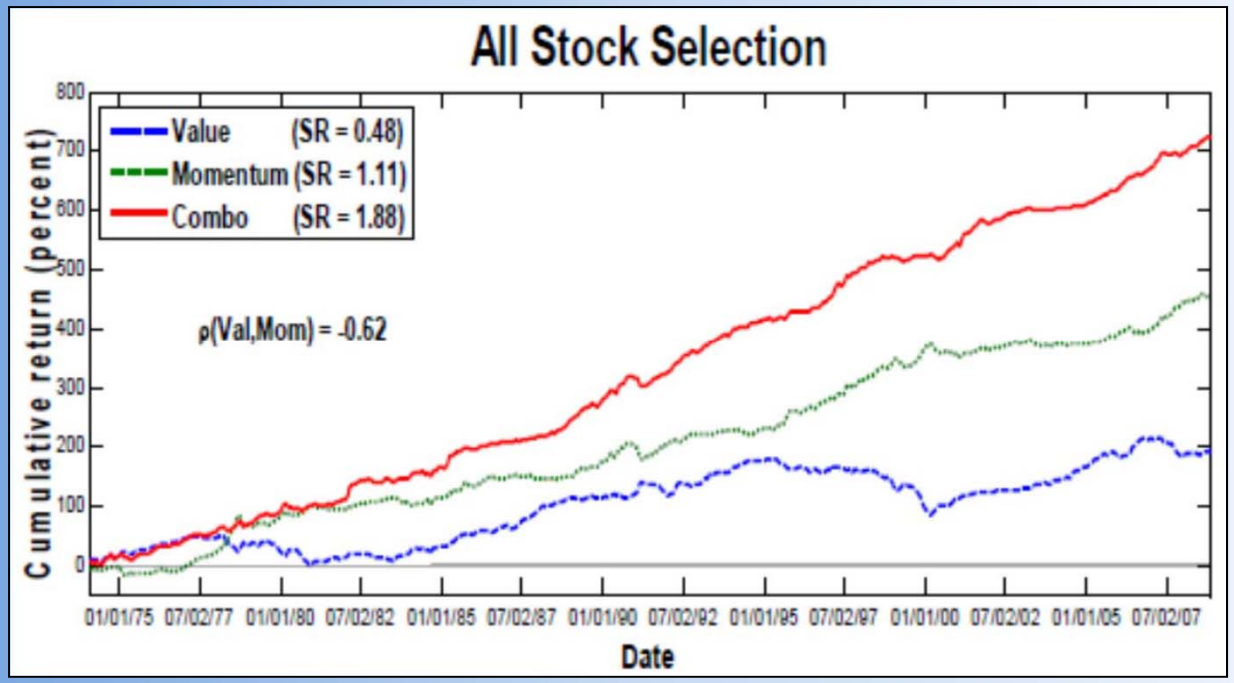
Historical Back-testing

- The benefits of a combined value-momentum portfolio have been well-documented in academic literature.



Source: Asness, et al (2009)

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How Valuentum Stocks in the DJIA Outperformed

- Our approach identified the best- and worst-performing portfolios (Jan 1995 - May 2012).

Momentum (LR - SR)	Value (LR - SR)	Combined (LR - SR)
321.0%	72.9%	426.7%

* LR = Long Return; SR = Short Return

Source: Nelson (2012)

Portfolio	Return
Valuentum Long Average	776.7%
Momentum Long Average	672.3%
Value Long Average	548.2%
Data Universe Average	511.8%
Data Universe Median	482.9%
Growth Long Average	475.3%
Weak Momentum Long Average	351.3%
Valuentum Short Average	350.0%

Source: Nelson (2012)

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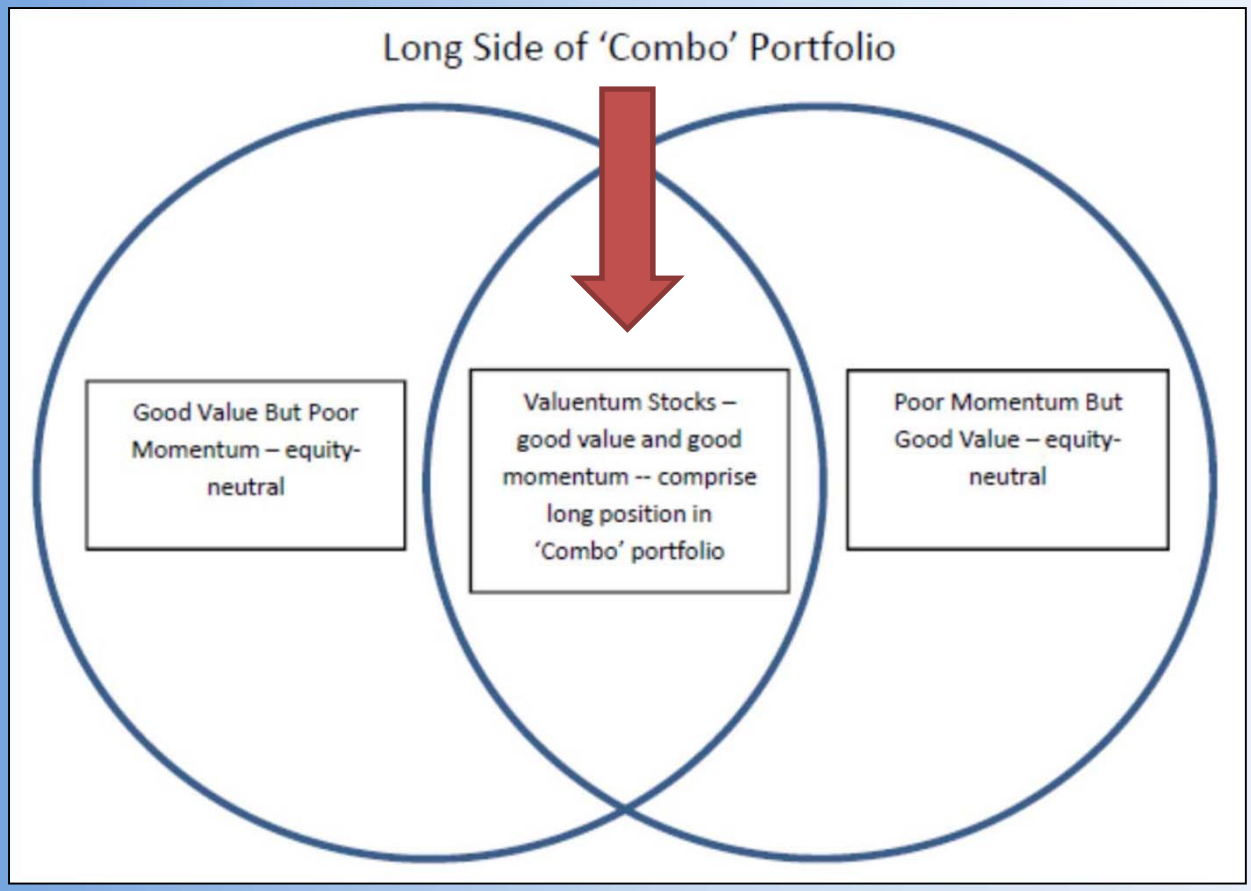
We Focus on the Sweet Spot



Source: Nelson (2012)

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EDAC Technologies (EDAC)

VBI Rating of 9

Image Source: BigCharts

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Example 3: AMR Corp

VBI Rating of 1

Image Source: BigCharts

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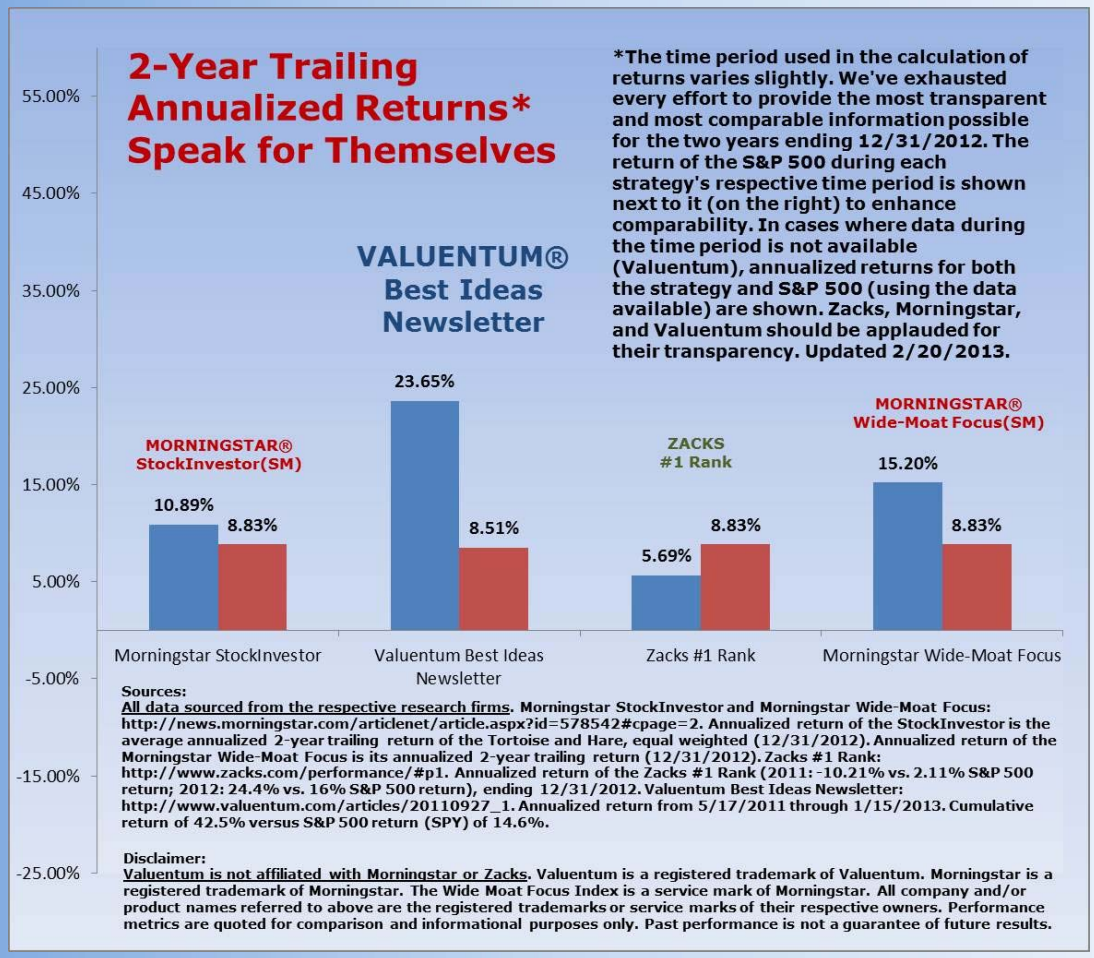
The Performance of Our Best Ideas Newsletter Portfolio



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How Do We Identify Firms with Both Good Value and Good Momentum Characteristics?

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Our Valuentum® Buying Index™

The Valuentum® Buying Index (VBI) combines rigorous financial and valuation analysis with an evaluation of a firm's technicals and momentum indicators to derive a score between 1 and 10 for each company. The VBI places considerable emphasis on a firm's DCF valuation, its relative valuation versus peers (both forward PE and PEG ratios), as well as its technicals in order to help investors pick the best entry and exit points on the most interesting stocks.

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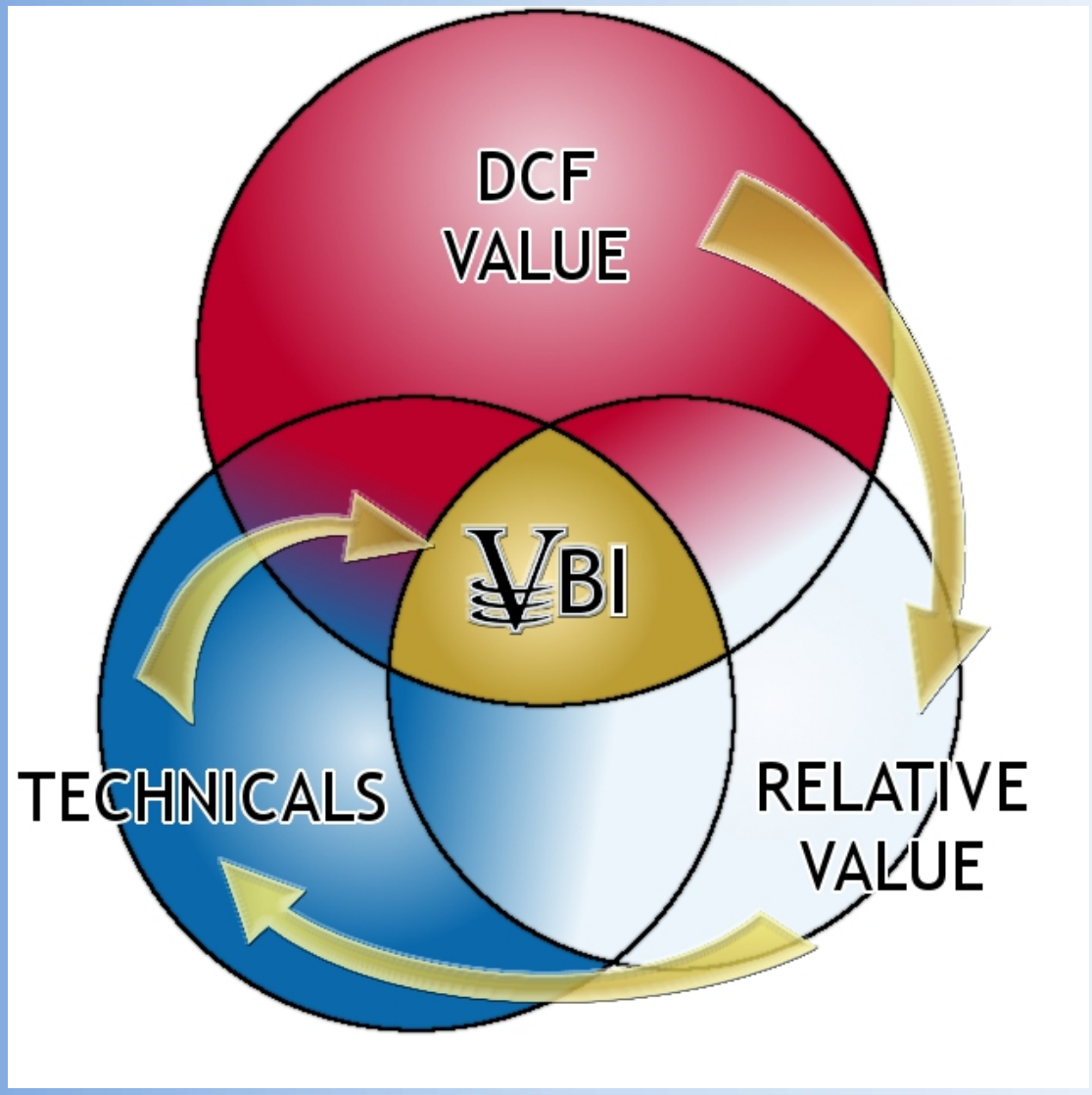

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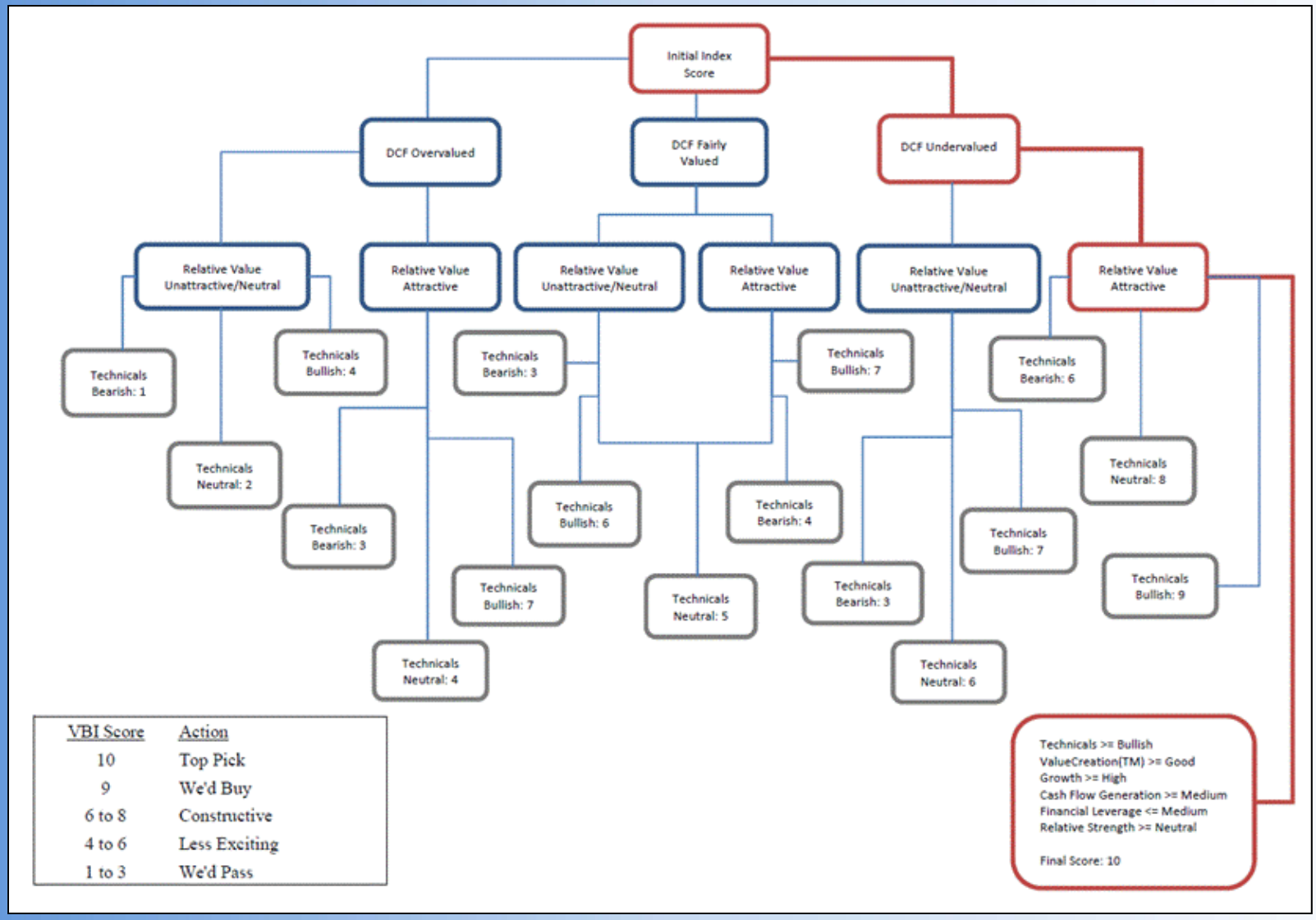

VBI Score	Action
10	Top Pick
9	We'd Buy
6 to 8	Constructive
4 to 6	Less Exciting
1 to 3	We'd Pass

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Momentum Doesn't Mean Fast Money!

- Risk management tool—we avoid catching falling knives and being the "greater fool."
- Used for timing entry/exit points
- Low turnover avoids taxes, commissions, allows for compounding
- "It takes character to sit there with all that cash and do nothing. I didn't get to where I am by going after mediocre opportunities."- Charlie Munger
- Only the **BEST** investment opportunities

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Valuentum Investments

- eBay (EBAY)
  - Initial VBI: 10
  - Underappreciated PayPal unit, return of the marketplace via fixed prices
  - Return: 80% (as of May 13)
- Visa (V)
  - Initial VBI: 7
  - Fantastic ROIC and free cash flow
  - Aggressive share repurchases at favorable prices
  - Return: 66% (as of May 13)

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Was Warren Buffett a Valuentum Investor?

- Mr. Buffett has invested in undervalued stocks that have generated significant outperformance over time.
- By definition, these stocks have had both good value and good momentum characteristics.
- The Oracle of Omaha's outperformance in part can be attributed to the Valuentum Style of Investing!

A Young Warren Buffett

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The 12 Most Important Steps To Understand the Stock Market

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#1: The Stock Market Is a Market

- The stock market is made up of people. People make mistakes. People have biases. Some people are greedy; some people are fearful.
- The stock market is not a precise mechanism (Question: good earnings → stock price reaction?)
- The stock market is a market filled with individuals making decisions about what to buy or sell. And these buy and sell decisions move the stock price.
- Some investors like to make things complicated, but **an explanation of the market doesn't get any simpler than that – it's a market**. (Examples: micro cap shares; technical breakouts)

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#2: There Is No Long Term

- The financial industry loves long-term investors. And rightfully so for them: there is less flight risk of your assets if you are a long-term investor.
- "Long-term investing" is one of the market's biggest fallacies. At any point in time, the stock price of a company is based on **expectations** of **future** earnings and cash flow.
- In 10 years, the stock price of a company will **still** be based on **expectations** of **future** earnings and cash flow at that time.
- We will never reach the long term. In fact, there is no long term. Please understand this concept is different than saying that "in the long-term, we are all dead." What we're saying is that **the market will always be a discount mechanism of future earnings and cash flow**.

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#3: Stocks Do Not Magically Converge to Intrinsic Value or a Target Price

- Often, investors hear that a stock is undervalued or overvalued, and this informs their investment decision as if some magic wand will cause the stock to magically converge to intrinsic value.
- Stocks can stay overvalued for decades, undervalued for decades, or fairly valued for decades.
- Only when there is buying or selling in the stock based on its overvalued or undervalued state does a stock actually converge to intrinsic value.
- It doesn't matter if **YOU** think a stock is undervalued or overvalued. It matters if others (after you) think a stock is undervalued or overvalued, and then buy or sell that stock driving it higher or lower—only then will it converge to intrinsic value.
- The market is not magic—other people have to eventually agree with you for your ideas to work out. **As an investor, we are highly dependent on what other people think. You must hope they eventually come around to what you believe.**

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#4: Everything in the Stock Market is a Self-Fulfilling Prophecy

- Technical analysis works sometimes because people buy or sell based on technical analysis, driving a stock higher or lower respectively.
- Value investing works sometimes because people buy or sell based on value principles, driving a stock higher or lower respectively. Neither technical analysis nor value investing works all of the time.
- Stock prices converge to intrinsic value because investors collectively think the stock is worth intrinsic value and vote with their capital to drive the stock price to its intrinsic value. If everybody thought a stock was worth intrinsic value, it would trade precisely at its intrinsic value. If nobody thought a stock was worth intrinsic value, it would never reach its intrinsic value.
- If you think a stock is worth intrinsic value, but nobody else does or ever will then **you have an underperformer on your hands.**
- It is this self-fulfilling prophecy that makes the stock market what it is. If all investors think one thing, it will be true in the stock market.

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#5: The Stronger the Competitive Advantage the Lower the Stock Return

- This can't be! No way! You refuse to admit it! Everybody can't be wrong! But what about Buffett?
- Well, you don't have to take our word for it – all else equal, a stock research firm that does economic moats concluded that companies with wide economic moats underperform stocks with narrow economic moats, and that stocks with no economic moats had the best returns (over the time period studied).
- If you are looking for underperformance, you'll likely find it by identifying the stock with the strongest competitive advantages. The fact of the matter is that the stocks with the strongest competitive advantages are already discovered—they have already been found. They have been bid up to levels where excess returns may be difficult to come by.
- Stock prices are driven by expectations of future earnings and cash flow. Competitive advantage analysis **alone** will not lead you to the best-performing stocks.

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#6: Earnings Surprises Are Analyst Misses Not the Company's

- A company is not doing better or worse just because an analyst or group of analysts (consensus) fails to accurately predict quarterly results. Companies beat or miss earnings expectations because analysts are wrong with their forecasts.
- Earnings beats and misses offer very little value to the investor. Once a company reports numbers in a quarter, the quarter is over (and is history). Stock prices are determined by future expectations of earnings and cash flow. **The only thing investors care about is the future.**
- **Question**: What if a company continues to miss earnings expectations every quarter into infinity? Will its stock price keep going down forever until it reaches 0?'

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#7: The Recent Trend Toward Dividend Investing May Be Good (and Bad) for the Individual Investor

- On one hand, dividend growth investing is good in that it helps investors find strong, stable, dividend-paying companies such as J&J and P&G. It prevents them from getting involved in speculative, high-risk companies (remember the dot com craze), which in many cases is the last thing a retiree is interested in doing.
- On the other hand, **dividend-paying companies have in many cases been transforming into speculative companies** (think MLPs, mortgage/residential REITs). Many are overly-dependent on the healthy functioning of the capital markets.
- And many investors continue to stretch for those 10%+ yielding entities that may not survive for long (think SVU, RNDY, etc.).
- Dividends are just one component of cash flow distributed to shareholders. A company's intrinsic value is based on its entire future free cash flow stream.
- **Did you know?** A company's stock price is reduced by the amount of its dividend payment (once it goes ex-dividend).

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#8: The P/E Ratio Is a Short-Cut and Used Incorrectly

- Remember all your friends that hated math! Well, the fact of the matter is that the stock market is highly mathematical. It combines math, accounting, finance, psychology, economics, and pretty much every discipline out there.
- However, many investors don't like the math part and think the P/E ratio is a substitute for actually calculating an intrinsic value or using a research firm that applies intrinsic-value analysis.
- The P/E is a short-cut discounted cash flow model. But instead of thinking about the assumptions in a discounted cash flow model to arrive at an intrinsic value estimate, investors simply assign a P/E multiple to an earnings number.
- Investors sometimes use a company's own historical P/E ratio average or that of comparable companies to assign to the company's earnings stream. **You now know how wrong this is!**
- A company's P/E should be based on its very own future free cash flow stream, as the value of a firm is based on the future (not an assessment of its past or a comparable company).

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#9: You Will Be Wrong

- Individual investors sometimes think that every idea should work out and immediately at that. Wrong!
- **If you are a good investor, your winners will outperform your losers and you will make money.** If you're an excellent investor, you will still have a lot of losers, but you'll end up beating the market
- The fact of the matter is that you will be wrong at times. You will make mistakes. Some of your investments will lose money.
- Key takeaway: It doesn't matter who you are. You will be wrong at times.

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#10: Growth Is a Component of Value

- The mutual fund industry has confused just about everyone with respect to this concept. There are really not growth stocks and value stocks.
- There are either undervalued stocks, fairly valued stocks, or overvalued stocks. Growth is a component of value.
- Every analyst and investor should build a complete discounted cash flow model at least once in their life to see how growth fits into the value assessment.

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#11: Value and Momentum Outperform Everywhere

- "Momentum is the biggest embarrassment to efficient markets" – Eugene Fama
- 'Value and Momentum combined outperform in every market across every asset class – Tobias Moskowitz, University of Chicago
- Empirical evidence of the superiority of a combined value-momentum process in the portfolio of our Best Ideas Newsletter
- **Question**: Why then don't investors embrace this process?

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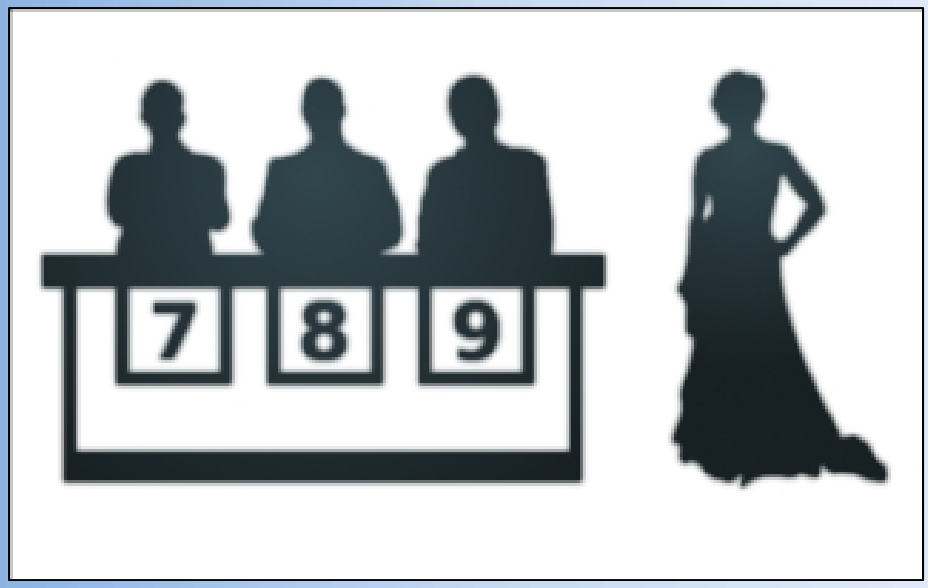
#12: John Maynard Keynes' Beauty Contest



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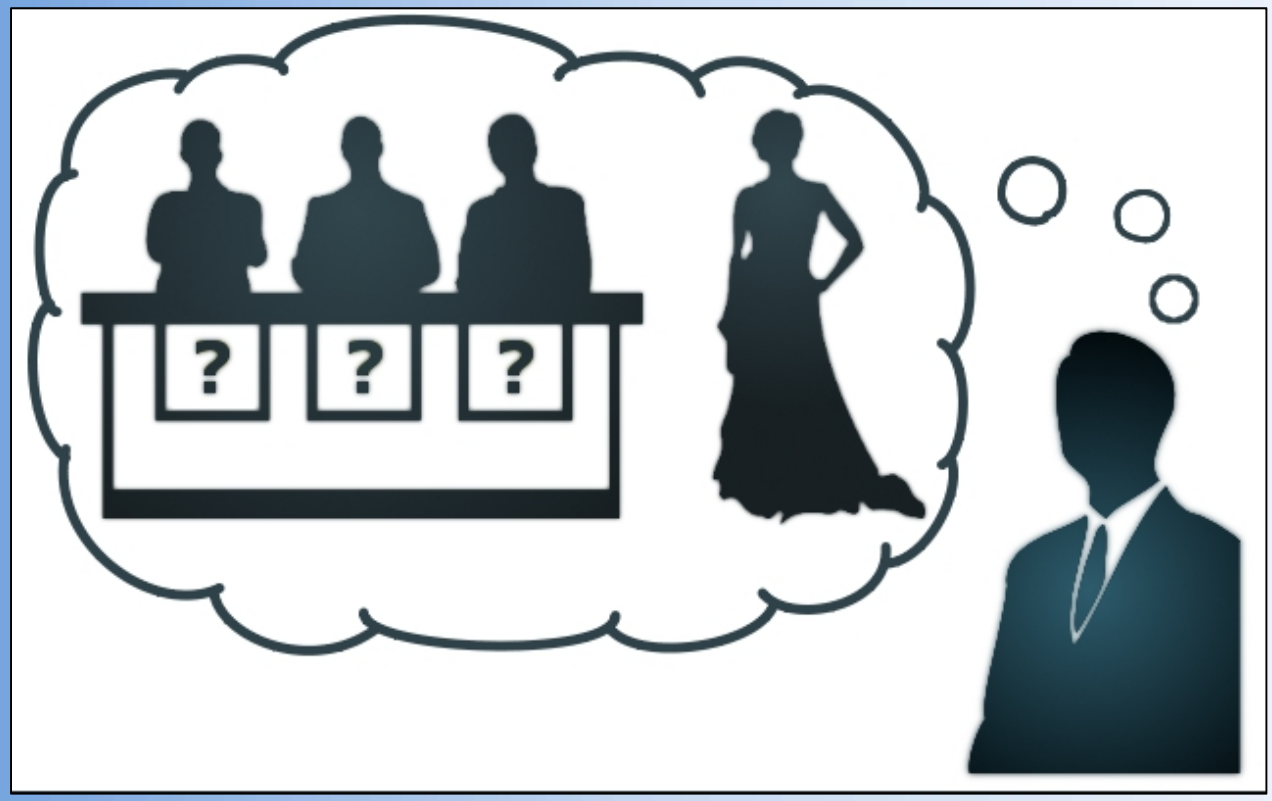
John Maynard Keynes' Beauty Contest



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Keynes' Beauty Contest Analogy

- Keynes compared the stock market to a beauty contest. He said that to pick winning stocks, investors need to pick the contestant (stock) that they think other judges (money managers) like, not the contestants they like.
- The secret to successful stock selection is to have a complete understanding of all investment disciplines in order to find the best stocks at the best time to buy – **This is called Valuentum investing**.
- After all, we need deep pocketed money managers to eventually agree with us for our stock calls to work out.
- It doesn't mean we're trying to front-run others – it means we do extensive DCF analysis, an extensive relative value assessment, and a technical/momentum assessment to identify future winners.

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Key Takeaway

- The best stocks are those that are undervalued and are just starting to exhibit strong momentum qualities, revealing the greatest likelihood of price-to-fair value convergence.

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Highly Ranked Valuentum Stocks*

- Broadcom (BRCM)
- DirecTV (DTV)
- Microsoft (MSFT)
- Emerson Electric (EMR)
- General Electric (GE)

*As of May 14, 2013

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On Dividends

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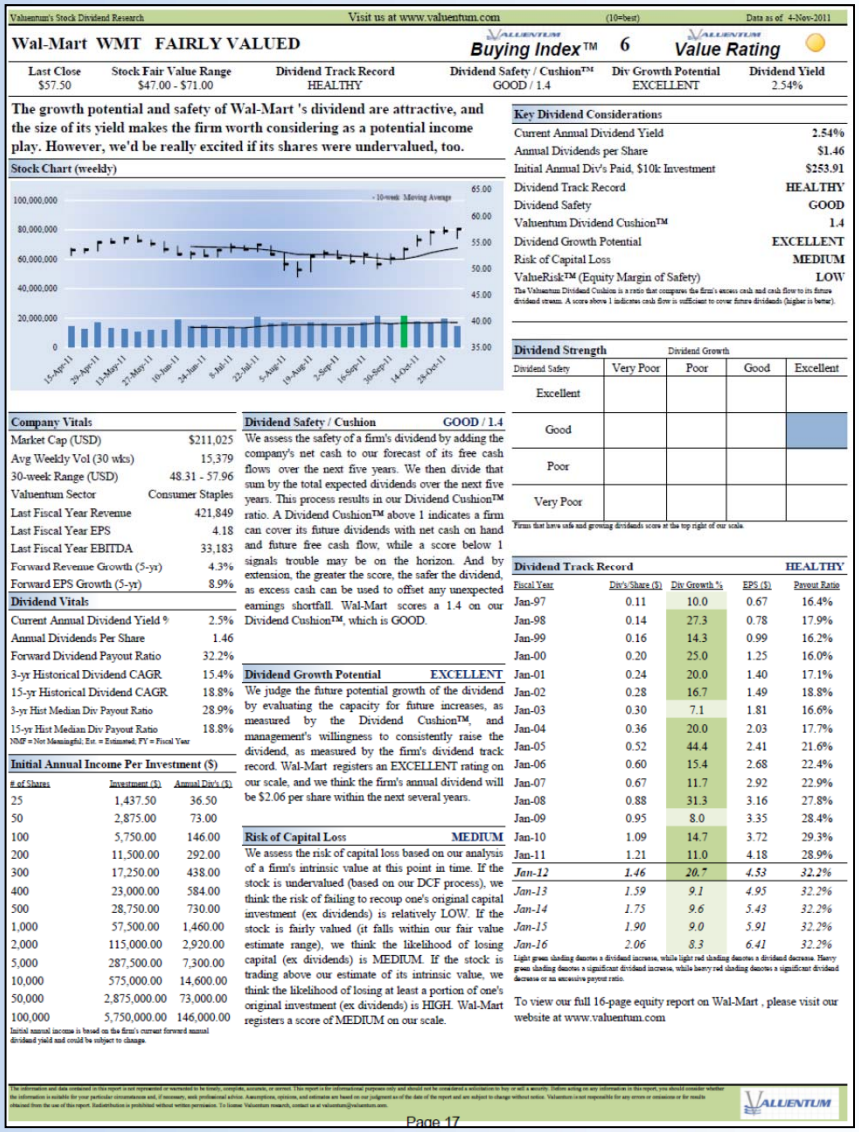
- Our Dividend Reports Assess the Growth and Safety of a Company's Dividend
- Our evaluation is forward-looking, insightful and systematically applied across our coverage universe



Valuentum's Stock Dividend Research — Visit us at www.valuentum.com — (10=best) — Data as of 4-Nov-2011

Wal-Mart WMT FAIRLY VALUED

Buying Index™ 6 — Value Rating

Last Close	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
$57.50	$47.00 - $71.00	HEALTHY	GOOD / 1.4	EXCELLENT	2.54%

The growth potential and safety of Wal-Mart 's dividend are attractive, and the size of its yield makes the firm worth considering as a potential income play. However, we'd be really excited if its shares were undervalued, too.

Stock Chart (weekly)

Key Dividend Considerations

Current Annual Dividend Yield	2.54%
Annual Dividends per Share	$1.46
Initial Annual Div's Paid, $10k Investment	$253.91
Dividend Track Record	HEALTHY
Dividend Safety	GOOD
Valuentum Dividend Cushion™	1.4
Dividend Growth Potential	EXCELLENT
Risk of Capital Loss	MEDIUM
ValueRisk™ (Equity Margin of Safety)	LOW

The Valuentum Dividend Cushion is a ratio that compares the firm's excess cash and cash flow to its future dividend stream. A score above 1 indicates cash flow is sufficient to cover future dividends (higher is better).

Dividend Strength

Dividend Safety \ Dividend Growth	Very Poor	Poor	Good	Excellent
Excellent				
Good				
Poor				
Very Poor				

Firms that have safe and growing dividends score at the top right of our scale.

Company Vitals

Market Cap (USD)	$211,025
Avg Weekly Vol (30 wks)	15,379
30-week Range (USD)	48.31 - 57.96
Valuentum Sector	Consumer Staples
Last Fiscal Year Revenue	421,849
Last Fiscal Year EPS	4.18
Last Fiscal Year EBITDA	33,183
Forward Revenue Growth (5-yr)	4.3%
Forward EPS Growth (5-yr)	8.9%

Dividend Vitals

Current Annual Dividend Yield ®	2.5%
Annual Dividends Per Share	1.46
Forward Dividend Payout Ratio	32.2%
3-yr Historical Dividend CAGR	15.4%
15-yr Historical Dividend CAGR	18.8%
3-yr Hist Median Div Payout Ratio	28.9%
15-yr Hist Median Div Payout Ratio	18.8%

NM? = Not Meaningful, Est. = Estimated, FY = Fiscal Year

Initial Annual Income Per Investment ($)

# of Shares	Investment ($)	Annual Div's ($)
25	1,437.50	36.50
50	2,875.00	73.00
100	5,750.00	146.00
200	11,500.00	292.00
300	17,250.00	438.00
400	23,000.00	584.00
500	28,750.00	730.00
1,000	57,500.00	1,460.00
2,000	115,000.00	2,920.00
5,000	287,500.00	7,300.00
10,000	575,000.00	14,600.00
50,000	2,875,000.00	73,000.00
100,000	5,750,000.00	146,000.00

Initial annual income is based on the firm's current forward annual dividend yield and could be subject to change.

Dividend Safety / Cushion — GOOD / 1.4

We assess the safety of a firm's dividend by adding the company's net cash to our forecast of its free cash flows over the next five years. We then divide that sum by the total expected dividends over the next five years. This process results in our Dividend Cushion™ ratio. A Dividend Cushion™ above 1 indicates a firm can cover its future dividends with net cash on hand and future free cash flow, while a score below 1 signals trouble may be on the horizon. And by extension, the greater the score, the safer the dividend, as excess cash can be used to offset any unexpected earnings shortfall. Wal-Mart scores a 1.4 on our Dividend Cushion™, which is GOOD.

Dividend Growth Potential — EXCELLENT

We judge the future potential growth of the dividend by evaluating the capacity for future increases, as measured by the Dividend Cushion™, and management's willingness to consistently raise the dividend, as measured by the firm's dividend track record. Wal-Mart registers an EXCELLENT rating on our scale, and we think the firm's annual dividend will be $2.06 per share within the next several years.

Risk of Capital Loss — MEDIUM

We assess the risk of capital loss based on our analysis of a firm's intrinsic value at this point in time. If the stock is undervalued (based on our DCF process), we think the risk of failing to recoup one's original capital investment (ex dividends) is relatively LOW. If the stock is fairly valued (it falls within our fair value estimate range), we think the likelihood of losing capital (ex dividends) is MEDIUM. If the stock is trading above our estimate of its intrinsic value, we think the likelihood of losing at least a portion of one's original investment (ex dividends) is HIGH. Wal-Mart registers a score of MEDIUM on our scale.

Dividend Track Record — HEALTHY

Fiscal Year	Div's/Share ($)	Div Growth %	EPS ($)	Payout Ratio
Jan-97	0.11	10.0	0.67	16.4%
Jan-98	0.14	27.3	0.78	17.9%
Jan-99	0.16	14.3	0.99	16.2%
Jan-00	0.20	25.0	1.25	16.0%
Jan-01	0.24	20.0	1.40	17.1%
Jan-02	0.28	16.7	1.49	18.8%
Jan-03	0.30	7.1	1.81	16.6%
Jan-04	0.36	20.0	2.03	17.7%
Jan-05	0.52	44.4	2.41	21.6%
Jan-06	0.60	15.4	2.68	22.4%
Jan-07	0.67	11.7	2.92	22.9%
Jan-08	0.88	31.3	3.16	27.8%
Jan-09	0.95	8.0	3.35	28.4%
Jan-10	1.09	14.7	3.72	29.3%
Jan-11	1.21	11.0	4.18	28.9%
Jan-12	*1.46*	*20.7*	*4.53*	*32.2%*
Jan-13	*1.59*	*9.1*	*4.95*	*32.2%*
Jan-14	*1.75*	*9.6*	*5.43*	*32.2%*
Jan-15	*1.90*	*9.0*	*5.91*	*32.2%*
Jan-16	*2.06*	*8.3*	*6.41*	*32.2%*

Light green shading denotes a dividend increase, while light red shading denotes a dividend decrease. Heavy green shading denotes a significant dividend increase, while heavy red shading denotes a significant dividend decrease or an unsustainable payout ratio.

To view our full 16-page equity report on Wal-Mart , please visit our website at www.valuentum.com

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Predicting Dividend Cuts: The Valuentum® Dividend Cushion™

The Valuentum Dividend Cushion Caught These Dividend Cuts in Advance

A Valuentum Dividend Cushion Score Below 1 Indicates a Firm's Dividend is At Risk in the Years Ahead

Dividend Cutter	Cut Date	Dividend Cushion (Before Cut)	Reason for Dividend Cut
Avery Dennison (AVY)	31-Jul-09	0.66	Reduced dividend to support debt-reduction efforts.
ConAgra Foords (CAG)	16-Mar-06	-0.59 (1)	Restructuring, divestitures.
Constellation (CEG)	18-Feb-09	-4.36	Refocus on core business of generating and selling power.
DR Horton (DHI)	6-May-08	-0.03	Housing turmoil.
Gannett Co. (GCI)	25-Feb-09	-0.06	Excessive debt; preserve cash amid newspaper industry.
La-Z-Boy (LZB)	17-Feb-09	0.89	Suspended dividend to preserve cash downturn in home furnishings.
Marriott Intl (MAR)	1-May-09	2.18 (2)	Suspended dividend in the wake of w business travel, but dividend achieve highs again, May 6, 2011.
Masco Corp (MAS)	11-Feb-09	-0.74	Cut dividend to ensure ability to fund and service debt coming due.
New York Times (NYT)	20-Nov-08	0.04	Effort to preserve cash. Downturn in industry. Loss of investment-grade cr
Pfizer (PFE)	26-Jan-09	0.54	Bought Wyeth to diversify revenue ba $22 billion+ in debt.
Sara Lee Corp (SLE)	8-Aug-06	0.70	Streamlining operations, business uni divestitures to raise cash.
Sunoco Inc. (SUN)	6-Oct-09	-0.85 (3)	Poor margins, overseas competition.
SuperValu (SVU)	20-Oct-09	-5.78	Rising unemployment, competition from Wal-Mart, etc.
Valero Energy (VLO)	27-Jan-10	0.15	Lower demand for gas and diesel.
Vulcan Materials (VMC)	14-Oct-11	-1.42	Free up much-needed cash amid downturn in aggregate demand.

(1) Forecast period for ConAgra, 2007 through 2011.

(2) Marriott is an instance where management prematurely cut its dividend, in our opinion. The Cushion reflected little risk at the time of cut, and sure enough Marriott restored its payout to record high

(3) Forecast adjusted to reflect Sunoco's poor free cash flow trends beyond last reported year.

Backtesting Methodology: Net balance sheet (year prior to dividend cut). Free cash flow for years beginning in year of dividend cut through reported years. If reported years do not total five, last reported year is extrapolated for remainder of forecast period. Dividends paid reflects what the dividends would be ex dividend cut.

Company Name	Dividend Cushion
Abbott Labs (ABT)	2.3
Coca-Cola (KO)	1.9
Family Dollar (FDO)	4.4
International Business Machines (IBM)	3.7
Johnson & Johnson (JNJ)	2.5
Merck (MRK)	2.5
Molex (MOLX)	2.5
Pepsi (PEP)	1.3
Proctor & Gamble (PG)	1.4
Wal-Mart (WMT)	1.4

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Our Best Ideas Newsletter*		**X**	**X**	**X**
Our Dividend Growth Newsletter*		**X**	**X**	**X**
An Experienced Opinion on Stocks in Your Portfolio		X	X	X
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