OUR BEST IDEAS NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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www.valuentum.com info@valuentum.com

Portfolio Return	Benchmark Return	Outperformance
36.5%	10.2%	26.4%

Portfolio Inception Date: May 17, 2011

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Congress Can't Move Mountains But It Can Move the Fiscal Cliff

By Brian Nelson, CFA

Brian Nelson, CFA
President, Equity Research
brian@valuentum.com

RJ Towner
Associate Director, Equity Research
rj@valuentum.com

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The next few weeks will be interesting…to say the least. The equity markets are staring down the "fiscal cliff," a set of laws that, if implemented January 1, 2013, as planned, will choke off the current economic recovery and likely send stocks tumbling as valuations are reset for lower potential growth. The resolve of Republican leader and Speaker of the US House of Representatives John Boehner to broader the tax base (and not raise tax rates) is unshakable, while President Barack Obama and fellow Democrats continue to view his re-election as a mandate to raise tax rates on the American people. The impasse is not likely to change anytime soon, and it is very improbable that Congress will ditch Santa Claus for a resolution in such a short time frame.

Still, we're not worried. Our Best Ideas portfolio is well-positioned for outperformance regardless of what

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Are Apple's Fundamentals Deteriorating?

By RJ Towner

Given Apple's (AAPL) recent share price performance during the past 3 months, we've heard whispers questioning the strength of the company's fundamentals. It first started with the Google (GOOG) Maps debacle when somehow replacing the default maps program on the iPhone with an inferior product was going to sink the entire company. Then fears of the iPad Mini--either not selling or cannibalizing sales of the full-sized iPad and subsequently crippling margins--became the next fear.

Apple's Fundamentals Remain Sound

However, there is no evidence of a product slowdown at Apple. The iPad Mini sold out its first run in a short amount of time, and data over the Black Friday weekend showed that the iPad accounted to 88.3% of total tablet sales.

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Further, the iPhone 5 only recently became widely available in the United States, and we believe it will be the best-selling smartphone of all time. Though gross margins may fall slightly, Apple's impressive supply-chain management could help mitigate the total impact on profitability.

Because Apple is among the most widely-held stocks, rumors occur almost daily about the company's future (one only has to go to Seeking Alpha to find a plethora of uninformed opinions). Apple TV, iPhone 5S, and even a cheaper iPhone have been rumored, but we prefer not to speculate on specific new products. We think it is fair to assume that the firm will continue to come up with innovative products, even if we aren't aware of exactly what they are. In fact, a significant portion of Apple's current revenue stream didn't exist as recently as just 5 years ago, and the company's innovation track record is the best we've ever seen. Still, we're not forecasting breakneck growth at the company for it to reach our fair value estimate, and we think our projections remain achievable and conservative.

What's the Latest Rumor?

The latest rumor blames the change in the capital gains tax rate for Apple's share price decline. Though this may make sense to some degree (as Apple has been a big winner for a lot of investors), we don't think the company's full 20% share decline from the peak is solely a result of profit taking. And we do not think the cause of Apple's share decline is nearly as fundamental as it is based on momentum. Apple's share price appreciation was parabolic (almost straight up), causing some investors to pile into shares, leading shares to spike to over $700. When upward price momentum stalled, we think these same investors dumped shares of Apple. Okay. But where did the money go?

If we compare Apple to two other tech companies, we can see that the share prices of both Facebook (FB) and Research in Motion (RIMM) have increased considerably during the past 3 months. Both RIM and Facebook have shown improving fundamentals—better mobile ad monetization at Facebook and the launch date for Blackberry 10 at RIM—thus increasing investor interest. We think it is entirely possible that some investors have simply been betting on the faster-moving tech stocks rather than Apple, which remains a solid long-term investment. We inevitably believe that these investors will migrate once again to higher-quality Apple in the coming months.

What's the Bottom Line?

Profit taking and downward momentum have been the key drivers of Apple's recent stock move lower -- not fundamentals. We think it may just take a favorable earnings report or two (or a hefty dividend hike or buyback) to get the company's share trajectory back on track toward our intrinsic value estimate. Apple has unmatched fundamental strength, a cash balance of over $120 billion that can buy a meaningful number of companies in the S&P 500, and shares that are trading at bargain-basement levels. The firm may face some tough sledding in the months ahead, but the company is in the portfolio of our Best Ideas Newsletter, and we're not budging. There are few better firms out there on the market today.

Company Spotlight: Google (GOOG)

By RJ Towner and Brian Nelson, CFA

Before the meteoric rise in the price of Apple (AAPL), Google (GOOG) stole most of the tech-stock headlines and, according to some, was pretty much a sure bet to become a $1,000 stock. However, looking under the hood, the company has had some turmoil during the past few years.

In addition to bringing back founder Sergey Brin as the CEO, the company has created the world's most successful mobile operating system to date (Android), a social network with over 100 million users, and failed to purchase Groupon (GRPN), which at the present seems like it was a blessing. Additionally, the company is working on cars that drive themselves, shuttered Google Wave and the "Twitter killer" Google Buzz. And it bought Motorola Mobility. All of these events have made Google a much different company than it was even a year ago.

Once known exclusively for its search dominance, which it maintains, Google has become a tech company focused on a number of things: social, Android, ads, YouTube, Chrome, and research. In this article, let's dive into a few markets that we think will decide the future of Google. We think the company will have some megahits in the years ahead, and the shares are worth over $900 each, in our view, revealing substantial upside from current levels.

Android

Giving away one's mobile operating system certainly isn't as profitable as selling one (at least in the short term), but Google is betting that stealing market share will inevitably lead to dominance, which it will be able to exploit later. That strategy has made the Android OS (operating system) the most used mobile operating system in the world, with Apple coming in second and Blackberry (RIMM) now a distant third. However, we think the open source code of the Android OS may lead to lower retention rates.

But lower retention rates for its system may not be totally Google's fault, as the problem may actually lie with the hardware manufacturers. HTC, Samsung, LG and Motorola all use the Android OS, but the experience differs across producers. Further, the actual quality of the hardware is inconsistent, and users don't have the option of going to the Apple store for repairs and refunds. Interestingly enough, we've seen a shift in the Android market to consumers primarily purchasing the luxury phones like the Galaxy SIII and the Note.

In earlier research, we noted that we expect retention rates for Android to be lower than iOS (Apple's operating system). We think iOS will likely become the leader in market share in the US. However, since most carriers do not subsidize phones like carriers in the US, it looks like Android will dominate global market share due to lower average selling prices on smartphones. Rumors have surfaced that Apple may try to build a cheap phone to compete, but we think they'd rather lose market share than put downward pressure on margins.

Furthermore, Android has yet to penetrate the tablet market. The iPad is the dominant product in that market and Gartner estimates that iPads accounted for 73% of all tablet shipments in 2011. While RIM and Microsoft (MSFT) have yet to pose a competitive threat, we don't see Android tablets gaining the market share or stickiness of the iPad. Amazon (AMZN) has also come out with a tablet of its own, undercutting the vast majority of the market given the quality of the product. But because the iOS interface is the same across all Apple devices—an intuitive experience across all Apple platforms—we think it's easier to keep users in the Apple ecosystem than the Android ecosystem. We fully expect Apple to retain its dominance over Android.

Google+

With over 100 million members, one would think Google+ is a thriving social network. However, that doesn't seem to be the case. The April 9 issue of Bloomberg Businessweek revealed that users spend an average of 2.5 minutes per month on Google+ versus 7.5 hours per month on Facebook.

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Admittedly, Google+ has several cool features unavailable on other social networks like hangouts, where you can web-chat with a group of friends, and circles, which allow you to decide who you share your posts with. But features don't create a social network, networks do.

Twitter and Facebook (FB) can both co-exist because they serve different roles. Facebook is more personal, and allows you to interact with all of your friends, share all of your photos, and keep-in-touch (without actually keeping-in-touch). Since several users have had their Facebook pages for around five years, Facebook acts as a digital time capsule that literally cannot be replicated. Its network effect is dominant.

On the other hand, Twitter is a real-time information site. Instead of searching for a something on Google, several users now go to Twitter, which doesn't have the time delay that Google and Bing have. Additionally, users can interact with millions of users from all over the world. There's currently no other forum where prominent actors, athletes, pundits, and even traders interact with each other so quickly and efficiently.

Google+ combines some features of Twitter, such as the ability to interact with massive amounts of strangers, and the ability to archive memories like Facebook. However, since the network lacks, well, the network of Facebook and Twitter, such features fall on deaf ears. Unlike Facebook or Twitter, where one must consciously go through the sign-up process, Google+ takes two minutes for users with Gmail accounts. Thus, we think the actual new user base is significantly smaller. We aren't very optimistic about the future of Google+ at this time.

Search

Although we aren't particularly bullish on Android or Google+, let's not forget about Google's search/ad business. Though Bing seems to be gaining market share, which Forbes estimates was at 15.1% at the end of 2011, Google still dominates, with 66% of the search market. Adsense still generates the vast majority of Google's high-margin revenue.

Much like social, we think Facebook and Twitter are bigger threats to search than Bing or Yahoo!. Facebook and Twitter are getting so good at dominating users' time spent on the web that companies now post their Twitter handles or Facebook pages on commercials and in stores, rather than their own websites. We think companies prefer the real-time feedback and interaction provided by the likes of Twitter and Facebook. The big risk for Google is that Internet users bypass Google and go directly to Facebook and Twitter to search for what they want. Search functionality might be mediocre on Facebook, but remember that Microsoft owns nearly 2% of Facebook and could lend some of its search technologies to improve the user experience.

It also appears that mobile ads are stealing market share from desktop ads, but mobile ads seem to lack the same ROI and aren't nearly as effective as desktop ads. Facebook reported fantastic increases in mobile ad sales, and we see Instagram as another potential mobile revenue driver. Google will have to focus on innovating in the mobile market in order to stay relevant to advertisers looking to reach consumers via smartphones and tablets.

However, it's important to remember that Google does--and will likely continue to--dominate the rest of the web. Adsense is still among the top advertisement products in terms of ROI (return on investment), and its share is dominant. We think this will continue to fuel Google's profitability.

Research and development

If there's one area that could propel Google far above our fair value estimate, we think it lies in research and development. With an army of engineers and brilliant computer scientists, we think some amazingly innovative products could come out of research and development (R&D) at Google.

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*Company Spotlight: Google…*continued from previous page

Project Glass was released in early April, and while it may not be for everyone, it's certainly exciting. Glasses that allow you to control social networks, search, and take pictures all-in-one seems more like a sci-fi fantasy rather than a possible reality. But Google is working on it.

The self-driving car and other projects

In Google's home state of California, the company recently won government approval for testing cars that drive themselves. Though the idea seems dangerous, Google and several automakers contend that cars driving themselves may be the way of the future (we can't forget that airplanes didn't always have autopilot). If this becomes the new standard in driving and Google is responsible for the technology, the company could profit handsomely.

Google Fiber is another project that could be a game-changer in the internet realm. The test city is Kansas City, where the company rolled out its internet fiber optics network. Speeds top 1GB per second (or 100x faster than the average Americans internet connection), and the company offers tiered pricing up to $120 per month. Initial feedback looks positive, and we think Google will slowly build out networks nationwide if demand surges in Kansas City.

We can't be sure that anything in the R&D department will be a success, but owners of the stock do get the added benefit of any unforeseen innovation that may not come with owning mature entities such as McDonald's (MCD) or AT&T (T), for example.

Google's valuation

We think Google's shares look undervalued, even though fears of mobile-advertising acceptance have weighed on the company. We don't expect mobile or Google+ to propel the company to higher profitability, but we think the firm will likely maintain market share on the traditional web for a very long time. Mobile ads aren't quite what PC ad sales were in terms of ROI and cost per click, but we think Google will adjust. Given the innovative nature of the company, we wouldn't be surprised to see Google as a leading glasses maker, car-software innovator, internet provider or anything else in the next ten years. We continue to hold the company in the portfolio of our Best Ideas Newsletter.

*Congress Can't Move Mountains…*continued from page 1

happens on Capital Hill in the next few weeks. Should the US economy be sent off the "fiscal cliff," our outsize cash position (roughly 30% of our portfolio value) will enable us to scoop up potential bargains and position our portfolio for even greater outperformance (as any potential downside price overreaction is inevitably retraced). However, the most likely outcome is that Congress will delay any permanent policy changes (move the 'cliff' not mountains, the latter we use to describe the miracle needed to reach a deal in such a short time), in which case, we would expect the steady build of outperformance generated by portfolio constituents to continue uninterrupted.

Earnings growth from S&P 500 companies should continue into the fourth quarter, and the current forward price-to-earnings ratio of S&P 500 companies of 12.6 remains well below the 10-year average (14.2), so we like the overall market valuation. Emerging market growth, though slowing, remains strong, with third-quarter GDP in China north of 7% (a breakneck pace). The US housing and automotive markets should continue their recovery, and the US banking system remains on solid footing.

Importantly, we reiterate the view that equity markets can still move significantly higher despite the potential for lower economic growth, given central bank easing across the globe. This fact is (in part) what allowed us to capture significant outperformance in our portfolio this year, while economic prognosticators sat idly on the sidelines, watching the markets move ever higher (**nearly 87% of hedge funds are trailing the S&P 500 this year**). We're pleased to have widened the gap of our portfolio outperformance during 2012, and we expect to do so again in 2013. We're honored to have you on this journey with us!

Inside Intel's Debt Offering

By RJ Towner and Brian Nelson, CFA

Chipmaker Intel (INTC) has seen its share price take a large haircut this year, as investors worry about the decline of the PC, as well as Intel's lack of presence in the mobile ecosystem. Still, the company sits on a $10.4 billion cash hoard ($3 billion net cash), continues to make strides in mobile (though it's not there yet), and it has continued to do well in the enterprise market.

So why did the company just announce that it will raise $6 billion of debt? The first obvious reason is to capitalize on low interest rates. The 5 year notes of the offering will yield a paltry 1.35% ($3b), the 10 year notes will yield 2.7% ($1.5b), the 20 year notes will yield 4% ($750m), and the 30 year notes will yield 4.25% ($750m). This new $6 billion capital isn't coming at much of a cost, though it certainly increases the company's risk profile. Still, the new infusion of cash will be used to repurchase shares and continue heavy research & development investments.

Though the firm's free cash flow will decline (interest expense is an operating cash flow item under GAAP), total cash expenditures from financing activities (dividends) could decline more than the decline in operating cash flow (interest expense). Given that the spread of the firm's dividend yield (~4.5% annually) over the cost of the newly-issued debt is between 25 and 315 basis points (1.35% to 4.25%), the company will be making real cash savings by retiring stock and replacing it with debt.

Further, the deal looks like a homerun because shares of Intel appear considerably undervalued, in our view. Repurchasing stock when the shares are undervalued should yield a favorable return to shareholders (it is a value-creating proposition). And, technically speaking, the buyback could put a "floor" on the stock price because the firm would likely make large purchases upon any price declines (absorbing supply).

Ultimately, we like the debt offering, even though it adds considerable financial leverage to the firm's business. Oddly, it could increase the firm's Valuentum Dividend Cushion score because, as we previously mentioned, total cash outlays as it relates to dividend payment obligations will decline due to the reduced number of shares. We like the firm's current valuation, and we think rumors of its demise are greatly exaggerated. We continue to hold the firm in the portfolio of our Best Ideas Newsletter.

November Auto Sales Roundup

By RJ Towner

November auto sales were strong across the board, with the SAAR expected to be around 15.2 million units. Let's take a look at performance on an individual company basis.

Ford

Best Ideas Newsletter holding Ford (F) healthily exceeded its consensus sales growth forecast of 3.5% unit growth, with sales expanding 6.5% during November and retail sales growing 12%. Total small car units surged 76% year-over-year, making it Ford's best November small car performance in 12 years. Utilities and trucks units lagged cars, growing 2% and 3.7%, respectively, compared to 15.2% growth in total car sales.

Although performance was boosted due to sales being pulled into November as a result of Sandy, we thought the results were good, especially since the company announced it will increase US production 11% in the first quarter of 2013 versus the same period last year. The F-Series continues to steal share from other pickup truck manufacturers, as the increase in gas mileage has made the truck line-up even more appealing than smaller, less powerful options. We were also encouraged to see Mustang sales rebound, suggesting the car model may be coming back into favor after choppy results throughout much of the year.

On the downside, Lincoln continues to struggle, with sales falling 9% year-over-year to just over 5,700 units. Though the company reiterated its commitment to reviving the once-legendary brand, the increase in popularity of rivals such as BMW and Audi has made re-branding an even more challenging effort. Even as Lincoln struggles though, the rest of the company continues to perform well, so we remain confident that Ford has substantial valuation upside from current levels.

GM

General Motors' (GM) results weren't as encouraging, as 3.4% year-over-year sales growth fell short of consensus expectations for unit sales. Retail sales were not very good, falling 0.1%. Buick and Cadillac continue to perform well, growing 22% and 30%, respectively, while Chevrolet sales remained flat.

Car unit sales were pretty good, though some standouts included the Volt (up 303.4%), the Corvette (up 21.2%), and the Buick Enclave (up 22.8%). However, unit sales of the Camaro dipped 12.9%, while SUV unit sales were down pretty much across the board. We expect this trend to continue as crossover and small SUV sales cannibalize sales of the more profitable likes of the Tahoe and Suburban.

Pickup sales were poor, with the Colorado diving 33% year-over-year (even without competition from the Ford Ranger), while the Silverado fell 10%. Competition from Ford and Toyota (TM) seems to be eroding Chevrolet's pickup market share, and we do not see the trend reversing itself in the near term. Further, days sales of inventory for trucks sits at 139—nearly double what the company is targeting. Although truck sales should see a nice bounce from the Sandy aftermath, we won't like the profitability outlook until the company cleans up its inventory. We remain on the sidelines.

Toyota

Recently, we've become bigger fans of Toyota as the company continues to successfully execute its small car line-up in the US. November was no different, with unit sales surging 17.2% year-over-year. The Toyota cars division continued to be exceptionally strong, advancing 16.5% year-over-year, led by a huge surge in the Corolla (up 40%) and solid 8.5% growth in the Prius family.

Stealing share from GM, light truck sales surged 18.3% year-over-year thanks to a 31% increase in sales of the Tacoma full-sized pickup. We think the combination of superior fuel economy and US production (the Tacoma and Tundra are built in the US) has made the Tacoma an attractive alternative to Big Three pickups, though the F-series remains the strongest, in our view.

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Our Best Ideas Portfolio

By Valuentum Analysts

Portfolio Return	Benchmark Return	Outperformance
36.5%	10.2%	26.4%

Portfolio Inception Date: May 17, 2011

Below we outline the constituents of our Best Ideas portfolio and their respective weightings and returns thus far. Each subsequent issue discusses Valuentum's latest changes to the portfolio, a summary of new names on our watch list, as well as analysis and trends impacting companies on our Best Ideas List. We currently have about 30% of our portfolio in cash, a level we're looking to bring down in coming months. Typically, we like to have the most cash when the market is making new highs and fully invested when the market is putting in short-term lows.

Our investment process is completely transparent and easy to implement in your own portfolio. The goal of our Best Ideas Newsletter is to outperform the S&P 500 Index and to generate positive returns each year regardless of the market environment. Firms added to our Best Ideas portfolio are the cream of the crop based on our stock-selection methodology.

OUR BEST IDEAS -- as of December 14, 2012 — **Best Ideas Portfolio Inception Date: May 17, 2011**

Portfolio Holdings	Symbol	Initial VBI*	Current VBI**	First Purchase	Cost Basis ($)	Total Shares	Total Cost ($)	Price/Share ($)	Current Value ($)	% of Portfolio	% Return (dividends included)
Bullish											
Apple Corp.	AAPL	10	3	17-Jun-11	328.99	16	5,270.84	509.79	8,156.64	6.0%	56.4%
Altria Group	MO	8	3	28-Jun-11	26.43	252	6,667.36	33.16	8,356.32	6.1%	34.0%
Astronics	ATRO	10	6	6-Jun-11	21.19	162	3,439.86	20.67	3,348.54	2.5%	-2.7%
Buffalo Wild Wings	BWLD	7	3	13-Jul-11	65.42	77	5,044.34	73.79	5,681.83	4.2%	12.6%
eBay	EBAY	10	6	3-Oct-11	31.04	200	6,207.00	50.36	10,072.00	7.4%	62.3%
EDAC Tech	EDAC	9	6	6-Jun-11	5.23	673	3,536.79	12.27	8,257.71	6.0%	133.5%
Financial Select SPDR Fund	XLF	NA	UR	9-Jan-11	13.46	150	2,026.00	16.00	2,400.00	1.8%	19.8%
Ford Motor	F	7	7	12-Sep-11	10.69	650	6,955.50	11.10	7,215.00	5.3%	4.4%
Google	GOOG	10	3	23-Oct-12	683.49	4	2,740.96	701.96	2,807.84	2.1%	2.4%
Health Care ETF	XLV	9	9	22-May-12	36.60	125	4,582.00	40.51	5,063.75	3.7%	11.6%
Intel	INTC	6	3	12-Sep-11	20.48	150	3,086.50	20.53	3,079.50	2.3%	4.7%
Intuitive Surgical	ISRG	5	3	22-May-12	532.13	5	2,667.65	533.11	2,665.55	2.0%	-0.1%
Precision Castparts	PCP	8	6	6-Jun-11	152.07	40	6,089.80	184.20	7,368.00	5.4%	21.1%
SPDR S&P Bank ETF	KBE	NA	UR	9-Jan-12	21.07	100	2,114.00	23.29	2,329.00	1.7%	11.5%
Republic Services	RSG	8	6	19-May-11	31.42	201	6,329.42	29.13	5,855.13	4.3%	-1.3%
Rio Tinto	RIO	9	9	22-May-12	46.40	75	3,487.00	54.92	4,119.00	3.0%	19.7%
Visa	V	7	6	30-Nov-11	107.46	60	6,461.30	146.82	8,809.20	6.5%	37.1%
Cash									40,957.30	30.0%	0.0%
Bearish											
PetSmart	PETM	1	1	23-Oct-12	1.90	2	389.50	0.00	0.00		-100.0%
December 2012, $65 strike (put option)											
Urban Outfitters	URBN	2	2	23-Oct-12	0.95	5	488.25	0.00	0.00		-100.0%
December 2012, $33 strike (put option)											
Best Ideas Portfolio Value							100,000.00		**136,542.31**		**36.5%**
S&P 500 Index (SPY)				17-May-11	132.69	754	100,000.00	142.11	107,099.25	97.2%	
Cash									3,092.92	2.8%	
Benchmark Portfolio Value									**110,192.18**		**10.2%**
Relative Outperformance											**26.4%**

This portfolio is not a real money portfolio. Data as of December 14, 2012. Cost basis includes commissions. Results include dividends, but not interest received on cash balance.

* VBI score at the time we added the firm to the portfolio.

** See our methodology regarding the Valuentum Buying Index (VBI).

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November Auto Sales Roundup ...continued from page 7

Lexus continues to stage a bit of a comeback against stiff competition from the German manufacturers, with passenger car sales jumping 18.2% and SUV sales up 15%. We're big fans of the Lexus due to its fantastic reputation for quality and reliability. We continue to believe shares of the Japanese auto manufacturer are undervalued.

Honda

Honda (HMC) posted a fantastic November—in fact, it was the best month in the company's history. Sales jumped 38.9% year-over-year, driven by a 75% surge in Civic sales and 82% surge in Accord sales. Though both numbers are lapping the supply-chain disruption of the previous year, we think the numbers were solid and exhibit how the company has recaptured its momentum after redesigning its flagship models.

Acura sales expansion trailed the pace of the rest of the company, growing 23.6%. As with Toyota, the luxury brand is struggling to capture sales from Audi and BMW. Nevertheless, Honda remains much more important to the rest of the company. We aren't interested in shares at this time.

Volkswagen, Chrysler

The great growth story continues to be Volkswagen, as sales jumped 29.3% year-over-year. Audi sales were also strong, rising 24% year-over-year, with Volkswagen US sales exceeding 500 thousand units for the first time ever. After refocusing its efforts on making market-specific vehicles, both brands have been doing great. Chrysler sales were also fantastic in November, with sales jumping 14% and leading to the best November at the company since 2007. Fiat's purchase of the company could end up looking like a bargain, as the brand returns to relevancy.

All things considered, we particularly liked the performance of Best Ideas portfolio holding Ford, and we remain comfortable with our current position in the firm. We retain auto exposure in the portfolio of our Dividend Growth Newsletter via wheel-maker Superior Industries (SUP).

November Retail Sales Disappoint

By RJ Towner

Without question, November retail sales numbers have been lackluster. Although the number of retailers that report monthly sales figures continues to decline, let's take a look at some of the interesting insights we saw from those that still report numbers.

Kohl's

Even though we're fairly bearish on Kohl's (KSS) over the long term, we did not expect the fourth quarter to start off so poorly. Same-store sales fell 5.6% year-over-year, lapping a 6.2% decline during the same period in 2011. Total sales fell 4.9%, and the company continues to lose momentum. The firm blamed Hurricane Sandy and recognizing e-commerce sales in December as the major drivers of weakness, but we think the results highlight how poorly management is executing. We thought the firm gave intentionally weak guidance, but if November is any indication, previous guidance may prove to be optimistic. We're staying away from shares.

Macy's

Department store Macy's (M) reported weaker than anticipated same-store sales of -0.7% compared to a consensus estimate of 1.5% growth. The company blamed Sandy, which is more reasonable than Kohl's blaming Sandy, in our view, since the company is so heavily leveraged to the northeast. Macy's noted that Thanksgiving weekend was its largest in company history, and we believe the firm's fantastic multi-channel selling strategy will yield strong results in the fourth quarter. Online sales jumped 39.2% during the month. We continue to believe shares are fairly valued.

Please see *November Retail Sales Disappoint*...on next page

November Retail Sales Disappoint ...continued from previous page

Nordstrom

Nordstrom's (JWN) November same-store sales were also weak, falling 1.1% year-over-year. The company also announced it will join Macy's, Saks (SKS) and JC Penney (JCP) in no longer providing monthly same-store sales data.

Regardless, our key takeaway was the continued divergence between Nordstrom and Nordstrom Rack, with the flagship same-store sales falling 2%, while Rack jumped 4.2%. Not surprisingly, Sandy was one excuse, but the company also blamed weakness in clearance events for women and children as a driver. According to management, consumers want "newness" (not the first time we've heard this), so having a fresh mix enter the store during the holiday season will be crucial, in our view. We aren't interested in shares for the portfolio of our Best Ideas Newsletter at this time.

Gap

While the previous companies struggled mightily in November, Gap (GPS) saw same-store sales jump 3% year-over-year during the month, though that figure compares to a 5% decline in November of 2011. The number also represents the second consecutive month of sequential deceleration (September: 6%, October: 4%), suggesting the firm's momentum is slowing.

Gap and Banana Republic North America outperformed Old Navy, growing 5% and 3%, respectively versus a 1% growth rate for Old Navy (coming off -9% in November 2011). We're optimistic about the new management leading Old Navy, which we think could result in some revenue upside. Unfortunately, it won't be this quarter or season, so we're looking to Summer/Fall 2013 to see a turnaround. Even though shares have fallen substantially today, we continue to believe they are fairly valued.

TJX Companies/Ross Stores

Same-store sales growth at both TJX Companies (TJX) and Ross Stores (ROST) were slower during November, with same-store sales advancing 3% and 2%, respectively. Neither blamed Sandy, though we think it impacted TJX slightly more than Ross.

We don't view the monthly results as any sign of weakness in either of the firm's business models, but it is a sign that sales for the entire retail industry were weak during November. We also think both firms may be suffering from discount competition from eBay (EBAY) and Amazon (AMZN), both of which performed extraordinarily well on Black Friday weekend.

Limited Brands

Growth at Limited Brands (LTD) was solid, with same-store sales up 5% in November compared to an increase of 3% in October. Victoria's Secret followed up a monster November 2011 (up 11%) with a 4% increase in November 2012. Bath & Body Works jumped 6% year-over-year, and the company continues to execute well in stores and online. We're not interested in shares, since they score just a 6 on the Valuentum Buying Index (our stock-selection methodology).

The Case for the Valuentum Style of Investing

To download (pdf) our academic white paper study on the tremendous benefits of the Valuentum Style of Investing, please click on the link below (and then select open) or paste the following link into your browser:

http://www.valuentum.com/downloads/20120528/download

The Case for the Valuentum Style of Investing

Brian Nelson, CFA*

First Version: May 2012

Abstract

The benefits of value and momentum strategies on an individual basis have been well-documented in financial literature. Academic research has also concluded that a simply-constructed portfolio consisting 50% of a long-short value-oriented portfolio and 50% of a long-short momentum-oriented portfolio produces a higher Sharpe ratio and lower volatility than either value or momentum alone. We study the reasons behind this phenomenon and strive to answer the question: what are the types of stocks that drive such outperformance? Though the benefits of using a combined value and momentum approach in a portfolio management setting have been widely-accepted, we believe we are the first to identify the abnormal-return benefits of investing in a cohort of individual stocks that have both good value and good momentum qualities while shorting a cohort of individual stocks that have both poor value and poor momentum qualities. We also reveal the inherent link between the diverse backing of combined value and momentum strategies in financial literature and our stock-selection methodology, the Valuentum Buying Index, which identifies undervalued firms with strong momentum qualities.

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* Brian Nelson, MBA Graduate School of Business, University of Chicago, is President of Equity Research and ETF Analysis at Valuentum Securites, Inc, an independent investment research firm serving individual investors, financial advisors, and institutional money-managers. Special thanks to Elizabeth Nelson, Director of Knowledge Management at Valuentum Securities, Inc for her retrieval of relevant documentation to make this paper possible and to the dozens of analysts and colleagues at Morningstar and Driehaus Capital Management for the thoughts and comments during the past several years that ultimately shaped this analysis.

Urban Outfitters Third Quarter Results Were Lackluster

By RJ Towner

Teen and twenty-something apparel retailer Urban Outfitters (URBN) reported mediocre third quarter results. The company grew total revenue 14% year-over-year to $693 million, roughly in-line with consensus expectations. Earnings were a penny short of consensus, coming in at $0.40 per share, a 21% increase.

Gross margins improved 220 basis points year-over-year to 37.6%, but we weren't incredibly impressed with profitability. We think a lot of the increase came from moving Free People to a more heavily direct-to-consumer business rather than a wholesale business, though management also noted that discounting was less prevalent during the quarter. Performance across the brands diverged, with comparable retail net sales at Free People up 24%, up 7% at Urban Outfitters, and up just 1% at Anthropology. However, it's important to note that online sales are driving the majority of this growth, as same-store sales actually fell 1%. While the company likes to assert that it doesn't matter what happens in the stores—management will stop breaking the figure out in 2014—we think it is material. If stores are losing momentum, which isn't the case at most retailers, we think the brands could also be losing momentum.

Higher online spending led to higher gross margins, but SG&A costs also grew, increasing 70 basis points year-over-year to 24.1% of sales. We'll be watching to see if online investments are more accretive to the bottom line in the fourth quarter. The company offers free shipping for orders over $100 for most segments, which could hurt profitability to some degree. Going into the holiday season, comparable inventory is flat, while total inventories are up only 8% year-over-year. As we've seen from several other retailers, it appears the focus for this year's holiday season will be on maintaining gross-margin dollars rather than flooding stores with product at the end of the third quarter. We could see the company follow Macy's (M) strategy of releasing new product during the holiday season to add some "freshness" into the store.

Overall, we aren't any more excited about the company following the quarter. Gross margins, though improving, are still down substantially from all-time highs, and are unlikely to fully recover, in our view. We like Urban's position as a mass-hipster retailer, but we think Free People could prove to be a trend rather than a new lifestyle brand. We think the holiday season will be telling about the brand's overall momentum, which we continue to have a negative stance on. Management revealed that same-store sales were down 2% due to average selling prices, and 3% due to units, which suggests some promotional activity that could continue into the holiday season. We believe shares of the retailer are overvalued at this time, and we hold a put option on the company in the portfolio of our Best Ideas Newsletter. We note, however, that it is possible this position may expire worthless.

PetSmart Remains Overvalued

By Valuentum Analysts

Pet supplies retailer PetSmart (PETM) reported better than expected third quarter results. Revenue grew 9% year-over-year to $1.6 billion, roughly in-line with consensus expectations. Earnings per share jumped 50% year-over-year to $0.75 per share, cruising past consensus estimates. Cash flow was also strong, as the company generated $93 million in free cash flow, returning $18 million via dividends and $60 million worth of share repurchases.

Pet spending continues to remain resilient, as same-store sales surged 6.5% compared to the same period last year on 2.3% more transactions. Merchandise sales were strong, growing 9% year-over-year to $1.4 billion, and gross margins increased 30 basis points to 30.2%. Services revenue, which includes veterinary and training services, increased 8.4% year-over-year to $175 million, though gross margins were flat at 26.3%. SG&A for the quarter increased by a few million dollars on an absolute basis, but fell 80 basis points as a percentage of sales to 21%. New marketing campaigns continue to drive consumers through the doors, and the firm is experiencing great SG&A leveraging. With a move towards smaller store sizes, PetSmart has also been able to boost sales per square foot while taking on lower fixed costs—almost always a positive for profitability.

The company continues to benefit from a shift to "upscale consumables," which has increased merchandise margins, as well as average revenues per transaction. The same shopper that has continued to frequent Whole Foods (WFM) in spite of its high prices is shopping at PetSmart and purchasing organic food and treats for dogs and cats. As much as people love their pets, we think spending on these items will be sensitive to any major economic deterioration. Still, the "humanization" of pets continues to be a positive trend for the company, in our view.

Going forward, the company expects comparable store sales growth of 6%-7%, and total sales growth of 10%-11% for the year. The firm also boosted its full-year earnings guidance to $3.47 to $3.51 from its previous range of $3.30 to $3.40. It also announced CFO Chip Malloy will resign effective June 2013. We cannot really say anything negative about Malloy, who has presided under the firm's fantastic capital allocation strategy over the past few years.

Although the quarter was strong, we still aren't fans of PetSmart at its current valuation. Though worries of the fiscal cliff and a change in tax policy have yet to hit pet enthusiasts, we think any material negative economic momentum resulting from the failure to strike a deal will hurt both margins and sales growth. We hold a put option on the name in the portfolio of our Best Ideas Newsletter for downside protection in event of a market swoon.

DuPont Announces Repurchase Program and Solid Fiscal Year 2013 Guidance

By Valuentum Analysts

Conglomerate DuPont (DD) announced a $1 billion share repurchase program. The firm's shares have been largely stuck in neutral (shares are about where they were at the beginning of the year), but we think the announcement signals that management believes the company is inexpensive at current levels.

DuPont also announced that its earnings per share for fiscal 2012 will come in at $3.25-$3.30 on a continuing operations basis, the high end of its previous guidance range (but wrapping the consensus estimate). More importantly, the firm provided earnings growth guidance of low- to mid-single-digits during 2013 thanks to strength from agricultural investments, advanced materials, and industrial biosciences. Sales are expected to grow in the low-single digits for the year. Excluding the impact of a weak chemicals segment, the company expects earnings to grow at least in the high-teens in 2013 compared to 2012.

We think the poor expected conditions in the firm's Performance Chemicals segment, which is expected to be down substantially with margins falling 6-7 percentage points in 2013, bodes negatively for Dow Chemical (DOW). However, the bad news is not necessarily terrible for peer Eastman Chemical (EMN), which has a substantially different chemical product line-up than Dow and DuPont. We had highlighted Eastman Chemical on page 5 of the November 2011 edition of our Best Ideas Newsletter, calling for 35% pricing upside. Eastman has since delivered this return and more.

We think DuPont's guidance (strong agricultural performance) reflects favorably on Monsanto (MON), one of the dominant players in the biotechnology portion of the agricultural space. With brutal growing conditions throughout much of 2012 due to widespread drought, we think farmers, who collectively have relatively strong balance sheets (incomes), will invest in greater technology to ensure a healthy harvest for 2013.

The new buyback signals that management believes shares are undervalued, and we think DuPont has upside to the high-$50s based on our fair value estimate (at the time of this writing). Still, the firm's score on the Valuentum Buying Index (our stock-selection methodology) isn't that great at the time of this writing, so we're not rushing to add it to our portfolio. However, the company's annual dividend yield of approximately 3.9% and its Valuentum Dividend Cushion qualitative rating of 'good' make the company an attractive total return investment, in our view. We're watching the firm very closely.

Other Ideas for Your Radar

By Valuentum Analysts

Our Valuentum Buying Index (VBI), which places a considerable emphasis on a firm's valuation, is the primary driver behind names included in our best ideas portfolio. However, the size of our coverage universe lends itself to a plethora of new ideas beyond the ones we seek to capitalize on. Below, we provide a unique screen that sorts companies we feel are undervalued on both a DCF and relative value basis (the first two pillars of our VBI; the third is a technical assessment). We update this screen monthly and deliver it to you in our newsletter (for your added convenience, we also post it on our site). You'll see we hold a number of these firms in our portfolio (EDAC, RIO), and we continue to monitor the remainder for the most opportune time to add them. The names on this list are the cream of the crop for the value investor and can supplement your "shopping list" of new ideas.

Name	Symbol	DCF Valuation	Relative Valuation	Price/Fair Value
Microsoft	MSFT	UNDERVALUED	ATTRACTIVE	0.56
EDAC Tech	EDAC	UNDERVALUED	ATTRACTIVE	0.59
Coinstar	CSTR	UNDERVALUED	ATTRACTIVE	0.59
Jabil Circuit	JBL	UNDERVALUED	ATTRACTIVE	0.59
Tenneco	TEN	UNDERVALUED	ATTRACTIVE	0.62
Helen of Troy	HELE	UNDERVALUED	ATTRACTIVE	0.62
Endo Pharma	ENDP	UNDERVALUED	ATTRACTIVE	0.63
Cisco	CSCO	UNDERVALUED	ATTRACTIVE	0.64
General Cable	BGC	UNDERVALUED	ATTRACTIVE	0.65
Mylan	MYL	UNDERVALUED	ATTRACTIVE	0.66
Rio Tinto	RIO	UNDERVALUED	ATTRACTIVE	0.66
Huntsman	HUN	UNDERVALUED	ATTRACTIVE	0.66
Revlon	REV	UNDERVALUED	ATTRACTIVE	0.66
Libbey Inc	LBY	UNDERVALUED	ATTRACTIVE	0.67
AAR Corp	AIR	UNDERVALUED	ATTRACTIVE	0.67
FTI Consulting	FCN	UNDERVALUED	ATTRACTIVE	0.68
Teva Pharma	TEVA	UNDERVALUED	ATTRACTIVE	0.69
Chicago Bridge & Iron	CBI	UNDERVALUED	ATTRACTIVE	0.69
Koppers	KOP	UNDERVALUED	ATTRACTIVE	0.69
Tempur Pedic	TPX	UNDERVALUED	ATTRACTIVE	0.71
Broadcom	BRCM	UNDERVALUED	ATTRACTIVE	0.71
Omega Healthcare	OHI	UNDERVALUED	ATTRACTIVE	0.72
Insperity	NSP	UNDERVALUED	ATTRACTIVE	0.72
Verint	VRNT	UNDERVALUED	ATTRACTIVE	0.73
Aeropostale	ARO	UNDERVALUED	ATTRACTIVE	0.74
Zimmer	ZMH	UNDERVALUED	ATTRACTIVE	0.77
Johnson & Johnson	JNJ	UNDERVALUED	ATTRACTIVE	0.80
Quality Systems	QSII	UNDERVALUED	ATTRACTIVE	0.80

Other Ideas... continued on next page

Other Ideas... continued from previous page

The initial table below showcases firms that fit the bill of the Valuentum investor, with each posting a 9 or a 10 on our index. These are names that we may swap into our portfolio on the long side (if not already held) should their upside potential become greater than our current holdings.

We also show firms that register a 1 or 2 on our VBI. These names represent put-option candidates. We provide the respective lists below, and each firm's report can be found on our website.

Name	Symbol	Industry	VBI
Broadcom	BRCM	Integrated Circuits	9
FTI Consulting	FCN	Management Services	9
General Cable	BGC	Electrical Equipment - industrial	9
Goldman Sachs	GS	Banks & Money Centers	9
Huntsman	HUN	Chemicals - broad	9
Johnson & Johnson	JNJ	Household Products	9
Libbey Inc	LBY	Household Products	9
Revlon	REV	Luxury Goods	9
Rio Tinto	RIO	Mining - diversified	9
Tenneco	TEN	Auto Parts Suppliers	9
Teva Pharma	TEVA	Pharmaceuticals	9
Zimmer	ZMH	Medical Devices	9

Name	Symbol	Industry	VBI
Central European Media	CETV	Media	1
Cepheid	CPHD	Medical Devices	1
Cerner	CERN	Medical Srvc Providers	1
Holly Energy	HEP	Oil & Gas Pipelines	1
Hyatt	H	Hotels	1
Iron Mountain	IRM	Commercial Services	1
LinkedIn	LNKD	Internet Software & Svcs	1
Mercury General	MCY	Insurance - Property & Casualty	1
Petsmart	PETM	Specialty Retailers	1
Rollins	ROL	Chemicals - broad	1
Tanger Factory	SKT	REIT - Retail	1
Teradata	TDC	Computer Hardware	1
Ulta Salon	ULTA	Personal Services	1
Fifth Third	FITB	Banks & Money Centers	2
Infinity	IPCC	Insurance - Property & Casualty	2
Lumber Liquidators	LL	Specialty Retailers	2
Rackspace	RAX	Business Services	2
Sun Life	SLF	Insurance - Life	2
Urban Outfitters	URBN	Specialty Retail - apparel	2

Valuentum's Retail ETF Research — Visit us at www.valuentum.com — Ratings as of 12/15/2012 — As of 11/23/2012

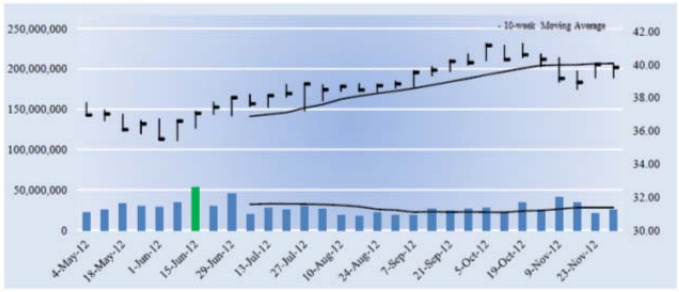
Health Care Select Sector SPDR XLV Fair Value: $41.00

Buying Index™ 3 **Value Rating**

Last Close	3-yr Proj. Excess Return	Relative Expense Assessment (Ratio)	Valuentum Style	Investment Manager	Peer Category
$40.02	1.9%	EXCELLENT (18 bps)	LARGE-CAP VALUE	State Street	US-Sector-Health Care*

We're big fans of the Health Care Select Sector SPDR. The ETF is undervalued and has an excellent expense ratio. Investors should be aware of the concentration of its top 5 holdings, however.

ETF Chart (weekly)



The week with the highest trading volume out of the last 13 weeks was a week of heavy selling, or distribution (red bar).

Key ETF Considerations

3-yr Projected Excess Return	1.92%
DCF Value (All Const. P/FV Wgt Avg)	FAIRLY VALUED (0.98)
Valuentum Buying Index (All Const. VBI Wgt Avg)	3 (5.9)
Relative Expense Assessment (Ratio)	EXCELLENT (18 bps)
ValueCreation™ (Top 15 Constituents)	EXCELLENT
ValueRisk™ (Top 15 Constituents)	MEDIUM
Technical Evaluation (ETF)	BEARISH
Money Flow Index (ETF)	NEUTRAL
Upside/Downside Volume (ETF)	BEARISH
Near-term Technical Resistance, 10-wk MA (ETF)	40.00
Primary Benchmark	S&P Health Care Select Sector Index

Const = Constituent. Please view glossary on page 5 for definitions and additional information.

ETF Constituent Quality

ValueCreation™

ValueRisk™	Very Poor	Poor	Good	Excellent
Low				
Medium				
High				
Very High				

ETFs that have better quality companies within them score at top right of our scale.

ETF Vitals

Avg Weekly Vol (30 wks)	27,585
30-week Range (USD)	35.38 - 41.4
Fund Net Asset Value (Price)	$40.03
Shares Outstanding	146.67 M
Total Net Assets	$5,871.20 M
Inception Date	12/16/1998
Gross Expense Ratio	0.18%
Fund Dividend Yield	1.93%
30 Day SEC Yield	1.94%
Distribution Frequency	Quarterly
Short Selling Allowed	Yes
Exchange	NYSE ARCA EXCHANGE

Source: Relevant Investment Manager

Fund Objective (Source: Relevant Investment Manager)

"The Health Care Select Sector SPDR® Fund, before expenses, seeks to closely match the returns and characteristics of the S&P Health Care Select Sector Index (index ticker: IXV). Source: State Street."

Fund Constituent Analysis - See page 3 For Expanded Holdings Analytics

Top 5 Concentration: 43.2%

Company Name	Weighting %	VBI	Price / Fair Value	Forward P/E	PEG	ValCreation™	ValueRisk™
Johnson & Johnson	12.5	9	0.80	14.0	1.5	EXCELLENT	LOW
Pfizer Inc	11.9	7	0.86	11.5	1.6	EXCELLENT	MEDIUM
Merck & Co Inc New	8.8	6	1.27	12.2	2.6	POOR	HIGH
Abbott Labs	5.6	3	0.87	13.0	1.5	EXCELLENT	LOW
Amgen Inc	4.4	7	0.91	12.8	1.4	EXCELLENT	MEDIUM
Gilead Sciences Inc	3.8	5	1.06	17.7	2.2	EXCELLENT	MEDIUM
Unitedhealth Group Inc	3.7	NA	NA	NA	NA	NA	NA
Bristol Myers Squibb Co	3.6	6	1.13	17.2	3.5	VERY POOR	MEDIUM
Lilly Eli & Co	3.2	5	1.06	15.4	1.9	EXCELLENT	MEDIUM
Express Scripts Hldg Co	2.9	NA	NA	NA	NA	NA	NA
Medtronic Inc	2.9	6	0.83	11.0	2.2	EXCELLENT	MEDIUM
Baxter Intl Inc	2.5	5	0.97	13.2	1.9	EXCELLENT	MEDIUM
Biogen Idec Inc	2.4	5	1.27	23.9	2.1	EXCELLENT	MEDIUM
Celgene Corp	2.2	6	0.94	15.7	1.8	EXCELLENT	MEDIUM
Allergan Inc	1.9	6	1.12	21.8	2.1	EXCELLENT	MEDIUM
Top 15 Analysis	**72.1**	**5.8**	**0.97**	**14.0**	**1.9**	**EXCELLENT**	**MEDIUM**

The Top 15 Analysis row reflects the following: Fund Weighting: Sum of top 15 weightings of fund. VBI: Weighted average of the VBI scores of the top 15 constituents of the fund. Price/Fair Value: Weighted average of the P/FV ratios of the top 15 constituents of the fund. Forward P/E and PEG ratios reflect the median of the respective measures for firms we cover in the top 15 constituents of the fund. The ValueCreation and ValueRisk ratings reflect the median of the top 15 constituents of the fund. For firms under review or not yet covered by Valuentum, a default VBI rating of 5 and P/FV rating of 1 are applied such that their respective impact is minimized.

ETF Performance %

	Month End	Quarter End
YTD	17.14%	17.47%
1 Year	21.68%	29.04%
3 Year	14.81%	14.03%
5 Year	4.11%	4.57%
10 Year	5.79%	6.43%
Inception 12/16/1998	5.11%	5.16%

Past performance does not guarantee future returns. Investment return/principal values will fluctuate depending when shares are sold.
Source: Relevant Investment Manager

Index Characteristics

Index Dividend Yield	1.93%
Est. 3-5 Year EPS Growth	9.21%
Forward P/E Ratio	13.38
Price/Cash Flow	11.41
Return on Equity	17.2%

Source: Relevant Investment Manager

Index Risk & Statistics

Annualized Volatility	12.47
Beta vs S&P 500	0.76
Wght Avg. Market Cap	$82,873.91 M

Source: Relevant Investment Manager

ETF Peer Analysis

ETF Name	Ticker Symbol	Val Buying Index (VBI)	3-yr Proj. Excess Ret.	Net Exp. Ratio	ValCreation™	ValueRisk™	Net Assets
SPDR S&P Biotech	XBI	3	-3.59%	0.35%	GOOD	MEDIUM	$620.11 M
SPDR S&P Pharma	XPH	3	4.95%	0.35%	EXCELLENT	MEDIUM	$340.98 M
SPDR S&P HC Equipment	XHE	3	0.43%	0.35%	EXCELLENT	MEDIUM	$19.90 M
SPDR S&P Health Care Services	XHS	7	0.19%	0.35%	GOOD	MEDIUM	$10.02 M
Health Care Select Sector SPDR	XLV	3	1.92%	0.18%	EXCELLENT	MEDIUM	$5,871.20 M

Peer Group Source: ETF Industry Guide, State Street. Source: Bloomberg, SPDR ETF Research & Analytics Team. Data is as of the referenced date and is subject to change. * Source: State Street. UR = Under Review. Net expense ratio may be as of 12/31/2011 for firms not covered by Valuentum. Gross expense ratio quoted when net expense ratio is not applicable.

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http://www.valuentum.com/articles/20120712_1

Valuentum Retail Equity Research — Visit us at www.valuentum.com — Ratings as of 6-Nov-2012 — Data as of 5-Nov-2012

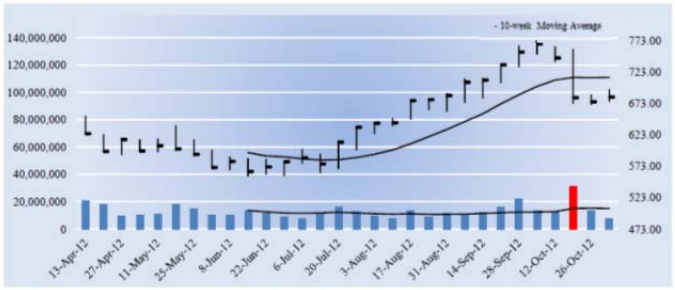
Google GOOG UNDERVALUED 4.5%

Buying Index™ 3 — Value Rating ✓

Last Close	Estimated Fair Value	Fair Value Range	Investment Style	Sector	Industry
$682.96	$921.00	$714.00 - $1128.00	MEGA-CAP BLEND	Information Technology	Internet Software & Svcs

Google has a strong future in search—both on the desktop and via mobile devices.

Stock Chart (weekly)



The week with the highest trading volume out of the last 13 weeks was a week of heavy selling, or distribution (red bar).

Investment Considerations

DCF Valuation	UNDERVALUED
Relative Valuation	NEUTRAL
ValueCreation™	EXCELLENT
ValueRisk™	MEDIUM
ValueTrend™	POSITIVE
Cash Flow Generation	STRONG
Financial Leverage	LOW
Growth	AGGRESSIVE
Technical Evaluation	VERY BEARISH
Relative Strength	STRONG
Money Flow Index (MFI)	NEUTRAL
Upside/Downside Volume (U/D)	DETERIORATING
Near-term Technical Resistance, 10-wk MA	714.00

DCF = Discounted Cash Flow; MFI, U/D = Please see glossary. MA = Moving Average

Business Quality

ValueRisk™ \ ValueCreation™	Very Poor	Poor	Good	Excellent
Low				
Medium				■
High				
Very High				

Firms that generate economic profits with little operating variability score near the top right of the matrix.

Company Vitals

Market Cap (USD)	$223,474
Avg Weekly Vol (30 wks)	13,084
30-week Range (USD)	556.52 - 774.38
Valuentum Sector	Information Technology
5-week Return	-10.0%
13-week Return	6.8%
30-week Return	8.7%
Dividend Yield %	0.0%
Dividends per Share	0.00
Forward Dividend Payout Ratio	0.0%
Est. Normal Diluted EPS	54.78
P/E on Est. Normal Diluted EPS	12.5
Est. Normal EBITDA	25,053
Forward EV/EBITDA	10.1
EV/Est. Normal EBITDA	7.3
Forward Revenue Growth (5-yr)	15.6%
Forward EPS Growth (5-yr)	18.2%

NMF = Not Meaningful; Est. = Estimated; FY = Fiscal Year

Investment Highlights

• Google earns a ValueCreation™ rating of EXCELLENT, the highest possible mark on our scale. The firm has been generating economic value for shareholders for the past few years, a track record we view very positively. Return on invested capital (excluding goodwill) has averaged 105.8% during the past three years.

• Although we think the firm's DCF valuation indicates a potential attractive investment opportunity, we'd be more comfortable investing in the firm if it was more attractively priced on a relative basis versus peers as well.

• Google has an excellent combination of strong free cash flow generation and low financial leverage. We expect the firm's free cash flow margin to average about 27.6% in coming years. Total debt-to-EBITDA was 0.3 last year, while debt-to-book capitalization stood at 6.7%.

• The company's stock price has outperformed the benchmark during the last quarter, and its valuation still looks interesting at these levels. Investors could be accumulating shares, as the stock continues to trade at bargain-basement levels.

• Google has a strong future in search—both on the desktop and via mobile devices. However, we think the Motorola Mobility acquisition will destroy value, and we continue to remain bearish on Android's profit potential (not market share potential).

Relative Valuation

	Forward P/E	PEG	Price / FV
Baidu	21.7	1.2	66.5%
WebMD	-38.6	NMF	108.1%
Yahoo	15.0	1.8	102.2%
Yahoo	14.6	3.7	116.5%
Peer Median	14.8	1.8	105.1%
Google	**17.0**	**1.3**	**74.2%**

Price / FV = Current Stock Price divided by Estimated Fair Value

Returns Summary

	3-year Historical Average
Return on Equity	19.9%
Return on Assets	16.8%
ROIC, with goodwill	64.5%
ROIC, without goodwill	105.8%

ROIC = Return on Invested Capital; NMF = Not Meaningful

Leverage, Coverage, and Liquidity

In Millions of USD

Total Debt	4,204
Net Debt	-40,422
Total Debt/EBITDA	0.3
Net Debt/EBITDA	NMF
EBITDA/Interest	243.0
Current Ratio	5.9
Quick Ratio	5.7

NMF = Not Meaningful

Financial Summary

Fiscal Year End:	----- Actual ----- Dec-10	Dec-11	Projected Dec-12
Revenue	29,321	37,905	41,885
Revenue, YoY%	24.0%	29.3%	10.5%
Operating Income	10,381	12,242	16,005
Operating Margin %	35.4%	32.3%	38.2%
Net Income	8,505	9,737	13,160
Net Income Margin %	29.0%	25.7%	31.4%
Diluted EPS	26.31	29.76	40.22
Diluted EPS, YoY %	59.1%	13.1%	35.2%
Free Cash Flow (CFO-capex)	7,063	11,127	11,729
Free Cash Flow Margin %	24.1%	29.4%	28.0%

In Millions of USD (except for per share items)

Structure of the Internet Software & Services Industry — NEUTRAL

The Internet software/services industry is composed of a variety of companies with rapidly-changing business models. Most focus on improving the ways people connect with information, either via Internet search or by social media platforms, and generate revenue primarily by delivering cost-effective online advertising. Constituents earn significant returns on invested capital due to their capital-light operations, though competition remains fierce. We expect most companies in this group to look substantially different 10 years from now than they do today. Overall, we're neutral on the structure.

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Valuentum Retail Equity Research | Visit us at www.valuentum.com | Ratings as of 13-Nov-2012 | Data as of 9-Nov-2012

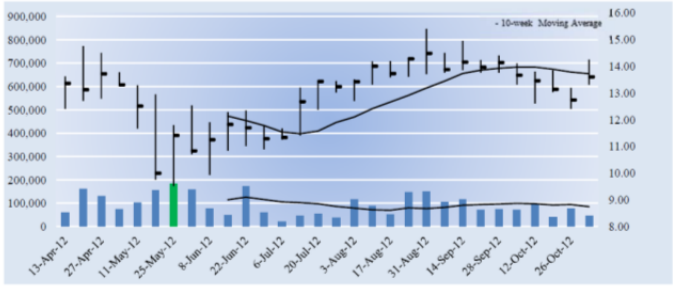
EDAC Tech EDAC UNDERVALUED 17.6%

Buying Index™ 6 **Value Rating** ✓

Last Close	Estimated Fair Value	Fair Value Range	Investment Style	Sector	Industry
$13.60	$23.00	$16.00 - $30.00	MICRO-CAP BLEND	Industrials	A&D Suppliers

EDAC Tech appears undervalued on the basis of both our DCF process and relative value assessment versus peers.

Stock Chart (weekly)



The week with the highest trading volume out of the last 13 weeks was a week of heavy buying, or accumulation (green bar).

Investment Considerations

DCF Valuation	UNDERVALUED
Relative Valuation	ATTRACTIVE
ValueCreation™	VERY POOR
ValueRisk™	MEDIUM
ValueTrend™	POSITIVE
Cash Flow Generation	WEAK
Financial Leverage	MEDIUM
Growth	HIGH
Technical Evaluation	BEARISH
Relative Strength	NEUTRAL
Money Flow Index (MFI)	NEUTRAL
Upside/Downside Volume (U/D)	DETERIORATING
Near-term Technical Resistance, 10-wk MA	14.00

DCF = Discounted Cash Flow; MFI, U/D = Please see glossary. MA = Moving Average

Business Quality

ValueCreation™

ValueRisk™	Very Poor	Poor	Good	Excellent
Low				
Medium	■			
High				
Very High				

Firms that generate economic profits with little operating variability score near the top right of the matrix.

Company Vitals

Market Cap (USD)	$71
Avg Weekly Vol (30 wks)	93
30-week Range (USD)	9.51 - 15.4
Valuentum Sector	Industrials
5-week Return	-3.6%
13-week Return	0.3%
30-week Return	9.4%
Dividend Yield %	0.0%
Dividends per Share	0.00
Forward Dividend Payout Ratio	0.0%
Est. Normal Diluted EPS	1.60
P/E on Est. Normal Diluted EPS	8.5
Est. Normal EBITDA	20
Forward EV/EBITDA	6.5
EV/Est. Normal EBITDA	4.4
Forward Revenue Growth (5-yr)	11.2%
Forward EPS Growth (5-yr)	24.6%

NMF = Not Meaningful; Est. = Estimated; FY = Fiscal Year

Investment Highlights

• EDAC Tech is supplier of precision components (jet engine parts, special tooling) to the aerospace sector. United Tech is its largest customer, and EDAC has secured a position on the firm's geared turbofan engine (high pressure compressor hubs, turbine disks), which is turning into a favorite powerplant among commercial OEMs in the narrowbody arena.

• EDAC Tech's valuation is compelling at this time. The firm is trading at a nice discount to our estimate of its fair value, even after considering an appropriate margin of safety. The firm's forward earnings multiple and PEG ratio also look attractive versus peers.

• EDAC Tech's backlog growth has been the best in the aerospace supply chain. The level stands at roughly $300 million, up from $140 million at the end of 2010 and just over $20 million in 2005. We expect future orders to continue to be robust.

• The firm's share price performance has been roughly in line with that of the market during the past quarter. We'd expect the firm's stock price to converge to our fair value estimate within the next three years, if our forecasts prove accurate.

• The firm's PEG ratio is not only below 1, but it also falls below the median of its peer group. This provides additional support for the firm's attractive valuation on a DCF basis.

Relative Valuation

	Forward P/E	PEG	Price / FV
Hexcel Corp	15.2	1.9	100.9%
Precision Castparts	16.8	1.4	85.7%
Rockwell Collins	11.9	1.8	92.4%
Spirit AeroSystems	71.6	0.1	84.4%
Peer Median	16.0	1.6	89.0%
EDAC Tech	**12.6**	**0.8**	**59.1%**

Price / FV = Current Stock Price divided by Estimated Fair Value

Returns Summary

	3-year Historical Average
Return on Equity	18.5%
Return on Assets	8.2%
ROIC, with goodwill	-6.7%
ROIC, without goodwill	-6.7%

ROIC = Return on Invested Capital; NMF = Not Meaningful

Financial Summary

	----- Actual -----		Projected
Fiscal Year End:	Dec-10	Dec-11	Dec-12
Revenue	73	87	105
Revenue, YoY%	33.7%	18.6%	21.0%
Operating Income	2	6	10
Operating Margin %	2.4%	7.4%	9.4%
Net Income	1	4	6
Net Income Margin %	1.2%	4.1%	5.6%
Diluted EPS	0.17	0.68	1.08
Diluted EPS, YoY %	-89.0%	300.9%	59.0%
Free Cash Flow (CFO-capex)	-3	2	-1
Free Cash Flow Margin %	-4.6%	2.9%	-0.6%

In Millions of USD (except for per share items)

Leverage, Coverage, and Liquidity

In Millions of USD

Total Debt	17
Net Debt	15
Total Debt/EBITDA	1.8
Net Debt/EBITDA	1.6
EBITDA/Interest	9.2
Current Ratio	2.3
Quick Ratio	1.1

NMF = Not Meaningful

Structure of the A&D Supplier Industry — GOOD

The aerospace supply chain will benefit from the multi-year backlogs at the airframe makers, Boeing and Airbus. Though the current upswing looks robust, commercial aerospace has historically been cyclical and remains influenced by airline profits, passenger traffic, credit-market health, and geopolitical conditions. Participants generally operate under contracts with significant long-term price concessions, so cost-containment remains critical. The strongest suppliers are those that have long-standing customer relationships, technical expertise, and state-of-the-art manufacturing facilities. We like the group.

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Our Methodology – The Valuentum Buying Index (VBI)

By Valuentum Analysts

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. The more investors that are interested in the stock for reasons based on their respective investment mandates, the more likely it will move higher.

As such, 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 (10=best). 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. We believe our methodology helps identify the most attractive stocks at the best time to buy, helping to avoid value traps and lagging performance due to the opportunity cost of holding a stock with great potential but at an inopportune time.

A Rigorous, Discounted Cash Flow Valuation Assessment

Our methodology starts with in-depth financial statement analysis, where we derive our ValueCreation, ValueRisk, and ValueTrend ratings, which together provide a quantitative assessment of the strength of a firm's competitive advantages. After evaluating historical trends, we then make full annual forecasts for each item on a company's income statement and balance sheet to arrive at a firm's future free cash flows. We derive a company-specific cost of equity (using a fundamental beta based on the expected uncertainty of key valuation drivers) and a cost of debt (considering the firm's capital structure and synthetic credit spread over the risk-free rate), culminating in our estimate of a company's weighted average cost of capital (WACC). We don't use a market price-derived beta, as we embrace market volatility, which provides investors with opportunities to buy attractive stocks at bargain-basement levels.

We assess each company within our complete three-stage free cash flow to the firm (enterprise cash flow) valuation model, which generates an estimate of a company's equity value per share based on its discounted future free cash flows and the company's net balance sheet impact, including other adjustments to equity value (namely pension and OPEB adjustments). Our ValueRisk rating, which considers the underlying uncertainty of the capacity of the firm to continue to generate value for shareholders, sets the margin of safety bands around this fair value estimate. For firms that are trading below the lower bound of our margin of safety band, we consider these companies undervalued based on our DCF process. For firms that are trading above the higher bound of our margin of safety band, we consider these companies overvalued based on our DCF process.

A Forward-Looking Relative Value Assessment

Our discounted cash-flow process allows us to arrive at an absolute view of the firm's intrinsic value. However, we also understand the critical importance of assessing firms on a relative value basis,

Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

versus both their industry and peers. Many institutional money-managers--those that drive stock prices—pay attention to a company's price-to-earnings (PE) ratio and price-earning-to-growth (PEG) ratio in determining whether entities are undervalued. With this in mind, we have included a forward-looking relative value assessment in our process to further augment our rigorous discounted cash-flow process. If a company is undervalued on both a price-to-earnings ratio and a price-earnings-to-growth (PEG) ratio versus industry peers, we would consider the firm to be attractive from a relative value standpoint.

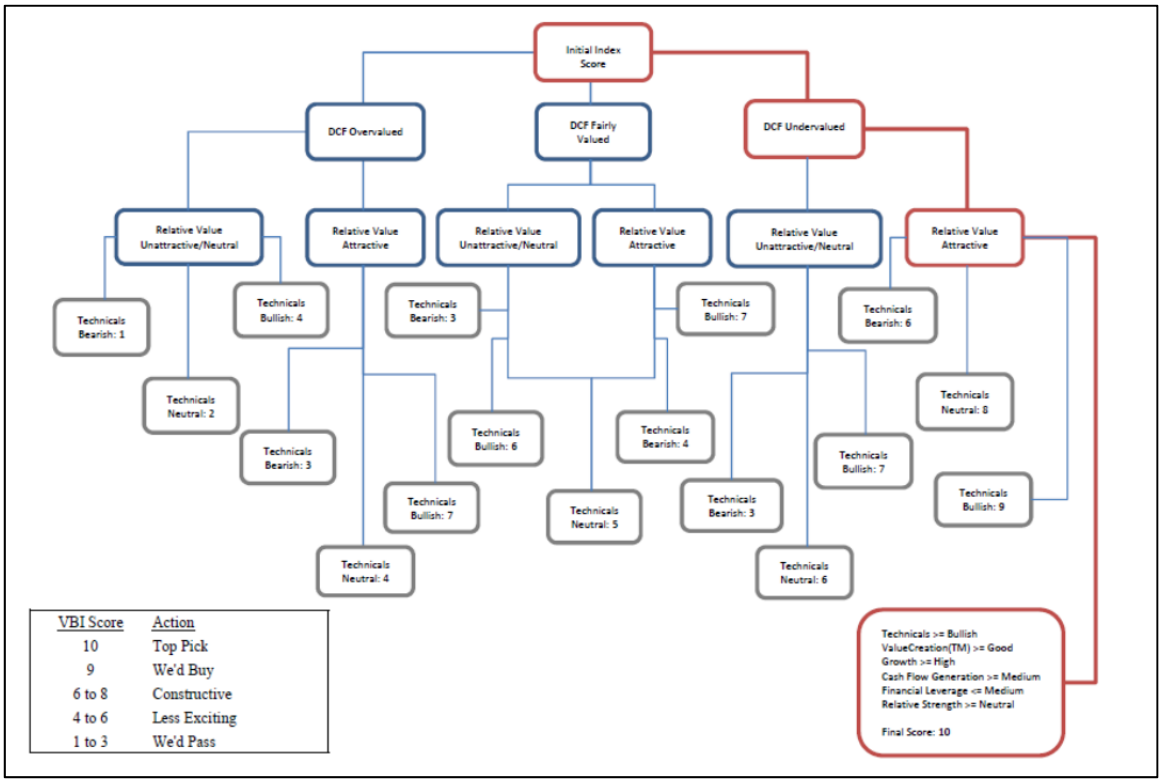
Avoiding Value Traps and Opportunity Cost

Once we have estimated a firm's intrinsic value on the basis of our discounted cash-flow process, determined if it is undervalued according to its firm-specific margin of safety bands, and assessed its relative value versus industry peers, we then evaluate the company's technical and momentum indicators to pin-point the best entry and exit points on the stock. An evaluation of its moving averages, relative strength, upside-downside volume, and money flow index are but a few considerations we look at with respect to our technical and momentum assessment of a company's stock.

Putting It All Together - the Valuentum Buying Index

Let's follow the red line on the flow chart below to see how a firm can score a 10, the best mark on our index (a "Top Pick"). First, the company would need to be 'UNDERVALUED' on a DCF basis and 'ATTRACTIVE' on a relative value basis. The stock would also have to be exhibiting 'BULLISH' technicals. The firm would need a ValueCreation rating of 'GOOD' or 'EXCELLENT', exhibit 'HIGH' or 'AGGRESSIVE' growth prospects, and generate at least a 'MEDIUM' or 'NEUTRAL' assessment for cash flow generation, financial leverage, and relative price strength.

This is a tall order for any company, but we're looking to deliver the very best of ideas to our clients and subscribers. Firms that don't make the cut for a 10 are ranked accordingly, with the least attractive stocks garnering a score of 1 ("We'd Pass"). Most of our coverage universe falls between 3 and 7, but at any given time there could be large number of companies garnering either high or low scores, especially at market lows or tops, respectively.



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

Valuentum Best Ideas Newsletter: Volume 2, Issue 12

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