OUR DIVIDEND GROWTH NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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Valuentum Securities Inc.
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Annualized Return	Annualized Goal	Outperformance
15.5%	Mid-High Single Digits	8.0pts

*Please see note below regarding performance measurement.

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"Stock market returns predict future economic activity, *not the other way around*."
– Brian Nelson, CFA

***NOTE**: The Dividend Growth portfolio's goal is to generate a mid-to-high single digit annual return (about 7.5%) over rolling 3-5 year periods. As of today, June 1, 2015, the portfolio is significantly exceeding this goal.

The US Economy Is Shrinking

By Brian Nelson, CFA

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Best Dividend Growth Ideas: MO, AAPL, COH, CSCO, ETP, GE, HAS, HCP, INTC, JNJ, KMI, MDT, MSFT, O, PG, PPL, XLE

"The way you lose money in the stock market is to start off with an economic picture. I also spend fifteen minutes a year on where the stock market is going." and "If you spend more than 13 minutes analyzing economic and market forecasts, you've wasted 10 minutes." – Peter Lynch

I'm not so much a Peter Lynch disciple as I am a logical thinker. According to the legendary fund manager, you have a total of three minutes to read this piece on broader economic activity, and then move on to more useful analysis.

There's no time to waste!

Peter Lynch was the manager of the Magellan Fund at Fidelity Investments through the late 1970s and during the 1980s, where he averaged nearly a 30% average annual return, often more than doubling the performance of the S&P 500 (SPY) index each year. During his tenure, the Magellan Fund was one of the best, if not the best, performing mutual funds in the world. If you haven't studied his famous texts *One Up on Wall Street* and *Beating the Street* yet, then reading those works is your homework for this month.

Please see *The US Economy Is Shrinking*...on next page

*The US Economy Is Shrinking…*from previous page

The lessons from Mr. Lynch go on and on. Here are two more excellent analytical insights that fit the topic of this article.

> **"Nobody can predict interest rates, the future direction of the economy, or the stock market. Dismiss all such forecasts and concentrate on what's actually happening to the companies in which you've invested."** It is far more productive for an investor to focus their time and energy on systems which are potentially understandable in a way which might reveal a mispriced asset. George Soros said once: "Unfortunately, the more complex the system, the greater the room for error." The simplest system on which an investor can focus is an individual company. Trying to understand something as complex as an economy in a way which outperforms the markets is not a wise use of time and is unlikely to happen (Source: 25iq).
>
> **"The GNP six months out is just malarkey. How is the sneaker industry doing? That's real economics."** The difference between the predictive power of microeconomics and macroeconomics is "night and day" since with the former vastly fewer assumptions are required and the systems involved are far less complex. The best investors make investing as simple as possible, but no simpler. Lynch is saying he may pay attention to the economics of an industry, but only to understand the economics of the companies he chooses to follow (Source: 25iq).

If you need to take a moment, I understand.

Macroeconomic newsletters have been preying on investors since government bodies started measuring economic activity, but their usefulness is minimal at best and dangerous at worst. So then why are we addressing the 0.7% point contraction in US GDP during the first quarter if we don't want you to spend much time analyzing the economy?

Great question. We're writing this up to show you that the equity markets can perform incredibly well during intermittent periods of economic contraction. Just take a look at the image on the cover page. The other reason is that many investors have the relationship between economic activity and stock market returns completely backwards.

Academic research, far and wide, suggest "stock prices have been found to provide important information about future economic activities. Fama (1981), Fischer and Merton (1984), and Barro (1990), among many others, document a positive relation between stock market return and subsequent growth in investment and output. Hui Guo (2002)." Stock market returns predict future economic activity, *not the other way around*.

So why do investors pay so much attention to the economy? Your guess is as good as mine, but it likely has to do with the good ol' sales pitch that you may have heard for why one has to include emerging markets exposure in their portfolios in the first place. Can you hear the sales team at your local wealth advisor pulling out their pitch decks now?

> "Emerging markets are growing faster, and they'll be a larger weight in the global economy in the decades to come. You need exposure. You're going to miss out." – Hypothetical Salesperson

Who better than *The Economist* magazine to debunk the usefulness of evaluating economic activity in its very own 2014 article, *The Growth Paradox: Past Economic Growth Does Not Predict Future Stock Market Returns*:

> Let us assume that they make forecasts of economic growth by extrapolation from the data for the previous five years, and put money in the equity markets of the countries that have grown the fastest. Since 1972, that approach would have delivered a return of 14.5% a year in dollar terms. But had they invested in the economies with the slowest growth record, investors would have earned 24.6%.

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Amazing, isn't it? The economies with the slowest growth record outperformed those with the fastest. According to *The Economist* magazine, here's why:

> This may partly be down to a "value" effect, similar to that observed with individual stocks. Countries with good growth records become favored by investors who bid up share prices accordingly; future equity returns are thus lower. But countries with poor growth records see their stock markets shunned; their share prices are thus cheap and offer higher subsequent returns. Another problem is that extrapolating from past economic growth simply doesn't work. The report finds no correlation since 1900 between GDP growth per person in an individual country in one year and growth two years later.

All told, stock prices are leading economic indicators. In fact, the S&P 500 stock index is included in the Conference Board's 'Composite Index of Leading Indicators.' Economic activity provides little insight into how stock prices will perform. Now you know.

Our three minutes are up.

It's Official: Intel Buys Altera

A version of this article appeared in the April edition of the Dividend Growth Newsletter.

By Brian Nelson

Newsletter portfolio holding Intel announced today that it would buy Altera (ALTR) after months of deal talks. We think Intel paid a pretty penny for the company at $54 per share, and we wouldn't expect Altera's $2 billion revenue stream to be much of a needle-mover against Intel's $50+ billion revenue base, at least initially. However, there are a few reasons why this would be a strategic win for Intel, not the least of which is defensive in nature. Let's recap those reasons for those that may have missed our previous article.

Altera is one of the top standard cell ASIC (application-specific integrated circuit) suppliers in terms of revenue. Due to the rising cost of transistors, however, the ASIC and ASPP (application-specific standard product) models have come under pressure as of late. Altera's response has been to position itself as one of the two largest manufacturers of field-programmable gate arrays, FPGAs, a sub-segment of programmable logic devices (PLDs) that have much better economics than either ASICs or ASPPs and are poised to displace legacy technologies, almost across the board (ASSP, ASIC, DSP, MCU, CPU, and GPU).

	ASIC	ASSP	PLD
CUSTOMIZABLE	Yes, by chip fabrication facility	No	Yes, by end user
ERASABILITY/REPROGRAMMABILITY	No	No	Yes
RELATIVE TIME TO MARKET	Slow	Immediate	Fast
RELATIVE UNIT COST	Low	Moderate	Moderate to high
CUSTOMER'S DEVELOPMENT COST	High	Low	Moderate
FIELD UPGRADABILITY	No	No	Yes

Image source: Altera

By most estimates, the ASIC and ASSP replacement opportunity alone offers growth that's twice as fast as the overall semiconductor industry, something Intel wants, and Altera brings to the table a complete FPGA portfolio (Generation 10), from the Max 10 (refresh CPLD/low-end) to the Arria 10 (mid-range markets), and the Stratix 10 on the high end. Altera estimates that the PLD (FPGA) market was nearly $5 billion in 2014, but the combined portion of the ASIC and ASSP markets that was accessible for PLD displacement was over $50 billion, revealing the tremendous growth potential of PLDs (FPGAs). Altera's Stratix Series already cooperates with Intel 14nm Tri-Gate technology, offering customers double the performance gains in most cases. In a recent Intel presentation, the tech behemoth showcased the significant cost per transistor savings in its 14bnm TriGate technology. The new HyperFlex core fabric architecture results in a level of performance and power efficiency that is unmatched by any existing FPGA architecture, according to the firm.

Please see *Intel...*on next page

Intel...from previous page

We like Altera's competitive position to win new business and its existing partnership with Intel, which should smooth deal integration. In fact, Altera's management will tell you that its partnership with Intel has given it an upper hand in addressing performance, power consumption, and cost at the same time, while rivals have struggled with each sequentially. From what we can tell, this has given Altera an early-mover advantage, even relative to its chief FPGA rival Xilinx (XLNX), and the growing "process technology gap" for new designs between PLDs (FPGAs) and the ASIC alternative is revealing. Even if Altera doesn't sustain such an advantage relative to technology-savvy peers, the benefits of FPGAs over ASICs should generate a market large enough for a number of players.

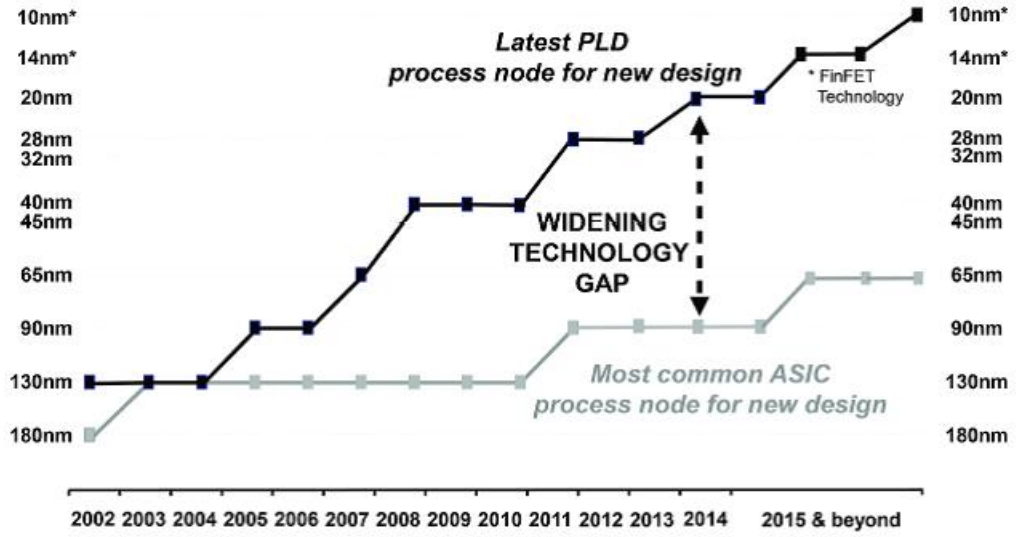

Image source: Altera

If there's one firm that knows the future of the semiconductor industry, it's Intel. The move to acquire Altera is not based on a hunch. The executive suite at Intel knows the potential of FPGAs because it has been working closely with Altera for a few years now. Altera will create an "incumbency" advantage in this market relative to rivals (as it displaces older technology), and we think Intel has grand plans to capitalize on the growth potential. The cost of switching PLD vendors, for example, is incredibly high given the significant investment in design and prototyping, suggesting a long life-cycle, and Intel knows the value of a profitable recurring revenue stream. Cost savings by bringing Altera in-house will be material for Intel.

As for Altera on a standalone basis, the company's economic returns have been great as of late, with the company's operations registering a very attractive Economic Castle rating. From a financial standpoint, free cash flow is robust, and the company is targeting healthy gross (67%-70%) and operating (33%-34%) margins over the next several years. Altera's cash flow from operations has expanded to ~$670 million at the end of 2014 from ~$590 million at the end of 2012 while capex has hovered around $40-$60 million. The firm's total cash stood at ~$2.6 billion at the end of 2014, relative to total long-term debt of ~$1.5 billion. Altera's strong financial health is exemplified by the fact that it has raised its dividend threefold since the end of 2008. The strong cash-flow generation and excess cash would help pad Intel's dividend growth prospects.

The semiconductor industry continues to consolidate—NXP Semi (NXPI) bought Freescale (FSL) recently—and we don't think this will be the last deal that Intel inks should it be completed. Our $38 per share fair value estimate for Intel remains unchanged until further financial deal details come to light. We raised our fair value estimate of Altera to the deal price. We'll be monitoring the integration closely.

The Dividend Growth Portfolio

Annualized Return	Annualized Goal	Outperformance
15.5%	Mid-High Single Digits	8.0pts

DIVIDEND GROWTH PORTFOLIO -- as of June 1, 2015 — Dividend Growth Portfolio Inception Date: January 1, 2012

Company Name	First Purchase	Avg Cost ($)	# of Shares	Total Cost ($)	Last Close	Current Value ($)	% of Portfolio	Exp. Yrly Div's ($)
Altria (MO)	12/30/2011	29.65	202	5,996.30	51.20	10,342.40	6.3%	420.16
Apple (AAPL)	7/24/2013	63.17	77	4,870.76	130.54	10,051.58	6.1%	160.16
Cisco (CSCO)	11/14/2014	26.15	100	2,622.00	29.18	2,918.00	1.8%	84.00
Coach (COH)	9/19/2014	37.55	80	3,011.00	35.81	2,864.80	1.8%	108.00
Energy Sector SPDR (XLE)	4/1/2015	77.86	62	4,827.50	78.22	4,849.64	3.0%	127.71
Energy Transfer (ETP)	12/30/2011	45.85	142	6,517.70	55.96	7,946.32	4.9%	576.52
General Electric (GE)	10/21/2013	26.18	240	6,290.20	27.28	6,547.20	4.0%	220.80
Hasbro (HAS)	12/30/2011	31.89	220	7,022.80	72.39	15,925.80	9.7%	404.80
HCP (HCP)	9/19/2014	40.11	75	3,015.25	39.11	2,933.25	1.8%	169.50
Intel (INTC)	12/30/2011	24.25	289	7,015.25	33.90	9,797.10	6.0%	277.44
Johnson & Johnson (JNJ)	12/30/2011	65.58	107	7,024.06	100.04	10,704.28	6.5%	321.00
Kinder Morgan (KMI)	10/22/2014	38.72	157	6,086.04	41.29	6,482.53	4.0%	301.44
Medtronic (MDT)	12/30/2011	38.25	157	6,012.25	76.70	12,041.90	7.4%	191.54
Microsoft (MSFT)	12/30/2011	25.96	154	4,004.84	47.23	7,273.42	4.4%	190.96
Proctor & Gamble (PG)	12/30/2011	66.71	105	7,011.55	78.85	8,279.25	5.1%	278.25
PP&L (PPL)	12/30/2011	29.42	238	7,008.96	34.77	8,275.26	5.1%	354.62
Realty Income (O)	7/24/2013	44.35	60	2,668.00	45.91	2,754.60	1.7%	136.20

Last Trades: CVX removed (3/16/2015). XLE added (4/1/2015).

Cash	2,363.42	33,566.43	20.5%	4,323.10
Dividend Growth Portfolio	100,000.00	**163,553.76**	100.0%	**TBD**

DG Portfolio Annualized Return (from inception through current date)	**15.5%**
DG Portfolio Annualized Return Goal (Mid-to-High Single Digit Returns)	7.5%
DG Portfolio Annualized Return Outperformance	**8.0%**

UR = Under Review

**Upper bound of fair value range noted.

****The yield an investor would have received if they had held the fund over the last 12 months assuming the most recent NAV.

This portfolio is not a real money portfolio. Data as of June 1, 2015. Cost basis includes commissions. Results include divdends, but no interest received on cash balance.

DIVIDEND GROWTH PORTFOLIO -- as of June 1, 2015

Company Name	Yrly Div's Paid ($) / Shr	Div Yield %	Ex Div Date	Next Pay Date (cycl)	Div Cushion™	Div Safety	Div Growth	Fair Value	VBI Score	Price/Fair Value
Altria (MO)	2.08	4.06%	mid-Jun 2015	mid Jun 2015 (quart)	1.2	GOOD	GOOD	$51.00	3	1.00
Apple (AAPL)	2.08	1.59%	early Aug 2015	Aug 2015 (quart)	5.0	EXCELLENT	EXCELLENT	$148.00	6	0.88
Cisco (CSCO)	0.84	2.88%	late June 2015	early July 2015 (quart)	3.1	EXCELLENT	EXCELLENT	$36.00	7	0.81
Coach (COH)	1.35	3.77%	early June 2015	early June 2015 (quart)	2.1	GOOD	EXCELLENT	$50.00	6	0.72
Energy Sector SPDR (XLE)	2.06	2.63%	late June 2015	early July 2015 (quart)	-	GOOD	NEUTRAL	-	-	-
Energy Transfer (ETP)	4.06	7.26%	early Aug 2015	Aug 2015 (quart)	2.3	GOOD	GOOD	$63.00	4	0.89
General Electric (GE)	0.92	3.37%	early June 2015	June 2015 (quart)	2.0	GOOD	GOOD	$30.00	7	0.91
Hasbro (HAS)	1.84	2.54%	late Jul 2015	mid Aug 2015 (quart)	1.7	GOOD	EXCELLENT	$66.00	6	1.10
HCP (HCP)	2.26	5.78%	early Aug 2015	early Aug 2015 (quart)	1.8	GOOD	EXCELLENT	$46.00	3	0.85
Intel (INTC)	0.96	2.83%	early Aug 2015	early Sep 2015 (quart)	2.4	GOOD	GOOD	$38.00	4	0.89
Johnson & Johnson (JNJ)	3.00	3.00%	late Aug 2015	early Sep 2015 (quart)	2.6	GOOD	EXCELLENT	$111.00	5	0.90
Kinder Morgan (KMI)	1.92	4.65%	late Jul 2015	mid Aug 2015 (quart)	1.2	GOOD	GOOD	$42.00	3	0.98
Medtronic (MDT)	1.22	1.59%	late June 2015	July 2015 (quart)	4.0	EXCELLENT	EXCELLENT	$72.00	6	1.07
Microsoft (MSFT)	1.24	2.63%	mid Aug 2015	mid Sep 2015 (quart)	3.1	EXCELLENT	EXCELLENT	$56.00	6	0.84
Proctor & Gamble (PG)	2.65	3.36%	mid Aug 2015	early Aug 2015 (quart)	1.5	GOOD	EXCELLENT	$74.00	4	1.07
PP&L (PPL)	1.49	4.29%	early June 2015	early June 2015 (quart)	Held for diversification reasons.			$35.00	6	0.99
Realty Income (O)	2.27	4.94%	monthly	monthly	2.0	GOOD	GOOD	$60.00	6	0.77

Standard Disclaimer: Our Dividend Growth portfolio is for information purposes only and should not be considered a solicitation to buy or sell any security. Valuentum is not responsible for any errors or omissions or for results obtained from the use of our Dividend Growth Newsletter and accepts no liability for how readers may choose to utilize the content.

Apple and World Domination?

By Brian Nelson, CFA

Contact us at info@valuentum.com if you are not receiving email transaction alerts.

Everybody wants to love Apple (AAPL), except those that don't own it. If you don't own it, don't sweat it. We still very much like the company, but there are a number of other companies where we can certainly find common ground.

Our cost basis on Apple is but a fraction of where it is trading (see page 5), and we're still happy with the latest transaction on the company from the July 24, 2013, email transaction alert when Apple was added to the Dividend Growth Newsletter portfolio and when the existing position in the Best Ideas Newsletter portfolio was increased. To us, Apple is not so much a technology company, as it is levered to the ongoing strength toward consumer mobilization, which is inevitable. The firm's ecosystem cannot be replicated, and its balance sheet continues to be padded with strong cash flow generation. Look for ongoing share buybacks and dividend increases for many years into the future.

If you don't like Apple because Warren Buffett may not like technology, or you are conservative, here's an interesting statistic: after spending billions on share buybacks during its two fiscal quarters of the year, Apple ended its fiscal second quarter with $193 billion in cash and investments. Berkshire Hathaway's market capitalization is ~$360 billion. Apple's market cap is ~$750 billion, more than twice Berkshire's. The iPhone-maker could buy the Oracle of Omaha in a non-dilutive half-cash ($180 billion), half-stock ($180 billion) deal in one fell swoop, and it won't even miss the cash.

Apple has staying power – from our perspective, the numbers simply mean it cannot become the next Blackberry (BBRY) or Motorola Razr (MSI). It's a mathematical impossibility. Any threat can simply be bought out.

World domination?

Mr. Icahn (IEP) thinks so. The activist investor has brought even more attention to the high-flyer with his latest letter. In it, Icahn raised his price target of Apple $24 to $240 per share, and while we think this number is a bit high, we do think that the company's shares have upside to the high end of our fair value range, which is a more-conservative $175 per share. Icahn's new price target is based on a multiple of 18 times expected fiscal 2016 earnings per share of $12 (excluding net interest income) + $24.44 per share in net cash. You can access Apple's landing page on our website at the following link:

http://www.valuentum.com/search2?searchtext=aapl&searchtype=symbol

Maybe this is old news, but Apple continues to prove doubters wrong. What was once a pipe dream to spectators--seeing Apple at a split-adjusted price of $1,000 ($143 per share)--is now within reach, and Icahn's view that Apple will dominate new categories is a serious reality. Let's think for a second: with the momentum of Apple's ecosystem and its presence in the consumer psyche, can you see customers lining up to buy the first iCar? We can--even if we're not going to buy an Apple car ourselves. The market continues to have it wrong, and no matter your opinion of Mr. Icahn, he makes some really good points:

> It is our belief that large institutional investors, Wall Street analysts and the news media alike continue to misunderstand Apple and generally fail to value Apple's net cash separately from its business, fail to adjust earnings to reflect Apple's real cash tax rate, fail to recognize the growth prospects of Apple entering new categories, and fail to recognize that Apple will maintain pricing and margins, despite significant evidence to the contrary. Collectively, these failures have caused Apple's earnings multiple to stay irrationally discounted, in our view…
>
> …When we compare Apple's P/E ratio to that of the S&P 500 index, we find that the market continues to value Apple at a significantly discounted multiple of only 10.9x, compared to 17.4x for the S&P 500, awarding the S&P500 with a 60% premium valuation to Apple.

Please see *Apple…*on next page

Apple...from previous page

Apple is a holding in both newsletter portfolios. From our perspective, there's no hype or "bubble" surrounding Apple's stock. With a balance sheet and free cash flow stream like Apple's, the company's shares have solid fundamental support, and that won't change anytime soon. The company's strongest competitive advantage may be that it can buy almost anything…in this light, what's the competitive threat? Apple is a fantastic example of the potential price performance of a "wide" moat and a highest-rated Economic Castle all in one.

Hewlett-Packard Still Not Our Favorite Tech Idea

By Kris Rosemann

On May 21, Hewlett-Packard (HPQ) reported its 2015 second-quarter earnings, which included an update on its turnaround plan and upcoming separation. As you may be aware, HP has had a difficult time combatting secular demand declines and macroeconomic headwinds in recent years, and its near-term outlook remains weak. Though it scores exceptionally well on our Valuentum dividend metrics, the firm's turnaround plan will likely affect its dividend negatively. Overall revenue is expected to continue to decline in coming periods, but management has high hopes for the effectiveness of the separation of HP into two Fortune 50 companies.

Reported revenue for the quarter was a slight miss at ~$25.5 billion, a decline of 7% on a reported basis compared to the year ago period, or 2% at constant currency, reflecting the macroeconomic headwinds previously mentioned. The reported figure was only $180 million lower than expected, not exactly substantial when considering revenue was $25.5 billion for the quarter. Non-GAAP EPS declined 1% to $0.87 on a reported basis, largely tied to operating expenses being down 8%. Currency was a factor in the falling expenses, and SG&A and R&D were both reported as declining. On a constant currency basis, however, R&D spending was up from the year-ago period, a positive sign for the long-term outlook of the company. The decline in SG&A is primarily a result of job cuts that have been taking place at HP, which aims to reduce its workforce by 55,000 by the end of fiscal 2015. Nearly 4,000 people were laid off in the most recent quarter.

Perhaps unsurprisingly to those that have been following the company for some time, each segment reported a decline in revenue for the period. The biggest loser was the firm's Enterprise Services segment--~20% of 2014 revenue—where sales fell 16% in the quarter. Speaking on the goal of improving execution despite top-line struggles, operating profit for the segment showed an increase for the quarter. Personal Systems, HP's largest segment by percentage of revenue at ~30%, performed well compared to expectations in a softening market. The division's revenue was flat on a constant currency basis, and down 5% on a reported basis.

Revenue in the company's second-largest segment, its Enterprise Group segment, fell only 1% on a reported basis and was buoyed by positive momentum from industry standard servers, strength which is expected to continue in the second half of the fiscal year. HP's printing segment, an expected source of growth for the separating company in coming years, reported a decline of 7%. Management pointed to a highly-competitive market, aggressive pricing from overseas competitors, and currency headwinds as explanations for poor top-line performance of the segment that delivered ~20% of 2014 revenue.

HP also provided an update on the separation plan it announced last October in its recent report. As a quick recap, the reasons for the separation are to 1) provide a sharper focus on markets served, 2) increase ability to adapt and shift more rapidly, and 3) provide an increased connection between results and rewards for shareholders. HP's management feels the separation will satisfy the need to act with greater speed and agility in order to compete effectively in a world where technologies, markets and consumer expectations are changing more rapidly than ever. We tend to agree.

Please see *HP*...on next page

***HP*...from previous page**

The two new publically traded companies will be Hewlett-Packard Enterprise, which will include HP's Enterprise Group, Enterprise Services, Software, and Financial Services segments, and HP Inc., which will include HP's Personal Systems and Printing segments. Management expects the separation to accelerate its turnaround plan and offer the ability to increase focus on long-term growth and profitability. The targeted completion date is October 2015.

It doesn't take much to realize the near-term for HP is less than exciting, and the current turnaround plan is focused on the long-term health of the company, so investors shouldn't expect great improvements to come quickly. The firm's most recent earnings report, which was generally in line with management's expectations, supports such a view. We like the separation of the company into two smaller entities in theory. HP has simply gotten too big to maintain the laser-focus needed to compete as effectively as it once did across all of its rapidly-developing end markets.

Whether or not the two companies that eventually emerge from the separation will be able to effectively execute the goals of the turnaround plan remains to be seen. We aren't ready to dive in just yet, and we point to Apple (AAPL) and Microsoft (MSFT) as two of our ongoing favorites in large cap technology. Both are trading below fair value and have fantastic long-term growth prospects.

Are Corporate Credit Ratings Really Useful?

This article was originally published on our website www.valuentum.com.

By Brian Nelson, CFA

There is no way… hold on, let me start over.

There is *absolutely* no way that a company whose primary product price can fall 50% or more in a couple months is a pristine AAA-rated credit. It makes little sense. Having evaluated the credits of hundreds of companies spanning all sectors and industries, you're never going to convince me that such a business model is worthy of a coveted AAA credit rating.

Never.

This week, Standard & Poor's (MHFI) reiterated Exxon Mobil's (XOM) AAA rating, as if the conditions that shellacked the energy markets the past 6 months simply do not apply to Exxon. Instead, the rating agency opted to lower the firm's liquidity rating from "strong" to "adequate." If you're scratching your head at this point, so are we. From our perspective, S&P likely didn't want to send reverberations through the credit markets with a headline-making downgrade, not that we think it would have been material in any case. The bond markets tend to price credit risk well in advance of any moves by the rating agencies.

Throwing aside the fact that crude oil prices have collapsed in recent months resulting in Exxon's cash flow from operations being practically cut in half from last year's first-quarter levels on a GAAP basis ($8 billion versus $15.1 billion), the company's net balance sheet is weaker and the firm is significantly more capital intensive than either of the two other credits it shares the AAA rating with--Microsoft (MSFT) and Johnson & Johnson (JNJ). If we assume mid-single-digit annual cash dividend expansion relative to a high-single-digit pace for J&J and double-digit growth rate for Microsoft, Exxon's dividend obligations are also quite hefty.

Neither the volatility of its business model, nor the relative comparison of its balance sheet and free cash-flow generating capacity on a forward-looking basis support Exxon's credit rating. And our forecasts factor in a return to normalcy in the crude-oil markets! It's time for a true downgrade. Exxon is no longer a AAA-rated credit in my book. S&P has this one wrong.

Target or Walmart?

By Brian Nelson, CFA

It's not the roaring 1990s anymore, investors!

There are serious risks to the business models of Target (TGT) and Walmart (WMT), and everyone is looking the other way, consoling themselves with their steady and growing stream of dividends. These investors say, "as long as they pay the dividend, I don't care," as if this signals a proud achievement in some way, by which many experienced market participants will then respond, "and now we know why the individual investor is frequently blindsided."

The dividend is a symptom of the health of free cash flow, and management teams can dip into the balance sheet to support the payout. Only trends in free cash flow generation, supported by moaty business models, speak to the strength of a company's underlying fundamentals – this is not a matter of opinion, but a matter of fact. Business owners all over the world know that cash flow is their most important asset—not what they pay out as a distribution in any given year. Shareholders are business owners.

Like a master magician, executive teams draw the attention of the investors to a source of distraction (an increasing dividend) away from the chosen object of analysis worthy of attention (the business and future free cash flows). The causes of a distraction are varied: "the lack of ability to pay attention; lack of interest in the object of attention, or the great intensity, novelty or attractiveness of something other than the object of attention." Are you attracted only by the dividend? Then, the master magicians in the executive suite are having their way with you. It's the card up their sleeve. The dividend is just one of many important things, and you should know this by now.

Let's get to Target and Walmart.

First, there is one reason that we are vitally concerned with the long-term picture at Target, and we'll talk about this in depth. Second, there are two reasons why we think Walmart's long-term picture is bleak, albeit both of the factors at Walmart arguably apply to Target's business model, too. Now, don't get us wrong. Let's be clear. Are Target and Walmart fantastic free cash flow generators? Absolutely. Do Target and Walmart have substantial competitive advantages? Absolutely. Will Target and Walmart continue to pay their dividends for the foreseeable future? Absolutely.

These aren't the points we are addressing. Every business will have strengths and weaknesses, and in this piece, we'd like to address the ones most prevalent on our minds – both for brevity and relevancy. Target's and Walmart's 16-page stock reports and the commentary archives on them can be accessed on their respective landing pages. So, when we speak of concerns, we're talking about fundamental dynamics, and how they may come back to impede future earnings and cash-flow performance, perhaps not in the next year or two, but in the next 5 to 10 years.

For those that may have missed the event, Target closed the last of its 133 retail stores in Canada April 12, laying off 17,000 employees and taking a $5.1 billion quarterly charge. The justification for leaving Canada boiled down to the following rather unusual short-term oriented statement: "Unfortunately, we were unable to find a realistic scenario that would get Target Canada to profitability until at least 2021." Six years? Just six years? This is a blink-of-an-eye for most long-term investors. But yet, complete abandonment? We didn't think the problems in Canada were unfixable. Inventory, pricing, and branding should be core competencies for any retailer. After all, there are successful retailers in Canada, and Target's one of the best in the US. It should have worked.

Right?

Here's what you need to know – and here's the real reason why Target abandoned Canada.

Please see *Target or Walmart...*on page 13

Stocks with High Valuentum Buying Index Ratings and Strong Dividend Growth Prospects

By Valuentum Analysts

The table below showcases firms in our coverage universe that have high Valuentum Buying Index™ ratings and strong dividend growth prospects. The table represents a list of interesting dividend-paying stocks that are *among* the most timely dividend growth ideas based on our stock-selection methodology. You'll see that many of them are already holdings in our Dividend Growth portfolio (see page 5).

Though our dividend-growth portfolio is near fully-invested, we may swap in firms on this list or firms on our dividend-growth watch list (see the next page) at the right price or if our analyst team determines that a new add has more potential total return opportunity than a current holding. At any time, however, our favorite dividend growth ideas are included in the Dividend Growth portfolio.

Company Name	Symbol	Industry	Div Yield	VBI	Div Growth	Div Cushion
Collectors Universe	CLCT	Leisure	6.1%	6	GOOD	1.3
Corrections Corp	CXW	Management Services	5.5%	7	EXCELLENT	1.3
Universal Health Realty	UHT	REIT - Healthcare	5.0%	6	GOOD	2.2
LTC Properties	LTC	REIT - Healthcare	4.6%	6	EXCELLENT	1.6
Brookfield Infrastructure	BIP	Utilities	4.5%	6	GOOD	0.9
Meridian	VIVO	Diagnostic Substances	4.5%	7	GOOD	1.7
Verizon	VZ	Telecom Services - diversified	4.4%	7	GOOD	2.0
Realty Income Corp	O	REIT - Retail	4.4%	6	EXCELLENT	2.0
Rio Tinto	RIO	Mining - diversified	4.2%	6	EXCELLENT	1.9
Healthcare Realty Trust	HR	REIT - Healthcare	4.2%	6	GOOD	2.1
Ventas	VTR	REIT - Healthcare	4.1%	6	EXCELLENT	1.6
Tupperware	TUP	Containers & Packaging	4.0%	6	EXCELLENT	1.3
Entergy	ETR	Utilities - Large	4.0%	6	GOOD	1.5
Retail Properties of America	RPAI	REIT - Retail	3.8%	6	EXCELLENT	2.8
Unilever N.V.	UN	Food Products - Large	3.8%	7	EXCELLENT	1.3
Reynolds American	RAI	Tobacco	3.8%	6	GOOD	1.2
Superior	SUP	Auto Parts Suppliers	3.7%	6	GOOD	2.2
Unilever PLC	UL	Food Products - Large	3.7%	7	EXCELLENT	1.3
General Electric	GE	Conglomerates	3.7%	7	GOOD	2.0
Computer Prog and Syst	CPSI	Medical Srvc Providers	3.6%	6	EXCELLENT	1.6
GameStop	GME	Specialty Retailers	3.6%	6	EXCELLENT	3.3
DDR	DDR	REIT - Retail	3.6%	6	EXCELLENT	2.5
Thomson Reuters Corp	TRI	Securities Research	3.5%	7	GOOD	1.2
Ameren	AEE	Utilities	3.5%	6	GOOD	1.5

At any time, our favorite dividend growth ideas are included in the Dividend Growth portfolio, page 5.

The Dividend Growth Watch List

By Valuentum Analysts

The dividend growth watch list, which is proprietary to the Dividend Growth Newsletter, showcases firms commonly held in many dividend growth portfolios. As with the list on the previous page, we may replace firms held in the Dividend Growth portfolio (see page 5) with companies found in the table below should their dividend growth potential (and/or total return potential) become relatively more attractive than portfolio constituents'. We find tremendous value in keeping track of dividend growth firms in order to better monitor ideal entry points. We continue to scour our coverage universe for firms to add to our dividend growth watch list, which we update in every edition of our Dividend Growth Newsletter.

DIVIDEND GROWTH WATCH LIST - as of June 1, 2015

Company Name	Yrly Div's Paid ($) / Shr	Div Yield %	Div Cushion™	Div Safety	Div Growth	Fair Value	VBI Score	Price/Fair Value	Price ($)
3M (MMM)	4.10	2.58%	1.6	GOOD	EXCELLENT	$134.00	6	1.19	158.98
Abbott (ABT)	0.96	1.96%	3.2	EXCELLENT	GOOD	$43.00	3	1.14	48.94
AbbVie (ABBV)	2.04	3.05%	1.9	GOOD	EXCELLENT	$71.00	3	0.94	66.93
ADP (ADP)	1.96	2.30%	6.0	EXCELLENT	EXCELLENT	$94.00	3	0.91	85.30
Analog Devices (ADI)	1.60	2.33%	2.3	GOOD	EXCELLENT	$53.00	6	1.30	68.75
Becton, Dickinson (BDX)	2.40	1.70%	2.7	GOOD	EXCELLENT	$169.00	6	0.83	140.82
Bob Evans (BOBE)	1.24	2.70%	1.7	GOOD	EXCELLENT	$46.00	4	1.00	45.94
Boeing (BA)	3.64	2.58%	2.5	GOOD	EXCELLENT	$141.00	6	1.00	141.25
Chicago Rivet (CVR)	0.72	2.39%	2.9	EXCELLENT	GOOD	$33.00	6	0.91	30.18
Coca-Cola (KO)	1.32	3.22%	1.9	GOOD	EXCELLENT	$43.00	4	0.95	40.94
Colgate-Palmolive (CL)	1.52	2.27%	1.8	GOOD	POOR	$58.00	3	1.15	66.90
Collectors Universe (CLCT)	1.40	6.54%	1.3	GOOD	GOOD	$21.00	6	1.02	21.42
Cracker Barrel (CBRL)	4.00	2.86%	1.4	GOOD	GOOD	$130.00	6	1.08	139.79
Deere (DE)	2.40	2.59%	1.3	GOOD	EXCELLENT	$99.00	6	0.94	92.64
Dover (DOV)	1.60	2.13%	2.1	GOOD	EXCELLENT	$77.00	4	0.98	75.17
DuPont (DD)	1.96	2.74%	2.1	GOOD	GOOD	$66.00	6	1.09	71.64
Eli Lilly (LLY)	2.00	2.53%	2.0	GOOD	GOOD	$61.00	6	1.30	79.00
Exxon Mobil (XOM)	2.92	3.43%	1.3	GOOD	EXCELLENT	$83.00	6	1.03	85.13
General Dynamics (GD)	2.76	1.97%	3.6	EXCELLENT	EXCELLENT	$122.00	3	1.15	140.25
Genuine Parts (GPC)	2.46	2.73%	1.8	GOOD	EXCELLENT	$84.00	6	1.07	90.23
H&R Block (HRB)	0.80	2.51%	4.2	EXCELLENT	GOOD	$34.00	6	0.94	31.86
Harris (HRS)	1.88	2.36%	1.8	GOOD	EXCELLENT	$77.00	3	1.04	79.70
Honeywell (HON)	2.07	1.99%	3.0	EXCELLENT	EXCELLENT	$99.00	7	1.05	104.06
Hormel Foods (HRL)	1.00	1.75%	3.1	EXCELLENT	EXCELLENT	$45.00	4	1.27	57.07
IBM (IBM)	5.20	3.06%	2.4	GOOD	EXCELLENT	$170.00	6	1.00	170.18
Illinois Tool Works (ITW)	1.94	2.07%	2.6	GOOD	EXCELLENT	$82.00	6	1.14	93.78
Kimberly-Clark (KMB)	3.52	3.22%	1.1	GOOD	GOOD	$99.00	4	1.10	109.15
Lockheed Martin (LMT)	6.00	3.14%	1.7	GOOD	EXCELLENT	$169.00	6	1.13	191.07
Merck (MRK)	1.80	2.96%	2.2	GOOD	GOOD	$54.00	6	1.13	60.75
Northrop Grumman (NOC)	3.20	2.00%	2.8	EXCELLENT	EXCELLENT	$137.00	6	1.17	159.94
Occidental Petrol (OXY)	3.00	3.80%	1.3	GOOD	EXCELLENT	$78.00	3	1.01	78.89
Owens & Minor (OMI)	1.01	3.01%	1.7	GOOD	EXCELLENT	$33.00	4	1.02	33.50
Paychex (PAYX)	1.52	3.08%	2.9	EXCELLENT	EXCELLENT	$42.00	6	1.18	49.41
Phillip Morris (PM)	4.00	4.81%	0.5	GOOD	GOOD	$71.00	4	1.17	83.19
Raytheon (RTN)	2.68	2.59%	2.8	EXCELLENT	EXCELLENT	$92.00	6	1.13	103.51
St. Jude (STJ)	1.16	1.56%	3.3	EXCELLENT	EXCELLENT	$67.00	7	1.11	74.39
Texas Instr (TXN)	1.36	2.44%	1.9	GOOD	EXCELLENT	$53.00	6	1.05	55.71
United Technologies (UTX)	2.56	2.19%	1.9	GOOD	EXCELLENT	$119.00	7	0.98	117.00
UPS (UPS)	2.92	2.94%	2.0	GOOD	EXCELLENT	$102.00	6	0.98	99.48
VF Corp (VFC)	1.28	1.82%	2.3	GOOD	EXCELLENT	$63.00	7	1.11	70.21
Verizon (VZ)	2.20	4.47%	2.0	GOOD	GOOD	$56.00	7	0.88	49.22
Walgreens (WBA)	1.35	1.57%	1.8	GOOD	EXCELLENT	$69.00	6	1.25	85.98
Wal-Mart (WMT)	1.96	2.62%	1.5	GOOD	EXCELLENT	$79.00	3	0.95	74.73

UR = Under Review

Yields to Avoid

By Valuentum Analysts

As many investors know, firms can often become cheap for good reasons. That is, they are not trading cheaply because of Mr. Market's irrational behavior, but instead are trading at depressed levels due to deteriorating underlying fundamental characteristics that actually justify its current share price, even if traditional valuation techniques suggest the firm's shares are inexpensive. On a similar note, firms that boast high dividend yields may do so because the market has little confidence in the sustainability of its dividend and believes a cut may be just around the corner.

Though we fall short of saying the following list of firms will slash their respective dividends anytime soon, our dividend-cut predictive indicator—the Valuentum Dividend Cushion™--indicates that the firms below are at significant risk for a dividend cut in coming years. We think the dividend-growth investor should steer clear of the following firms' shares.

Company Name	Symbol	Industry	Est Div Yield	Div Safety	Div Cushion
Peabody Energy	BTU	Industrial Minerals	0.2%	VERY POOR	-318.4
KB Home	KBH	Homebuilders	0.6%	VERY POOR	-47.8
Lennar	LEN	Homebuilders	0.4%	VERY POOR	-46.0
Range Resources	RRC	Independent Oil & Gas	0.3%	VERY POOR	-16.1
Ryder System	R	Rental and Leasing	1.6%	VERY POOR	-14.1
D. R. Horton	DHI	Homebuilders	1.0%	VERY POOR	-12.4
CONSOL Energy	CNX	Industrial Minerals	0.8%	VERY POOR	-11.1
Yamana Gold	AUY	Metals & Mining - gold	1.5%	VERY POOR	-10.6
Chesapeake	CHK	Independent Oil & Gas	1.8%	VERY POOR	-8.0
Cablevision	CVC	Media - CATV	2.9%	VERY POOR	-7.7
Barrick Gold	ABX	Metals & Mining - gold	1.6%	VERY POOR	-7.3
Pioneer Natural Resources	PXD	Independent Oil & Gas	0.1%	VERY POOR	-6.0
Tidewater	TDW	Energy Equipment	3.0%	VERY POOR	-5.3
Cliffs Natural Resources	CLF	Mining - diversified	8.4%	VERY POOR	-5.2
Newmont Mining	NEM	Metals & Mining - gold	0.4%	VERY POOR	-4.7
Hess	HES	Refiners	1.4%	VERY POOR	-4.2
Textainer	TGH	Rental and Leasing	5.6%	VERY POOR	-3.9
Apache	APA	Independent Oil & Gas	1.6%	VERY POOR	-3.4
TAL Intl	TAL	Rental and Leasing	7.0%	VERY POOR	-3.4
MDC	MDC	Homebuilders	4.0%	VERY POOR	-3.2
Murphy Oil	MUR	Refiners	3.1%	VERY POOR	-2.4
Windstream	WIN	Telecom Services - diversified	10.0%	VERY POOR	-1.9
Noble Energy	NBL	Independent Oil & Gas	1.5%	VERY POOR	-1.9
Koppers	KOP	Building Materials	5.1%	VERY POOR	-1.8
Frontier Comm	FTR	Telecom Services - diversified	5.8%	VERY POOR	-1.5
DineEquity	DIN	Restaurants - Fast Cas & Full Svc	3.2%	VERY POOR	-1.5
Quad/Graphics Inc	QUAD	Book Publishing	5.4%	VERY POOR	-1.5
Time Warner Cable	TWC	Media - CATV	1.6%	VERY POOR	-1.4
Centurylink	CTL	Telecom Services - diversified	5.3%	VERY POOR	-1.4
Service Corp Intl	SCI	Personal Services	1.6%	VERY POOR	-1.3
Cimarex	XEC	Independent Oil & Gas	0.6%	VERY POOR	-1.2
Allegheny Technologies	ATI	Aluminum	2.4%	VERY POOR	-1.1
Regal	RGC	Movie Production	3.9%	VERY POOR	-1.0
ConAgra Foods	CAG	Food Products - Large	2.7%	VERY POOR	-1.0

The Valuentum Dividend Cushion™ has an excellent track record of predicting dividend cuts. For more information, please select the following link (login required):

http://www.valuentum.com/articles/20130528

*Target or Walmart...*from page 9

At the beginning of 2014, the incentive committee at Target added ROIC as a third metric to its performance stock unit plan (measured through 2017). According to the new incentive plan, the Canadian Segment would be "included in ROIC to ensure participants are held accountable for the significant startup investment related to this key growth initiative." Brian Cornell joined Target as board chairman and the new CEO in August 2014. Did you really think the new head honcho was going to spend his first six years on the job languishing over building a business in Canada, while receiving no incentive pay for such efforts? We think not. Hence, the exit from Canada ensued, for good or bad.

From our perspective, however, by abandoning Canada, Target has effectively capped the size of its company. As perhaps many of our Canadian friends would agree, the US and Canada aren't too different. In fact, we can't think of many differences at all. However, Target's foray into Canada and its rapid abandonment of its efforts in the country reveal something terribly wrong with the transportability of its franchise--and an incentive structure at the top that's still too near-term focused. We learned about the superiority of ROIC over operating EPS targets in incentive structures with respective to the example with IBM (IBM), but the length of the measurement period of an incentive plan is important as well. It's very possible that a 10-year incentive program as it relates to Target's Canadian business would have kept top brass in the game.

In 2021, we think Target investors will look back and say, "We could have had a profitable Canada by now." It's very probable, and we can't wait to find out.

Let's now move on to Walmart.

First, we won't belabor this issue, but the well-documented view of encroaching online competition from Amazon (AMZN) and from dollar-store retailers such as Dollar General (DG) and Dollar Tree (DLTR) is only worth a brief mention, and we'll now move on. 'Nuff said, as you may say.

Second, Walmart is at the center of political upheaval in America. The company has become the poster child for all of what many believe is unfair pay practices, and this will be difficult to overcome as the ranks of millenials swell. We talked about the frightening path of labor expenses in this piece here, but they won't abate…at least not anytime soon. We nearly fell out of our desk chairs when we heard the country's second-largest city Los Angeles was raising its minimum wage to $15 per hour over time, following the lead set by Seattle. It didn't just pass – the City Council voted 14-to-1 in favor!

With product prices under pressure and labor costs on the rise, something's got to give. *It really doesn't take a mathematician* to understand that Walmart is simply getting squeezed and may be in a lot of trouble over the long haul. As for the minimum wage hikes, we don't know how workers will fare during the next recession, which is an inevitable part of the cycle, but when revenue falls and labor-costs-per-person have price floors, the only response is layoffs. Both Target and Walmart know it.

Could our social programs in raising wage floors be setting us up for one of the worst economic periods in history – the next recession? We're not ruling it out, but that's a topic for another day.

"Everyone has the brainpower to follow the stock market. If you made it through fifth-grade math, you can do it." – Peter Lynch

What's The Deal with US Housing?

By Brian Nelson, CFA

Pictured: An unfinished sub-division in rural Illinois, May 2015.

Better weather is here, and housing construction is booming.

The US Census Bureau's latest tally for the seasonally-adjusted annualized rate of housing starts in April came in at 1.14 million, up an incredible 20% from the revised March estimate of 944k (sequentially) and up 9% from the April 2014 rate (year-over-year). That's some nice expansion, to say the least.

Our long-held indirect plays on the US housing recovery have been a couple of ETFs, which focus on an improving consumer credit environment and incremental loan growth from the depths of the Financial Crisis. The two ETFs can be found in the Best Ideas Newsletter portfolio, and we continue to believe that they are the best indirect way to play improving housing strength in the States. These two ETFs are the Financial Select SPDR (XLF) and the SPDR S&P Bank ETF (KBE).

Our overall views on seeking direct exposure to the US housing market is best summed up in our ETF report that covers the Consumer Discretionary sector, which can be downloaded here (pdf). We encourage readers to download that piece, and read it. There's a lot of context behind our views on US housing and the builders, in general. Our biggest concern—and this is not a new one—is that the best period of economic growth in this decade may be behind them. Though we will see fits and starts (e.g. housing starts in April), we're entering into a period of contractionary monetary policy and slower economic growth. That just doesn't bode well for direct housing plays, in our view.

But for investors seeking such exposure, there are a couple diversified options.

Within our coverage, two consumer discretionary ETFs have a focus on construction and homebuilding, the SPDR S&P Homebuilders ETF (XHB) and the iShares U.S. Home Construction ETF (ITB). State Street's XHB is a more varied play on the drivers of the US housing market and is not as tied to the fundamentals of the homebuilders themselves, unlike that of the ITB. Out of the top 10 holdings of the XHB, for example, only four are homebuilders, weighted collectively

Please see *US Housing ...*on next page

*US Housing...*from previous page

at ~15% of the fund. The XHB may be the best ETF to consider for investors seeking diversified exposure to housing-related companies, in general. However, for investors pursuing diversified and direct exposure to the homebuilders, the ITB may be the most relevant option for them. For example, the top 5 holdings in the ITB, which are all homebuilders--Lennar (LEN), DR Horton (DHI), PulteGroup (PHM), Toll Brothers (TOL) and NVR (NVR)—account for over 40% of fund assets.

Though investors may consider dabbling in the builders to capture the latest fumes of this bull market, we're not very enthused by the home improvement retailers—Home Depot (HD) and Lowe's (LOW)—even as we say we very much like their economic returns and long-term growth prospects. As with any investment, the return to the investor is principally based on the price paid for the asset (stock), and even strong companies can turn into poor investments if initiated at the wrong price. This is the problem challenging a new investment in the home-improvement retailers at the moment.

Home Depot is delivering strong comparable store sales growth, as it did during its fiscal first-quarter results, but the cyclical nature of the housing market is undeniable. As with many consumer discretionary entities, the market is pricing Home Depot as if it is a secular growth story tied to steadily-growing (or stable) end markets. The housing bust of the last decade showed us that this just isn't the case. Home Depot and rival Lowe's are two of the most overvalued stocks on the market today. We're not happy to say so, but their valuations are stretched, unfortunately.

Our US housing exposure continues to be indirect and tied to diversified securities levered to improving consumer credit and incremental loan growth. The aforementioned financials ETFs fit the bill.

A Tale of Two Companies: Duality in the Valuentum Buying Index

By Kris Rosemann

Let's take a look at two firms that have been at opposite ends of our Valuentum Buying Index. At the high end of the scale we have American International Group (AIG). The firm has been rated a 9 on the VBI scale--which rates companies on a scale of 1-10--for years now. Our low-end example will be Lumber Liquidators (LL). While the firm's poor rating may seem like an obvious call, the importance of our rating is based on timing, which will be expanded upon shortly. Let's take a look at both of these companies, the factors that have caused them to receive their respective VBI ratings, and what is currently driving their businesses.

We'll begin with AIG, the high-end company. Members know that we're not fans of the investment prospects of the insurance industry, but they also know that we have liked AIG for some time. We were saying that shares were attractive as early as November 2012, and we reiterated the opinion that AIG was our favorite idea in the insurance industry in November 2013. As of our most recent update of the insurance industry, the company registers a 9 on the Valuentum Buying Index, and our fair value estimate stands at $75+ per share. Shares are currently trading at ~$60.

As can be seen in the graph below, AIG has been enjoying quite the bull run in recent years, and we don't expect it to stop anytime soon. Shares recently reached their highest point since 2011. Management remains focused on the deployment of capital to enhance long-term returns, while prudently managing liquidity and capital risks. The firm reported solid results in the first quarter of 2015, indicating that it is on track with its long-term goals. After-tax operating income for the period was $1.7 billion, flat when compared to the year-ago period, but first-quarter book value per share excluding accumulated other comprehensive income (AOCI) and deferred tax assets (DTA) grew 14% from the first quarter of 2014, to $60.69.

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*A Tale of Two Companies…*from previous page

Balance sheet improvements remain a focus at AIG. The company reduced its debt by over $10 billion in 2014 and has continued to improve its risk profile thus far in 2015. These actions have contributed to the decision of management to continually repurchase shares; it repurchased ~$1.4 billion of shares in the first quarter, as well as ~$800 million more in the month of April. Additionally, on April 30, the firm's board of directors authorized the repurchase of up to $3.5 billion worth of shares. Since we value AIG's shares above its current market price, we would view any buyback activity as value-creating.

Our Valuentum Buying Index rating of 9 remains unchanged upon the latest update, and we continue to expect upside. Our fair value estimate of $75+ per share is certainly attainable and considers only modest improvement in return on equity and value-generating capacity. Shares of AIG remain our favorite idea in the insurance space.

Let's turn to our low-end example, Lumber Liquidators, which has had a history of poor VBI ratings. The firm has hit tough times of late and is currently attempting to navigate through a public relations nightmare. There have been concerns over its sourcing practices and the resulting impact on gross profits. Investigators are looking for evidence the company imported wood products from forests in far eastern Russia that are home to the endangered Siberian tiger. Adding to the public relations nightmare was a '60 Minutes' segment in early 2015 that revealed that Lumber Liquidators Chinese-made laminate flooring may be using an elevated amount of harmful chemicals (formaldehyde). The company claims its products are compliant, but perception may hurt sales.

Lumber Liquidators' most recent quarterly results are showing signs of the negative publicity and regulatory actions against the firm. Though sales grew 5.6% from the year-ago period, net income declined from a positive $13.7 million in the same period in 2014 to a net loss of $7.8 million in the first quarter of 2015. A 23.8% increase in SG&A expenses is mostly to blame for the loss. The stark increase was primarily due to a ~$10 million non-deductible accrual for a regulatory matter resulting from the investigation of the firm's sourcing practices.

Please see *A Tale of Two Companies…*on next page

*A Tale of Two Companies...*from previous page

So far in the second quarter of 2015, the effects of the '60 Minutes' scandal have been impactful. Sales were down ~2% through the month of April, with sales at comparable stores of the comparable year-ago period being down over 7%, and a ~6% decrease in number of customers invoiced. Much like the quality of its laminate flooring, the reputation of the company has been tainted, at least temporarily. Adding to the upheaval within the firm, it agreed to terminate its CFO, effective June--and the firm's CEO just resigned unexpectedly.

The previously mentioned events aren't new news if you've been following the firm lately, so the significant share price drop may not have surprised many. However, the importance of the company's poor VBI rating is timing. In the chart below, the historical VBI ratings for Lumber Liquidators can be seen.

LL Rating History	Price	Fair Value	VBI
27-Feb-15	$51.86	$54.00	4
19-Sep-14	$58.00	$57.00	3
11-Apr-14	$85.68	$88.00	3
6-Dec-13	$104.20	$75.00	1
30-Aug-13	$99.42	$63.00	4
26-Apr-13	$82.63	$51.00	4
1-Feb-13	$58.94	$43.00	4
28-Sep-12	$50.68	$30.00	2
8-Jun-12	$30.26	$23.00	4
3-Feb-12	$22.38	$18.00	6
28-Oct-11	$15.33	$15.00	4

Notice that near the peak of the firm's bull run at the end of 2013 our index was prepared to make a call that some investors may have scoffed at. With a rating of 1 in December 2013 (when shares were over $100 each), those following Valuentum methodology would have received a very serious warning. As is displayed in the chart above, the market has been anything but kind to share prices since that time, and shares are now trading at ~$21. We hope you didn't try to catch this falling knife. We sure didn't.

The importance of these examples is the potential that the VBI has in identifying investment options that have a strong likelihood of equity price appreciation, or depreciation in the case of Lumber Liquidators. In both, the three pillars of the index--DCF valuation, relative valuation, and technicals/momentum--came together to provide an accurate forecast of what to expect from the companies.

FAQ: What's the Best Way to Use the Valuentum Process?

By Brian Nelson, CFA

A version of this article was originally published in August 2012.

First and foremost, firms in our Best Ideas portfolio should be considered our best ideas at any point in time. The Best Ideas portfolio can always be found on page 8 of our monthly Best Ideas Newsletter. Firms in our Dividend Growth portfolio should be considered our best dividend growth ideas at any point in time. The Dividend Growth portfolio can always be found on page 5 of our monthly Dividend Growth Newsletter.

Let's talk about how the Valuentum Buying Index (VBI) informs which ideas we include in our actively-managed portfolios. We've noticed via our statistical backtesting that the momentum factor behind our process tends to be much more pronounced (powerful) over longer periods of time. This was one of

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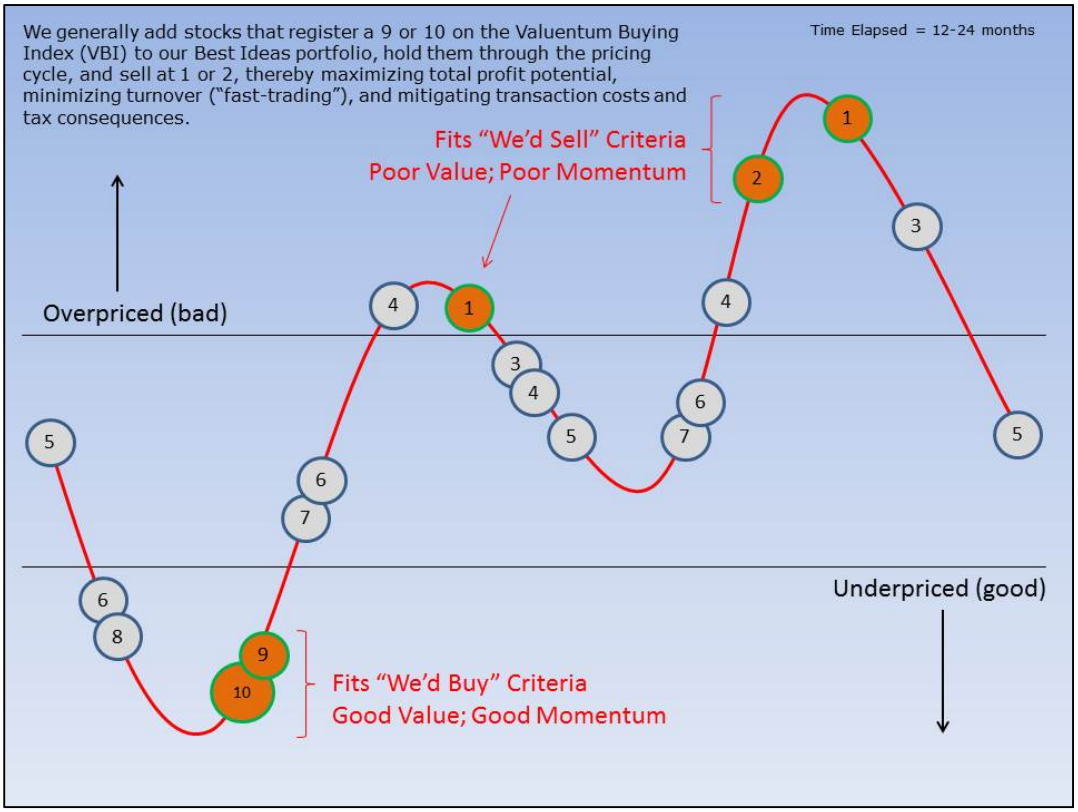
the interesting findings of our academic white paper study. We try to replicate this dynamic with the update cycle of our reports (and the time horizon for our ideas to work out). That's why our reports are updated regularly (at least quarterly) or after material events and not daily or weekly. We don't want to whipsaw our membership, nor do we think churn is the way to generate outperformance.

Though the time frame varies depending on each idea, we expect our best ideas to work out over a 12-24 month time horizon (on average) -- any shorter than that is mostly luck, in our view. We tend to add firms to our Best Ideas portfolio when they register a 9 or 10 on our Valuentum Buying Index (VBI) and tend to remove firms from our Best Ideas portfolio when they register a 1 or 2 on our VBI. You'll notice that we have a qualitative overlay in the portfolio, which is necessary and similar in thinking as if you were to imagine a value investor not adding every undervalued stock to his/her portfolio. There are always tactical and sector weighting considerations in any portfolio construction.

As for the time horizon for ideas, we like to maximize profits on every idea, with the understanding that momentum does exist and that prices over and under shoot intrinsic value all of the time. A value strategy (10 --> 5) truncates potential profits, while a momentum strategy (4 --> 1) ignores profits generated via value assessments. We're after the entire profit potential. So, for example, if a firm is added to the Best Ideas portfolio as a 10 and is removed as a 5, we would have tuncated profit potential. Most of our highly-rated Valuentum Buying Index rated stocks have generated the vast outperformance of the Best Ideas portfolio. Please view the pricing cycle below.



Importantly, regarding our process, we don't blindly and immediately add firms to our portfolio once they score a 9 or 10 (and we do not add all firms that score a 9 or 10 to our portfolio). For example, Google

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(GOOG), a current Best Ideas portfolio holding, registered a 10 on our scale, but we remained patient and didn't add the company to our portfolio until after it reported earnings in late 2012, which provided us with an even better entry point (as new information came to light). We engage in a qualitative portfolio management overlay to maximize returns and minimize risk. The number informs our process, but the team makes the allocation decisions of the portfolio.

After adding firms to our Best Ideas portfolio, we may tactically trade around these positions when they have VBI ratings between 3 and 8 depending on the size of their weighting in our portfolio or their attractiveness relative to other opportunities (a score of 3 through 8 is typically equivalent to a 'we'd hold'). We tend to remove firms from our Best Ideas portfolio when they register a 1 or 2 on our process. Importantly, however, firms in our Best Ideas portfolio, which have generally registered a 9 or 10 on our scale when we added them, should be considered our best ideas at any point in time.

Take eBay (EBAY) as another example of our process in action. The firm initially flashed a rating of 10 in late September 2011 (at $32 per share), and we added it to our Best Ideas portfolio. The VBI rating changed to a 6 in December 2011 and then back to a 10 in May 2012. Because the rating never breached a 1 or 2, we did not remove the position from our portfolio. In fact, we tactically added to it. eBay is probably one of the better examples to use for illustrating the prolonged outperformance driven by undervalued stocks that are beginning to generate good momentum. We like to capture the entire pricing cycle and not truncate it as most value investors do.

Though eBay may register a lower VBI rating in a subsequent update, we would still view it as one of our best ideas, as it is a holding in our Best Ideas portfolio (it has never flashed a 'We'd Sell' signal, 1 or 2). Obviously, there have been more straight-forward opportunities in our Best Ideas portfolio, especially in the case of EDAC Tech (EDAC), which had tripled since we added it to the portfolio (never registering below a 9 along the way). The VBI ratings on our most recent 16-page reports, downloadable directly from our website, reflect our current opinion on the company. Illustrations of share price appreciation and our initial positions for EBAY and EDAC can be seen below.

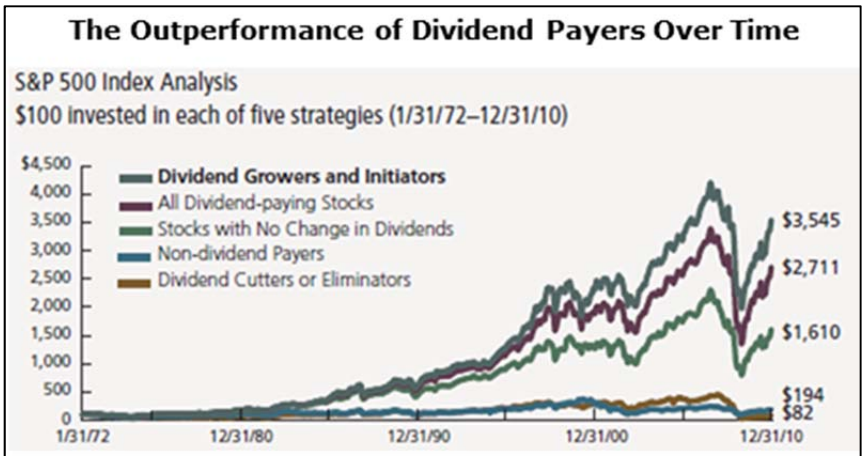
The Valuentum Buying Index, like all methodologies, informs the investment decision process, but in constructing a portfolio, a qualitative overlay is not only necessary but has been shown to optimize performance in the white paper study.

Please let us know if you have any further questions at info@valuentum.com.

About the Valuentum Dividend Cushion™

By Valuentum Analysts

History has revealed that the best performing stocks during the previous decades have been those that shelled out ever-increasing cash to shareholders in the form of dividends. In a recent study, S&P 500 stocks that initiated dividends or grew them over time registered roughly a 9.6% annualized return since 1972 (through 2010), while stocks that did not pay out dividends or cut them performed poorly over the same time period.



Source of the chart data: Ned Davis Research, 12/31/10. Image Source: Capital Markets Perspectives, "Investing for Dividend Growth", Oppenheimer Funds. Based on an equal-weighted geometric average of total return of dividend-paying historical S&P 500 Index stocks, rebalanced annually. The chart uses actual annual dividends to identify dividend-paying stocks and changes on a calendar-year basis. Past performance does not guarantee future results.

Such analysis is difficult to ignore, and we believe investors may be well-rewarded in future periods by finding the best dividend-growth stocks out there. As such, we've developed a rigorous dividend investment methodology that uncovers firms that not only have the safest dividends but also ones that are poised to grow them long into the future.

How did we do this? Well, first of all, we scoured our stock universe for firms that have cut their dividends in the past to uncover the major drivers behind the dividend cut. This is what we found out: The major reasons why firms cut their dividend had to do with preserving cash in the midst of a secular or cyclical downturn in demand for their products/services or when faced with excessive leverage (how much debt they held on their respective balance sheets).

The Importance of Forward-Looking Dividend Analysis

Armed with this knowledge, we developed the forward-looking Valuentum Dividend Cushion™, which is a ratio that gauges the safety of a dividend over time.

Most dividend analysis that we've seen out there is backward-looking – meaning it rests on what the firm has done in the past. Although analyzing historical trends is important, we think assessing what may happen in the future is even more important. The S&P 500 Dividend Aristocrat List, or a grouping of firms that have raised their dividends for the past 25 years, is a great example of why backward-looking analysis can be painful. One only has to look over the past few years to see the removal of well-known names from the Dividend Aristocrat List (including General Electric and Pfizer) to understand that backward-looking analysis is hardly worth your time. After all, you're investing for the future, so the future is all you should care about.

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We want to find stocks that will increase their dividends for 25 years into the future, not use a rear-view mirror to build a portfolio of names that may already be past their prime dividend growth years. The Valuentum Dividend Cushion™ measures just how safe the dividend is in the future. It considers the firm's net cash on its balance sheet (cash and cash equivalents less debt) and adds that to its forecasted future free cash flows (cash from operations less capital expenditures) and divides that sum by the firm's future expected dividend payments. At its core, it tells investors whether the firm has enough cash to pay out its dividends in the future, while considering its debt load. If a firm has a Valuentum Dividend Cushion™ above 1, it can cover its dividend, but if it falls below 1, trouble may be on the horizon.

In our study, the Valuentum Dividend Cushion™ process caught every dividend cut made by a non-financial, operating firm that we have in our database, except for one (Marriott). But interestingly, the Valuentum Dividend Cushion™ indicated that Marriott should have never cut its dividend, and sure enough, two years after the firm did so, it raised it to levels that were higher than before the cut.

Here are the results of the study (a Valuentum Dividend Cushion™ below 1 indicates the dividend may be in trouble). The Valuentum Dividend Cushion™ score shown in the table below is the measure in the year before the firm cut its dividend, so it represents a predictive indicator. The measure continues to do well by members in real-time as well (beyond the constraints of any academic study).

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 Foods (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 downturn of newspaper industry.
La-Z-Boy (LZB)	17-Feb-09	0.89	Suspended dividend to preserve cash amid downturn in home furnishings.
Marriott Intl (MAR)	1-May-09	2.18 (2)	Suspended dividend in the wake of weak business travel, but dividend achieved record highs again, May 6, 2011.
Masco Corp (MAS)	11-Feb-09	-0.74	Cut dividend to ensure ability to fund operations and service debt coming due.
New York Times (NYT)	20-Nov-08	0.04	Effort to preserve cash. Downturn in newspaper industry. Loss of investment-grade credit rating.
Pfizer (PFE)	26-Jan-09	0.54	Bought Wyeth to diversify revenue base. Raised $22 billion+ in debt.
Sara Lee Corp (SLE)	8-Aug-06	0.70	Streamlining operations, business unit 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.

At the very least, using the Valuentum Dividend Cushion™ can help you avoid firms that are at risk of cutting their dividends in the future. And we are the only firm out there that does this type of in-depth analysis for you. We provide the Valuentum Dividend Cushion™ score in the dividend reports and monthly Dividend Growth Newsletter, and we also scale the safety of a firm's dividend based on this measure in simple terms: Excellent, Good, Poor, Very Poor.

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Here's a glimpse of the Valuentum Dividend Cushion™ score (as of November 2011) for a sample set of firms in our coverage universe. Please note that the current score on these and hundreds more are available with a membership to our website:

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

Subscribe to Valuentum to monitor the Dividend Cushion of firms you own.

Understanding Dividend Growth

It takes time to accumulate wealth through dividends, so dividend growth investing requires a long-term perspective. We assess the long-term future growth potential of a firm's dividend, and we don't take management's word for it. Instead, we dive into the financial statements and make our own forecasts of the future to see if what management is saying is actually achievable. We use the Valuentum Dividend Cushion™ as a way to judge the capacity for management to raise its dividend – how much cushion it has – and we couple that assessment with the firm's dividend track record, or management's willingness to raise the dividend.

In many cases, we may have a different view of a firm's dividend growth potential than what may be widely held in the investment community. That's fine by us, as our dividend-growth investment horizon is often longer than others'. We want to make sure that the firm has the capacity and willingness to increase the dividend years into the future and will not be weighed down by an excessive debt load or cyclical or secular problems in fundamental demand for their products/services. We scale our dividend-growth assessment in an easily-interpreted fashion: Excellent, Good, Poor, Very Poor.

What Are the Dividend Ideas We Seek to Deliver to You in Our Newsletter?

First of all, we're looking for stocks with dividend yields that are greater than the average of the S&P 500, or about 2% (but preferably north of 3%). This excludes many names, but we think such a cutoff eliminates firms whose dividend streams aren't yet large enough to generate sufficient income. Second, we're looking for firms that register an 'EXCELLENT' or 'GOOD' rating on our scale for both safety and future potential growth. And third, we're looking for firms that have a relatively lower risk of capital loss, as measured by our estimate of the company's fair value.

The Valuentum Dividend Cushion™ has an excellent track record of predicting dividend cuts. For more information, please select the following link (login required):

http://www.valuentum.com/articles/20130528

Valuentum Dividend Growth Newsletter: Volume 4, Issue 6

Valuentum's Dividend Growth Newsletter is published monthly. To receive this newletter on a monthly basis, please subscribe to Valuentum by visiting our website at http://www.valuentum.com. Or contact us at info@valuentum.com.

Fair Value Range. The fair value range represents an upper bound and lower bound, between which we would consider the firm to be fairly valued. The range considers our estimate of the firm's fair value and the margin of safety suggested by the volatility of key valuation drivers, including revenue, gross margin, earnings before interest, and enterprise free cash flow (the determinants behind our ValueRisk™ rating).

ValueRisk™. This is a proprietary Valuentum measure. ValueRisk™ indicates the historical volatility of key valuation drivers, including revenue, gross margin, earnings before interest, and enterprise free cash flow. The standard deviation of each measure is calculated and scaled against last year's measure to arrive at a percentage deviation for each item. These percentage deviations are weighted equally to arrive at the corresponding fair value range for each stock, measured in percentage terms. The firm's performance is measured along the scale of LOW, MEDIUM, HIGH, and VERY HIGH. The ValueRisk™ rating for each firm also determines the fundamental beta of each firm along the following scale: LOW (0.85), MEDIUM (1), HIGH (1.15), VERY HIGH (1.3).

Dividend Track Record. We assess each firm's dividend track record based on whether the fundamentals of the firm have ever forced it to cut its dividend. If the firm has ever cut its dividend (within the last 10 years), we view its track record as RISKY. If the firm has maintained and/or raised its dividend each year (over the past 10 years), we view its track record as HEALTHY.

Dividend Safety. We measure the safety of a firm's dividend by adding its net cash to our forecast of its future cash flows and divide that sum by our forecast of its future dividend payments. This process results in a ratio called the Dividend Cushion™. Scale: Above 2.75 = EXCELLENT; Between 1.25 and 2.75 = GOOD; Between 0.5 and 1.25 = POOR; Below 0.5 = VERY POOR.

Valuentum Dividend Cushion™. This is a proprietary Valuentum measure that drives our assessment of the firm's Dividend Safety rating. The forward-looking measure assesses dividend coverage via the cash characteristics of the business.

Dividend Growth Potential. We blend our analysis of a firm's Dividend Safety with its historical Track Record, while also considering historical dividend growth trends. We believe such a combination captures a firm's capacity (cash flow) and willingness (track record) to raise its dividend in the future. Scale: EXCELLENT, GOOD, POOR, VERY POOR.

Risk of Capital Loss. We think capital preservation is key for the dividend investor. As such, we evalute the risk of capital loss by assessing the intrinsic value of each firm based on our discounted cash-flow process. If a firm is significantly OVERVALUED, we think the risk of capital loss is HIGH. If a firm is FAIRLY VALUED, we think the risk of capital loss is MEDIUM, and if a firm is UNDERVALUED, we think the risk of capital loss is LOW.

Dividend Strength. Our assessment of the firm's dividend strength is expressed in a matrix. If the safety of a firm's dividend is EXCELLENT and its growth prospects are also EXCELLENT, it scores high on our matrix (top right). If the firm's dividend safety and the potential future growth are VERY POOR, it scores lower on our scale (bottom left).

Excerpt from *The 13 Steps to Understand the Stock Market*

Step #12: **Valu**e and Mom**entum** Outperform Everywhere

Momentum is the biggest embarrassment to efficient markets (according to the "father of modern finance" and Nobel laureate in Economics, Eugene Fama), academic research continues to conclude that 'Value and Momentum' combined outperform in every market across every asset class, and we continue to demonstrate empirical evidence of the superiority of a combined value-momentum process in the portfolio of our Best Ideas Newsletter. Key takeaway: Value and momentum combined outperform in every market across every asset class.

-- The **Valu**-**entum** Team

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For general information about Valuentum's products and services, please contact us at info@valuentum.com.