OUR BEST IDEAS NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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Valuentum Securities Inc.
www.valuentum.com info@valuentum.com

Portfolio Return	Benchmark Return	Outperformance
92.9%	59.9%	33.0pts

Our Best Ideas (see page 8): AAPL, BABA, BWLD, MO, CSCO, EBAY, XLF, GE, GILD, GOOG, GOOGL, XLV, INTC, KBE, KORS, PCLN, PYPL, RSG, RIO, TEVA, UNP, XLU, V

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Goals of our Best Ideas Newsletter: We want to deliver positive returns to you, our subscriber, year after year, in addition to outperforming the market benchmark. Our Best Ideas portfolio is generally found on page 8 of each edition.

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"The price of crude oil cares very little about how many US domestics it sends into Chapter 11 protection, even if the natural result from failures is lower production."
- Brian Nelson, CFA

As the World Turns

By Brian Nelson, CFA

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

Kris Rosemann
Associate Investment Analyst

= ALL-TIME HIGH

KEY CONCEPT: Firms in the Best Ideas portfolio (see page 8), which have generally registered a 9 or 10 on the VBI when added, should be considered our best ideas at any point in time. After adding firms to the Best Ideas portfolio, we may tactically trade around these positions when they have VBI ratings between 3 and 8 and depending on the size of their weighting in the portfolio or the attractiveness of them relative to other opportunities (a score of 3 through 8 is equivalent to a 'we'd hold'). We tend to remove firms from the Best Ideas portfolio when they register a 1 or 2 (we'd sell). View page 27 for more details about how the team utilizes the Valuentum Buying Index to run the portfolio.

Our growing concern over market participants' lackadaisical approach to what will inevitably become a contractionary monetary cycle has been evident for months. The US market crash of August 24 has disrupted the comfort levels of many investors, however, but it has not derailed the confidence of long-term planners, nor has it interrupted the conviction of optimists that believe the sky is the eventual limit for equity prices in their lifetimes. We take a more measured and cautious view of risky assets at Valuentum, and we'll never tell investors to ignore the information contained in market prices.

The risk of a recession in the US beginning this year is remote, but concerns are mounting for 2016. US gross domestic product continues to expand at a nice pace and the US employment rate is sitting at the lowest level it has been in years, while job openings approach multi-year highs (or a "new series high," according to the BLS). Times are great in America, but the rest of the world is not so lucky. Chinese equity prices have collapsed, though many with tremendous hindsight vision say this was obviously going to happen, even if the recessions in commodity-dependent countries such as Brazil and Canada may not have been equally predictable. Brazil's credit rating is now junk-rated, according to S&P, South Africa's GDP is shrinking and the rand is setting currency-crisis lows. Nigeria's economy, the largest on the African continent, is slowing considerably as a result of the slide in crude oil.

Peculiarly, we felt the air come out of the equity markets in January, either as investors opted to de-risk in advance of the sixth year of this bull market or a result of the collapse in the energy resource price environment, both equally plausible explanations. It is quite feasible that the investors who had bought into the "peak oil" thesis, theorized by Shell geoscientist Marion Hubbert and defined as the point in time after which the rate of production would enter into terminal decline, finally threw in the towel. Originally predicted that annual production would peak in 1970, the "peak oil" theory had been somewhat accurate for years, and energy price "bulls" did their best to make the case that "peak oil" had already

As the World Turns...continued on next page

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occurred up through late last decade, propping up energy stocks as the story proliferated. "Fracking" in the shale rich regions of the North Dakota Bakken, South Texas Eagle Ford and Niobrara formations have changed all of this thinking, however—or at least it should have. Some are still holding on.

Many investors are hurting. The largest energy stocks, believed to be stalwarts even during the toughest times, have given up large gains. The strongest of the strongest, Exxon Mobil (XOM) has fallen to ~$70 per share from over $100 in 2014, Chevron (CVX) has dropped to the mid-$70s from over $130 over the same time, and ConocoPhillips (COP) has performed equally as poorly. Midstream giant Kinder Morgan's (KMI) shares have collapsed to our $29 per share fair value estimate after the bold call in early June, and the bottom in the energy complex is still nowhere in sight, at least from our vantage point. Commercial crude oil inventories are the highest they've been for this time of year in more than 80 years, and Saudi Arabia is not letting up even in the face of "desperate" pleas from weaker member nations of OPEC, namely Venezuela, which continues to deal with runaway inflation.

The world is drowning in crude oil, and the latest prognosticators believe the next stop for the price of the black liquid will be in the $30s and then the $20s. The cash cost of bringing a barrel of oil equivalent to the surface rests in the low-teens (after fixed "sunk" costs), and it has been less than two decades since crude oil prices averaged ~$12 in 1998. With OPEC's new strategy of fighting tooth and nail for market share instead of operating with intentions to support the price, a revisit to levels of the late 1990s cannot be ruled out. The price of a barrel of oil is not set by the all-in, cycle cash costs of a extracting a barrel of oil equivalent, but by supply/demand characteristics of the marketplace. The price of crude oil cares very little about how many US domestics it sends into Chapter 11 protection, even if the natural result from failures is lower production.

The planned production cuts by US-based domestics are encouraging, but the plethora of asset write-offs and capital spending reductions may not be enough if the world economy catches China's cold. South Korea already has, Japan's slump in machinery orders in July is somewhat eye-opening, and deflation in China is a potential reality (producer prices in China sunk the most in six years in August). Both supply and demand for the energy resource pricing are moving targets, and should supply begin to slow, demand will have to hold to see any relief. That's far from guaranteed in light of major economies entering or nearing recession.

Still, not all is terrible. The shock of the abrupt drop in the S&P 500 in late August drove the credit markets to a near-standstill in the last weeks of August, according to Moody's and Franklin Templeton, but they've normalized a bit during the past week or so. According to Informa Global, September 9 was the "second-busiest day of the year," though it remains to be seen whether such a snap-back move was merely pent-up issuance from the evaporation of previous weeks. Even a few weeks of "missed" growth opportunities may be enough to impact gross domestic product in 2016. The "animal spirits" of risk-taking haven't been completely eliminated, however.

Consensus estimates are calling for the second consecutive quarterly decline in earnings in the third quarter, the first time this has happened since the depths of the Great Recession in 2009, and analysts continue to push earnings estimates lower, according to FactSet's tally on September 11. The forward 12-month price-to-earnings ratio is ~15.3 times, above both the 5-year and 10-year averages, implying that there is still risk to the downside with respect to broader equity valuations, especially if earnings estimates are further revised downward. The stronger US dollar will continue to pressure the pace of reported multi-national earnings expansion and dollar-denominated commodity prices.

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We continue to like the US markets for equity exposure, where currency headwinds and economic deterioration have been absent thus far. One of the largest mispricings in the market continues to be Apple (AAPL) at less than 9 times earnings, excluding net cash, though it generates a large percentage of revenue from non-US markets. The latest reading, however, suggests that pre-orders for Apple's flagship iPhone are the highest they've ever been, though comparisons to previous iterations are muddied with the inclusion of China in recent data (see page 10). Michael Kors (KORS) is trading significantly below our estimate of its intrinsic value, and the company's expected growth prospects and strong net cash position on the balance sheet speak to an interesting proposition, but not one without substantial "fashion" risk.

Buffalo Wild Wings (BWLD) has found its way back into the Best Ideas Newsletter portfolio after we took substantial profits in the position earlier this year. With most of its growth potential still residing in North America, we like its potential strength in the face of global economic weakness, particularly as the restaurant chain capitalizes on a variety of demographics, namely families—something one wouldn't expect from a concept focused on "beer, wings and sports." We provided 5 counterpoints to a well-publicized piece on concerns that Alibaba's (BABA) shares may fall another 50% from here, and while we believe the company is underpriced, sentiment on China's economic growth and key constituents tied to consumer spending in the country have perhaps never been worse (see below).

As the world turns, we're keeping a close eye on a number of things. First, we're monitoring property prices in Shanghai and in other larger Chinese cities to assess the potential calamity that falling housing prices and deflation would have on the country's banking sector and the likelihood of contagion via the British banks, HSBC and Standard Chartered, and on US ones, namely Citigroup and JP Morgan. Second, we're watching the price of crude oil closely, as its fall will have huge implications on the earnings trajectory of companies that benefit (airlines, restaurants) as well as the ones that suffer (upstream and energy services). The net effect of falling crude oil prices has thus far been negative for S&P 500 earnings, but this may change as the energy sector becomes an ever-smaller part of index construction. Third, who can forget about the Fed, the expected duration of any tightening monetary cycle, and the resulting implications on dividend-paying stocks as Treasury yields rise?

We've spent a lot of time walking through Apple's prospects in several articles of this edition of the Best Ideas Newsletter. We hope you enjoy them and the newsletter in its entirety!

5 Counterpoints To The Puzzling Attack on Alibaba

By Brian Nelson, CFA

Alibaba is not a "dot-bomb" like the infamous blow-ups in the US in the late 1990s/early 2000s. The Chinese e-commerce giant is significantly profitable and free cash flow positive, and growth prospects are tremendous. Calling for a ~15 times multiple on next year's earnings, as a large publisher has done, where next year's earnings are but a fraction of the company's earnings power 5-10 years from now is an attempt, in our view, to punish the stock at a vulnerable time when global economies are shuddering and the Chinese equity markets continue to face immense pressure. Our estimate of the firm's long-term intrinsic value is significantly higher than its current market price, but the mounting proliferation of fear may very well hurt shares in the near term.

A large publisher ran a negative article on Alibaba (BABA) last weekend, "Alibaba: Why It Could Fall 50% Further (1)" As the article has successfully struck fear into the hearts of US investors in light of ongoing Chinese market collapse, it has also successfully hurt Alibaba's stock. There are a few things that we think are worth emphasizing that were lacking in the piece.

*5 Counterpoints...*continued on next page

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Image source: Gwydlon M Williams

1) Alibaba is significantly free cash flow positive.

Unlike the many Internet sensations of the late 1990s and early 2000s that were burning through millions and millions of cash every quarter, Alibaba is significantly free cash flow positive (cash flow from operations less all capex). In the June quarter alone, assuming a USD-to-RMB exchange rate of 6.2, the company hauled in $1.54 billion in free cash flow. Annualizing the quarterly tally gets to a run-rate free cash flow stream of ~$6.16 billion. For a company that is growing as fast as Alibaba, generating positive free cash flow at all (in the context of a net cash-rich balance sheet, which it has) is a large dent to the bear case outlined in the publisher's piece over the weekend. In the case of most young, fast-growing companies, investments tend to overwhelm cash flow from operations. This is not the case with Alibaba, which remains a cash-flow rich enterprise.

2) Alibaba's valuation is not stretched.

Aside from the absence of the most important financial aspect of business evaluation (free cash flow), an in-depth assessment of the company's valuation was missing in the piece. For example, if we assume a mere 5% annual growth rate in Alibaba's traditional free cash flow and add back Alibaba's net cash balance of $10 billion and its various other holdings in Alibaba Pictures, Alibaba Health, Ant Financial, YoukuTudou and Weibo, we can implicitly back into the firm's current share price and market capitalization (~$160 billion) with a value – and that's only with a 5% long-term growth assumption.

Alibaba's revenue has grown nearly 7-fold since 2011 and its net income has advanced 15 times over the same period. We think a 15 times multiple that is stipulated as "fair" on Alibaba's shares is far from it. Companies such as Coca-Cola and Procter & Gamble, for example, where growth is under pressure for various reasons, are trading at near-20 times forward earnings and Apple which is trading at an incredible ~9 times, less net cash, show the tremendous pitfalls of using any kind of multiple analysis across different companies--or even for similar companies for that matter, as in the case of the publisher's comparison of Alibaba to eBay. A discounted cash-flow model is the only true way of uncovering an entity's intrinsic worth.

3) Why no long-term focus?

As we have outlined before, our affinity with Alibaba is a function of what the company will look like 10, 20, 30 years from now--not how the firm's shares will perform over the next few quarters, which we admit may be rough in light of macroeconomic issues in China. The points that the publisher makes about slowing "growth in volume" from (~50% to ~34%), for example, are semantics, in our view. Where we'd grow concerned is if growth in revenue and gross merchandise volume (GMV) slowed to a single-digit pace; only then would we have to take a hard look about whether one of the largest economies in the world will face what most may call a "hard landing." From our perspective, it's unreasonable to expect ongoing revenue acceleration for a company that is as large as Alibaba. The company has a lot of room to the downside in the growth of key value-driving metrics (revenue, earnings, free cash flow) before shares would be considered expensive.

5 Counterpoints...continued on next page

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4) Why is precision important?

In light of the tangible free cash flow generation, should investors really be concerned about the precision of how many online users are in China at present—whether it is 367 million or 400 million or 450 million. Does it really matter?

Such estimates are incredibly difficult to make, in any case. What we think is important is to acknowledge that there are currently ~1.4 billion people in China at the moment, the growth runway is long, and online penetration rates are still low. If Alibaba's user numbers should be lower than reported, as the publisher argues, it would then mean that future growth potential is larger! This is actually a good thing.

What we're skeptical of is not the average annual spend per online user in China of $1,215, which the publisher points to as being suspect, but the US measure of "$963 annual average for US online shoppers." We have a difficult time believing that the average US online shopper spends ~2-3% of the median household income of ~$40k online? Does that include business spending online? We think a sub-$1,000 number in the US is actually the one that is too low.

5) Businesses are their future free cash flow streams.

We think Alibaba gets it.

Businesses are their future free cash flow streams – and the view that "the fruits of the businesses, including cash flow and profits, are transferred to the holding company," that US shareholders own is a tribute to the very idea and focus of the intrinsic qualities of any business.

As Alibaba has stated many a time before, "Alibaba shareholders own shares in a holding company that holds 100% equity stakes in its Chinese operating subsidiaries…Through ownership in the shares of Alibaba…shareholders own these assets and have direct access to the cash flows generated from operations of the wholly-owned subsidiaries through dividends."

We think the publisher's fear mongering will be successful, but there is a very important silver lining. The article has brought to light important information for the investment community to continue to hash out, thereby improving transparency, and counter-intuitively increasing the confidence investors will place in Alibaba. At the moment, the company accounts for less than 3% of the Best Ideas Newsletter portfolio, a rare short-term miscue and black eye, but something that shouldn't pose a material headwind to growing outperformance in the Best Ideas portfolio.

The long-term picture at Alibaba remains bright, in our view, but that doesn't mean shares won't suffer in the near term, much like large cap peers Tencent (TCEHY) and Baidu (BIDU), as economic malaise in China proliferates. Alibaba's response to the magazine's article is worth reading first.

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(1) http://www.barrons.com/articles/alibaba-why-it-could-fall-50-further-1442036618?mod=BOL_hp_highlight_1?mod=BOL_hp_highlight_1&cb=logged0.6035561966254128

Quantifying Apple's Tremendous Investment Case

By Brian Nelson, CFA

A prolonged period of low interest rates has driven income investors to dividend growth investing as a way to achieve retirement goals. Traditional dividend growth analysis has rested on evaluating a company's dividend payout ratio and its track record of historical consecutive annual dividend increases. A supplement to these approaches, the forward-looking, cash-flow- based Dividend Cushion ratio maps a company's future expected free cash flows to its future expected cash dividends paid (after considering balance sheet health) and has shown to be a superior indicator of both dividend growth (risk) and total return relative to other dividend growth analytical processes. The results in the (Dividend Cushion) paper showcase the outperformance of a select number of high-yielding equities with strong Dividend Cushion ratios relative to both S&P 500 firms and companies with decades of consecutive annual dividend increases. – Valuentum Securities

Download the white paper at the following link (pdf):

http://www.valuentum.com/downloads/20150506/download

Excitement surrounding shares of Apple's (AAPL) equity has again reached a fever pitch, only days after concerns about China pummeled shares. We think consumers are as thirsty for new, improved devices, as investors are enthused about the company's valuation anomaly and the long-term dividend growth potential of its stock. From new iPhones to an improved Apple TV set top box to an iPad Pro to new accessories for the Apple Watch and another version of the iPad mini, Apple continues to turn heads.

But that's just the tip of the iceberg. The company's stock is as rock-solid as it gets, too. The iPhone giant's cash flow from operations has advanced more than 45% through the first nine months of its fiscal year 2015, to a staggering $67.8 billion. To put this step-change in cash-flow generation into perspective, for all of the fiscal years of 2014, 2013 and 2012, respectively, the company generated $59.7 billion, $53.7 billion, and $50.9 billion. We're starting to think our $70-$75 billion forecasts for cash from operations in fiscal 2015 and fiscal 2016 are too conservative. For one, if the existing pace of cash-flow growth is any indication, Apple will generate ~$85 billion in cash from operations during the current fiscal year and only shell out ~$10 billion in capital spending.

That's ~$75 billion in traditional free cash flow in one year!

Since any valuation construct considers the net cash on the balance sheet as tangible, bird-in-the-hand wealth that the shareholder already owns, let's get to numbers in this area. As of June 27, Apple held $202.8 billion in cash and marketable securities against a total debt load, consisting of short and long-term debt, of ~$49.9 billion, making for a net cash position of $152.9 billion. Let's now deduct this $152.9 billion straight from Apple's market capitalization of ~$639.2 billion, resulting in a "present value" estimate $486.3 billion. The way to interpret this $~486 billion number is rather straightforward within the valuation context.

If you believe Apple, on a present-value basis, can generate more than ~$486 billion in traditional free cash flow cumulatively over the rest of its corporate life (not in one year, but forever), then shares are cheap. If you think, however, that Apple will only operate at current cash-flow levels for about the next 6-7 years on the basis of its current run-rate of $75 billion in annual traditional free cash flow, not expanding or contracting, and then never generate another dollar in free cash flow again after the seventh year, you might say shares are fairly valued at present levels. If you believe that Apple's cash flow generation prowess for the rest of its corporate life (i.e. cumulatively into perpetuity) will fall short of the ~$486 billion number, then you might view shares as expensive. This is one way of conceptualizing the balance sheet and free cash flow generation within the valuation context.

Quantifying Apple...continued on next page

*Quantifying Apple...*from previous page

Our bet is that Apple will generate cumulative discounted free cash flow significantly greater than the ~$486 billion mark. The equity markets, in our view, are truncating Apple's free cash flow stream after year 6 or 7, and by extension, are pricing in a doomsday scenario for Apple. Not only are the markets assuming the iPhone will eventually go the way of Blackberry's (BBRY) namesake and Motorola's (MSI) Moto RAZR, but that all of Apple's products will vanish in time, including the iPad and anything else it has in the pipe, and that its ecosystem will collapse. This is what's built into Apple's stock, which trades at just ~8.7x consensus fiscal 2016 earnings, less net cash on the balance sheet. That's nearly half of the multiple of the average stock in the S&P 500.

The story with Apple gets better though.

At Valuentum, our work is grounded in free-cash-flow based and balance-sheet analysis, not only with respect to equity valuation, but also with respect to assessing future dividend health. To understand how much Apple could increase its dividend, a look at its cash flow statement is telling. During the fiscal years of 2014 and 2013, for example, Apple paid out in cash as dividends $11.1 billion and $10.5 billion, respectively, and is on pace to pay out roughly ~$11.5 billion in fiscal 2015. Let's go back to what Apple is on pace to generate in traditional free cash flow (cash flow from operations less capital spending) during the current fiscal year: ~$75 billion. That means, in terms of free cash flow generation for this fiscal year alone, Apple can cover its dividend payout ~6 times--depending on what the reported numbers end up being.

If this hasn't caught your attention, it's even better.

The $152.9 billion that Apple holds on its balance sheet as net cash is yet another backstop to its dividend payment as well. Said differently, should Apple's traditional free cash flow in any given year ever come up short to the cash dividends paid, Apple would be able to tap into its balance sheet to pay a portion or all of the dividend. Not only can Apple cover its annual cash dividend with traditional free cash flow ~6 times, but the net cash on the balance sheet covers its annual cash dividend 13+ times. When we speak of dividend safety at Valuentum, this is what we're talking about.

We apply this framework within the context of the Dividend Cushion™ ratio, which we publish for all firms within our coverage universe. The Dividend Cushion ratio takes the sum of company's net cash on its balance sheet and the sum of the company's future traditional free cash flow generation over the next five years, and divides that sum by the company's future expected cash dividends paid and growth in them over the next 5 years. Our forecast for Apple's dividend growth is between 15%-25% over the next five years, and the iPhone giant still registers a Dividend Cushion ratio of 5.

It's now probably easy to see why Apple is one of Valuentum's favorite ideas on the market today. Entities that have overleveraged balance sheets and that pay out all of their cash flow from operations as dividends to shareholders can't possibly have safe dividends, in our view. Know the difference. The Dividend Cushion ratio is available for all companies in our coverage universe. Transocean (RIG) has been but the latest company the Dividend Cushion ratio had warned about before an impending cut or elimination.

Predicted Dividend Cuts - Real Time

Company Name	Symbol	Date
American Capital	AGNC	recurring
Annaly Capital	NLY	recurring
Chesapeake	CHK	Jul-15
Hi-Crush	HCLP	Jul-15
Peabody Energy	BTU	Jan-15
Linn Energy	LINE	Jan-15
Seadrill	SDRL	Nov-14
Arch Coal	ACI	Feb-14
First Energy	FE	Jan-14
Weight Watchers	WTW	Oct-13
Consol Energy	CNX	Oct-13
Pitney Bowes	PBI	Apr-13
Exelon	EXC	Feb-13
Cliffs Natural	CLF	Feb-13
CenturyLink	CTL	Feb-13
Dover Downs	DDE	Jan-13
Roundy's	RNDY	Nov-12
Strayer	STRA	Nov-12
SuperValu	SVU	Jul-12
JC Penney	JCP	May-12

The Best Ideas Portfolio

By Valuentum Analysts

Portfolio Return	Benchmark Return	Outperformance
92.9%	59.9%	33.0pts

= ALL-TIME HIGH

Below we outline the constituents of the portfolio and their respective weightings and returns thus far. Each subsequent issue discusses Valuentum's latest changes to the portfolio and analysis and trends impacting companies in our Best Ideas portfolio. We currently have ~31% of the portfolio in cash, a level we're looking to bring down in coming months. Tactically, 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 portfolio 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, the Valuentum Buying Index.

OUR BEST IDEAS PORTFOLIO -- as of September 15, 2015 (intraday) — **Best Ideas Portfolio Inception Date: May 17, 2011**

Portfolio Holdings	Symbol	Initial VBI*	Current VBI**	Fair Value	P/FV	First Purchase	Cost/Shr ($)	# Shares	Total Cost ($)	Price/Shr ($)	Current Value ($)	Cumulative Div's Rec'd	% of Portfolio	% Return (dividends included)
Bullish														
Apple Corp.	AAPL	10	6	$142.00	0.82	17-Jun-11	51.92	107	5,569.33	116.02	12,414.14	856.57	6.4%	138.3%
Alibaba	BABA	IPO	3	$136.00	0.47	19-Sep-14	92.95	78	7,264.10	63.96	4,988.88		2.6%	-31.3%
Altria Group	MO	8	6	$55.00	0.98	28-Jun-11	28.39	315	8,958.11	53.73	16,924.95	2,212.25	8.8%	113.6%
New: Buffalo Wild Wings	BWLD	6	6	$195.00	1.02	27-Aug-15	196.20	10	1,969.00	198.18	1,981.80		1.0%	0.7%
Cisco	CSCO	9	7	$36.00	0.72	14-Nov-14	26.15	100	2,622.00	25.87	2,587.00	61.00	1.3%	1.0%
eBay	EBAY	10	UR	UR	UR	3-Oct-11	Pre-split	100	3,103.50	25.75	2,575.00		1.3%	+++
Financial Select SPDR	XLF	NA	6	NA	NMF	9-Jan-11	13.46	150	2,026.00	23.28	3,492.00	181.05	1.8%	81.3%
General Electric	GE	7	3	$29.00	0.87	21-Oct-13	25.99	375	9,761.75	25.20	9,450.00	555.75	4.9%	2.5%
Gilead Sciences	GILD	10	9	$161.00	0.69	19-Sep-14	106.76	68	7,273.34	110.82	7,535.76	58.48	3.9%	4.4%
Google - Class C	GOOG	10	4	$679.00	0.94	23-Oct-12	450.92	7	3,170.42	635.47	4,448.29	10.35	2.3%	40.6%
Google - Class A	GOOGL	10	4	$679.00	0.94	4-Apr-14	Split	7	Split	665.20	4,656.40		2.4%	+++
Health Care ETF	XLV	9	6	NA	NMF	22-May-12	36.60	125	4,582.00	71.13	8,891.25	356.50	4.6%	101.8%
Intel	INTC	6	4	$38.00	0.78	12-Sep-11	20.48	150	3,086.50	29.71	4,456.50	442.50	2.3%	58.7%
SPDR S&P Bank ETF	KBE	NR	NR	NA	NMF	9-Jan-12	21.07	100	2,114.00	34.16	3,416.00	174.00	1.8%	69.8%
New: Michael Kors	KORS	8	8	$66.00	0.66	27-Aug-15	42.98	46	1,984.08	43.88	2,018.48		1.0%	1.7%
PayPal	PYPL	UR	UR	UR	UR	17-Jul-15	Spin-off	100	Splt	33.50	3,350.00		1.7%	+++
Priceline	PCLN	10	7	$1681.00	0.78	26-Feb-15	1248.97	3	3,753.91	1310.66	3,931.98		2.0%	4.7%
Republic Services	RSG	8	4	$40.00	1.01	19-May-11	31.42	201	6,329.42	40.49	8,138.49	917.58	4.2%	43.1%
Rio Tinto	RIO	9	3	$58.00	0.63	22-May-12	46.40	75	3,487.00	36.55	2,741.25	511.65	1.4%	-6.7%
Teva Pharma	TEVA	6	3	$65.00	0.99	24-Jul-13	41.22	77	3,180.94	64.40	4,958.80	233.19	2.6%	63.2%
Union Pacific	UNP	6	3	$102.00	0.85	24-Jul-13	79.67	40	3,193.80	86.87	3,474.80	174.00	1.8%	14.2%
Utilities Select SPDR	XLU	NR	NR	NA	NMF	18-Mar-14	41.12	83	3,419.96	41.81	3,470.23	158.95	1.8%	6.1%
Visa	V	7	6	$75.00	0.94	30-Nov-11	26.86	188	5,064.39	70.39	13,233.32	226.39	6.9%	165.8%
Latest changes: BWLD, KORS were added to the portfolio Aug 27; AAPL trimmed Aug 20. Please contact us at info@valuentum.com if you are not receiving the email transaction alerts.														
Cash -- changes in monthly cash balance reflects dividends received and trading gains/losses, where applicable.											59,733.21		31.0%	0.0%
Bearish														
For investors seeking 'short' or 'put option' exposure, please consider firms with VBI ratings with 1 and 2 as ideas.														
Best Ideas Portfolio Value									100,000.00		**192,868.53**			**92.9%**
S&P 500 Index (SPY)						17-May-11	132.69	754	100,000.00	197.92	149,159.70	10,757.40	93.3%	
Cash											10,757.40		6.7%	
Benchmark Portfolio Value											**159,917.10**			**59.9%**
Relative Outperformance														**33 pts**

Data as of September 15, 2015 (intraday). 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). Best Ideas portfolio is not a real money portfolio.

Standard Disclaimer: Our Best Ideas 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 Best Ideas portfolio and accepts no liability for how readers may choose to utilize the content.

Business as Usual at Apple

By Kris Rosemann

Apple (AAPL) is at it again. The tech giant revealed its most recent updates and advancements in a special event on September 9. Featured in the event were the latest iterations of the iPhone, iPad, iOS, Apple TV, WatchOS, and Apple Watch.

Apple's flagship product, the iPhone, has undergone its routine iteration, but the end result is anything but routine. The iPhone 6s and 6s Plus are perhaps the most advanced smartphones the world has seen thus far. The addition of 3D touch sensors was the highest touted new feature by Apple. With this feature, users are now able to use the amount of pressure they apply to the screen to select a variety of functionality options from one ordinary selection. Using different amounts of force, users are able to dip in and out of various content all while retaining the context in which the information is being sent. The engineering behind 3D touch is nothing short of amazing, as the hardware used is approximately 10 times more efficient than that used in the average phone. This function is but a tiny glimpse into the unlimited potential Apple can create from the way its groundbreaking hardware and software work together.

The advancement of Apple's A9 chip is similarly impressive; it now allows for performance in handheld devices that was formerly only available in desktop computers. iPhone 6s and 6s Plus CPU speeds are up to 70% faster and GPU speeds are up to 90% faster than the previous iteration of the iPhone thanks to the A9 chip. As one would expect, the most recent rollout of iOS, iOS9, is the most advanced yet, providing for Wi-Fi and LTE speeds up to twice as fast as the previous iteration of the operating system.

The iPhone's camera has also been upgraded. It now is equipped with a 12 megapixel rear iSight camera, compared to the 8 megapixel camera on the iPhone 6. The rear camera is capable of taking high-definition videos with ~4 times the resolution of the standard 1080p high-definition video. These new features are now wrapped in same grade aluminum commonly used in the aerospace industry, and the screen is made from the strongest, most durable glass of any smartphone available, according to Apple. For what it's worth, the new iPhones are available in two additional colors: gold and rose gold.

Speaking of gold, that is precisely what Apple believes it has struck with its most recent iPad, the iPad Pro. Its expanded target demographic with the new model is in its name: professionals. With a 12.9" display and nearly twice the CPU performance of the iPad Air 2, the iPad Pro makes multi-tasking a breeze. It is geared toward not only consuming content, but also creating content. The larger screen and available attachments, such as a portable and fully-sized smart keyboard, make the new iPad more like a computer than any other tablet.

Along with being larger, the iPad Pro screen has the highest resolution of any iOS device. It is also the first iPad to automatically adjust display settings based on the content on the screen at any given moment. This feature helps extend battery life as it improves energy efficiency. Other accessories for the device include the Apple Pencil, a feature the company had previously steered clear of, but gave in likely due to consumer demand, particularly from the usage needs of professionals. The Apple Pencil is incredibly responsive to both tilt and pressure, allowing the user to create a range of artistic strokes and effects. Apple is not going to replace the computer with its first iteration of the iPad Pro, but with an increasingly wide range of people utilizing the iPad for an increasingly wide range of uses, the idea behind the new model is the beginning of something to that effect.

Apple has also set out to revolutionize the way we watch TV. Apple TV is attempting to capture a shift in consumer preferences to a viewing manner in which the viewer decides the programming, not the TV. But the new Apple TV does so much more than simply display programming. The AppStore will soon be available on Apple TV, enabling users to turn their living room into anything from a dance studio to a classroom; family game night will never be the same.

Business as Usual ...continued on next page

*Business as Usual…*from previous page

The new tvOS and the Siri Remote will compete directly with products such as Amazon's (AMZN) Echo. The voice controlled remote can take commands and search across all apps and services, or within specific apps. The Siri Remote also uses a touch screen to scroll, select, and navigate selections on the TV, similar to the action used to control iPhones. According to Apple, "The Siri Remote takes the work out of watching TV," and the Apple Watch takes the work out of checking your iPhone.

We covered all of the incredible features of the Apple Watch after its initial release this spring. A few new features were recently announced, such as "time travel," which allows users to check weather, events, and other aspects of their future schedules with the turn of a dial. Several different styles of watch-face and band are now available for the Apple Watch as well. Most importantly, the Apple Watch has received a 97% customer satisfaction rating in its first few months of availability, and the time may be approaching when an established, sustainable wearable technology market emerges. Only then will the Apple Watch begin to have a material impact on Apple's financial performance.

So what does all of these product updates mean for investors?

In short, everything. These types of special events help drive the Apple brand. Not many companies can hold a conference in the legendary Bill Graham Civic Auditorium, a venue commonly reserved for rock stars, to showcase existing product iterations. The executive team played to a full house, and the crowd was hanging on to every word. The Apple brand is unlike anything else we've seen before.

What's more impressive is Apple's incredible financial stability. As readers know, we are constantly immersed in free cash-flow-analysis, and Apple may be the king of cash. In a recent article we quantified Apple's tremendous investment case and showed the incredible pace at which the firm generates free cash flow, which continues to support its fortress-like balance sheet. The financial flexibility very well may grant Apple the freedom to do whatever it wants with respect to future product developments.

We can't imagine a world without Apple and its products, and we can't imagine any scenario in which this is not the case for the foreseeable future. The fall of an apple led to the discovery of one of the most important concepts in the history of our world (gravity), and the ascension of Apple very well may lead to another monumental development. We may have lightened our position a bit, but we won't be caught on the sidelines.

iPhone Demand Remains Strong

By Kris Rosemann

The demand for new iPhones remains as strong as ever. A holding in both newsletter portfolios, Apple (AAPL) announced September 14 that it is on pace to break last year's first weekend iPhone sales record of 10 million units sold following the unveiling of its most recent product updates.

There are a few important distinctions between this round of iPhone upgrades and previous cycles, however. Apple pushed the release date back to September 25 this year, compared to the release date of September 19 for last year's unveiling of the iPhone 6 and 6 Plus. This will give the company more time to improve the logistics of its actual release date; it hopes to streamline the process to eliminate as much of the already prevalent back orders.

Further, the release of the sales unit update on September 14 came after the new iPhones were available for pre-order by one less day than the previous year, making comparisons a bit more difficult. Offsetting that dynamic, however, the new iPhones were available for pre-order and immediate release in two additional countries, China and New Zealand, compared to the previous iteration. The incremental sales in China will have material implications, and a record performance should have been expected since this is the first time the country has been included in the initial release of new iPhones.

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According to a blog that tracks the wait time for different iPhone models, wait-time for pre-orders of the iPhone 6s Plus is 3-4 weeks. In China, the wait for all iPhone 6s models is 2-3 weeks, and other notable countries--such as the UK, Canada, and Japan--have a similar wait for select 6s models. Pre-order demand has been higher than most anticipated, including Apple.

Apple has faced ongoing investor concern that a potential weakening of the world's second-largest economy, China, would limit its growth trajectory, but the firm has had the utmost confidence in its dealings--as evidenced by a recent letter from CEO Tim Cook. The recent release of pre-order information supports his stance that the company has continued to experience strong growth in China despite macroeconomic concerns swirling the country. Share gains in China have been a key driver as recent data has revealed.

The lack of consistency and clarity surrounding the sales unit release September 14 keeps us from drawing any material conclusions about the true levels of demand for the newest iPhones, however. It is certainly reasonable to believe that Apple will sell more iPhones in its upcoming launch weekend than ever before, but the addition of China and other factors make informative comparisons to previous upgrade cycles difficult, to say the least. The launch of the iPhone upgrade plan from Apple, for example, is yet another dynamic that has further muddied the pre-order picture.

The upgrade plan may turn out to be a more significant development than the new iPhones themselves. For one, the new plan essentially allows Apple to turn over 60% of its existing revenue base into a recurring revenue stream, a fantastic step forward in its business model. In the plan, consumers enter into a 24-month agreement in which they pay a flat monthly rate for an iPhone. At the end of the 12 months they are then eligible for an upgrade to the newest iPhone model, but the phone is not fully paid for until the end of the 24-month agreement. The development of this plan could be a source of significant, sustainable upside, and if it receives positive feedback and generates consumer traction, it will be an ongoing positive for the firm in the long run, even if the structure of the plan itself is easily replicated by rivals.

All told, we aren't getting too excited over Apple's overarchingly positive release concerning its iPhone pre-orders given the large number of moving parts relative to last year's numbers, but we remain very positive on the company's outlook and financial position as a whole. The company remains one of our favorite ideas within our coverage universe.

Yahoo! Weighing Its Options

By Kris Rosemann

The IRS has thrown a monkey wrench in Yahoo!'s (YHOO) plans for a tax-free spin-off of its 384 million shares of Alibaba (BABA), worth nearly $40 billion.

In late January, Yahoo! announced a plan for the spin-off of its remaining position in Alibaba into a newly-formed investment company, to be called Aabaco Holdings. Yahoo had planned for the stock of the new company to be distributed pro rata to existing Yahoo shareholders. After the completion of the proposed transaction, Aabaco Holdings would either directly or indirectly own the 384 million shares of Alibaba formerly owned by Yahoo, along with a 100% ownership interest in Aabaco Small Business, which would be a newly-formed entity that owns Yahoo Small Business. Yahoo Small Business currently operates as a division of Yahoo.

In order for the proposed transaction to be tax free, it must satisfy active trade or business requirements; it cannot merely be a vehicle to distribute profits, which is the reason Yahoo included the spin-off of Yahoo Small Business with the disposal of its Alibaba holdings. For all intents and purposes, Yahoo has essentially packaged 384 million shares of Alibaba with a relatively immaterial portion of its current operations in an attempt to avoid billions in taxes.

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A similar situation took place in 2014 with Liberty Interactive (QVCA) spinning its holdings of TripAdvisor (TRIP) into a holding company in order to distribute the profits tax-free to its shareholders, and to allow the company to continue trading without the overhanging risk of another publically-traded company on its books. In both cases, the operating division of the parent company involved in the spin-off was small, arguably immaterial. Since Liberty Interactive's scenario satisfied the active trade or business requirements, one would have thought Yahoo's case would be accepted as well.

But not so fast.

About a month after the announcement of its plan, Yahoo submitted a request to the IRS for a private letter ruling on whether or not Aabaco's ownership of Aabaco Small Business would satisfy the active trade or business requirements. Private letter rulings are submitted by a company when it wishes to receive an opinion from the IRS on whether a potential transaction could result in a tax violation; they are not a necessity. A positive private letter ruling from the IRS would mean Yahoo would know for sure the transaction would be completely tax-free to its shareholders and pass muster with the government body.

However, in mid-May, the IRS announced it was reconsidering its ruling policy with respect to the active trade or business requirements. Then in late July, the IRS formally announced that it was "studying potential new administrative guidance with respect to certain issues" that included the active trade or business requirements. This led the IRS to inform Yahoo in early September that it would not grant a ruling on the matter. It is important to note that the IRS did not directly indicate that it was ruling against the tax-free spin-off, but that it had rejected the request for a ruling.

After receiving the news that the IRS had rejected its request for a ruling, Yahoo formally withdrew its request, but the firm continues to work with its counsel on its spin-off plans. The seemingly complex ruling (or lack of a ruling) that took place may have been an indication from the IRS that it had planned to rule adversely on the proposed transaction Yahoo had in place at the time of its request, but that it was not axing it if Yahoo fine-tunes the deal to the IRS' liking.

In any case, Yahoo is left weighing its options with respect to how it should move forward, as it is becoming increasingly unlikely that it will receive a positive ruling from the IRS with each passing day. Yahoo could still proceed with its spin-off plans without IRS approval and then hope that the IRS would find the company's actions to be in-line with the active trade or business requirement, but this is fraught with uncertainty and far from guaranteed. As we stated in January, the tax burden may eventually land in shareholders' laps.

The Importance of a Holistic Investment Approach

By Brian Nelson, CFA

The very best investors, in my view, are ones that approach investing as business owners, much like the well-publicized viewpoints of the Oracle of Omaha himself, Warren Buffett, who views stocks as pieces of a business, not pieces of paper.

Whether it is the local McDonald's franchisee, the mom and pop coffee shop competing with the corner Starbucks, the local hardware store trying to stay afloat against Home Depot and Lowe's, the family dentist or physician or independent financial advisor, these entrepreneurs "live" strategic analysis, competitive evaluations, and free cash flow management. They know what matters in their business, and they know what is required to drive future free cash flows, which is how they make a living.

*The Importance of a Holistic Investment Approach…*continued on next page

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Business owners understand that their livelihood depends on allocating revenue across expenses, future investments, and dividends, among other items. Sole proprietors know very well--that tax considerations aside--it matters very little whether they receive the income stream from their business as a salary or as a dividend (the IRS cares about this distinction, however). They understand that the cash that would be paid as a dividend would have accrued on the balance sheet if it weren't. These entrepreneurs understand that such cash is already theirs and that they don't need to pay it to themselves in order to "own" it.

As an investor in a corporation, you are a partial owner of a business. Warren Buffet knows this – that's in part why he doesn't waste his time with dividends. Entrepreneurs that are involved in the day-to-day cash flows of the business know that they already own any dividends they will pay to themselves. But why don't external investors embrace this truism? Why don't investors understand that a dividend is a payment of cash to them that they already "own?" Running a company and dealing with both its ups and downs has given me experiences far beyond those ever gained in any other aspect of my investment career, whether it be on the buyside or at Morningstar.

At Valuentum, we understand that the dividend is vitally important to retirees and near-retirees for income, and we pay very close attention to it, but we also believe in a holistic business evaluation process that goes beyond a company's dividend and its yield. As business owners, we take a hard look at all of the free cash flows of the business that investors own. We offer a fair value range for every company in our coverage.

We pay close attention to the information contained in stock prices, which can at times offer valuable insight into the business' relationship with customers, the supply chain and beyond. The Financial Crisis taught the world how important it is to pay attention to the information contained in stock prices, particularly in the financial sector, where GAAP accounting offered little in the way of predicting the "run-on-the-bank" dynamics that hit Washington Mutual and counterparty risk that buried Bear Sterns and Lehman Brothers.

Investors must continue to go beyond the dividend to truly understand the business. Think like an entrepreneur. Think like a business owner. And don't ignore the information contained in stock prices. The Valuentum process looks at all of this and more.

Major Grocers Growing Sales But Not Clean Stories

By Kris Rosemann

Firms in the mature food retailers industry generally have slim profit margins and face significant competition from brick-and-mortar locations (discount, department, drug, dollar, warehouse clubs and supermarkets) as well as Internet-based retailers--including Amazon (AMZN). Though the industry is not terribly cyclical, economic conditions, disposable income, credit availability, fuel prices, and unemployment levels drive ticket size and traffic trends. Offering consumers a compelling value proposition is a must, even as higher-priced organic food offerings proliferate.

The national average for gas prices are over $1 lower than at this time a year ago, according to reports, though places in the Midwest continue to feel the pinch at the pump from a key refinery shut down in Indiana. Other economic conditions have been relatively favorable, with unemployment rates reaching the lowest level since early 2008 and job openings approaching all-time highs. These and other factors have helped Kroger (KR), SuperValu (SVU), and Whole Foods Market (WFM) to top-line growth in their most recently reported quarters, and cost controls continue to be a key driver behind earnings leverage across the group.

Let's take a closer look at the quarterly performance of each of these three major grocers.

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Kroger Has Reported Nearly 50 Consecutive Quarters of Same Store Growth

Kroger's recently reported results for the quarter ended August 1 caught the attention of investors, as its shares rallied following its release September 11. The company reported identical supermarket sales excluding fuel growth of over 5%; the quarter represents Kroger's 47th consecutive quarter of identical supermarket sales, excluding fuel, growth. Including fuel sales, the identical supermarket sales grew at a much more modest rate of 1.3%, a direct result of lower gasoline prices compared with the year-ago period.

Kroger reported net earnings of $433 million, or $0.44 per share, representing nearly 25% growth compared to the second quarter of fiscal 2014. Management cited its ability to leverage operating expenses due to strong cost controls and improving fuel margins as drivers for this significant pace of earnings expansion. The outstanding results led the company to raise its guidance for earnings per share for the full fiscal year. It is now expecting net earnings per diluted share in a range of $1.92-$1.98, compared to the previous guidance range of $1.90-$1.95. Kroger also raised its full-year expectations for identical supermarket sales growth from a range of 3.5%-4.5% to 4%-5%.

Without a doubt, Kroger is executing at a very high level. However, we'd prefer the company have a stronger balance sheet. It has only $268 million in cash on the books, compared to current debt over $1.5 billion and long-term debt of nearly $10 billion. Even though Kroger sports an investment-grade credit rating supported by a manageable net debt to adjusted EBITDA ratio of ~2, in the context of other ideas, we're not fans of this kind of leverage in such a competitive environment. Kroger yields just north of 1%.

SuperValu Slowly Improving

SuperValu reported its first quarter of fiscal 2016 results, ended June 20, in late July. The firm experienced revenue growth of 2.7% to $5.41 billion, and it leveraged such growth into operating earnings expansion of ~17% to $158 million compared to the year-ago period. The strong pace of earnings growth was driven by the increase in sales, as well as an improved gross margin--which advanced 60 basis points compared to the first quarter of fiscal 2015--and lower logistics costs. Management is confident in its ability to continue to effectively manage costs, even in an environment where sales growth wanes. Net earnings from continuing operations advanced from $0.18 in the prior-year period to $0.23 in the quarter.

SuperValu's cash from continuing operations more than doubled compared to the year-ago period, to $111 million. However, the company will need to string together several quarters of this type of cash flow generation to return to stable, financial ground as its debt-load far outweighs its cash position. Unlike Kroger, SuperValu's credit rating is junk status, and as of the end of the quarter, the firm had $2.2 billion in long-term debt compared to just $137 million in cash and equivalents. Though both of these measures have improved from the same time a year ago, SuperValu has a history of cash-flow mismanagement, as it was forced to suspend its dividend in 2012 in order to lower prices to compete with other grocers.

SuperValu is planning a spin off of its discount grocery store chain Save-A-Lot into a standalone public company. The firm believes this move will unlock additional value for its Save-A-Lot brand and its independent and retail food businesses; the separation would allow for greater management focus at each of the business units, with greater flexibility for each business to pursue its best interests while having a more focused allocation of capital investment. We generally like the potential move, though it is not likely to happen until sometime in 2016 at the earliest.

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Whole Foods Market Experiences Slow Organic Growth

Whole Foods Market reported the results of its fiscal 2015 third quarter, ended July 5, on July 29. The firm realized record quarterly revenue of $3.6 billion, or growth of 8%. Comparable store sales grew 1.3% on a constant currency basis. Operating income was relatively flat at $247 million compared to the year-ago period, as the cost of goods sold advanced at a higher pace than sales.

Free cash flow fell from $77 million in the comparable period of fiscal 2014 to $67 in the third quarter of fiscal 2015 due to increased capital expenditures. The deteriorating cash-flow generation isn't as concerning, however, as Whole Foods has a relatively strong balance sheet. It has essentially no long-term debt, which compares to over $800 million in cash, equivalents, and short-term investments on the books.

Whole Foods may very well need this financial flexibility in the near future, as it continues to navigate a series of public relations obstacles. New York City inspectors uncovered what they described to be "the worst case of overcharging" they had ever witnessed, where Whole Foods charged too much on weight-based pricing due to inaccurate labeling. Whole Foods has broken its trust with consumers, and many are flocking to the web to mock the company's products, the latest in regards to asparagus water.

For the full fiscal year of 2015, Whole foods is expecting sales growth of approximately 9%, driven by the opening of 38 new stores and boosted by comparable store sales growth in the low-single digits. It is projecting EBITDA to be ~9% of sales, which it surpassed in its fiscal third quarter with $353 million in EBITDA, or 9.7% of sales.

Wrapping Things Up

Though the top-line growth of each of these food retailers has been solid, we find issues with each of them as investment ideas. Kroger and SuperValu have significant financial leverage that we are not fond of, and SuperValu has a history of cash-flow mismanagement; we don't think investors will ever forget the suspension of its payout in 2012. Whole Foods has a much healthier balance sheet, but with the current public relations headwinds it is facing, we would like to see some traction in a recovery before considering it as an investment idea. On an operational standpoint, however, Kroger stands head-and-shoulders above its peers, in our view.

Unemployment Rate Falls to 5.1%! Great Times in America!

By Brian Nelson, CFA

The future is all that matters. This is a basic tenet of the stock market, where prices of equities are forward-looking discounting mechanisms.

August is now over, and we learned that the job market in the United States is close to the healthiest it has been in a long time—that is, if you buy into the data calculations behind the national unemployment rate, which now stands at a 5.1%. The mark is the lowest level since the Great Recession of late last decade and is now roughly half the levels experienced at the "height" of the Great Recession, which drove 10% of Americans that were willing to work out of a job.

The Fed has worked a "miracle," pulling the US from the edge of a cliff, over which was the coming of a modern-day Great Depression, and times are so good in America that "would-be" workers are leaving the civilian labor force in droves. The labor force participation rate held near all-time lows of 62.6% in August, hovering near the lowest levels in decades, while civilian employment remains near all-time highs matching the near all-time highs in the civilian labor force. The Bureau of Labor Statistics is not "fudging" the numbers, in our view, contrary to the latest musings of conspiracy theorists, nor do we think the unemployment rate is being propped up by "depressed" labor participation rate numbers from workers unable to locate "suitable" work.

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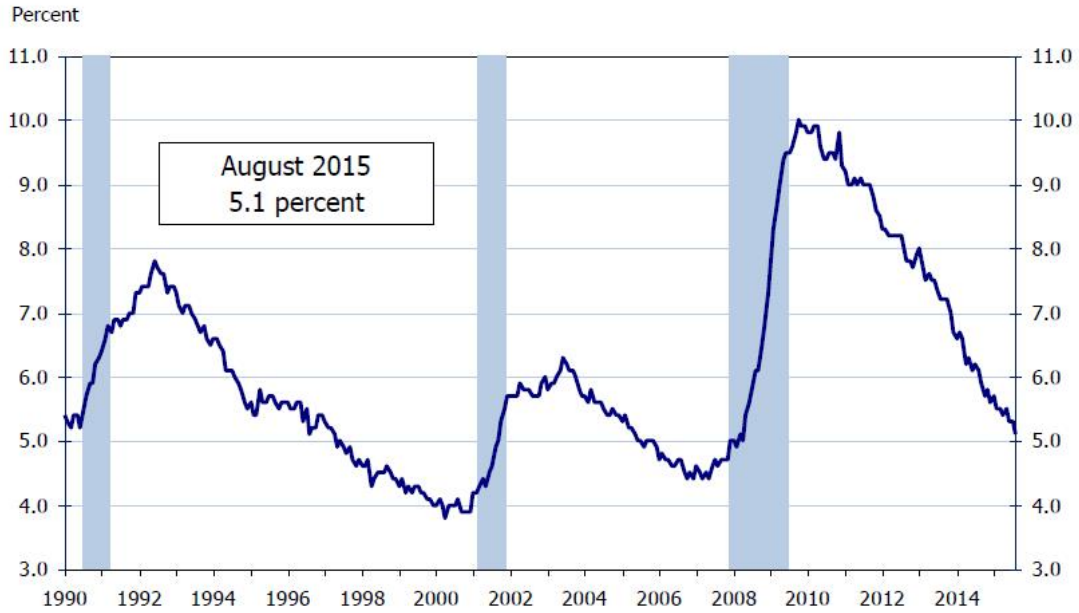

Note: Shaded areas represent recessions as determined by the National Bureau of Economic Research (NBER). Data online at http://data.bls.gov/timeseries/LNS14000000.

Source: Bureau of Labor Statistics, Current Population Survey, September 4, 2015.

Quite simply, we believe that due to accumulated wealth or other life decisions, people that don't want to work are leaving the work force and people that want to work are finding jobs like never before, for the most part. Frictional job shifts and a mismatch of skills will prevent near-0% unemployment, but "persons not in the labor force who want a job," a tally of ~6 million is only a smidgen above the 5.2 million available job openings, as of June. The pace of new job openings has been hovering at a 3% monthly pace. Those not currently working but want a job may disagree, and they have every right, too, but times in America are great, and a sub-5% mark for the unemployment rate may be just around the corner!

Savvy readers, however, understand that such optimism means little when it comes to the stock market. Just ask Radio Shack, or Eastman Kodak (KODK) or Washington Mutual, now a part of JP Morgan (JPM), or Merrill Lynch, now a part of Bank of America (BAC) how little their histories mattered as they were swept into financial distress.

There are as many ways to interpret the numbers as there are economists, but one thing is clear: we've come a long way since the depths of the Great Recession, and for the most part, consumers aren't as much upset about finding a job as they are about getting paid more. We had outlined in March that the only mention of "deflation" in the latest Fed minutes at the time, the January 27-28 meeting, was in relation to wages, something we called out as "ludicrous." Just a few short months later, highlights from the recent Beige Book released earlier this month centered on wage pressures.

The imposing strength of organized labor, something best exemplified in the falling price of Republic Airways (RJET) stock, which is battling for survival in light of disagreements with its pilots' union, and the domino effect of $15 minimum wage legislation across the largest cities in the country, have been taking their toll on business health. Walmart (WMT) is struggling to contain costs in light of continued investments in store associate wages, and

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the impact of minimum wage hikes have yet to take their toll on fast-food giants McDonald's (MCD) and Yum! Brands (YUM), among others. Fast-casual companies won't be spared either, as Panera Bread's (PNRA) most recent performance revealed.

We're not sure the Fed has a good handle on the US economy, and the labor report September 4 will likely have little bearing on whether it raises rates later this month, given recent dislocations in Asia and the recent US market crash. Richmond Fed President Jeffrey Lacker seems to be of the opinion that everything is going great in the US, however, and that a rate hike is "warranted sooner rather than later." He also tends to agree with our view that "research suggests that there is little if any excessive slack in the labor market." As we've outlined many a time before, the problem with looking strictly at economic indicators with respect to a coming contractionary monetary policy is the profound impact that a tightening would have on high-yielding dividend paying equities--which are priced more like bonds than anything else due to recent Fed policy, fair or not.

Not only are the fixed-income markets tied at the hip to Fed policy, but more so than in any other time in the history of financial markets, due in part to the current relationship between dividend yields and commonly-followed Treasury benchmark securities, accommodative and dovish Fed policy has become vital to the sustainable health of the equity markets. They've become interconnected in such a way arguably like never before. If we get a rate hike in September, the markets will likely sell off in the weeks and months following the announcement, even if it is met with relief at the time of the announcement. If we don't get a rate hike, the realities of the "Asian Contagion" are likely much more serious than even we have pondered, and the realities of such a dynamic coming to fruition may be even more concerning than any damage that any series of ill-timed rate hikes could ever do.

Broad market indexers could be in for more sliding in coming months.

The Watch List

By Valuentum Analysts

The Valuentum Buying Index (VBI), which places a considerable emphasis on a firm's valuation, is the primary driver behind companies included in our Best Ideas portfolio (see page 8). 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 often hold a number of these firms in our portfolio, 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.

Company Name	Symbol	Industry	DCF Valuation	Relative Valuation	P/FV
Commercial Vehicle Group	CVGI	Machinery - trucks	UNDERVALUED	ATTRACTIVE	0.45
Michael Kors Hldg	KORS	Luxury - Ultra & Aspirational	UNDERVALUED	ATTRACTIVE	0.60
Owens-Illinois	OI	Containers & Packaging	UNDERVALUED	ATTRACTIVE	0.68
Semtech Corp	SMTC	Integrated Circuits	UNDERVALUED	ATTRACTIVE	0.68
Gilead Sciences	GILD	Pharma - Generic/Other	UNDERVALUED	ATTRACTIVE	0.71
Priceline.com	PCLN	Internet & Catalog Retail	UNDERVALUED	ATTRACTIVE	0.72
Avnet	AVT	Electronic Suppliers	UNDERVALUED	ATTRACTIVE	0.73
Tenneco	TEN	Auto Parts Suppliers	UNDERVALUED	ATTRACTIVE	0.73
Perficient	PRFT	Business Services	UNDERVALUED	ATTRACTIVE	0.73
WP Carey	WPC	REIT - Retail	UNDERVALUED	ATTRACTIVE	0.74
Omega Healthcare	OHI	REIT - Healthcare	UNDERVALUED	ATTRACTIVE	0.75
NASDAQ	NDAQ	Exchanges	UNDERVALUED	ATTRACTIVE	0.76
Baidu	BIDU	Internet Software & Svcs	UNDERVALUED	ATTRACTIVE	0.78
Nathan's Famous	NATH	Restaurants - Fast Food & Coffee	UNDERVALUED	ATTRACTIVE	0.78
Outerwall	OUTR	Specialty Retailers	UNDERVALUED	ATTRACTIVE	0.79
AIG	AIG	Insurance - Property & Casualty	UNDERVALUED	ATTRACTIVE	0.79

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*Ideas...*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.

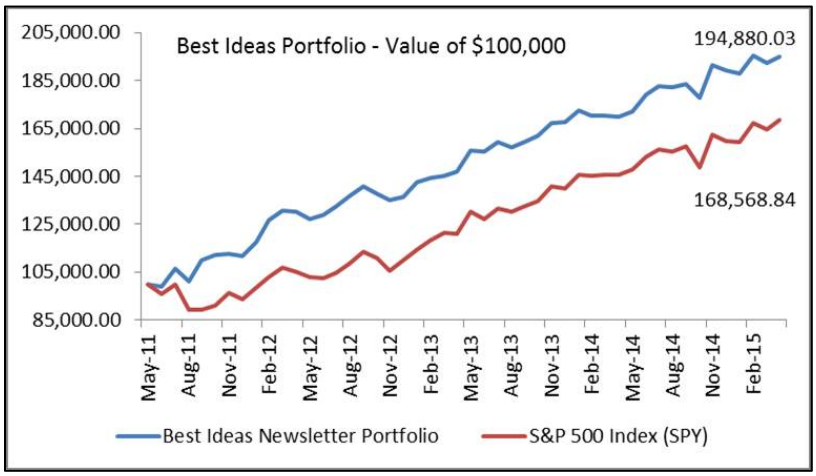
Company Name	Symbol	Sector	Industry	VBI
AIG	AIG	Financials	Insurance - Property & Casualty	9
Gilead Sciences	GILD	Health Care	Pharma - Generic/Other	9
NASDAQ	NDAQ	Financials	Exchanges	9
Omega Healthcare	OHI	Financials	REIT - Healthcare	9
Michael Kors Hldg	KORS	Consumer Discretionary	Luxury - Ultra & Aspirational	8
Nathan's Famous	NATH	Consumer Discretionary	Restaurants - Fast Food & Coffee	8
Owens-Illinois	OI	Materials	Containers & Packaging	8

Air Products & Chemicals	APD	Materials	Chemicals - broad	2
Alere	ALR	Health Care	Health Providers & Svcs	2
Bright Horizons Family	BFAM	Consumer Discretionary	Personal Services	2
Eli Lilly	LLY	Health Care	Pharmaceuticals - Big	2
Jack Henry	JKHY	Information Technology	IT Services	2
Mercury General	MCY	Financials	Insurance - Property & Casualty	2
National Beverage	FIZZ	Consumer Staples	Beverages - nonalcoholic	2
Rollins	ROL	Materials	Chemicals - mid/small	2
Royal Caribbean	RCL	Consumer Discretionary	Leisure	2
Ball Corp	BLL	Materials	Containers & Packaging	1
BioMarin Pharma	BMRN	Health Care	Biotechnology	1
Brown-Forman	BF.B	Consumer Staples	Beverages - alcoholic	1
Choice Hotels	CHH	Consumer Discretionary	Hotels	1
Columbia Sportswear	COLM	Consumer Discretionary	Retail - Under 30, Off-Price, Sport Appa	1
Hess	HES	Energy	Refiners	1
Hyatt	H	Consumer Discretionary	Hotels	1
Jack in the Box	JACK	Consumer Discretionary	Restaurants - Fast Food & Coffee	1
Lowe's	LOW	Consumer Discretionary	Specialty Retailers	1
Madison Square Garden	MSG	Consumer Discretionary	Media - entertainment	1
Magellan Midstream	MMP	Energy	Oil & Gas Pipelines	1
Manhattan Associates Inc	MANH	Information Technology	Software	1
MSCI	MSCI	Information Technology	Software	1
NewMarket	NEU	Materials	Chemicals - mid/small	1
Novartis	NVS	Health Care	Pharmaceuticals - Big	1
Novo Nordisk	NVO	Health Care	Pharmaceuticals - Big	1
Rayonier	RYN	Industrials	Conglomerates	1
WABCO	WBC	Consumer Discretionary	Auto Parts Suppliers	1

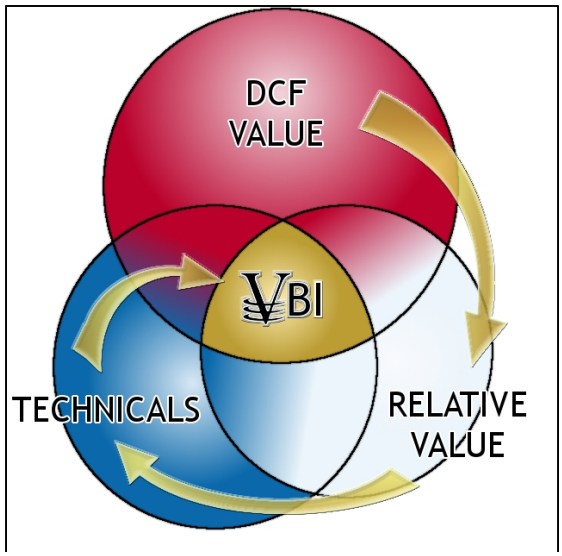
Our Methodology – The Valuentum Buying Index (VBI)

By Valuentum Analysts

At Valuentum, 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 deep-pocketed institutional investors that are interested in the stock for reasons based on their respective investment mandates, the more likely it will be bought and the more likely the price will move higher to converge to its true intrinsic value (buying a stock pushes its price higher). On the other hand, we think the worst stocks will be shunned by most investment disciplines and display expensive valuations, poor technicals and deteriorating momentum indicators.



Stocks that meet our demanding criteria fall in the center of the Venn diagram below, displaying attractive characteristics from a discounted cash-flow basis, a relative value basis, and with respect to a technical and momentum assessment. The size of the circles reveals the relative emphasis we place on each investment consideration, while the arrows display the order of our process -- value first then technicals and momentum last. We may like firms that are undervalued both on a DCF basis and relative value basis, but we won't like firms just because they're currently exhibiting attractive technical or momentum indicators. We're not traders or speculators. We're long-term investors and want to have complete confirmation and conviction in the best ideas we deliver to our subscribers.



Our Methodology – The Valuentum Buying Index continued on next page

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The center of the Venn diagram on the previous page, 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). Because our process factors in a technical and momentum assessment after we evaluate a firm's investment merits via our rigorous DCF and relative-value process, we're better able to pinpoint the best entry and exit points on the most undervalued stocks.

Research firms that just focus on valuation may encourage investors to buy a stock all the way down (a falling knife), while those that just use technical and momentum indicators may expose portfolios to significantly overpriced stocks at their peaks. Only when both sides of the investment spectrum are combined can investors get the best stocks on the market today at the best prices, in our view.

Let's examine the chart below, which showcases how the Valuentum process has the greatest profit potential of any investing strategy. The Valuentum process targets adding stocks to actively-managed portfolios when both value and momentum characteristics are "good" and removing them when both value and momentum characteristics are "bad" (blue circles: Buy --> Sell). The Valuentum strategy captures the entire equity pricing cycle, while the value and momentum strategies individually truncate profits.

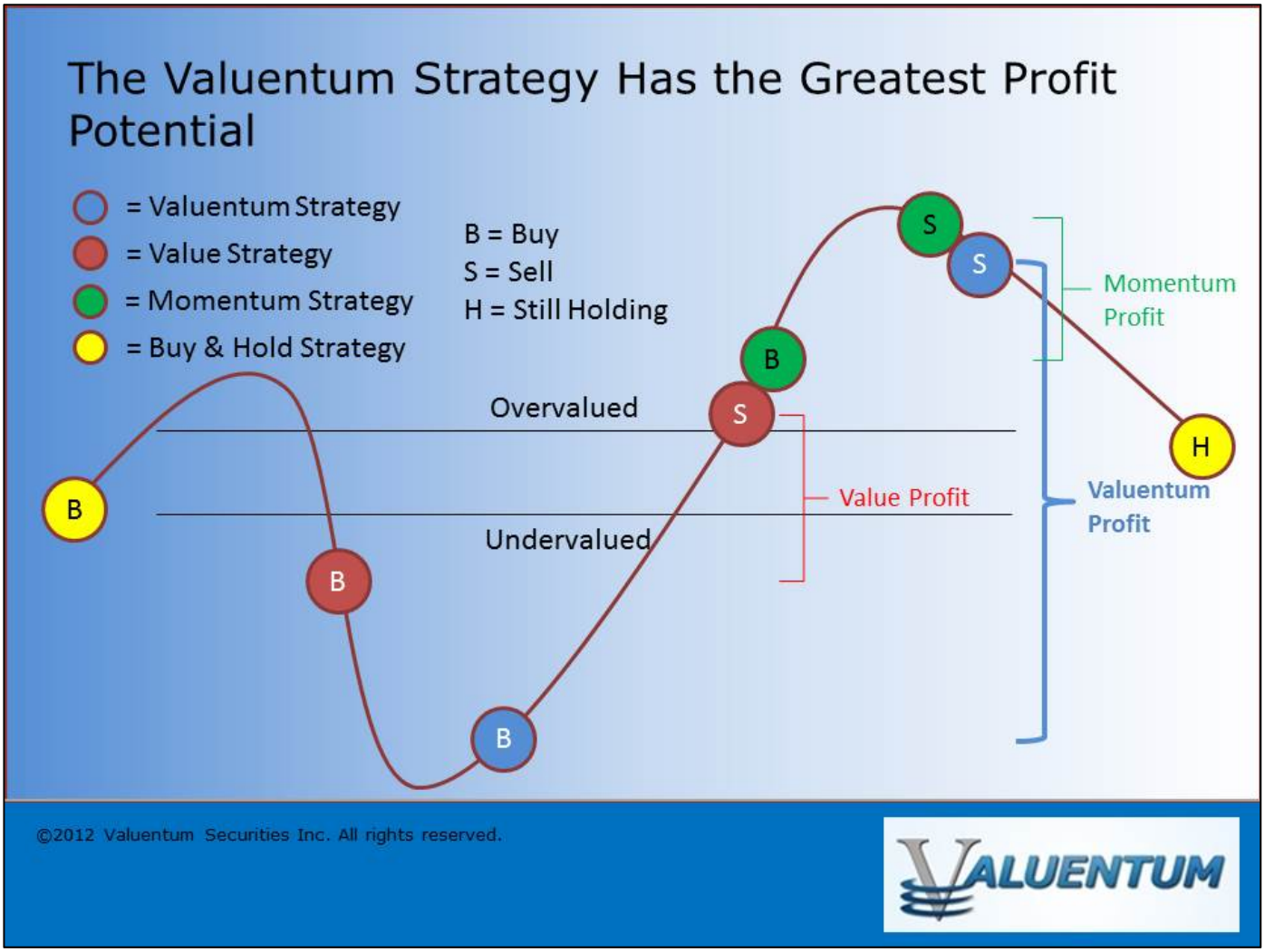

Illustration for educational purposes only.

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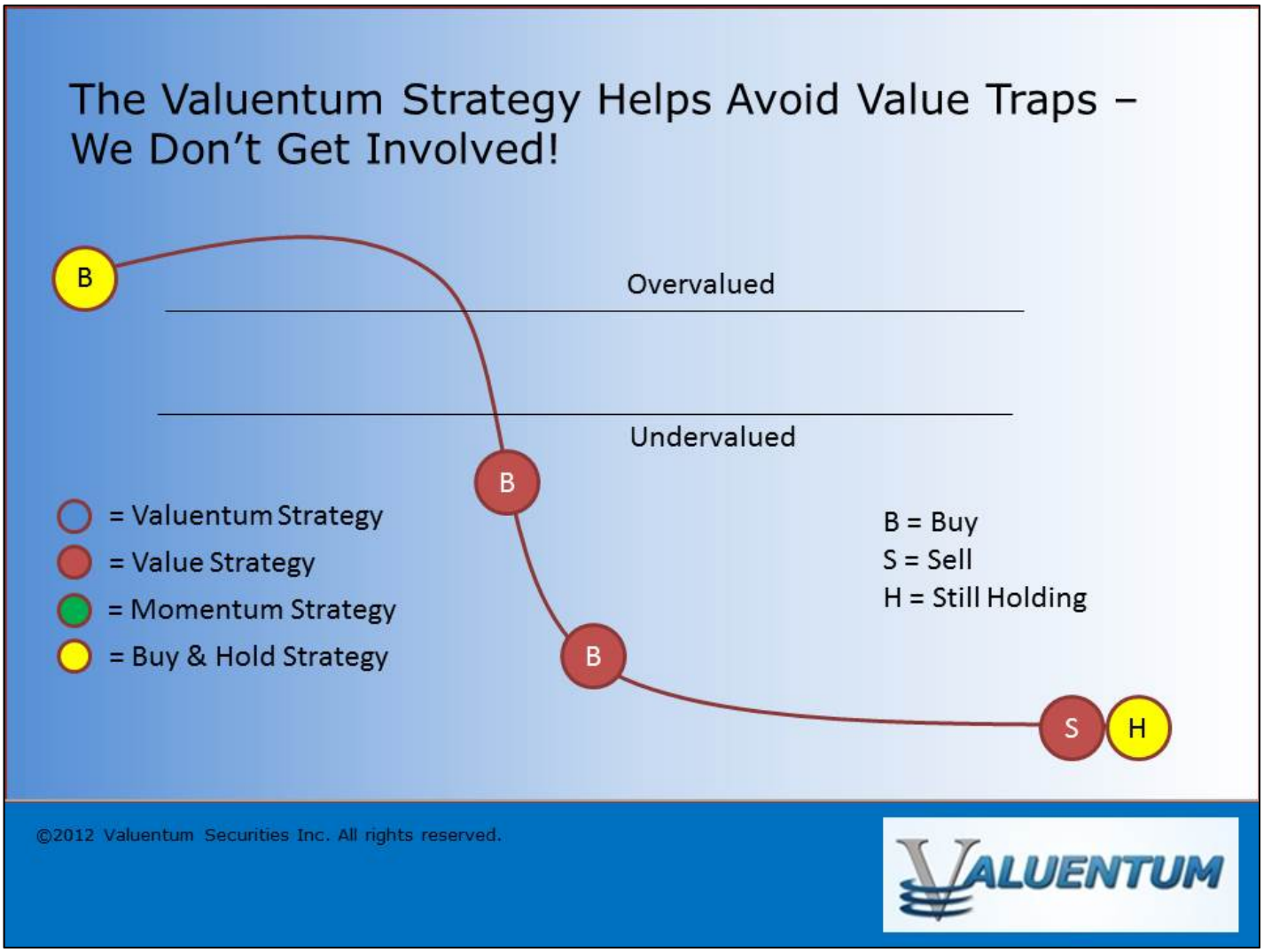
Furthermore, Valuentum subscribers are less likely to be involved in value traps because we demand material revenue and earnings growth for firms to earn a 10 on our Valuentum Buying Index. Value traps often occur as a result of secular declines in a firm's products or services, resulting in deteriorating revenue and earnings trends (and a falling stock price). Valuentum subscribers are less likely to be exposed to these "falling knives" since our process requires firms to not only be undervalued but also be exhibiting bullish technical and momentum indicators before we would consider adding them to our actively-managed portfolios.

Since the stock market is a forward-looking mechanism, price usually leads fundamentals. Without a turnaround in price, the risk that the fundamentals of an undervalued stock have not turned for the positive is higher. Where value strategies may encourage the buying of a stock all the way down regardless of whether fundamentals ever turn (red circles: Buy --> Sell), the Valuentum strategy simply steers clear of these situations. We wait for technical improvement in the equity, which often precedes fundamental changes at the company.

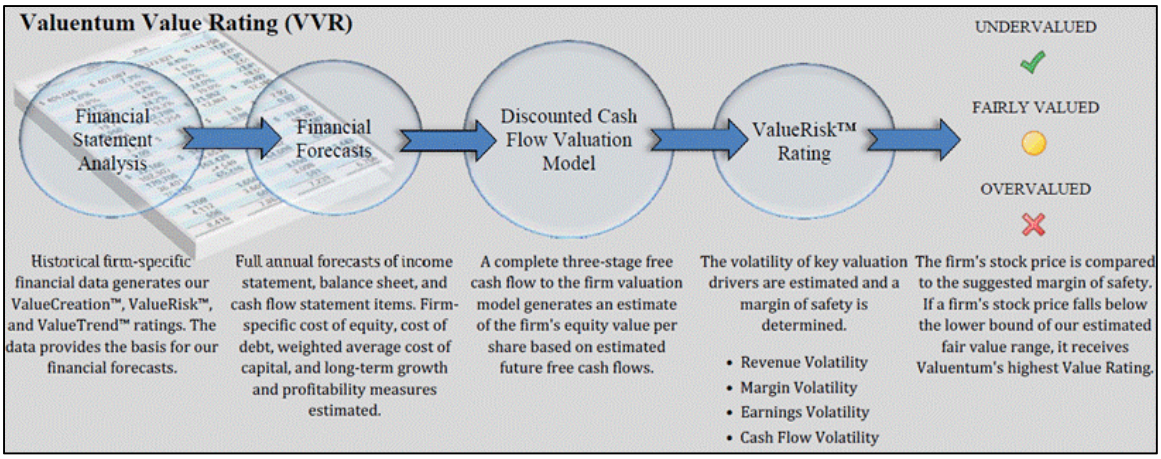


Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

I. We Use a Rigorous Discounted Cash Flow Valuation Process

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. We compare a company's return on invested capital (ROIC) to our estimate of its weighted average cost of capital (WACC) to assess whether it is creating economic profit for shareholders (ROIC less WACC equals economic profit). Firms that have improving economic profit spreads over their respective cost of capital score high on our ValueCreation and ValueTrend measures, while firms that have relatively stable returns score well with respect to our ValueRisk evaluation, which impacts our margin-of-safety assessment.



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 then 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.

We think a focus on discounted cash-flow valuation prevents investors from exposing their portfolios to significantly overpriced stocks at their peaks. The chart below reveals how pure momentum investors may expose their portfolios to pricing extremes and dramatic falls (green circles: Buy --> Sell). We stay away from these situations.

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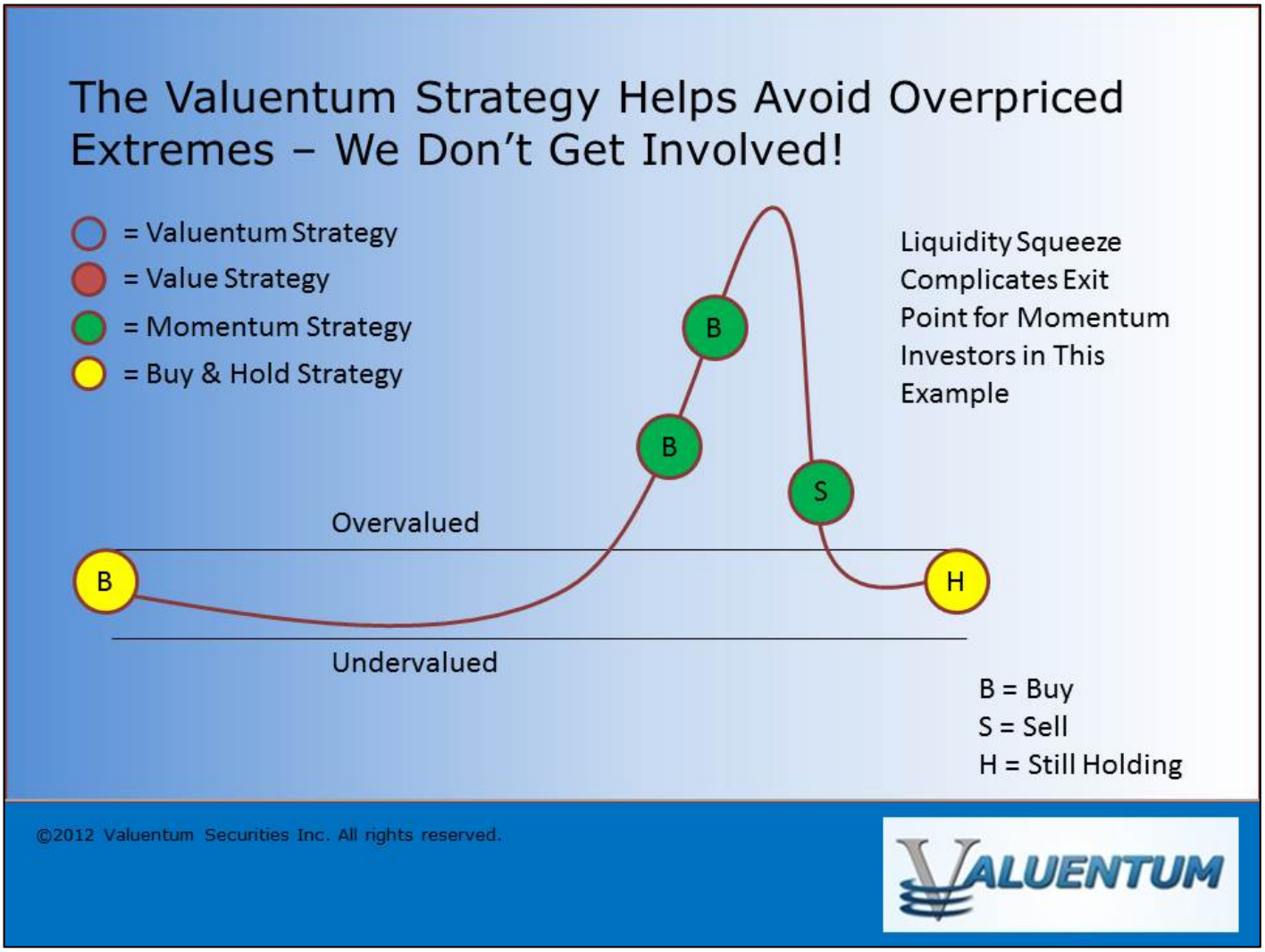

II. We Perform a Forward-Looking Relative Value Assessment

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, 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 making buy/sell decisions. 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.

III. We Seek to Avoid Value Traps, Falling Knives 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 whether it has 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 (but only after it meets our stringent

Our Methodology – The Valuentum Buying Index continued on next page

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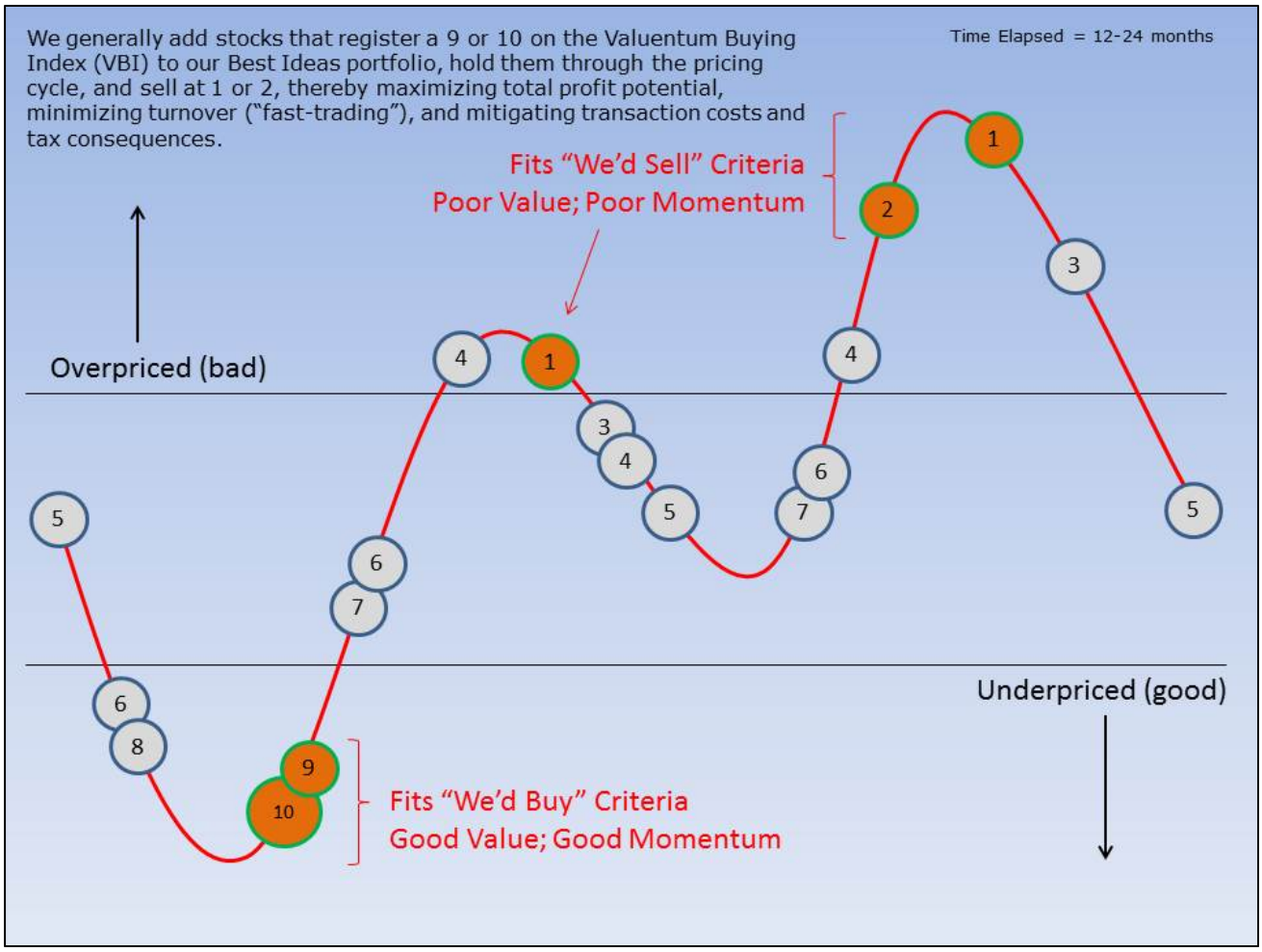
valuation criteria). Rigorous valuation analysis and technical analysis are not mutually exclusive, and we believe both can be used together to bolster returns. An evaluation of a stock's moving averages, relative strength, upside-downside volume, and money flow index are but a few considerations we look at with respect to our technical and momentum assessment of a company's stock.

We embrace the idea that the future is inherently unpredictable and that not all fundamental factors can be included in a valuation model. By extension, we use technical and momentum analysis to help safeguard us against value traps, falling knives, and the opportunity cost of holding an undervalued equity for years before it converges to fair value. Other research firms do not consider opportunity cost as a legitimate expense for investors.

Putting It All Together - the Valuentum Buying Index

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.

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, as shown below.



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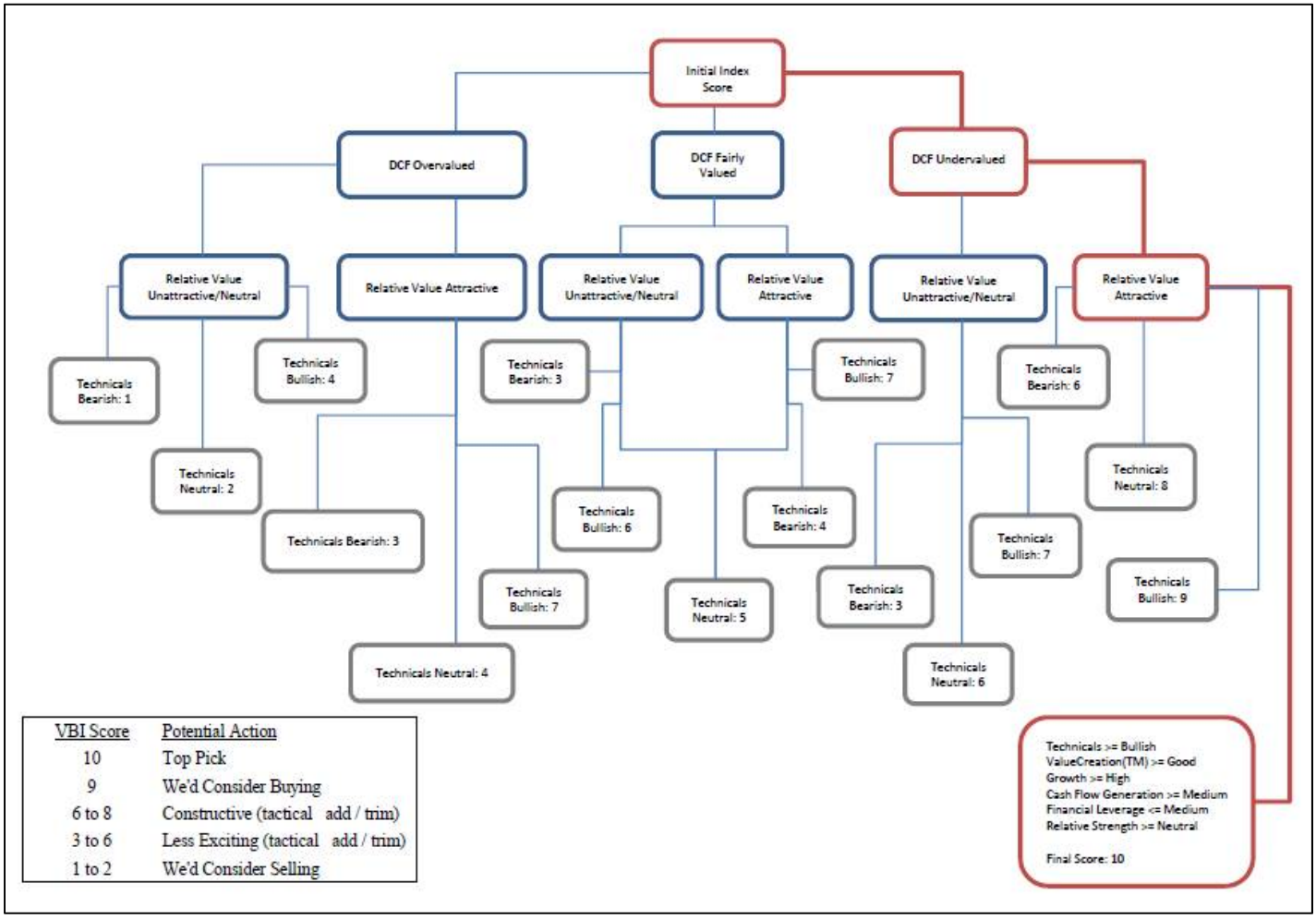
Let's follow the red line on the flow chart below to see how a firm can score a 10, the best mark on our index (a "Top Pick"). Please click here to view an enlarged pdf version. First, the company would need to be 'UNDERVALUED' on a DCF basis and 'ATTRACTIVE' on a relative value basis. The stock would 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 sell"). 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	Potential Action
10	Top Pick
9	We'd Consider Buying
6 to 8	Constructive (tactical add / trim)
3 to 6	Less Exciting (tactical add / trim)
1 to 2	We'd Consider Selling

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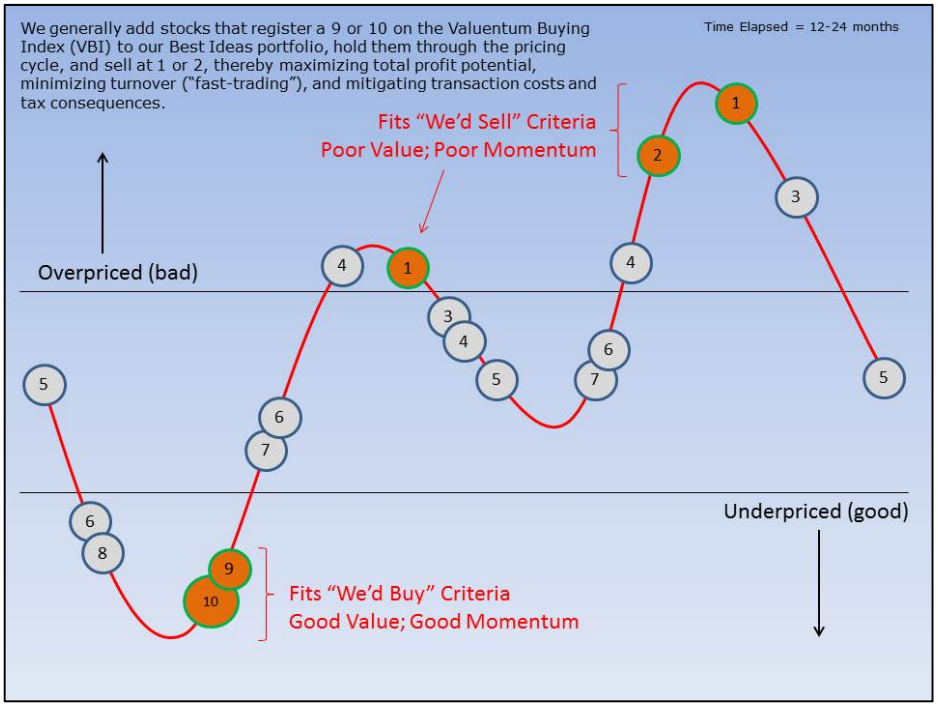
How We Use the Valuentum Buying Index in the Best Ideas Newsletter Portfolio

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 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 truncated 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.



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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 (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.

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.

About Our Name

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 to momentum investing. And a combination of the two approaches found on each side of the spectrum (value/momentum) in a name couldn't be more representative of what our analysts do here; hence, we're called Valuentum.

Valuentum Best Ideas Newsletter: Volume 5, Issue 9

Valuentum's Best Ideas Newsletter is published monthly. To receive this newsletter on a monthly basis, please subscribe to Valuentum by visiting our website at www.valuentum.com. Or contact us at info@valuentum.com.

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This report is not intended as a recommendation of the securities highlighted or any particular investment strategy. Before acting on any information found in this report, readers should consider whether such an investment is suitable for their particular circumstances, perform their own due-diligence, and if necessary, seek professional advice. This report has not been tailored to suit any particular person's portfolio or holdings.

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No warranty is made regarding the accuracy of any data or any opinions. The portfolio in the Valuentum Best Ideas Newsletter is hypothetical and does not represent real money. Performance assessment of the Valuentum Buying Index™ is currently ongoing, and we intend to update investors as soon as such results are available. Past performance is not a guarantee of future results.

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

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