OUR BEST IDEAS NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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Valuentum Securities Inc.
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Portfolio Return	Benchmark Return	Outperformance
98.2%	64.2%	34.1pts

See page 8.

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

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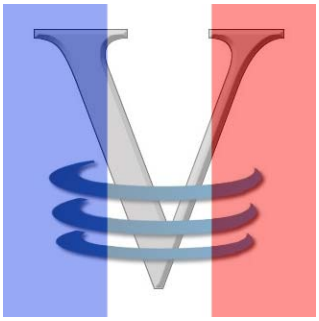

Goals of our Best Ideas Newsletter: We want to deliver positive returns to you, our subscriber, year after year, in addition to outperforming the market benchmark. Our Best Ideas portfolio is generally found on page 8 of each edition.

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Beginning of BlackBerry Turnaround?

By Kris Rosemann

A few recent developments could be pointing to a turnaround at BlackBerry, or is it too little too late?

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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 28 for more details about how the team utilizes the Valuentum Buying Index to run the portfolio.

Last January, we were puzzled by the situation surrounding BlackBerry (BBRY), and judging by the volatility in shares, many other investors were as well. The firm denied rumors that it would be purchased for a substantial premium by competitor Samsung (SSNLF) in hopes to continue its efforts to create a larger, more diverse portfolio to compete with Apple (AAPL); BlackBerry continues to bet on its ability to use its own patent portfolio to facilitate a turnaround, even if tying the knot may still be the easy way out. In any case, the possibility that such a turnaround has finally begun has increased…maybe.

In early November, BlackBerry completed the acquisition of secure mobile communications leader Good Technology for $425 million in cash, following the closing of the acquisition of AtHoc, a leading provider of secure, networked crisis communications, for $250 million in cash, in September. Though both of these deals have eaten into BlackBerry's net cash position, the firm retains a strong balance sheet, which will be integral in the continued turnaround efforts for the company. On a reported basis, its net cash balance at the end of August was over ~$2 billion, a nice sum (~$3 per share).

We like that Blackberry is not going "gentle into that good night," and while its difficult at the moment to say whether either will bear significant fruit beyond current expectations, both acquisitions will materially expand BlackBerry's portfolio in mobile cross-platform software and services; both also have exposure to a wide range of mobile operating systems, including the iOS. The majority of Good Technology's activations, for one, come from iOS device users, giving BlackBerry's security offerings enhanced potential to capitalize on Apple's strong position in the smartphone market.

The Good Technology acquisition is expected to be accretive to earnings and free cash flow in the first year following the closing of the deal and will contribute approximately $160 million in revenue in the first year to

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BlackBerry's software and services segment, where non-GAAP revenue grew 19% in the second quarter of fiscal 2016, ended August 29. Looking ahead to the rest of 2016, BlackBerry continues to anticipate positive free cash flow, as well as sustainable profitability beginning in the fourth quarter of fiscal 2016, which will end in February 2016. In the six months ended August 29, net cash provided by operating activities was $244 million and capital spending was $21 million, resulting in free cash flow of $223 million.

We have to say: we're starting to like the financials…

That said, in order to achieve sustainable profitability, BlackBerry is counting on its new handheld device, the BlackBerry Priv, which aims to combine the "the best of BlackBerry security and productivity with the expansive mobile application ecosystem available on the Android platform." The device has received good reviews, and perhaps most encouragingly is the fact that it sold out within hours of being listed on Amazon (AMZN). Best Buy (BBY) lists the device as "coming soon," and AT&T (T) is currently the only carrier to offer the Priv in the US, giving little visibility into the true demand for the smartphone.

Image Source: Blackberry

Pictured: The PRIV, a Blackberry secure smartphone, powered by Android

Despite the positive (optimistic?) reviews for the Priv, we are not sold on the staying power of a device with a slide-out, physical keyboard in the current market dominate by touch screens. We doubt that it will convert many iPhone users that are simply in love with the "magical" device. It is possible that the Priv could carve out a niche position as we do believe it is a unique offering, but this may depend on improvements and iterations moving forward. At the moment, we're viewing the Priv as a step in the right direction but not a slam dunk, by any means. According to engadget, the Priv prices for $1,100, certainly not a value device.

All in, however, if BlackBerry can recapture even a small piece of the smartphone market share, while continuing to grow its software and services segment, its turnaround efforts may bear fruit. We like the recent strategic acquisitions, and the increased exposure they provide to iOS is compelling. The turnaround remains a speculative bet, but our back of the envelope calculation values Blackberry's balance sheet at $3 per share and its free-cash-flow positive operations at $6 per share, arriving at a fair value estimate of $9. If the Priv turns out to be as popular as its first few hours on Amazon, we could see upside to the high end of the fair value range, or $12 per share.

Blackberry has found a way onto our radar screen. We can't believe it either. The arrow may finally be pointing up at BlackBerry.

Catching Up With Some of Our Best Ideas

By Kris Rosemann

Teva Pharmaceutical (TEVA)

Teva Pharmaceutical has been a key source of outperformance for the Best Ideas Newsletter portfolio since its addition in mid-2013, with its return excluding dividends currently at ~50%. We continue to think the generic pharma space offers significant opportunities for participants, and we like Teva's global market position. We're particularly big fans of its 'first-to-file' position in the US generics market, and we like its efforts to protect specialty drug Copaxone as the world's leading treatment of multiple sclerosis.

In the third quarter of 2015, foreign exchange rates took a slight toll on Teva's reported revenue, which fell 5% from the year-ago period to $4.8 billion; on a constant currency basis, revenue increased 3%. Non-GAAP operating income and non-GAAP earnings per share both advanced 2% in the quarter to $1.6 billion and $1.35, respectively. Margin improvement came from decreased sales and marketing expenses, which were partially offset by increased general expenses and research and development spending.

Teva has labeled the third quarter of 2015 as a transformative period, as it focused the majority of its efforts on the completion of a number of acquisitions, including the $40.5 billion acquisition of Actavis Generics, previously a part of Allergan (AGN), a deal that will expand the firm's commercial and research and development capabilities and geographic presence. Its generics segment has been firing on all cylinders with respect to profitability; the segment's profit margin has advanced more than 12 percentage points since 2013. This should only improve over time following the closing of the Actavis deal expected in the first quarter of 2016.

The firm's specialty medicines segment performed well on an organic basis in the third quarter of 2015, as revenue grew 5% when excluding the impact of foreign exchange rates. Teva's blockbuster drug Copaxone reported record quarterly sales in the US. Specialty medicines profitability grew 2% in the quarter, mostly due to reduced sales and marketing expenses. The company has a diverse specialty pipeline from early stage development through the registration phase that will continue to drive growth in the segment for years to come. A snapshot of the pipeline as of the end of the third quarter of 2015 can be seen below.

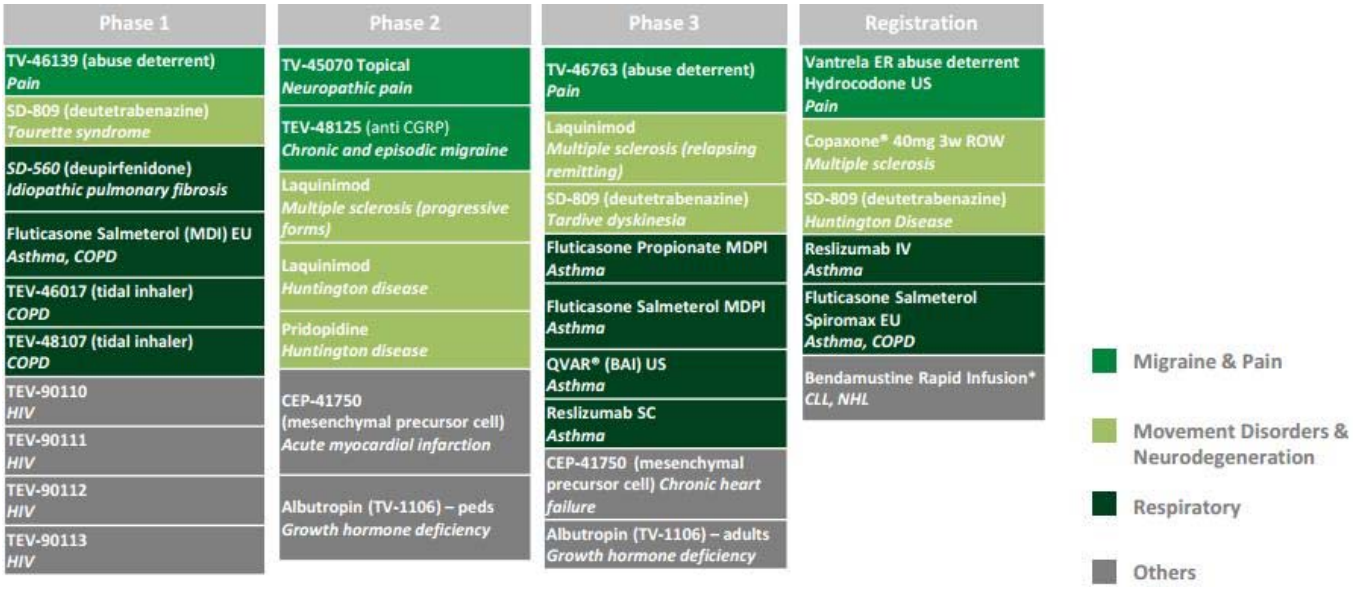

Image source: Teva quarterly presentation

Strong bottom-line performance throughout its business led Teva's management to raise its full-year 2015 guidance yet again; the firm has raised its guidance after each quarter in 2015. The generics pharma giant is now expecting earnings per share to be in a range of $5.40-$5.45, up from previous guidance of

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$5.15-$5.40. All in, we think there remains significant opportunity in Teva's existing pipeline, as well as the acquisition of Actavis. The upside of our fair value range suggests shares could easily reach the upper $70s.

Union Pacific (UNP)

Union Pacific remains our favorite railroad idea on a fundamental basis, and its shares have provided just over an 11% return since addition to the Best Ideas Newsletter portfolio in mid-2013, excluding dividends received. We expect the firm's operating ratio (a unique railroad term measured as one less its operating margin) to be among the best in the railroad industry by the end of this decade, and we like its exposure to growth in Mexico as well as future export expansion on the West Coast. Though less so than several of its East Coast peers, the railroad is still levered to coal, which has been a source of weakness in the company's recent performance as demand for variants of the commodity has declined significantly.

Total operating revenue for Union Pacific in the third quarter of 2015 fell 10% from the year-ago period, as volume declined 6% and offset core pricing gains. Coal, industrial products, and intermodal volumes all declined at a double-digit pace in the period. This pushed operating income down 5% and diluted earnings per share 2% lower, despite the company setting an all-time quarterly record for operating ratio. At 60.3%, Union Pacific's operating ratio improved 2 percentage points on a year-over-year basis and is a 1.1 percentage point improvement over the previous quarterly record, set in the fourth quarter of 2014. Lower fuel costs were the main driver and accounted for 1.5 percentage points of improvement. The company paid 40% less on average for diesel fuel in the quarter, compared to the third quarter of 2014.

Looking ahead to the rest of 2015 and into the next year, Union Pacific continues to face uncertainties. Volatile energy prices, the ever-fickle consumer economy, unpredictable grain markets, and the strengthening US dollar as it relates to export growth will all play a part in the demand for the firm's railroad operations. Nevertheless, the company's continued improvement in its operating ratio (the lower the better) is a solid indicator of its ability to drive profits, and it will help to mitigate any pressure the firm may receive on its top line, as was evident in the third quarter of 2015. Union Pacific remains our favorite railroad operator.

Michael Kors (KORS)

Michael Kors is one of the more recent additions to the Best Ideas Newsletter portfolio. We added the global luxury lifestyle brand after the sharp drop in the markets in late August 2015 at what we believe to be a deep discount to its intrinsic value. Thus far, shares have provided a modest return, a good portion of which has come after the company's most recent quarterly report. We're hoping that a nice technical break out of the downtrend will result in a large jump to initiate price-to-fair value convergence.

In the second quarter of its fiscal-year 2016, ended September 26, Michael Kors reported strong top-line growth across all of its geographical segments. Total revenue grew nearly 7% as reported to $1.13 billion, good for over 12% growth on a constant-currency basis from the year-ago period. Both retail sales and wholesale sales advanced 7.5% or more in the quarter, while licensing revenue fell. When excluding the impact of foreign exchange rates, the company increased sales in its Americas segment by 5.6%, and the constant-currency growth rates of its Europe and Japan segments were much greater at 20.6% and 60.7% on a year-over-year basis, respectively.

However, comparable-store sales fell 8.5% in the fiscal second quarter, or a decrease of 3.4% on a constant currency basis. The impressive top-line growth in the period was driven by store expansion; Michael Kors' store count increased by 215 stores from the second quarter of fiscal 2015. The jump in store count, among other investments, led to increased operating costs, as the firm realized nearly a 5 percentage point decrease in operating income margin. Decreasing gross margin played a role in the

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falling operating income as well, and operating income fell 10.6% from the year-ago period. Net income dropped 6.7%, while earnings per share were relatively flat due to decreased share count.

Looking ahead to the rest of fiscal 2016, Michael Kors expects to continue investing in digital flagships, corporate talent, new stores, shop-in-shops, infrastructure and distribution. This will lead to an increase of 200-220 basis points in operating expenses as a percentage of total revenue. Comparable-store sales are anticipated to fall by mid-single digits on a reported basis and low-single digits on a constant currency basis. Diluted earnings per share are expected to be in a range between $4.38-4.42 for the full fiscal year, roughly 10 times current-year earnings.

All things considered, we think the disparity between top-line and bottom-line growth in the second quarter of fiscal 2016 is reflective of management's initiatives to spread its brand as it increases store count. As the new stores mature in their respective markets, we expect comps to improve and operating leverage to take place. We will be watching both metrics closely moving forward, and until comparable store sales turn the corner, we can't say for certain that Michael Kors isn't a value trap. That's why its weighting is a mere ~1% in the Best Ideas Newsletter portfolio. We still may add a bit, however.

Investors Punish Priceline for Conservative Guidance

By Kris Rosemann

This isn't the first time this year Best Ideas Newsletter portfolio holding Priceline (PCLN) has been punished by investors for issuing weak guidance after a strong quarter (see our first-quarter piece). The strength of the US dollar played an important role in the weakness of the firm's performance, but we didn't see any material fundamental deterioration in its operations in the company's third-quarter results, reported November 9.

Gross travel bookings at Priceline grew ~22% in constant currency and 7% as reported to $14.8 billion in the third quarter on a year-over-year basis. The strength was driven by its international operations, where gross travel bookings grew 25% in constant currency. The company's global accommodation business booked a record 116 million room nights in the third quarter, good for 22% growth from the year-ago period. Booking.com now has over 820,000 properties with over 21 million bookable rooms available, an increase of approximately 38% from the same time in 2014. This gives the site the largest, most diverse selection of directly bookable accommodations in the world.

Though Priceline's international bookings continue to expand at a rapid pace, the firm's US operations have been a source of weakness. Gross travel bookings in the US fell 2.5% in the third quarter on a year-over-year basis, and now account for ~11.5% of the company's business. The strong US dollar has made the country a less popular destination for international travelers, and the firm also cited a 13% reduction in airfare as having a negative impact on its US gross travel bookings, even as such a step-down had a negligible impact on gross profit.

Despite the top-line weakness, Priceline's US operations helped drive solid growth in its overall gross profit, which advanced 29% in constant currency and 12% as reported from the year-ago period to $2.9 billion in the third quarter. Gross profit in the firm's US business advanced 22%, while its international operations grew gross profit 29% in constant currency. This strong constant currency gross profit expansion coupled with slightly improved operating margins resulted in strong bottom-line growth as well. Adjusted EBITDA grew 12% on a year-over-year basis, to $1.6 billion, surpassing the high end of the firm's guidance range of $1.525 billion.

Non-GAAP net income per diluted share also beat guidance in the third quarter. It grew by more than 14% from the year-ago period to $25.35, compared to guidance for the quarter of $22.95-$24.45 per share. The company's strong net income performance helped provide solid free cash flow generation through the first three quarters of 2015. Priceline generated nearly $2.1 billion in free cash flow in the period, good for slight growth on a year-over-year basis despite capital expenditures growing nearly

*Investors Punish Priceline...*continued on next page

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40%. This impressive free cash flow generating ability plays an important role in the maintenance of the firm's fortress-like balance sheet. As of September 30, Priceline had ~$9.4 billion in short-term and long-term cash and equivalents, compared to ~$5.4 billion in long-term debt.

Nevertheless, Priceline's shares were beaten up since releasing these seemingly sound results. Investors appear to have concerns with the company's guidance showing a deceleration in gross bookings growth and gross profit expansion. We aren't worried about the firm's operations, and as we mentioned earlier, this is not the first time it has issued perhaps too conservative of guidance. As we outlined when we added Priceline.com to the Best Ideas Newsletter portfolio, there's a lot of risk including this economically-sensitive equity in the portfolio so late into the global recovery, but it's hard not to like a company with a fortress-like balance sheet, strong free-cash-flow generating capacity, and an impressive brand portfolio.

We currently value shares at nearly $1,700 each, offering investors a solid valuation opportunity. We may add to the position in the Best Ideas Newsletter portfolio on any material weakness.

Alphabet (Google) and eBay Power Best Ideas Portfolio!

By Kris Rosemann

It's no secret that the Internet and the companies that operate within the Internet space are always changing. There must be continuous innovation and re-discovery to keep up with the competition to amaze society with the next great development. Consumers have become accustomed to many of the Internet giants doing just that, pushing the envelope and enriching their lives with a better, faster, or more convenient way of content consumption.

One of the many struggles that Internet-based entities have is not only how to create these new products, devices, or programs, but also how to monetize such breakthrough endeavors successfully. In a fast-changing environment, it is never easy to deliver sustainable, profitable and innovative growth. Let's take a look at the most recent quarterly performance of Internet giants Yahoo! (YHOO), eBay (EBAY), Amazon (AMZN), and Alphabet (GOOG, GOOGL), formerly Google. eBay and Alphabet are holdings in the Best Ideas Newsletter portfolio.

Yahoo! Sacrifices Short-Term Profit for Long-Term Focus

Yahoo! is working toward a narrowed focus on fewer products with higher quality for improved profitable growth. Though revenue performance may not be as bad as some are making it out to be, earnings continue to face pressure. GAAP revenue advanced 7% to ~$1.2 billion in the third quarter of 2015 from the year-ago period, driven by a 14% increase in display revenue. Gross search revenue grew 2% on a year-over-year basis. Mobile revenue grew from 20% of traffic-driven revenue in the third quarter of 2014 to 24% in the third quarter of 2015, and the company's Mavens growth strategy--which focuses on mobile, video, native, and social initiatives--accounted for 38% of traffic-driven revenue in the quarter, up from 29% in the comparable period in 2014.

Sustainable growth in Yahoo's top line is still of significant question given competing online advertisers in the likes of Facebook (FB), Google and Twitter (TWTR), but costs are ballooning, too. The firm reported a GAAP operating loss in the third quarter as traffic acquisition costs more than quadrupled from the year-ago period, to a total of $223 million. The company's agreement with Mozilla was a primary contributor to the issue, as the cost of search revenue increased from $3 million in the third quarter of 2014 to $119 million in the third quarter of 2015. The cost of display revenue more than doubled on a comparable basis as well. Yahoo also included an asset impairment charge of $42 million in relation to a change in strategy of on certain long-term video content, and a restructuring cost of $26 million related to resource realignment considerations in its operating loss in the quarter.

Yahoo has made it very clear that its operations are not where it needs them to be, and its reported earnings have reflected that sentiment. In addition to the restructuring and narrowed focus, the company

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has stated that completing the spinoff of Aabaco Holdings is its top priority. The tax implications of the spinoff remain uncertain, and if the tax burden is eventually handed to shareholders, it could spell big trouble for Yahoo's share price. We just don't see much of an investment opportunity in Yahoo's shares at the moment. It seems as though the IRS could slap the company with a fine at any time.

eBay Performs Well in First Quarter Without PayPal

In its first quarter without former subsidiary PayPal (PYPL), Best Ideas Newsletter portfolio holding eBay reported solid operational results. The company delivered strong top-line expansion as it continued to execute on its strategy of profitable long-term growth. Gross merchandise volume increased 6% on a currency-neutral basis in the quarter, and the firm's number of active buyers on a trailing 12-month basis grew 5%, to 159 million. These factors drove revenue 5% higher in constant-currency terms in the quarter from the year-ago period.

Showcasing the earnings leverage inherent to its business model, eBay's bottom-line growth outpaced its pace of revenue expansion in the third quarter. The firm grew income from continued operations by 7% on a year-over-year basis as operating expenses as a percentage of revenue dropped nearly 70 basis points. Reduced sales and marketing costs accounted for the primary source of the reduction. The company realized solid free cash flow of $462 million in the quarter, despite a significant increase in capital expenditures; it holds a solid net cash position of $0.6 billion, despite a rather large total debt load.

Aside from helping to drive management's decision to raise its full-year 2015 non-GAAP earnings-per-share outlook, to the range of $1.80-$1.82, the most impressive aspect of eBay's solid performance in the third quarter, in our view, was that the company completed a complex transaction in the middle of doing so! Updated 16-page reports on both eBay and PayPal will be published soon, and both will remain holdings in the Best Ideas Newsletter portfolio.

Amazon Continues to Expand Its Operating Margin

Amazon continues to grow at an incredible rate. The firm reported net sales increasing 23% on a year-over-year basis, to a total of $25.4 billion in the third quarter; excluding foreign exchange headwinds, net sales grew 30%. Sales growth is not expected to slow significantly in coming quarters. The troubling outlook for many big box retailers including Walmart (WMT) speaks to continued strength at the Internet retailing giant. Amazon expects a "record holiday season," which indirectly bodes well for eBay, too.

The real story at Amazon lately has been its improving margin though. Income from operations experienced a nearly $1-billion swing to a profit of $406 in the most recently-completed quarter from a loss of $544 in the third quarter of 2014. Amazon's trailing twelve month operating margin was at its highest point in the company's history at the end of the third quarter. Most of the strong operating performance fell right to the bottom line, too, with net income of $79 million in the third period of the year, compared to a net loss of $437 million in the year-ago quarter. Compared to the third quarter of 2014, the company's operating margin has swung more than 4 percentage points.

The significant margin expansion has driven Amazon back to profitability, and it has also boosted free cash flow considerably. In the trailing twelve month period ending September 30, the Internet retailing giant generated free cash flow of $5.4 billion, nearly 5 times more than the comparable period last year! Continued optimization of free cash flow remains a long-term goal at Amazon. We love this kind of focus on cash flow generation, as well as the solid net cash position the company holds on its balance sheet.

However, shares remain too pricey for our taste, and we just can't get comfortable with management's guidance and the sensitivity of its fair value to changes in its operating margin. In the current fourth quarter, for example, operating income is expected to be between $80 million and $1.28 billion, a huge range. A one percentage-point change in the company's mid-cycle operating margin assumption translates into a $50 per-share change in its fair value estimate.

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The Best Ideas Portfolio

By Valuentum Analysts

Portfolio Return	Benchmark Return	Outperformance
98.2%	64.2%	34.1pts

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 ~29% 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.

THE BEST IDEAS PORTFOLIO -- as of November 15, 2015 — **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	0.79	17-Jun-11	51.92	107	5,569.33	112.34	12,020.38	940.29	6.1%	132.7%
Alibaba	BABA	IPO	7	$137.00	0.55	19-Sep-14	92.95	78	7,264.10	75.85	5,916.30		3.0%	-18.6%
Altria Group	MO	8	6	$55.00	1.02	28-Jun-11	28.39	157	4,471.86	56.28	8,835.96	2,017.91	4.5%	142.7%
Buffalo Wild Wings	BWLD	6	3	$192.00	0.78	27-Aug-15	179.81	16	2,876.90	149.65	2,394.40		1.2%	-16.8%
Cisco	CSCO	9	9	$37.00	0.71	14-Nov-14	26.15	100	2,622.00	26.21	2,621.00	82.00	1.3%	3.1%
eBay	EBAY	10	UR	UR	UR	3-Oct-11	Pre-split	100	3,103.50	28.19	2,819.00		1.4%	+++
Energy Select SPDR	XLE	NR	NR	NA	NMF	6-Oct-11	67.14	143	9,608.02	65.98	9,435.14		4.8%	-1.8%
Financial Select SPDR	XLF	NA	6	NA	NMF	9-Jan-11	13.46	150	2,026.00	23.92	3,588.00	198.00	1.8%	86.9%
General Electric	GE	7	3	$29.00	1.04	21-Oct-13	25.99	375	9,761.75	30.28	11,355.00	642.00	5.7%	22.9%
Gilead Sciences	GILD	10	9	$161.00	0.64	19-Sep-14	106.76	68	7,273.34	102.57	6,974.76	58.48	3.5%	-3.3%
Google - Class C	GOOG	10	7	$682.00	1.05	23-Oct-12	450.92	7	3,170.42	717.00	5,019.00	10.35	2.5%	58.6%
Google - Class A	GOOGL	10	7	$682.00	1.05	4-Apr-14	Split	7	Split	740.07	5,180.49		2.6%	+++
Health Care ETF	XLV	9	6	NA	NMF	22-May-12	36.60	125	4,582.00	69.57	8,696.25	389.13	4.4%	98.3%
Intel	INTC	6	9	$38.00	0.85	12-Sep-11	20.48	150	3,086.50	32.11	4,816.50	478.50	2.4%	71.6%
SPDR S&P Bank ETF	KBE	NR	NR	NA	NMF	9-Jan-12	21.07	100	2,114.00	35.00	3,500.00	188.20	1.8%	74.5%
Michael Kors	KORS	8	8	$66.00	0.59	27-Aug-15	43.44	68	2,953.80	39.00	2,652.00		1.3%	-10.2%
PayPal	PYPL	UR	UR	UR	UR	17-Jul-15	Spin-off	100	Splt	34.53	3,453.00		1.7%	+++
Priceline	PCLN	10	7	$1681.00	0.77	26-Feb-15	1248.97	3	3,753.91	1297.75	3,893.25		2.0%	3.7%
Republic Services	RSG	8	4	$40.00	1.07	19-May-11	31.42	201	6,329.42	42.83	8,608.83	977.88	4.3%	51.5%
Rio Tinto	RIO	9	3	$58.00	0.59	22-May-12	46.40	75	3,487.00	34.24	2,568.00	511.65	1.3%	-11.7%
Teva Pharma	TEVA	6	3	$64.00	0.91	24-Jul-13	41.22	77	3,180.94	58.01	4,466.77	259.37	2.3%	48.6%
Union Pacific	UNP	6	3	$102.00	0.82	24-Jul-13	79.67	40	3,193.80	83.78	3,351.20	174.00	1.7%	10.4%
Utilities Select SPDR	XLU	NR	NR	NA	NMF	18-Mar-14	41.12	83	3,419.96	42.54	3,530.82	192.23	1.8%	8.9%
Visa	V	7	6	$75.00	1.04	30-Nov-11	26.86	188	5,064.39	78.11	14,684.68	252.71	7.4%	194.9%
Latest changes:														
Cash -- changes in monthly cash balance reflects dividends received and trading gains/losses, where applicable.											57,848.40		29.2%	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							Original -->		100,000.00	Current -->	**198,229.13**			**98.2%**
S&P 500 Index (SPY)						17-May-11	132.69	754	100,000.00	202.54	152,641.50	11,535.91	93.0%	
Cash											11,535.91		7.0%	
Benchmark Portfolio Value											**164,177.41**			**64.2%**
Relative Outperformance														**34.1 pts**

Data as of November 15, 2015. 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.

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Alphabet and eBay ...from page 7

Alphabet Expands Operating Margin While Investing for Innovation

The company formerly known as Google may have a new name, but it has continued its terrific performance track record. In the third quarter, the firm grew reported revenue by 13% on a year-over-year basis, to $18.7 billion; when excluding the negative impact of foreign exchange rates, its revenue growth was an impressive 21%. This top-line growth was driven by substantial mobile search growth, as well as contributions from YouTube and programmatic advertising. The company now has six products or websites in its network that have over 1 billion users worldwide.

Alphabet's ability to leverage its traffic acquisition and sales and marketing costs has been nothing short of impressive. The firm was able to expand its GAAP operating margin by 2 percentage points in the quarter even as it increased R&D spending by a full percentage point of revenue. This type of expense allocation will be imperative for the company, as it seeks to fulfill a mission to have its hand in everything from A to Z--hence the new name Alphabet. The solid margin expansion that took place in the quarter drove the company's non-GAAP earnings per share nearly 18% higher from the year-ago period, to $7.35 per share. Profitable innovation is the name of the game at Alphabet.

The biggest news in Alphabet's quarterly release, however, was that management will finally be returning cash to shareholders, something we outlined previously that would send the stock surging in our January 2015 note here:

> Google's cash has considerable value, but investors continue to discount its war chest. We think this spells opportunity. We value the search giant's shares north of $650 each, a significant premium over the ~$500 mark at which it was trading hands during the after-hours session following its fourth-quarter report. Should Google decide to buy back its underpriced stock in the near future, we'd expect shares to surge on the news.

The high end of our fair value range for Alphabet is now over $800 per share, and we would not be surprised to see shares of both classes of stock around those levels soon, even as the buyback currently only covers the class C variety, GOOG. The firm remains a core holding in the Best Ideas Newsletter portfolio, and we have no plans of changing that. G is for Google, but could also be for good, great, or glorious. Better yet, G is for gainful. To us, G means grateful. We're grateful to have you, our member, and we trust you are profiting greatly from our best ideas!

5 Reasons to Consider Not Owning McDonald's

By Brian Nelson, CFA

1. Difficult Comps to Come in Late 2016/Early 2017

McDonald's (MCD) has come roaring back to life.The company reported strong third-quarter performance October 22 and posted an impressive 4% global comparable sales growth rate in the period. We thought the fundamental performance was great, even though consolidated revenue and consolidated operating income dropped 5% and 2% in the quarter on a reported basis, respectively. On a year-over-year basis, constant-currency performance showed 7% top-line growth and 10% operating-income growth, both of which we thought were solid.

That said, the market seems to be accepting the report as evidence that McDonald's is permanently back on track, but we're striking a more cautious tone. We think the quarterly results and a few more good reports to follow represent a short-lived shot-in-the-arm from recent promotional initiatives than any sustainable dynamic that can or should be extrapolated into the perp with respect to the company's valuation. McDonald's all-day-breakfast initiatives have in part acted as a marketing tool to bring customers back to the Golden Arches, but once the fast-food giant starts to anniversary current performance of this year's third and fourth quarter in the back half of 2016, excitement will fizzle out, in our opinion.

Where might we be wrong? If McDonald's posts a consistent 4%+ global comparable sales comp in the third and fourth quarters of 2016 and into 2017, then we'll likely have to revisit our fundamental assessment of

McDonald's ...continued on next page

McDonald's ...from previous page

the aging burger restaurant. Until that happens, we think caution is the word on the Street.

2. The "REIT" Catalyst Is Off the Table…for Now

We eventually believe McDonald's will put the REIT idea for its real estate back on the table come 2017, when comparable store sales performance starts to wane again, which we expect to happen.

The Wall Street Journal had reported that board member Miles D. White stated the fast-food behemoth was nearing a decision on whether to create a "McREIT," and November 10 brought news that the idea has been shot down, at least for now. We posit that management is very pleased with the share-price performance as of late—the stock is at all-time highs—and the board may be saving this "card" for when shares are under pressure, a reasonable assumption. That REIT stocks haven't been performing well as a result of concerns of a drawn-out contractionary monetary cycle likely played a role in not pursuing a REIT, too.

Why do we think the "REIT" conversation is not over yet? McDonald's is pulling out all the stops, and we think investors will be pushing for the spin-off of a REIT once shares come under pressure again. Right now, however, investors are happy, even if franchises aren't.

3. The World Has Changed – McDonald's Cost Structure

Let's face it – the world has changed.

No longer do those working minimum wage jobs view the opportunity as a stepping stone to ascend the ladder of the universal dream. Individuals working for the lowest pay legally allowable want a "living" wage, and we believe there's nothing that's going to stop them from getting what they want.

On November 10, the Toronto Sun reported that US fast-food workers went on strike in 270 cities in a protest for higher wages and union rights. The "Fight for $15" campaign is real, and we think the workers are going to win. Berkeley was the latest city to raise its minimum wage to $15, and we think the tide will encapsulate most of the nation. Franchises simply can't afford strikes and walk-offs, and certainly not subpar service from disgruntled employees.

Higher wages will prevail, and McDonald's, just like WalMart (WMT) may feel tremendous pain in coming years. Here's what WalMart is going through, and there's nothing stopping McDonald's from being next in line:

> "…Walmart is at the center of a political upheaval in America that is challenging its business model. The company has become the poster child for all of what many workers believe is unfair pay, and such a tainted perception, fair or not, will be difficult to overcome as the ranks of millennials swell and demand their definition of "a living wage" after suffering through a very painful Great Recession. We talked about the upward path of labor expenses before, and we don't see a scenario where they will abate…at least not anytime soon...
>
> …On May 19, the US' second-largest city Los Angeles announced that it will raise its minimum wage to $15 per hour over time, following the lead set by Seattle and San Francisco. The wave for social change isn't just transitory, and from our perspective, the "minimum wage" revolution has staying power. We're hearing that there is a "minimum wage arms race" across the state of California. According to some reports, pizza places adopting the new wage hikes have to charge as much as $30 for a pizza and eliminate lunch hours, only to see sales fall 25%...
>
> …The social avalanche for change and a higher minimum wage has not been an isolated event. Two years ago, dozens of New York fast food workers went on strike, and many believed that change wasn't in the cards. But just last month, New York City raised "the minimum wage for fast-food workers to $15 an hour by the end of 2018." Washington DC may be next in line for $15 per hour, and other major cities in the US may be next. With the social media waves overflowing with workers pushing for more and more, the ability of groups to exert pressure on organizations has reached a pinnacle in the history of time…

McDonald's ...continued on next page

*McDonald's ...*from previous page

4. McDonald's Valuation Is Stretched

We use a three-stage discounted cash flow model to value shares of McDonald's and any other company in our coverage, save entities in the financials industry. The company's share price has gotten far ahead of its fundamentals, in our view.

Not only are we building in some nice profit growth for Mickey D's in coming years, but we're also factoring in a comparatively low cost of equity (discount rate) within the valuation process. Even if you may not agree with us that McDonald's shares are starting to get pricey, it's difficult to say that the company's shares are a bargain.

The fast-food giant is trading at ~22 times fiscal 2016 earnings, which factor in benefits related to recent promotional initiatives. Shares are definitely not on the "value" menu.

5. The Dividend Is a Distraction; Buybacks Will Be Value-Destructive

Savvy investors know that the board can do whatever it wants with the dividend until it can't.

Sometimes the board uses the dividend to distract investors from what's really happening in the business. Yum! Brands (YUM) and Kinder Morgan (KMI) are probably two of the more recent examples; both reported abysmal results but raised their dividend all the same. Investors have to be careful—management knows that you're viewing the dividend as a signal, so don't fall into the trap of accepting increases at face value. Stay focused on the fundamentals, not on arbitrary payout levels set by management.

Further, investors sometimes forget that they already own everything that management could ever give them. Entities that engage in massive capital return projects are merely moving money around. What's most important, however, is that management does not destroy "economic value" when pursuing such endeavors. McDonald's is loading up on debt, which has resulted in a credit-rating downgrade, and it is using the newly-raised capital to buy back its own stock in droves.

In no way do we view McDonald's shares as a bargain, so by extension, we'd view buying stock back at all-time highs as a foolish use of the cash. Said differently, the move is value-destructive, and while shareholders may benefit from a short-term boost in the stock price from open market purchases, investors are not getting the biggest bang for their buck. Don't get us wrong: There's nothing wrong with optimizing the capital structure, but such a move is better completed when shares are trading at a bargain than when they are pricey and at all-time highs.

The company plans to spend $30 billion for the three-year period ending 2016 in share buybacks and dividends, nearly double the $16.4 billion in the three-year period ending 2013. Management spent ~$4.7 billion in share repurchases year-to-date through the end of September.

We value shares of McDonald's at $85 each. Any repurchases made above this level increases the risk of destroying shareholder capital. You wouldn't buy overpriced stock, right? So why should management? The concept is the same.

Social Media Update

By Kris Rosemann

We did a more in-depth analysis of the "investability" of social media players at the end of the second quarter, and not much has changed. Twitter (TWTR) found its long-term answer at CEO, but its valuation distribution, or range of probable fair value outcomes, is equivalent to a lotto ticket, one that's not likely to pay off. Facebook (FB) continues to put up astounding numbers of active users, and LinkedIn (LNKD), while offering potential as a business-networking social media site remains unproven through the course of a more challenging job market, in our view. On fundamental basis, Facebook is our favorite one, and the social media giant remains near the top of our watch list for new idea considerations. Let's take a look at the third quarter results of the three companies.

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User Growth Remains Prevalent at Facebook

In September 2015, Facebook had just over 1 billion daily active users. For perspective, nearly one-seventh of the world's population uses Facebook every single day. This figure represents growth of 17% on a year-over-year basis. Monthly active users grew 14% to 1.55 billion in the third quarter, while mobile daily active users and mobile monthly active users advanced 27% and 23%, respectively. The solid user growth helped drive revenue 41% higher from the year-ago period to $4.5 billion. Average revenue per user increased nearly 24% on a year-over-year basis to $2.97, a figure that increases to $10.49 when considering users in only the US and Canada.

Despite the strong top-line trends that continued in the quarter, aggressive investments in research and development and sales and marketing slowed the pace of bottom-line growth at Facebook. Research and development spending grew to over 28% of revenue from ~19% in the third quarter of 2014, and marketing and sales expenses advanced to nearly 16% of revenue from just under 12% in the year-ago period. GAAP income from operations grew 4% in the quarter, and GAAP diluted earnings per share advanced 3% to $0.31 on a year-over-year basis. We would have liked to see faster bottom-line expansion, but the expenses for investments are understandable.

Free cash flow growth may have been the most impressive aspect in the quarter for Facebook, as it advanced 84% despite capital expenditures growing nearly 62%. This helped the company grow its cash, cash equivalent, and marketable securities total to ~$15.8 billion as of the end of the third quarter from ~$11.2 billion a year ago. This substantial cash balance will come in handy as Facebook continues to invest in its efforts to connect the world as the 'new Internet.' Judging by its recent growth and CEO Mark Zuckerberg's visionary abilities, we aren't ruling this out as a potential reality. We continue to look for an entry point in shares.

Twitter Still Free Cash Flow Negative

Twitter's user growth is far short of that of 'big brother' Facebook. In the third quarter of 2015, the firm reported monthly active users of 320 million, good for growth of 11% from the year-ago period. Monthly active user growth in the US was a lowly 4%, while the pace was 13% internationally. This helped push revenue up 58% on a year-over-year basis to $569 million. Advertising revenue growth outpaced total revenue growth, as it advanced 60% in the quarter on a reported basis.

Adjusted EBITDA may have been the biggest highlight for Twitter in the third quarter, as adjusted EBITDA margin grew to 25% of revenue from 19% in the year-ago period, more than doubling the total to $142 million. Another bright spot for the company in the period was the 39% decline in cost per ad engagement. This, along with significant operating margin improvement, helped non-GAAP earnings per share grow to $0.10 in the period from $0.01 in the third quarter of 2014. Nevertheless, the firm still failed to turn a profit on a GAAP basis.

In addition to recording a GAAP loss, Twitter remained free cash flow negative in the quarter. The firm's cash, cash equivalent, and marketable securities total fell $100 million in the quarter sequentially to ~$3.5 billion. Improvement in cash flow will be paramount to the health of the company and will perhaps be a byproduct of its main initiatives, which are disciplined execution, the simplification its services, and improved communication of the value of its services. We think these initiatives are a fine place to start, but the future of Twitter remains a speculative bet at best.

LinkedIn Still Benefiting from Strong Job Market

In the third quarter of 2015, LinkedIn reported member growth of 19%+, to $396 million on a year-over-year basis, and member page views grew nearly 36% in the period, to ~38 billion. This helped the company advance total revenue 37% from the year-ago period to $780 million. The firm's highest revenue growth came from its Talent Solutions segment, with a growth rate of 46% from the third quarter of 2014, to revenue of $502 million. The company's 'Marketing Solutions' revenue

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grew 28% on a year-over-year basis to $140 million, and 'Premium Subscriber' revenue advanced 21% to $138 million.

LinkedIn grew adjusted EBITDA in-line with the pace of revenue to $208 million, as its adjusted EBITDA margin remained unchanged from the year-ago period. An increase in depreciation and amortization and stock based compensation led to the company recording a GAAP loss of $0.31 per share in the third period of 2015, but on a non-GAAP basis, earnings per share grew 50% on a year-over-year basis to $0.78. That's some nice bottom-line growth.

The increase in non-GAAP earnings helped grow cash from operations--depreciation and amortization and stock based compensation are added back to GAAP net income in the calculation of cash from operations--and consequently free cash flow, which advanced nearly 21% from the year-ago period to ~$73 million. This came despite the 38% increase in capital expenditures on a year-over-year basis. The firm's cash, cash equivalents, and marketable securities grew slightly on a sequential basis to ~$3.1 billion in the period.

Though we note LinkedIn continues to put up strong growth, we're not sure the firm will be able to handle adversity well during the next economic downturn. Even under a situation where there may be more job-seekers in tough times, they will have less cash to spend on membership fees, and the firm's 'Talent Solutions' and advertising-based revenue streams may face significant pressure during slow economic periods as employers scale back recruiting needs. LinkedIn has benefited from 67 straight months of private sector job growth from February 2008 through September 2015. We maintain our view that the company's business model has not yet been tested, and we think investors may be surprised when times get tough.

US Oil Majors

By Kris Rosemann

The supply and demand imbalance of crude oil has been one of the most talked about market factors in 2015 as prices continue their downward trajectory. Unfortunately, the predictability of crude oil prices continues to fall as well.

One of the most important factors in the global supply of crude oil looking to 2016 is the developing situation in Iran. The country had indicated that it would increase its production of oil immediately following the lifting of economic sanctions from the US and EU by 500,000 barrels a day, and then potentially double that increase in the following months. While this still may be the most likely scenario, there could still be challenges to do the deal's implementation.

Some Iranian parliament members, for example, have demanded that their leaders do not carry out the commitments related to the country's nuclear capabilities until after all financial and economic sanctions are lifted. This may jeopardize the accord as it would be a breach of the Joint Comprehensive Plan of Action (JCPOA), which is set up to "ensure that Iran's nuclear program will be exclusively peaceful." Additional uncertainty surrounding the deal comes from the nation's leader Ayatollah Khamenei, who has given his blessing to the deal, but has also made repeated strong anti-western statements and warning that the deal is a "western plot."

Regardless of whether or not the sanctions against Iran are lifted and the country pumps surplus into the market, OPEC is already producing more oil than its demand requires. According to the cartel, demand for OPEC crude in 2015 is estimated to be ~29.6 million barrels per day, compared to September production figures of an average of ~31.6 million barrels per day (in 2016, demand for OPEC crude is forecast at 30.8 million barrels per day). The cartel has been adamant about increasing market share and seems intent on taking as much business from independent US producers as possible. All eyes and ears will be on OPEC's meeting December 4.

Levels of US commercial crude inventories are not helping either. As of October 23, US commercial crude oil stock was at 480 million barrels, the highest level for this time of year in at least 80 years. This factored into the EIA's decision to lower its estimates for 2016 West Texas Intermediate (WTI) crude oil prices to $54 per barrel, a reduction of $8 from previous forecasts. The EIA expects North Brent Sea crude oil to

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continue to trade at ~$5 more per barrel than West Texas Intermediate through 2016, however. The graph below shows the EIA's forecast for WTI crude in the coming year.

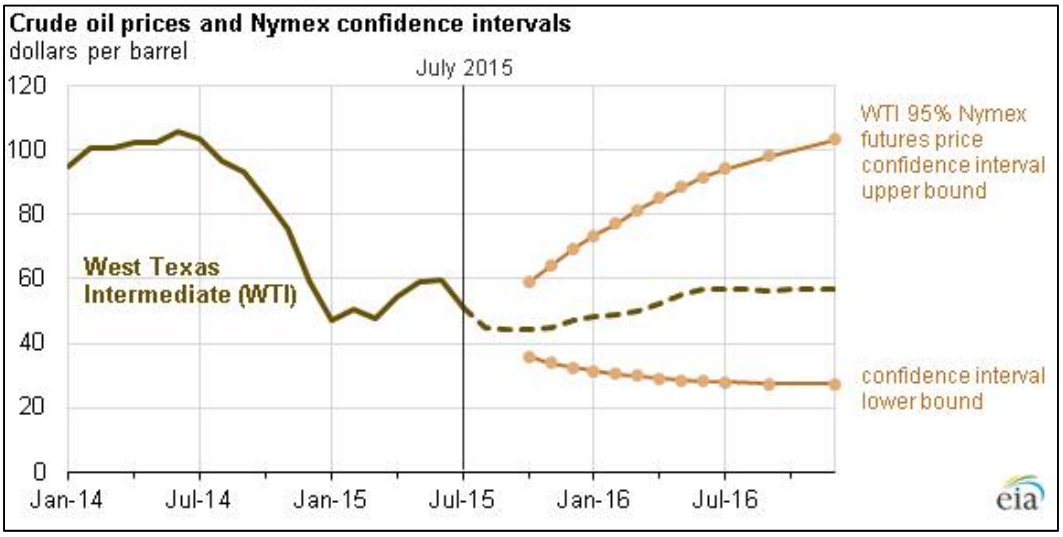

Image source: EIA.gov

The excess supply of crude oil is anticipated to be perpetuated by a number of factors through at least the next year and maybe longer if OPEC's new strategy of market share retention over price stability proves to be better for member nations. Recent news suggests OPEC members are experiencing some pain. Saudi Arabia may face a cash crunch in 5 years if oil prices stay at current levels.

Recessionary economic growth in emerging markets, namely Brazil (EWZ), weakness in export-dependent countries including Australia (EWA) and Canada (EWC), ongoing production growth, increases in global inventories thanks in part to OPEC's new strategy, and the potential for a significant increase in volume from Iran, even if the latter ends up only a marginal consideration, may continue to grow the gap between supply and demand. China's (FXI) slowing economic growth and the uncertainty surrounding it has not helped global demand, and increased production out of Russia (RSX) is not helping the levels of oversupply either.

Below is a graph showing Chevron's (CVX) expectations for global supply and demand in the coming year, which speaks of the current "overproduction" gap (black line is higher than red line). The oil giant is optimistic that the gap will close in coming periods, however.

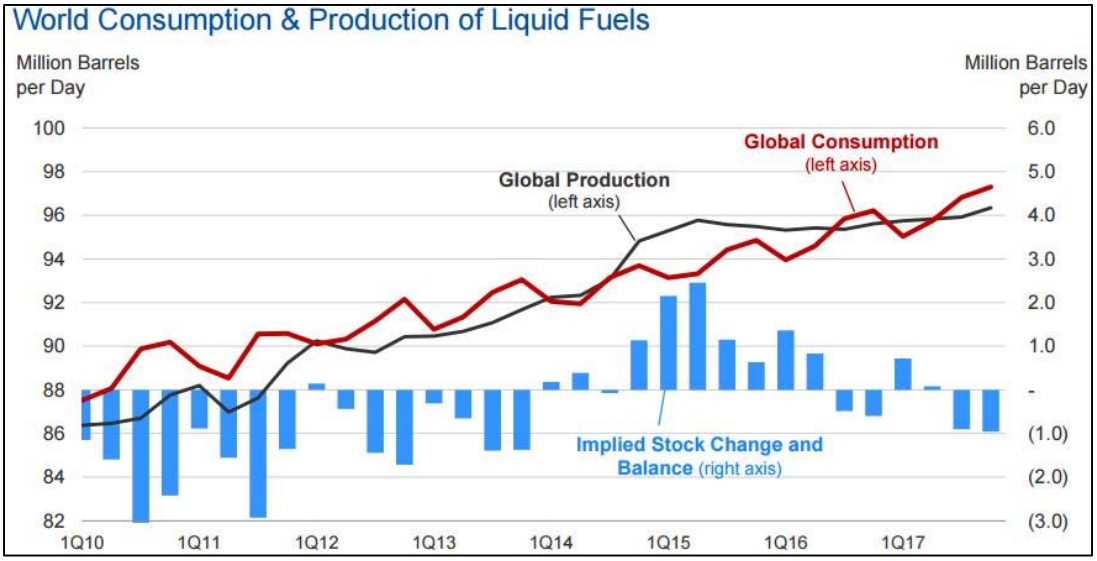

Image source: Chevron earnings presentation

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Major US oil producers seem to be having just as much difficulty making sense of the unpredictable situation as anyone. In addition to the growing supply-demand imbalance, the industry as a whole continues to be fraught with geopolitical risks unlike any other. The decline of crude oil prices has hurt the earnings and free cash flow generation of even the largest players. Let's take a look at the performance of a few of them through the first three quarters of 2015. Prior to the recent collapse in crude-oil prices, we had removed ConocoPhillips (COP) and Chevron. We include the Energy Select Sector SPDR (XLE) in the newsletter portfolios.

Exxon Mobil

Earnings per diluted share at Exxon Mobil (XOM) fell by 47% in the first three quarters of 2015 to $3.18. Lower price realizations led to a decline of more than $15 billion in earnings from the year-ago period, a straight-forward example of the impact the price of crude oil has had on producers. The firm's upstream operations experienced earnings falling nearly 72%, while increasing oil-equivalent production by 2.7%. On a positive note, its downstream operations more than doubled earnings, and the chemical segment grew earnings nearly 12% due to the expansion of margins related to the drop in crude oil prices. However, these segments are not nearly large enough to offset the decline in the company's upstream operations.

Cash from operations has also suffered as a result. Through the first three quarters of 2015, Exxon Mobil's cash from operations fell 31% to $26 billion, which was not sufficient in covering capital expenditures and shareholder dividends. Capital expenditures decreased 16% to $23.6 billion in the period, and shareholder distributions totaled $11.5 billion through nine months in 2015. The company raised $3.7 billion in debt and other financing, along with the sale of $1.6 billion in assets to cover the majority of these outflows. A cash draw of $400 million in the period resulted in cash and cash equivalents of $4.3 billion and debt of $34.3 billion, as of the end of the third quarter.

Exxon Mobil remains focused on cost management through all periods of the economic cycle. During the first nine months of 2015, the company reduced operating expenses by $7 billion and saved an additional $1 billion over its planned $4.5 billion reduction in capital expenditures. Upstream unit production costs have fallen approximately 10% in the period as well. We like the focus on cost control, but it has simply not been enough to overcome the collapse in crude oil prices over the short term.

Exxon Mobil continues to invest in its higher-margin businesses, most notably through its projects in Singapore and the Netherlands. Its plant expansion in Singapore will create the only manufacturer of its premier synthetic oil brand Mobil 1 in the Asia Pacific region, expanding the growth potential of its downstream operations. The project is expected to be completed in the second half of 2017, helping to create a more diverse and resilient portfolio for the company. Its project at the Rotterdam refinery in the Netherlands will strengthen the oil giant's position as the world's largest producer of lube basestocks.

For the full-year 2015, management is expecting average production per day to be approximately 4.1 million barrels, up from ~4 million barrels per day through the first nine months of the year. Exxon Mobil continues to add to the global supply glut. Capital expenditures are expected to be $34 billion in the year, with a reduction coming in 2016 and 2017. Having a reliable and growing dividend remains one of the company's priorities, and it plans to continue repurchasing shares to reduce its number of shares outstanding. Exxon Mobil remains one of the strongest entities in all of energy.

Chevron

Chevron also experienced a precipitous drop in diluted earnings per share during the first three quarters of 2015 due to lower price realizations. Diluted earnings per share fell 66.7% from the year-ago period to $2.76, as the company's average selling price per barrel was nearly halved. Its upstream operations recorded a net loss of $600 million in the period, led downward by its US division which recorded a net loss of $2.1 billion. These declines came despite net liquids, natural gas, and oil equivalent production being up through the first nine months of the year.

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Downstream earnings more than doubled in the three-quarter period to $6.59 billion due to the higher cracking margins associated with lower crude oil prices, and the firm's other segment, which includes cash management and debt financing activities, corporate administrative functions, insurance operations, real estate activities and technology companies, reported a net loss of $815 million during the first three quarters of 2015.

Chevron's cash flow generation suffered tremendously as well in the first nine months of 2015. Cash from operations fell more than 40% to nearly $15 billion, while capital expenditures fell less than 13% to $25.3 billion in the period. This did not discourage management from raising the quarterly dividend payout, however, and the company has paid $6 billion in dividends during the first three quarters of the year.

In order to cover its increasing cash commitments, Chevron continues to issue debt and has sold $11 billion in assets over the past two years. The company plans to continue to "high-grade" its portfolio and sell $5-$10 billion in assets through 2017. The firm expects capital expenditures to come in at approximately $35 billion for the full year, suggesting another severely negative free cash flow quarter is underway. Net debt at the end of the third quarter stood at $22.9 billion, and the firm's debt ratio is currently just under 19%.

One of Chevron's major priorities is to have its free cash flow cover its dividend payout by 2017, a very important initiative for any company that pays a dividend. The fact that the company has to borrow cash to cover its capital spending and dividend payouts at this point in the economic cycle is not surprising, but it does lead us to believe that there are more durable dividends available on the market. We had removed Chevron from the Dividend Growth Newsletter portfolio some months ago.

Chevron's cost management initiatives may still help, however. Through the first three quarters of the year, the company reduced its operating costs by 7%, and upstream unit costs fell 13%. The cost reduction focus is vital, as and every marginal benefit the firm can give itself at this point is a win. Looking ahead to 2016 and 2017, the firm expects to continue to reduce expenses, both operating and capital expenditures. Chevron is anticipating capital spending for 2016 in a range of $24-$26 billion and a range of $20-$24 billion in 2017 and 2018. The reduction in capital expenditures will coincide with the reduction of 6,000-7,000 jobs in 2016 and 2017. In the same two-year time period, net production growth of 13%-15% is expected.

We're keeping Chevron on the radar, and we're watching its balance sheet closely.

ConocoPhillips

ConocoPhillips has perhaps taken the drop in crude oil prices the worst of the three major oil companies covered in this writing. Through the first three quarters of 2015, the firm recorded an adjusted loss of $0.50 per share, as its total realized price per barrel was nearly halved in the period. ConocoPhillips, unlike Exxon and Chevron, does not have downstream operations to buoy its upstream performance. The company's production, excluding Libya and on a continuing basis, increased ~4% through the first nine months of 2015.

Free cash flow generation was a major issue during the first three quarters of 2015 for ConocoPhillips as well. The company recorded cash from operating activities of ~$6 billion in the period, including a $0.2 billion change in working capital. Capital expenditures in the same period exceeded cash from operations by $1.9 billion, however, and dividends paid totaled $2.7 billion in the first nine months of the year. In order to fund the cash outflows, the company increased debt by $2.4 billion to a total debt position of $24.9 billion, compared to cash and cash equivalents of just $2.4 billion. The firm's debt-to-capital ratio is now ~36%. The company's dividend still remains a priority.

ConocoPhillips continues to rein in costs in order to stay afloat. Through the first nine months of 2015, adjusted operating costs decreased 15% compared to the year-ago period, and management subsequently reduced its operating-cost guidance from $9.2 billion to $8.2 billion. Corporate expense

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guidance has also been reduced, though not by as significant of an amount. The company plans to materially reduce its deepwater spending through the rest of the year, and it will complete a phased exit from its deepwater operations in the coming years.

For full-year 2015 management expects production to be between 1,585-1,595 million barrels of oil equivalent per day, an increase of 3%-4% from continuing operations from 2014. Guidance for capital expenditures for the full year has been reduced from $11.5 billion to $10.2 billion as the firm continues its cost reducing efforts. Management did not provide specific guidance for the coming years, but it will lay out its 2016 capital spending and operating plan on December 10.

Wrapping Things Up

US oil producers were not the only companies to see profits decimated by falling crude oil prices. Chinese producers PetroChina (PTR) and Sinopec (SHI) saw profits fall 81% and 92% in the third quarter on a year-over-year basis, for example. As with US operators, both Chinese companies are struggling to find ways to stop the bleeding. The pain is easing, but it may be far from over for the energy complex.

Heading into the rest of the year and 2016, industry observers will be watching OPEC and Iran, rig counts in the US and changes in commercial supplies of crude oil in the States. We're not banking on a sustained recovery in crude oil prices anytime soon, and the days of $100+ per barrel crude oil are likely behind us for a very long time. Cost cutting plans of oil producers in the coming years reflect that they are thinking along the same lines.

At the moment, our only exposure to the energy complex is the below market-weight position in both newsletter portfolios in the Energy Select SPDR ETF (XLE), a diversified ETF that includes most of the majors and helps to mitigate any firm-specific risk. We continue to "play-it-safe" in energy as we expect defaults to increase in coming periods, especially for smaller, undercapitalized entities.

Commodity Prices Affect Waste Industry Performance

By Kris Rosemann

Waste industry economics are relatively easy to understand. Municipal solid waste has to end up somewhere, and therefore whoever has the most diverse disposal operations can set the bar with respect to pricing, which impacts tipping fees and the economics of transfer facilities and collection operations. After all, garbage pick-up operators won't be in business for long if they pay more to dispose of waste than they charge to pick it up. We view disposal operations as having oligopolistic tendencies, even if collection operations face some of the most intense pricing competition of any industry.

As for the players, Waste Management (WM) and Republic Services (RSG) have the largest disposal operations in the US. At the end of 2014, Waste Management owned or operated 252 landfill sites, the largest network of landfills in the country. That number stands at 189 for Republic Services and 58 at number three, Waste Connections (WCN), which added multiple tuck-in acquisitions in the third quarter. These players dominate the municipal solid waste industry and will for some time to come.

Both Waste Management and Republic Services reported solid core price increases near 4% in the third quarter of 2015. The companies' revenue growth from average yield stood at 1.8% and 2.5%, respectively. Republic Services added slight volume growth to arrive at total revenue growth of 3.4% and total revenue of $2.3 billion in the third quarter. Waste Management was the only one of the three to report revenue falling in the quarter, as asset sales and recycled metal prices hurt the comparison of reported top-line results; revenue fell by ~6.7% to $3.4 billion. Waste Connections' core price increased 2.7% in the quarter, and solid waste pricing and volume grew over 5%. The firm reported relatively flat revenue, however, at nearly $548 million due to sharp declines in recycling revenue and exploration and production waste treatment, recovery, and disposal revenue.

The fall in recycled metal prices was an issue throughout the industry. Both Waste Management and Waste Connections reported recycling revenues fell 15% or more from the year-ago period, and Republic Services

Waste Industry...continued on next page

Waste Industry...from previous page

cited low metal prices as significant headwinds in the quarter. The industry is not unaffected by changing commodity prices, despite the steady quality of the business models of operators within it. Falling commodity prices have also benefited the waste industry, as lower fuel costs helped margins in the third quarter. Waste Management cited fuel cost improvement as the main driver of its 140 basis point improvement in operating income margin, and Republic Services realized benefits to adjusted EBITDA margins as a result of lower fuel prices as well. Waste Connections reported solid waste margin expansion of approximately 200 basis points. The pricing power of the industry continues to benefit margins as well, and this is happening despite lower fuel surcharges.

Though its revenue faced pressure, Waste Management's margin improvement allowed it to grow earnings per share at the fastest rate of the three competitors in this writing. Diluted earnings per share grew more than 27% in the quarter due to improved operational performance in the period. Significant operational improvements were made in its recycling operations, where revenue fell 15%, but segment income remained flat from the year-ago period. Republic Services and Waste Connections were not able to mitigate the impact of falling recycled metals prices, reflecting the strength of Waste Management's scale and operations. Waste Connections reported a decline in adjusted earnings per share, and Republic Services reported a 2% increase in adjusted diluted earnings per share in the quarter on a year-over-year basis.

Though we like the operational improvements made in Waste Management's third quarter, we cannot deny the fact that the company returned more cash to shareholders in the quarter than it generated in free cash flow. It paid $472 million in dividends and share repurchases despite only generating $358 million in free cash flow, which fell by over 14% from the third quarter of 2014. The year-to-date ratio of free cash flow to cash returned to shareholders is much closer to 1 for the firm; Waste Management has flexibility to scale down share buybacks, however. Republic Services and Waste Connections have not allowed cash returned to shareholders to exceed their free cash flow generation thus far in 2015.

Though Republic Services has a slightly smaller net debt position than Waste Management—approximately $7.4 billion and nearly $9 billion, respectively—Waste Management has significantly higher free cash flow generating ability. For the full year, Waste Management is expecting to exceed the upper bound of its free cash flow guidance of $1.5 billion, and Republic Services is targeting $720-$745 million in adjusted free cash flow. Waste Connections has a much smaller debt position, with net debt coming in just under $2 billion. The smaller rival also retains a larger portion of free cash flow than its larger competitors. In the year-to-date period, the firm has generated nearly $300 million in free cash flow, while only returning $140 million to shareholders through dividends and share repurchases.

Though we like all three municipal solid waste operators, Republic Services remains our favorite play in the waste industry. The company holds what we believe to be the crown jewel of the waste industry in its Apex landfill, the largest in the US, in Clark County, Nevada. The barriers to entry in the waste collection industry are significant, and the pricing power that comes from holding significant landfill and collection assets is undeniable. The fact that we like Republic Services more dates back to 2012 and is a cause of our commitment to the Valuentum Buying Index. The firm has registered a much coveted score of 9 in the past, the very reason we added it to our Best Ideas Newsletter portfolio.

Waste Management and Waste Connections are strong companies as well and benefit from the same dynamics as Republic Services. The impact commodity prices will have on the companies will likely persist for some time, and we see no sustainable rebound in crude oil coming in 2016; a significant recovery in metal prices is not looking favorable in the short term either. Nevertheless, Republic Services is expecting solid growth in earnings per share and adjusted free cash flow in the upcoming year. We're still holding on to this trash taker.

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	Sector	DCF Valuation	Relative Valuation	P/FV
Michael Kors Hldg	KORS	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.60
Finisar	FNSR	Information Technology	UNDERVALUED	ATTRACTIVE	0.62
Zumiez	ZUMZ	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.63
Iconix Brand	ICON	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.64
Perficient	PRFT	Information Technology	UNDERVALUED	ATTRACTIVE	0.64
Owens-Illinois	OI	Materials	UNDERVALUED	ATTRACTIVE	0.68
Semtech Corp	SMTC	Information Technology	UNDERVALUED	ATTRACTIVE	0.68
Baidu	BIDU	Information Technology	UNDERVALUED	ATTRACTIVE	0.68
QUALCOMM	QCOM	Information Technology	UNDERVALUED	ATTRACTIVE	0.70
Community Health	CYH	Health Care	UNDERVALUED	ATTRACTIVE	0.70
Gilead Sciences	GILD	Health Care	UNDERVALUED	ATTRACTIVE	0.71
Omega Healthcare	OHI	Financials	UNDERVALUED	ATTRACTIVE	0.72
Priceline.com	PCLN	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.72
Avnet	AVT	Information Technology	UNDERVALUED	ATTRACTIVE	0.73
Tenneco	TEN	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.73
WP Carey	WPC	Financials	UNDERVALUED	ATTRACTIVE	0.74
Intl Paper	IP	Materials	UNDERVALUED	ATTRACTIVE	0.75
Cisco	CSCO	Information Technology	UNDERVALUED	ATTRACTIVE	0.75
NASDAQ	NDAQ	Financials	UNDERVALUED	ATTRACTIVE	0.76
Intel	INTC	Information Technology	UNDERVALUED	ATTRACTIVE	0.78
Nathan's Famous	NATH	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.78
Outerwall	OUTR	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.79
Convergys	CVG	Information Technology	UNDERVALUED	ATTRACTIVE	0.79
AIG	AIG	Financials	UNDERVALUED	ATTRACTIVE	0.79

*Ideas...*continued on next page

***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.

Company Name	Symbol	Industry	VBI	FV Estimate
Intel	INTC	Broad Line Semiconductors	9	$38.00
NASDAQ	NDAQ	Exchanges	9	$67.00
AIG	AIG	Insurance - Property & Casualty	9	$76.00
Cisco	CSCO	Networking Equipment	9	$37.00
Gilead Sciences	GILD	Pharma - Generic/Other	9	$161.00
Owens-Illinois	OI	Containers & Packaging	8	$30.00
Community Health	CYH	Hospitals	8	$36.00
Michael Kors Hldg	KORS	Luxury - Ultra & Aspirational	8	$66.00
Finisar	FNSR	Networking Equipment	8	$19.00
Nathan's Famous	NATH	Restaurants - Fast Food & Coffee	8	$47.00

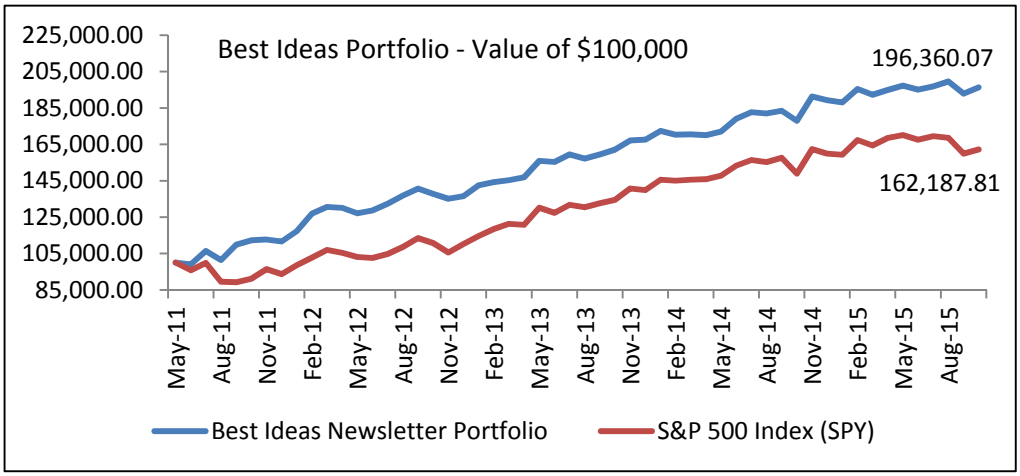
We also show firms that register a 1 or 2 on our VBI. These names represent put-option candidates. We provide the respective lists below, and each firm's report can be found on our website.

National Beverage	FIZZ	Beverages - nonalcoholic	2	$19.00
Air Products & Chemicals	APD	Chemicals - broad	2	$117.00
Rollins	ROL	Chemicals - mid/small	2	$20.00
Mercury General	MCY	Insurance - Property & Casualty	2	$42.00
Yelp	YELP	Internet Software & Svcs	2	$19.00
Jack Henry	JKHY	IT Services	2	$52.00
Royal Caribbean	RCL	Leisure	2	$73.00
Bright Horizons Family	BFAM	Personal Services	2	$46.00
Weight Watchers	WTW	Personal Services	2	$9.00
Eli Lilly	LLY	Pharmaceuticals - Big	2	$70.00
Advance Auto Parts	AAP	Specialty Retail - auto	2	$151.00
WABCO	WBC	Auto Parts Suppliers	1	$98.00
Brown-Forman	BF.B	Beverages - alcoholic	1	$66.00
BioMarin Pharma	BMRN	Biotechnology	1	$75.00
NewMarket	NEU	Chemicals - mid/small	1	$339.00
Rayonier	RYN	Conglomerates	1	$20.00
Ball Corp	BLL	Containers & Packaging	1	$56.00
Roper Industries	ROP	Electrical Equipment	1	$131.00
Choice Hotels	CHH	Hotels	1	$44.00
Hyatt	H	Hotels	1	$39.00
Madison Square Garden	MSG	Media - entertainment	1	$51.00
Mettler-Toledo	MTD	Medical Instruments	1	$225.00
West Pharma	WST	Medical Instruments	1	$42.00
BHP Billiton	BHP	Mining - diversified	1	$33.00
Novartis	NVS	Pharmaceuticals - Big	1	$81.00
Novo Nordisk	NVO	Pharmaceuticals - Big	1	$42.00
Jack in the Box	JACK	Restaurants - Fast Food & Coffee	1	$69.00
Manhattan Associates Inc	MANH	Software	1	$33.00
MSCI	MSCI	Software	1	$49.00
Lowe's	LOW	Specialty Retailers	1	$52.00

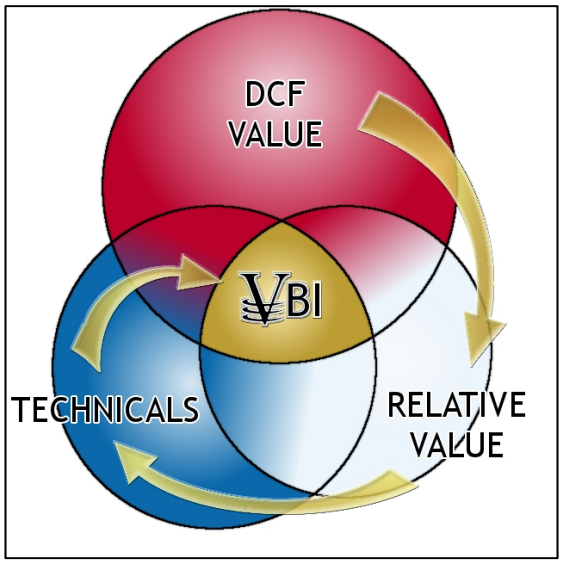
Our Methodology – The Valuentum Buying Index (VBI)

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

Our Methodology – The Valuentum Buying Index continued from previous page

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.

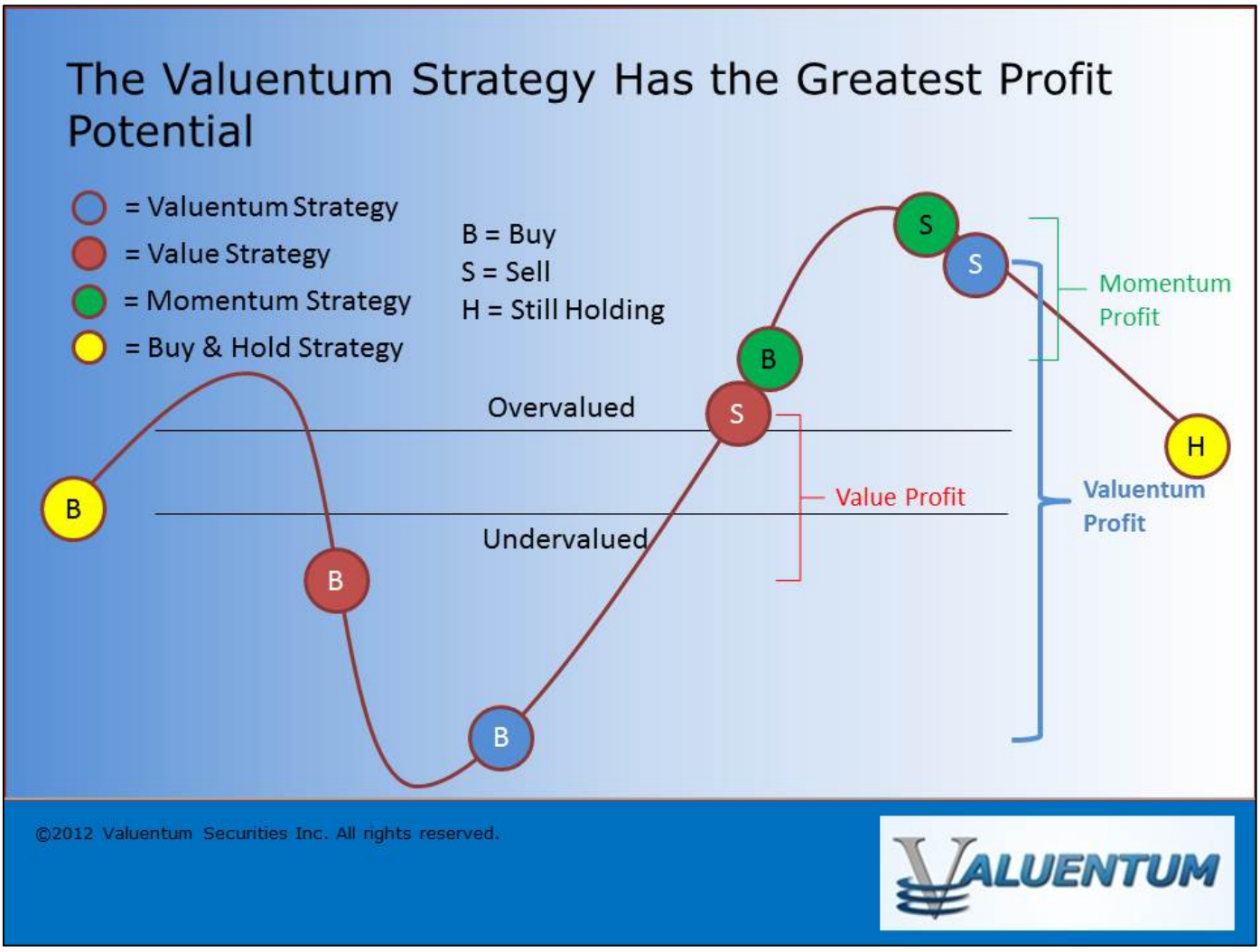


Illustration for educational purposes only.

Our Methodology – The Valuentum Buying Index continued on next page

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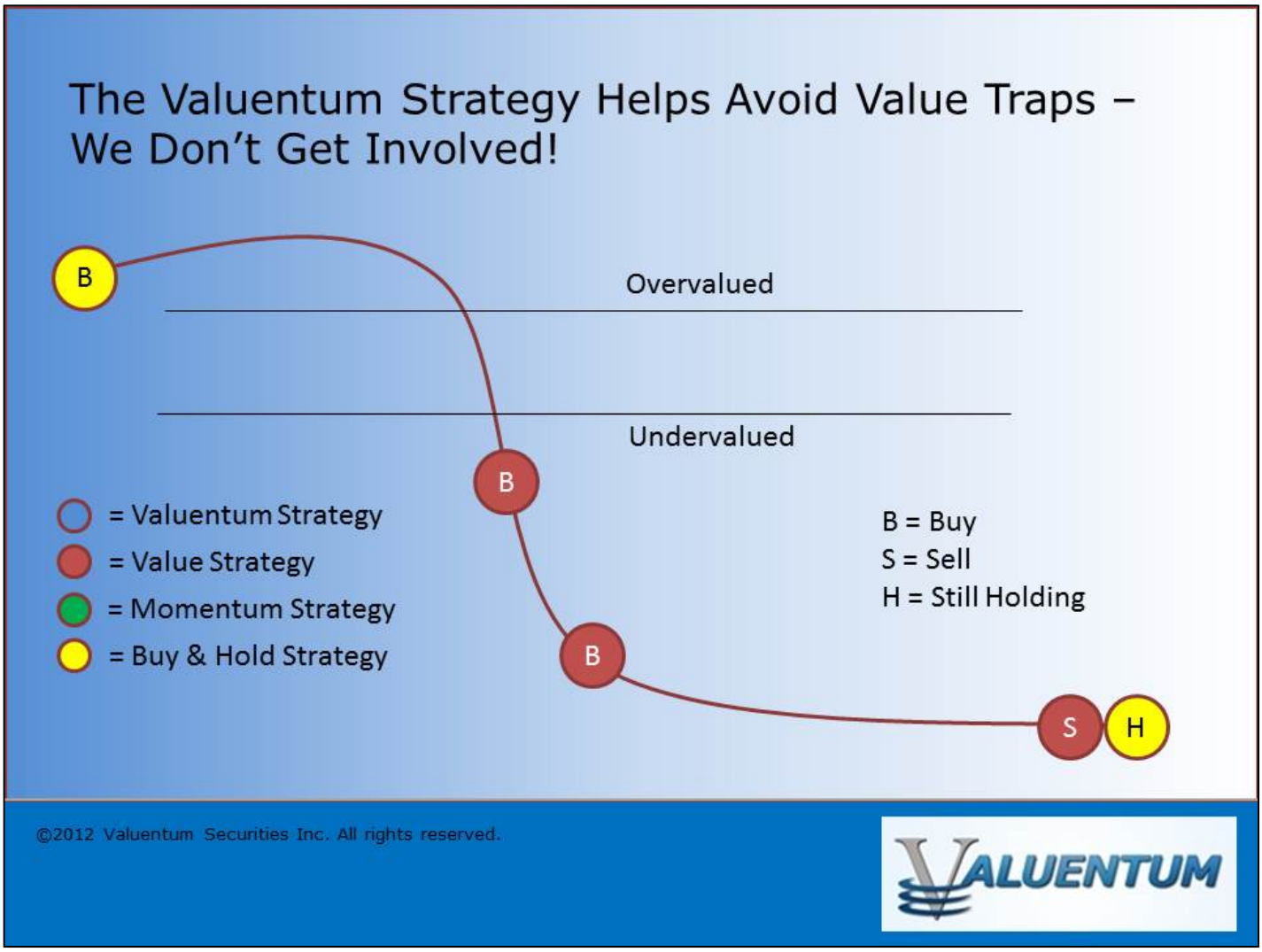
Furthermore, Valuentum subscribers are less likely to be involved in value traps because we demand material revenue and earnings growth for firms to earn a 10 on our Valuentum Buying Index. Value traps often occur as a result of secular declines in a firm's products or services, resulting in deteriorating 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.

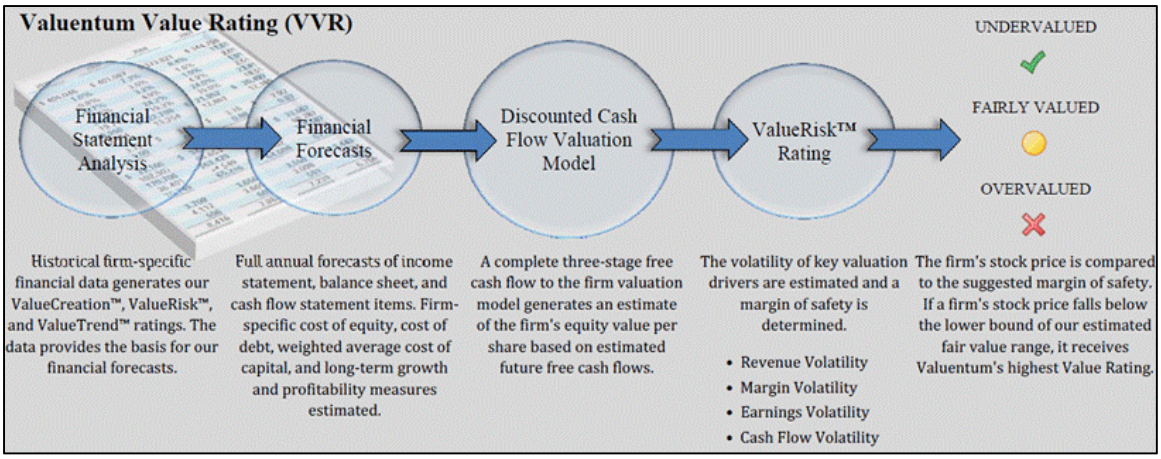


Our Methodology – The Valuentum Buying Index continued on next page

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.

Our Methodology – The Valuentum Buying Index continued on next page

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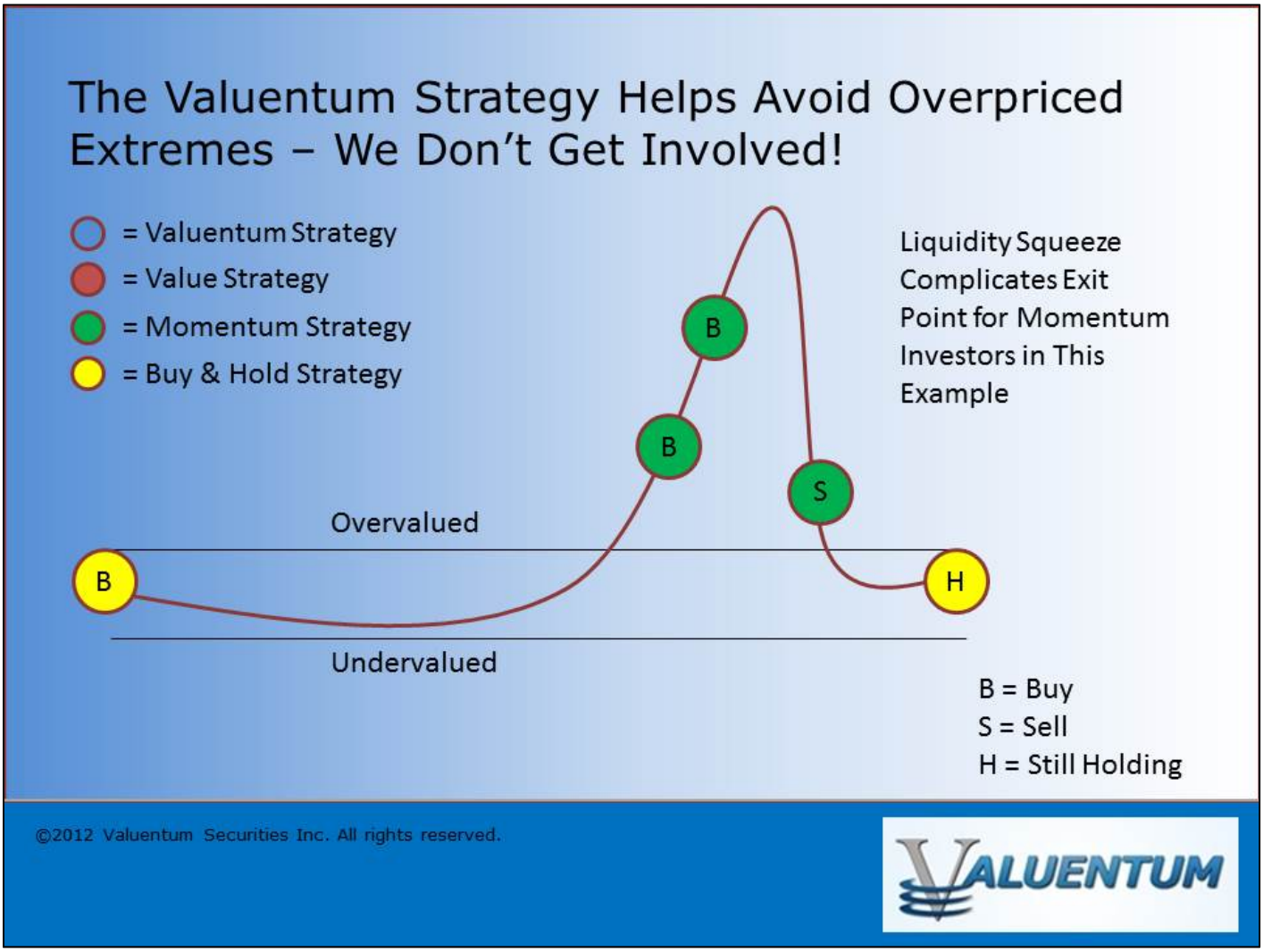

II. We Perform a Forward-Looking Relative Value Assessment

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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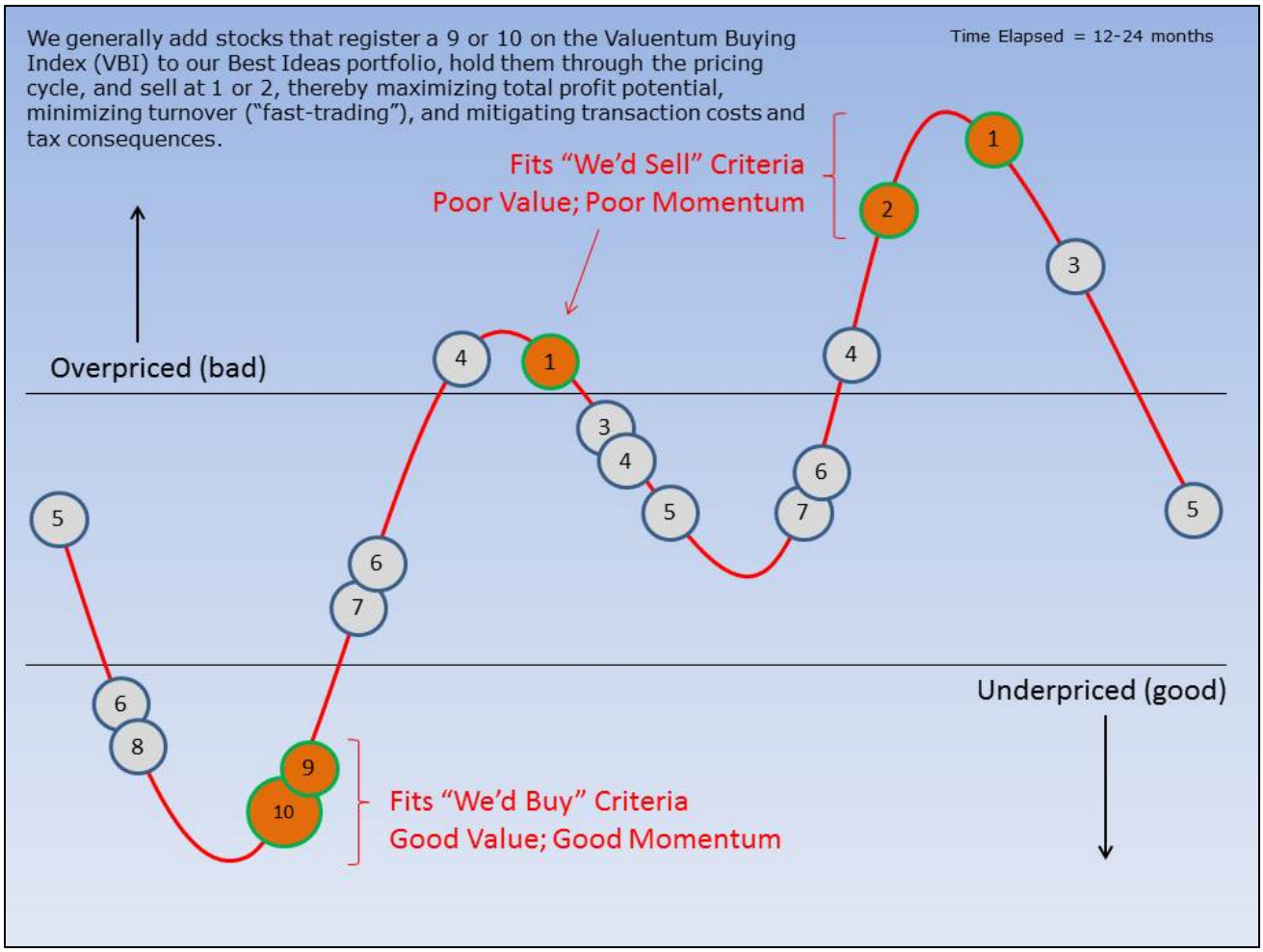
valuation criteria). Rigorous valuation analysis and technical analysis are not mutually exclusive, and we believe both can be used together to bolster returns. An evaluation of a stock's moving averages, relative strength, upside-downside volume, and money flow index are but a few considerations we 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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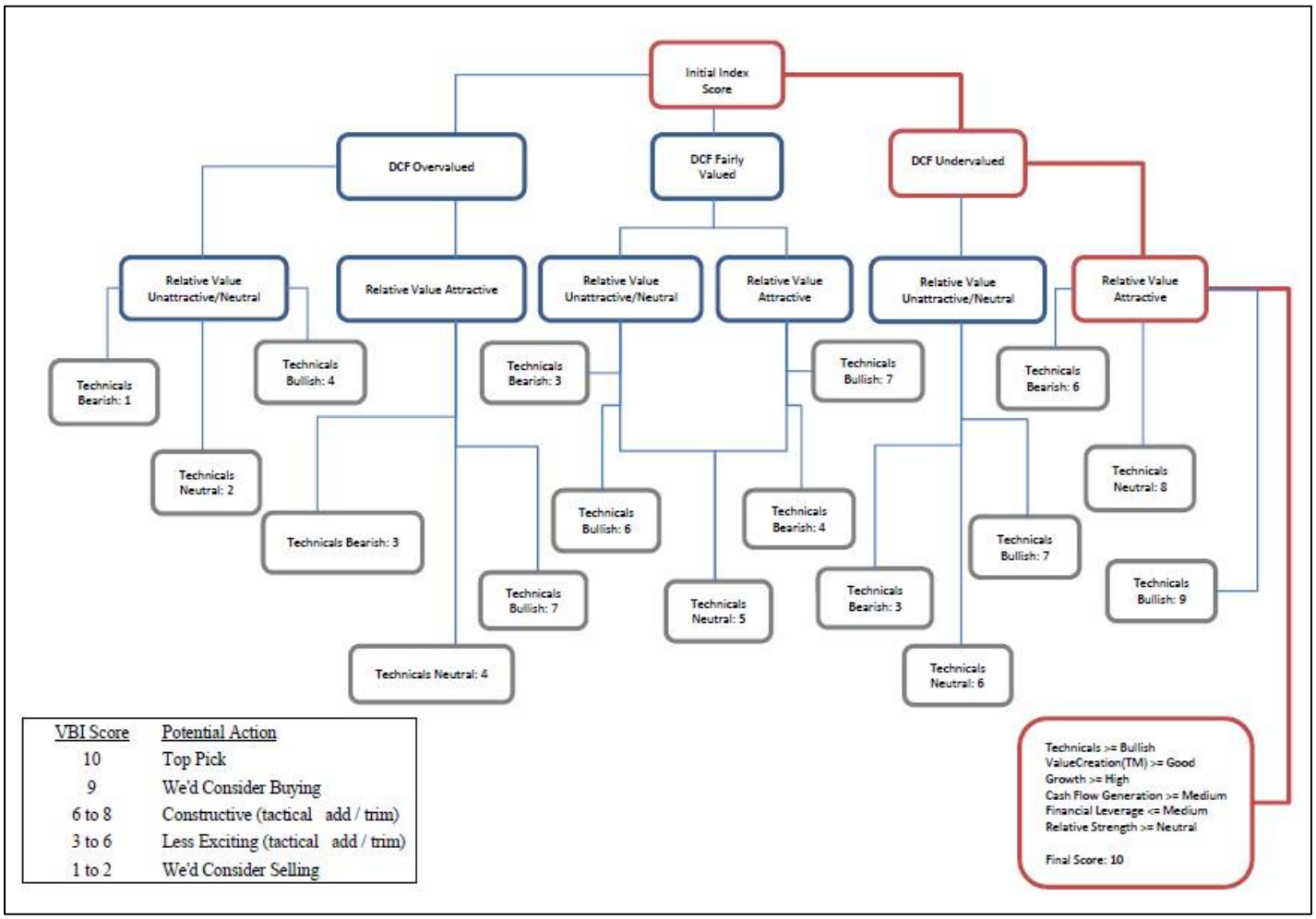
Our Methodology – The Valuentum Buying Index **continued from previous page**

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.



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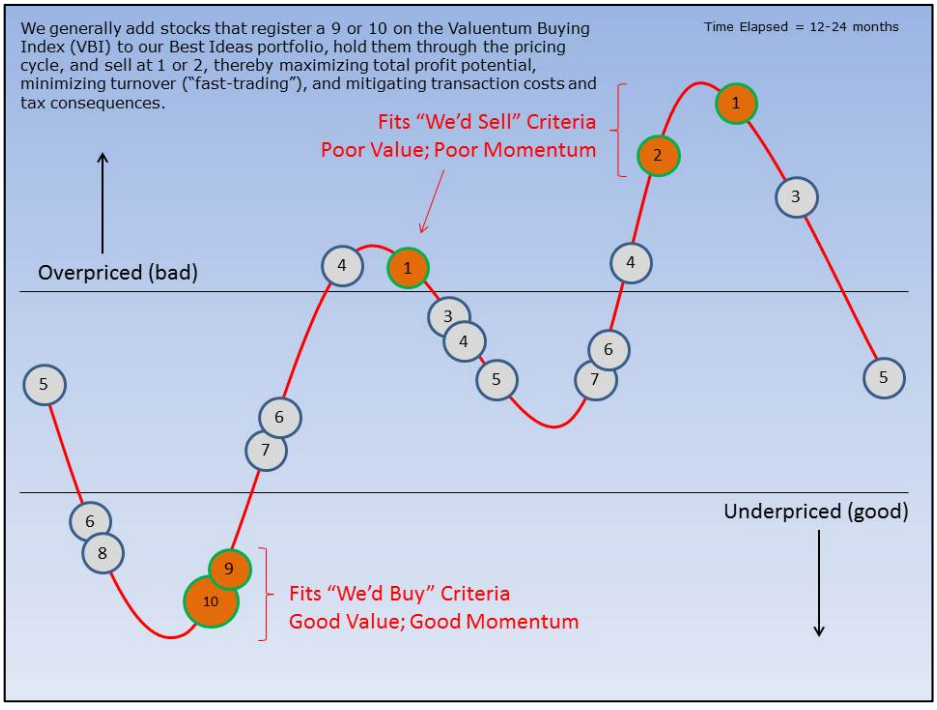
How We Use the Valuentum Buying Index in the Best Ideas Newsletter Portfolio

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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Our Methodology – The Valuentum Buying Index continued from previous page

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.

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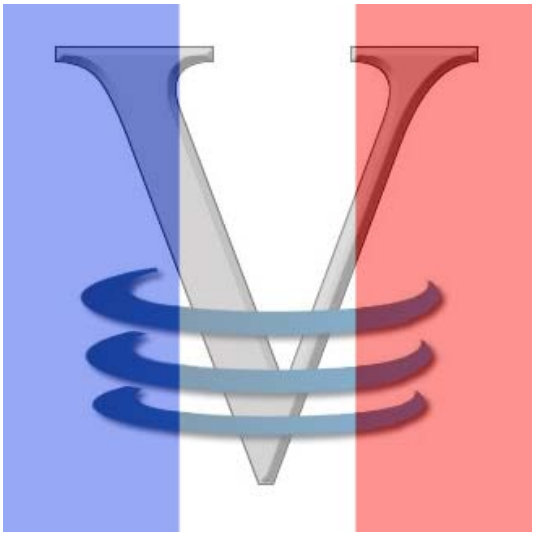

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