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
101.2%	69.7%	31.5pts

Our Best Ideas (see page 8): AAPL, MO, BWLD, CSCO, FB, XLF, GE, GOOG, GOOGL, XLV, INTC, JNJ, KBE, KMI, KORS, PYPL, PCLN, RSG, TEVA, UNP, XLE, XLU, V

Inside This Issue

1 The Bubble Is Still Inflating

3 Shocking?!?! Utility Dividends Aren't Always Safe

7 Alcoa Continues Swoon, Revises Aerospace 2016 Outlook to 6%-8% Expansion

8 The Best Ideas Portfolio

10 Debt, Debt and More Debt

12 Treasury Erects Iron Tax Curtain

13 Removal of Gilead Does Not Stop Portfolio from Setting All-Time Highs

15 Technical Analysis: It's Not What You Think

17 Financial Analysis 501: Understanding Stock Splits

19 The Watch List

21 About the Valuentum Buying Index

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

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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"...we may have underestimated just how much "air" the prospect of NIRP, or a delay in a rate hike by the Fed, could force into an already "bubbly" equity market, but no matter what may be ahead of the markets, we simply can't afford *not* to be cautious in light of existing valuations."
- Brian Nelson, CFA

See page 8.

The Bubble Is Still Inflating

By Brian Nelson, CFA

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= ALL-TIME HIGH

KEY CONCEPT: Firms in the Best Ideas portfolio (see page 8), which have generally registered a 9 or 10 on the VBI when added, should be considered our best ideas at any point in time. After adding firms to the Best Ideas portfolio, we may tactically trade around these positions when they have VBI ratings between 3 and 8 and depending on the size of their weighting in the portfolio or the attractiveness of them relative to other opportunities (a score of 3 through 8 is equivalent to a 'we'd hold'). We tend to remove firms from the Best Ideas portfolio when they register a 1 or 2 (we'd sell). View page 28 for more details about how the team utilizes the Valuentum Buying Index to run the portfolio.

The laws of finance are being bent, broken even. NIRP (negative interest rate policy) has changed everything. The world is upside down.

At the beginning of the year, we were expecting ongoing contractionary monetary policy by the Fed, but on January 29, all of that changed. In a surprise move, the Bank of Japan introduced a negative benchmark interest rate of -0.1%, meaning that instead of paying interest on deposits, it would charge banks to hold their money. The move seemed to blindside the Fed, and from where we stand, it has effectively put rate increases on pause. There's a reasonable chance of a rate hike in December, but the latest read from the CME is that there's no chance at all we'll see one in April, a sharply different view than a few months ago. After all, one might say: how can the Fed hike rates at a time when the rest of the world is engaged in subzero policy? We wrote extensively on the NIRP topic in the February 1 piece, "Dividend Growth 'Bubble' To Continue But For How Long?," and from the looks of it, the stock-market bubble is poised to get even bigger.

Here's the deal. Though a rather obscure article in the Journal, there was a rather peculiar story about how a Danish couple was paid interest on their mortgage. You read that correctly: they were paid interest on their mortgage, instead of paying interest. Denmark is not the only place that is pursuing NIRP either. Switzerland, Sweden, the European Central Bank and the aforementioned Bank of Japan are all using subzero rates in an effort to drive expansion. The story of the Danish couple may be overlooked by some, dismissed by others, but the implications are far-reaching when it comes to the laws of finance, in our

The Bubble is Still Inflating...continued on next page

*The Bubble is Still Inflating...*from previous page

view. Negative interest rates seem to bend everything we know about the financial discipline, and in some ways, break its core tenets. We're in unchartered territory. Central banks around the world are playing with fire, and they know it.

As interest rates hover below zero in most of the world and the Fed contemplates the path of the federal funds rate in light of lackluster inflation and generally weak gross domestic product growth, the most important consideration in finance is starting to break down: the time value of money, or the idea that a dollar today is worth more than a dollar tomorrow (as the dollar today can be invested at a positive interest rate to be worth more in the future). Why is this important? For one, where future free cash flows within the valuation framework are worth less as they are discounted back to today, a negative discount rate means something entirely different. Certainly the cost of equity would mean discount rates stay positive even under NIRP thanks to non-zero equity risk premiums, but an asymptotic situation is likely to unfold as all-in discount rates on future free cash flows approach zero themselves. The result as the discount mechanism gets ever smaller: exponentially rising equity prices. This phenomenon seems to already be happening in the least risky areas of the equity markets, ones known for having the lowest costs of capital -- the dividend-paying consumer staples (XLP) arena.

Get this. Shares of Coca-Cola (KO) are now trading hands at nearly $46 each, more than 22 times adjusted fiscal 2017 earnings. That's fiscal 2017 earnings, not fiscal 2016 or trailing fiscal 2015 earnings. The market is granting the beverage giant such a lofty forward earnings multiple despite its full-year reported revenue falling 4% and reported operating income dropping 10% in 2015. Sure we can make a large number of non-GAAP adjustments to make the Coca-Cola's results look better for the year, but the reported trajectory of the firm is downward, on a reported basis. Of course Coca-Cola is a great company, but the point we're trying to make is that its shares have not been soaring because its fundamentals are doing great. The reality is that the discount rate that the market is placing on Coca-Cola's future free cash flow stream is falling as expected interest rates collapse, driving the market's view of its valuation (as evidenced by its price) higher, something exacerbated by dividend growth investors piling into the stock. We're not saying readers should abandon the soda maker, but 22 times fiscal 2017 earnings is a lot to pay for any company, especially one where reported numbers are declining.

Coca-Cola is not the only company experiencing such an "asymptotic dynamic" either. Clorox (CLX) is trading at more than 24 times fiscal 2017 earnings, Colgate-Palmolive (CL) more than 23 times fiscal 2017 earnings, Kimberly-Clark nearly 21 times fiscal 2017 earnings, McDonald's (MCD) more than 21 times fiscal 2017 earnings, Pepsi (PEP) at more than 20 times fiscal 2017 earnings, 3M (MMM) is trading at nearly 19 fiscal 2017 earnings, and Federal Realty (FRT) is exchanging hands at 27 this year's expected funds from operations per share. Incredibly, most of these companies also hold net debt positions on the balance sheet, further illustrating the magnitude of enterprise "market cap" a lower discount rate is generating on these steady-eddy free cash flow generators.

Here's what we're getting at: if 20-30 times fiscal 2017 earnings is somehow reasonable today in light of existing conditions, why not 30 or 40 times fiscal 2018/2019 earnings eventually? This prognostication may sound like good news as it means higher stock prices, and maybe it's actually great news for many, but in the event the market does move fervently higher, readers should understand the advance may be driven more by ever-falling assumed discount rates within equity valuation frameworks, buttressed by buying from dividend growth investors, more than anything else. Because this bubble is inflating on some of the strongest business models with household brand names, prices on these equities could inflate considerably without much pushback from holders. We continue to be mostly long in the Best Ideas Newsletter portfolio as we plan to participate in any strong advance that may be coming, but a healthy dose of skepticism of the market will keep us on our toes.

The Bubble is Still Inflating...continued on next page

*The Bubble is Still Inflating...*from previous page

Clearly, we may have underestimated just how much "air" the prospect of NIRP, or a delay in a rate hike by the Fed, could force into an already "bubbly" equity market, but no matter what may be ahead of the markets, we simply can't afford not to be cautious in light of existing valuations. Can you imagine the shock on investors if some of the outsize forward valuations on some of the most tried-and-true dividend-payers revert back to traditional mid-teen forward multiples? In some cases, capital positions could be halved. Please be cognizant of the capital risks as broader equity markets continue to reside near all-time highs. We're always available for questions.

Shocking?!?! Utility Dividends Aren't Always Safe

By Kris Rosemann

Utility Dividend Cuts in our Coverage Universe Since 2000

Company	Symbol	Market Cap ($ in billions)	Year of Dividend Cut	Reason
Edison International	EIX	$22.83	2000	Deregulation of California power market leads to California Power Crisis.
PG&E	PCG	$28.96	2000	Deregulation of California power market leads to California Power Crisis.
Wisconsin Energy	WEC	$18.49	2000	Dividend cut to pay for new generating capacity and distribution upgrades.
CMS Energy	CMS	$11.44	2002	Credit issues tied to collapse of unregulated energy trading.
CenterPoint	CNP	$9.14	2002	Creditors required cut to refinance short-term debt used for unregulated power assets.
American Electric Power	AEP	$32.34	2003	Supply glut in unregulated wholesale power causes market to collapse.
NiSource	NI	$7.53	2003	Ventured into unregulated businesses, cut to avoid credit downgrade after market collapsed.
TECO Energy	TE	$6.51	2003	Growth strategy based on wholesale power backfires as prices collapse.
Ameren	AEE	$11.74	2009	Tough business conditions including higher operating and environmental costs amid recession.
Exelon	EXC	$32.16	2013	High exposure to unregulated power sector pressured cash flow in prolonged downturn.
First Energy	FE	$15.19	2014	Became dependent on less-dependable unregulated business to fund dividend.

We frequently receive questions as to why we don't include a number of individual utilities that have large dividend yields in the Dividend Growth Newsletter portfolio, released and updated on the first of each month via email. While this is a legitimate inquiry, a better question, however, may be: why is the baseline assumption that we should include individual utilities in the Dividend Growth Newsletter portfolio? Let's take a closer look at the underlying drivers of the performance of the utility sector in an attempt to properly address such questions. Though conclusions are presented broadly in industry context, it should be noted that each individual utility has its own firm-specific strengths and weaknesses.

First of all, there is plenty to like about the business models of utilities. Regulated utilities are often monopolies in their operating regions, to which they provide an essential service. This, coupled with the fact that the returns of regulated utilities are set by a regulatory body within a defined ratemaking process, causes the sector to be full of operators that boast steadily-growing earnings that appear to be materially dependable. Often times we warn against capital intensive business models, a key characteristic of utilities, but the regulated aspect of the utility business model reduces a fair amount of the risk associated with such large capital outflows. In fact, it is the fixed rate of return on such hefty investment that is the driver behind regulated utility earnings expansion.

From an analytical standpoint, however, the outlook for the regulatory framework of each individual utility, or its source of revenue and returns, can be very difficult to accurately project with any degree of certainty over the long haul. For example, will regulators complicate the return process, if not during the next few years, what about after that? How timely will regulators allow for payment, or will they at all, if the governing body's credit deteriorates significantly? There are a lot of questions with answers that may be beyond the forecasting ability of even the most astute and tenured financial analysts. In many cases, the investment analysis of a utility is based more on one's ability to predict political and regulatory frameworks than anything else.

Shocking?!?! Utility Dividends...continued on next page

Shocking?!?! Utility Dividends...from previous page

We're not alone in this view. Where the financials play a much more important role in the assessment of the credit quality of general operating firms, Moody's credit rating framework for regulated utilities, for example, is based mostly on an outlook of a given utility's regulatory environment. Moody's primary considerations of a utility's credit quality are based on analysis such as the consistency, supportiveness, and predictability of a firm's regulatory environment, as well as the historical track record of a utility's relationship with its regulatory body with respect to the outcomes and timeliness of rate case reviews.

The issue with the above considerations is that such assessments are often backward-looking, and in many cases, a regulatory environment can change suddenly with little or no forewarning, particularly in a politically-charged scenario. Favorable and timely rate case reviews are essential to a healthy operating environment for a utility, as a regulatory body's decision on the rates a utility is able to charge its rate base is essentially a ruling on the return a regulated utility will receive on its investment. If this process for a given utility has a history of being politically charged, inconsistent, or unfavorable to the utility in any way, it poses a major threat to the utility's operations moving forward and can result in a lower credit rating for the company.

In fact, in Moody's methodology, only 40% of the credit rating consideration for regulated utilities is based on the actual, tangible financials of the utility itself, and ironically, it is within this particular financial assessment that we tend to disagree with the rating agency's more sanguine view. From our objective perspective, most utilities are debt heavy, capital-intensive entities that pay out most of their earnings as dividends, retaining very little cash cushion in the event of an exogenous shock to their business. This is a read straight from the financial statements. In this light, and particularly in the context of a dividend payer, we can't help but be cautious, as the dependence on estimating the intricacies of changing regulatory environments fails to give us the comfort we would need to accept the added financial risk to the dividend payer.

Though Moody's notes that the utility sector has experienced few defaults and has a historically high recovery rate in the event of an adverse credit outcome, we think it is important to distinguish between the perspectives of debt and equity investors. The necessary nature of regulated utilities coupled with the political influence over such entities often means that defaults and recoveries across the sector may not be too frequent or severe, respectively, but the ability to continue to pay a dividend is a different question altogether. Where the regulatory "monopolistic" environment surrounding utilities, often credited as the source of most of their "moaty" characteristics, may help stave off a credit event, it may not do much in terms of sustaining the dividend, and we'll walk through a number of examples as to why.

In recent years, there have been two high-profile dividend cuts among major utilities in our coverage universe, the risks of both were highlighted by the Dividend Cushion ratio in advance of their respective cut (a ratio below 1 on the Dividend Cushion signals increased capital dependency, free cash flow shortfalls, an overleveraged balance sheet, or a function of all three). Incredibly, for such a group that comes with a near-pristine "dividend safety" perception from many in the dividend growth crowd, five of the fifteen large utilities in our coverage universe have either cut or suspended their dividends since 2000, and six more of the small/mid-cap variety in our coverage universe have cut or suspended quarterly payouts since 2000 as well. The table at the top of this article showcases the dividend cuts of utility holding companies just in our coverage universe since 2000 (note this includes only utilities from our coverage as there have been many more instances in the past 20 years).

The majority of the dividend cuts highlighted in the table came in the early 2000s, from 2000-2003, due to aggressive growth (capital investment) decisions made throughout the sector in the 1990s. Many utilities attempted to attract investors through unregulated growth projects after being

Shocking?!?! Utility Dividends...continued on next page

Shocking?!?! Utility Dividends...from previous page

considered too dull compared to faster-growing tech and other stocks at the time. However, as the federal government flirted with the idea of deregulation, the massive move of utilities to build merchant plants to sell power on the open market caused a power surplus and suppressed prices, which were set in the market and not by state regulators. Utilities were forced to take on debt to finance their projects, ultimately causing a cash shortage for a large portion of the sector. Even the largest and most dependable dividend payers were not immune to the cash shortage the industry partially brought upon itself through misguided wholesale power ventures.

American Electric Power (AEP), the largest electric utility in the US at the time, cut its dividend in 2003 after foraying too far from its regulated base in an attempt to capture growth, and TECO Energy (TE) was forced to snap its 43-year streak of consecutive dividend increases in 2003 after unforeseen problems in its large-scale bet on wholesale power sent it scrambling to shore up its financial position. Eight utilities in our coverage universe were forced to cut their dividends between 2000-2003, and in a twelve month period from spring 2002 through spring 2003, thirteen firms with major electric utility operations reduced or suspended their dividends. Many were forced to reduce their quarterly payouts as part of refinancing agreements with creditors as short-term debt raised to finance growth projects matured.

The political forces that were associated with the waffling of both federal and state governments in the late 1990s and into the 2000s were a part of the reason behind the dividend cuts of utilities. The California Power Crisis--which caused multiple utilities to cut their dividends, including Edison International (EIX) and PG&E (PCG) suspending their dividends--is a prime example of the political uncertainty that could crop up around a given utility. The state and federal governments were unable to properly work together, and the utilities involved, their customers, and their investors all found themselves in the dark. We cannot forget to mention the collapse of energy trader Enron around the same time period, which brought additional scrutiny to the energy and power markets, and further clouded the political environment. It is nearly impossible to predict how a politically charged situation will play out, a major reason we point to incalculable firm-specific risk being high in the utility sector.

In more recent memory, Exelon (EXC) cut its dividend in early 2013 due to the expectation for sustained weak market fundamentals across the unregulated power sector. At the time, Exelon owned three utilities and a large power provider, but the majority of the firm's business came from selling electricity generated in its power plants on the wholesale market. In fact, it was the largest owner and operator of nuclear-power plants in the US at the time, but low natural gas prices and relatively weak electricity demand suppressed unregulated wholesale-power prices and ultimately forced Exelon to reevaluate its capital allocation strategy. Exelon's credit rating was soundly in investment-grade territory at the time of the dividend cut, mostly due to Moody's opinion of its regulated utilities operations, which were unable to save the payout.

In 2014, First Energy (FE) became the latest large public utility to join the infamous list of dividend cutting utilities, and the story of its cut is similar to that of its predecessors. The firm had become too dependent on its unregulated power generation business to fund its dividend, and when adverse economic conditions and more costly regulatory and environmental mandates hit, it was sent searching for answers. The company subsequently aligned its dividend strategy with its regulated business, making its payout fully funded by regulated operations. Significant storm activity in the years leading up to the cut also posed an additional headwind to appropriate cash allocation practices for the company, as more than $1 billion in unexpected storm-related expenditures had accumulated. Weather poses yet another unpredictable, exogenous risk to the health of a utility's operations.

The Dividend Cushion ratio only has five years of historical data, but in its short time of existence, it has accurately predicted the heightened financial risk that ultimately led to the dividend cuts at Exelon and First Energy (two highly-rated credits), but such leveraged balance sheets and significant capital

Shocking?!?! Utility Dividends...continued on next page

*Shocking?!?! Utility Dividends…*from previous page

requirements--major red flags for any large dividend payer--are not uncommon for most operators in the utility space. The difference came in the two firms' inability to remain dedicated to their regulated businesses in addition to the increasing amount of regulatory and environmental mandates and general uncertainty surrounding their respective regulatory environments. Most public utility holding companies in our coverage universe have raw, unadjusted Dividend Cushions below 1 due in part to their large net debt loads, capital-intensity, and dividend obligations.

The Dividend Cushion methodology may, in theory, pull forward debt maturities into the 5-year forecast measurement period, generating a more punitive assessment of a utility's dividend health, but the measure is a more tangible, objective and financial-focused measure of dividend health within and across the utilities sector than issuer credit ratings alone. We think this is a good thing. In this light, the Dividend Cushion, while highlighting risks appropriately, may have a greater number of "false positives" in the utilities sector regarding the extent of dividend risks than in other sectors due in part to the greater dependence on qualitative, non-financial analysis in assessing the fundamentals of utilities operations, and by extension, a utility's ability to keep paying a growing dividend. However, as even the past 20 years have revealed, utilities' dividends aren't always safe.

From our perspective, we've reluctantly accepted the reality that publicly-traded utilities are almost entirely dependent on the regulatory environment to offset the well-documented balance sheet and free-cash-flow risk associated with their operations. For those that are uncomfortable knowing that pure and dependable financial analysis may be but a secondary consideration in determining the dividend health of an individual utility, sector utilities ETFs, such as the diversified Utilities Select SPDR ETF (XLU), become a much more attractive alternative. This is the camp that we find ourselves in. We'd much rather consider a dividend payer with a considerable net cash balance that is generating significantly more free cash flow than dividends paid. Such characteristics are not common within the utilities sector.

Though we've made the case why investors should be aware of the abnormal firm-specific risks to the dividend of any individual utility position, exposure to the broader sector may still make a lot of sense for a number of reasons. Not only are their diversification benefits to holding a broad basket of utilities stocks, but the spread between utility dividend yields and the risk free rate of a 10-year US Treasury bills remains attractive. With the Fed's promise to exercise caution on future interest rate increases, this relationship may stay intact for longer than most expect, meaning income-hungry investors may continue to flock to what classically have been considered among the safest dividend payers on the market, a distinction we'll leave you to decide it is fair or not. The utilities exposure in the Best Ideas Newsletter portfolio can also be viewed in part as a hedge against further market-driven interest rate declines, as most of the world engages in negative interest rate policy (NIRP), which may put a halt altogether by Fed activity. The chart on the following page compares the changes in the 10-year US Treasury bill yield (red) and the price of the XLU (blue) shortly after the initiation of our position in the XLU in spring 2014.

Utilities are among the most popular stocks for many income investors, a notion that has only intensified after years and years of loose monetary policy that has helped drive dividend yields of many utilities well past those of risk-free assets such as the 10-year Treasury bill. Utilities equities are generally considered "safer" investments relative to most other business models due in part to their fixed rate of returns through regulatory support and "monopolistic" characteristics that are common to their operations. Where consumer or industrial operating equities are beholden to sometimes punitive rivalries and cyclical economic trends, utilities are in part shielded from such dynamics. All of this sounds great, but that doesn't mean their dividends are iron-clad. If anything, we wanted to make sure with this piece that income investors were aware of the tangible dividend risks of the group, often suppressed by many research shops and even if such acknowledgement does not require action in portfolio context.

*Shocking?!?! Utility Dividends…*continued on next page

Shocking?!?! Utility Dividends…**from previous page**

Alcoa Continues Swoon, Revises Aerospace 2016 Outlook to 6%-8% Expansion

By Brian Nelson, CFA

Alcoa (AA) kicked off first-quarter 2016 earnings season April 12, but nobody reading our work should have much interest in shares. Our $10 fair value estimate for the company explains the lack of opportunity, and we laid in out in no uncertain terms in April 2015 that we thought, "The Time to Consider Owning Alcoa Has Passed." Even a few months before that write-up, we said the aluminum giant was trading at a peak multiple on peak earnings, a classic valuation "no-no," and since that time, shares of Alcoa have fallen more than 40%.

> *From our Jan 13, 2015 article:* Would we ever considering owning Alcoa near a cyclical peak in economic demand, roughly 5-7 years into one of the strongest stock-market recoveries in history, or said differently, in the current environment? **The short answer is: No.** Market veterans know that the time to consider buying Alcoa is at a cyclical trough, not at peaks, and only then if there is no tangible risk of default. Having run from under $8 per share in mid-late 2013 to nearly $16 per share, Alcoa is tired. We doubt there's enough juice left in the firm's tank to drive annualized earnings much higher than the $1.32 per share current organic run-rate ($0.33 per share x 4). Any further earnings expansion will be driven more by acquisitive behavior, and we're not sure Alcoa is getting the best deal on these transactions. *We're staying on the sidelines with respect to Alcoa's shares for the foreseeable future.* Any potential upside in shares is more than offset by downside risk that we know is real once the economy slows.

We like talking about our track record at times because we think it is important for readers to understand that avoiding big missteps such as the one in Alcoa may be as valuable, or in many cases

Alcoa Continues Swoon…**continued on page 9**

The Best Ideas Portfolio

By Valuentum Analysts

Portfolio Return	Benchmark Return	Outperformance
101.2%	69.7%	31.5pts

= ALL-TIME HIGH

Below we outline the constituents of the portfolio and their respective weightings and returns thus far. Each subsequent issue discusses Valuentum's latest changes to the portfolio and analysis and trends impacting companies in our Best Ideas portfolio. We currently have ~27% 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 April 15, 2016 (intraday) — **Best Ideas Portfolio Inception Date: May 17, 2011**

Portfolio Holdings	Symbol	Initial VBI*	Current VBI**	Fair Value	P/FV	First Purchase	Cost/Shr ($)	# Shares	Total Cost ($)	Price/Shr ($)	Current Value ($)	Cumulative Div's Rec'd	% of Portfolio	% Return (dividends included)
Bullish														
Apple Corp.	AAPL	10	3	$142.00	0.78	17-Jun-11	51.92	107	5,569.33	110.36	11,808.52	967.85	5.9%	129.4%
Altria Group	MO	8	6	$55.00	1.12	28-Jun-11	28.39	157	4,471.86	61.44	9,646.08	2,195.32	4.8%	164.8%
Buffalo Wild Wings	BWLD	6	3	$190.00	0.77	27-Aug-15	179.81	16	2,876.90	146.72	2,347.52		1.2%	-18.4%
Cisco	CSCO	9	7	$37.00	0.75	14-Nov-14	26.33	221	5,831.87	27.81	6,146.01	160.46	3.1%	8.1%
Energy Select SPDR	XLE	NR	NR	NA	NMF	6-Oct-15	67.14	143	9,608.02	63.75	9,116.25	142.14	4.5%	-3.6%
Facebook	FB	6	6	$130.00	0.84	29-Jan-16	112.10	50	5,612.00	109.78	5,489.00		2.7%	-2.2%
Financial Select SPDR	XLF	NA	6	NA	NMF	9-Jan-11	13.46	150	2,026.00	22.90	3,435.00	238.95	1.7%	81.3%
General Electric	GE	7	6	$31.00	1.00	21-Oct-13	25.99	375	9,761.75	30.97	11,613.75	814.50	5.8%	27.3%
Google - Class C	GOOG	10	7	$854.00	0.89	23-Oct-12	450.92	7	3,170.42	758.56	5,309.92	10.35	2.6%	67.8%
Google - Class A	GOOGL	10	7	$854.00	0.89	4-Apr-14	Split	7	Split	778.68	5,450.76		2.7%	+++
Health Care ETF	XLV	9	6	NA	NMF	22-May-12	36.60	125	4,582.00	69.80	8,725.00	456.63	4.3%	100.4%
Intel	INTC	6	3	$38.00	0.83	12-Sep-11	20.48	150	3,086.50	31.69	4,753.50	517.50	2.4%	70.8%
Johnson & Johnson	JNJ	6	6	$111.00	0.99	29-Jan-16	104.18	54	5,632.72	109.79	5,928.66		2.9%	5.3%
SPDR S&P Bank ETF	KBE	NR	NR	NA	NMF	9-Jan-12	21.07	100	2,114.00	31.45	3,145.00	218.40	1.6%	59.1%
Kinder Morgan	KMI	5	5	$20.00	0.92	17-Feb-16	17.29	157	2,721.53	18.36	2,882.52		1.4%	5.9%
Michael Kors	KORS	8	6	$62.00	0.84	27-Aug-15	43.44	68	2,953.80	52.26	3,553.68		1.8%	20.3%
PayPal	PYPL	UR	UR	UR	UR	17-Jul-15	Spin-off	100	Splt	38.54	3,854.00		1.9%	+++
Priceline	PCLN	10	6	$1459.00	0.91	26-Feb-15	1239.49	6	7,450.91	1324.47	7,946.82		3.9%	6.7%
Republic Services	RSG	8	7	$40.00	1.15	19-May-11	31.42	201	6,329.42	46.11	9,268.11	1,098.48	4.6%	63.8%
Teva Pharma	TEVA	6	3	$59.00	0.93	24-Jul-13	41.22	77	3,180.94	55.04	4,238.08	285.55	2.1%	42.2%
Union Pacific	UNP	6	3	$86.00	0.95	24-Jul-13	79.67	40	3,193.80	81.36	3,254.40	196.00	1.6%	8.0%
Utilities Select SPDR	XLU	NR	NR	NA	NMF	18-Mar-14	41.12	83	3,419.96	48.94	4,062.02	259.71	2.0%	26.4%
Visa	V	7	6	$75.00	1.07	30-Nov-11	26.86	188	5,064.39	80.06	15,051.28	279.03	7.5%	202.7%
Latest changes: PCLN, CSCO increased; KMI initiated (Feb 17); FB, JNJ added & EBAY, GILD removed (Jan 29); RIO, BABA removed (Jan 6).														
Cash -- changes in monthly cash balance reflects dividends received and trading gains/losses, where applicable.											54,176.50		26.9%	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 -->	**201,202.38**			**101.2%**
S&P 500 Index (SPY)						17-May-11	132.69	754	100,000.00	207.62	156,469.97	13,240.64	92.2%	
Cash											13,240.64		7.8%	
Benchmark Portfolio Value											**169,710.60**			**69.7%**
Relative Outperformance														**31.5 pts**

Data as of April 15, 2016 (intraday). Cost basis includes commissions. Results include dividends, but not interest received on cash balance.
* VBI score at the time we added the firm to the portfolio.
** See our methodology regarding the Valuentum Buying Index (VBI). Best Ideas portfolio is not a real money portfolio.

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

*Alcoa Continues Swoon…*from page 7

more valuable, than finding the "next big winner." We've had a couple losing positions in the Best Ideas Newsletter portfolio over the past five years as even the best fund managers have, but they weren't nearly as bad as Warren Buffett's foray into British grocer Tesco or IBM (IBM), for example, and certainly not like Bill Ackman's disaster in Valeant (VRX) or David Einhorn's misstep in SunEdison (SUNE). Readers ought to be shocked to hear that in the near-$6 billion Sequoia (SUQUX) at one point in 2015 Valeant had accounted for 30% of assets, with shareholders having "lost 25% over the past year, compared with a flat S&P 500." We're not exactly sure what went wrong at Sequoia – an overconfidence bias, a breakdown in oversight, too much pressure to outperform, or a combination of all three or something else, but shareholders aren't happy, in any case.

Valuentum's stock-selection methodology in considering a robust discounted cash-flow process, a relative valuation overlay, and technical and momentum indicators itself offers a series of checks and balances to aid in our team's qualitative portfolio management overlay within the newsletter portfolio context, but we also have stringent risk management controls in the newsletter portfolios. At cost, for example, we'd never add a new position to the newsletter portfolios in a magnitude greater than 5% of assets, and we'd never let a winner run past 10% of the assets of each newsletter portfolio. In recent years, we've had to trim equity positions in EDAC Technologies (formerly EDAC), Apple (AAPL), Altria (MO), Visa (V), and Medtronic (MDT) because of these particular risk controls. The Dividend Cushion ratio, while not perfect, acts as an important risk control in the Dividend Growth Newsletter portfolio, having alerted us to the impending dividend cuts at ConocoPhillips (COP) and Kinder Morgan (KMI) far in advance of the actual dividend cuts.

The biggest news out of the Alcoa quarterly report was probably expected, and something that we've been mentioning for some time, if not directly than in passing. The aluminum bellwether modestly lowered its 2016 outlook for the aerospace market, now projecting 6%-8% growth versus a previous estimate of 8%-9% expansion for the year – not a big change, but the direction is important. We first outlined the prospects of a potential "bubble" in wide-body market, "Surveying the Aerospace Arena (Oct 2015)," and it wasn't but April 7 that we noted in "Debt, Debt and More Debt," that, while expected, Boeing's (BA) commercial deliveries in the first quarter of 2016 fell more than 4%, even as shipments of its workhorse 737 and 787 Dreamliner remain robust. Investors in the commercial aerospace supply chain, which includes heavy hitters such as General Electric (GE), United Technologies (UTX), and Rockwell Collins (COL) remain very well-positioned, in our view, but we continue to describe the ongoing commercial aerospace upswing as "tired."

Alcoa's primary reason for the downward growth revision in aerospace is a rather benign one, pointing to lower orders for legacy models (e.g. Boeing's 767) and the timing prior to the ramp in new model introductions across the aircraft size spectrum. Aerospace equities, however, tend to be "priced" on incremental changes in demand, often in terms of order momentum rather than deliveries, per se, and in light of more recent developments, a plateau is forming, if only because order books are so full. Said differently, while there remains a strong commercial jet order book of ~14,600 plans, amounting to more than 9 years of production at 2015 delivery rates, shares in the supply chain could still face pressure in the event new order growth slows, fair or not. Alcoa noted that there are ~23,800 aircraft engines on firm order, so the visibility of commercial aerospace remains as clear as ever, even as emerging market weakness and volatile crude oil prices complicate fleet replacement decisions.

Though we continue to remind investors that we are more than seven years into stock market strength following the depths of the March 2009 panic bottom, we have a number of favorite ideas within commercial aerospace. First, we include General Electric in both newsletter portfolios. Second, we're strongly considering adding Berkshire Hathaway (BRK.A, BRK.B) to the Best Ideas Newsletter portfolio as it recently gobbled up our favorite commercial aerospace supplier Precision Castparts (formerly PCP), but we're being patient with price. We're fans of Boeing, United Technologies and Honeywell (HON) on a fundamental basis, and while there are small-cap opportunities in the supply chain (see here), we're generally shying away from adding cyclical exposure to small caps so late into the economic and credit cycle as investors continue to bid shares higher.

Debt, Debt and More Debt

By Brian Nelson, CFA

Many readers may be familiar with the rhetoric of the Presidential Election Cycle of 2016 and Democratic hopeful Bernie Sanders' view on making "college tuition free and debt free." Many may find his point of implementing a tax on Wall Street speculators rather intrusive to the heartbeat of the American economy and the driver behind innovation and standard-of-living improvements, but we'll leave that conversation for another day. But what's the shocking statistic, right?

Get this – and I hope you are sitting down. According to an article by the Journal, "more than 40% of Americans who borrowed from the government's main student-loan program aren't making payments or are behind on more than $200 billion owed." How much is $200 billion? To put that number in perspective, it equates to wiping the entire equity value of a global bank like JP Morgan (JPM) completely off the map, or about two Citigroup's (C), or AIG (AIG), General Motors (GM), and Boeing (BA) combined. One in six borrowers is in default on their student loan, meaning they haven't made a payment in over a year.

The implications on society may be far-reaching, perhaps playing into the attendance growth of more-affordable community colleges as opposed to the proliferation of attendance at expensive four-year universities that may never deliver on student expectations after graduation. The for-profit education industry has been pummeled by regulations for the past few years, with companies including Apollo (APOL) and Strayer (STRA) taking considerable lumps, but the problem goes far beyond institutions that are looking to make a profit for shareholders. America truly has a student loan problem, and there may not be an easy answer -- and unfortunately, the debt binge doesn't stop with student loans either.

The broader equity and credit markets are growing more and more worried about subprime loans -- not of the home mortgage variety that made front-page news late last decade during the Financial Crisis but subprime loans of auto substance. A few weeks ago, another article from the Journal revealed striking similarities to the housing crisis of the past in highlighting the "early performance of a bond issue called Skopos Auto Receivables Trust 2015-2," which had been constructed using subprime auto loans and formed only a few months ago in November 2015. According the report, through February, "about 12% of the underlying loans were at least 30 days past due, a third of which were more than 60 days delinquent." In nearly 3% of the packaged loans, the borrowers were bankrupt or had their vehicles repossessed.

We can't say whether such loan performance may be telling of weaker future auto sales at the Big 3, Ford (F), General Motors, and Fiat Chrysler (FCAU), but it's yet another data point worth considering. The US economy is resilient and pent-up demand for autos remains, but just how much has the magnitude of the surge in auto sales been augmented by lax lending standards? We're keeping our eye on the lending environment, and the auto lenders in particular, including Santander Consumer (SC) and Ally Financial (ALLY). Even the auto dealers including high-end Penske Auto (PAG) to no-haggle CarMax (KMX) may not be completely immune to any possible fallout. Just in its fourth-quarter earnings call April 7, CarMax's CEO Tom Folliard noted that the firm "faced a somewhat more challenging sales environment in the second half of the year."

Perhaps connected to the poor performance of student loans and auto debt are the challenges that mall retailers are currently facing. It is troubling to see branded retailers such as Aeropostale (ARO) and Bebe Stores (BEBE) trading at pennies per share given their tremendous popularity of years past, perhaps the former more than the latter, but nonetheless. We've been highlighting to members the significant risks of investing in any fickle teen retailer, "Investing in Teen Retail Is Like Rolling the Dice," so this shouldn't come as too surprising of a development that Pacific Sunwear (PSUN) filed for bankruptcy April 7. Surf and snow gear provider Quiksilver (ZQK) recently filed for bankruptcy, and Sports Authority is yet another firm that has recently encountered troubles.

Debt, Debt and More Debt **...continued on next page**

*Debt, Debt and More Debt…*from previous page

Putting the pieces together – student loan defaults, auto loan delinquencies, and mall-based retailing pressure – the creditworthiness of the youngest adult generation may not be the healthiest. Millennials may not only be cash-strapped, but their spending patterns may lend themselves more toward buying the latest-and-greatest technological gadgets from Apple (AAPL) and Fitbit (FIT) or eating out at the latest fast-casual place from Panera (PNRA) to Zoe's Kitchen (ZOES) to Buffalo Wild Wings' (BWLD) new concept PizzaRev than scooping up fashion at the mall. The depths of the next economic cycle, the timing of which is the only uncertainty, may very well claim the weakest department stores, namely JC Penney (JCP) and Sears Holdings (SHLD). There might not be a long-term picture for these storied franchises, unfortunately.

We've been one of the biggest "bulls" on the strength of the upswing of the commercial aerospace market the past few years, pointing to the significant and multi-year backlogs at the airframe makers, Boeing and Airbus (EADSY), but even the former may be hitting somewhat of a "financing" snag in continuing momentum, albeit a small one. Boeing has done a fantastic job reducing the size of its finance arm Boeing Capital Corp in recent years, but new CEO Dennis Muilenburg noted that the aerospace giant is "on the verge of losing sales," as the Export-Import bank drags its feet in appointing board members. We're not worried about Boeing, per se, but the supply chain could face minor issues if any key orders are held up. In widely-expected other news, Boeing noted April 7 that commercial aircraft deliveries fell more than 4% in the first quarter, even as deliveries of its workhorse 737 and 787 Dreamliner remained strong. The commercial delivery upswing seems to be getting tired, exacerbated by emerging market weakness and highly-volatile crude oil prices, both of which are complicating the fleet replacement decision at a number of carriers.

We've never been a fan of the banking business model, and we've outlined as much in our latest ETF piece on the sector, "ETF Analysis: Banks and Financials." Not only do we prefer diversified banking exposure via ETFs for the reasons outlined in the ETF piece, but our firm-specific theses continue to play out as dividends from the largest banks in the world come under siege. Santander (SAN) cut its dividend March 2015, Standard Chartered (SCBFF) cut its dividend August 2015, Deutsche Bank (DB) eliminated its dividend in October 2015, and Barclays (BCS) cut its dividend earlier this month. Credit Suisse (CS) also had its equivalent of a London Whale incident as traders racked up roughly $1 billion in losses before the firm was able to get things back "under control." We've address our reasons never to own a banking stock for its dividend in our "Banks and Money Centers Industry Report," and we think all investors should have a read. While controversial, the analysis continues to be spot on.

As a short update to the Yahoo! (YHOO) saga, one company that is not afraid of holding over $100 billion in long and short-term debt on the books continues to express interest in making a bid for the beleaguered Internet portal. That company is Verizon (VZ), and why not – what's another $8 billion or so in more debt when it has so much already? Rumors are that former CEO of standalone AOL Tim Armstrong may take the reins if a Verizon (AOL)-Yahoo tie-up does happen, perhaps closing the chapter on the tenure of Marissa Mayer. We continue to believe a deal with eBay (EBAY) may be Yahoo's best bet over the long haul, but with board members resigning, Starboard Capital launching a proxy fight, suitors leaking interest in bidding, the story remains influx. We continue to watch from the sidelines.

In case you missed it, we launched coverage of Heinz Kraft (KHC), and we're not excited about how the market is pricing its equity. Holders of its stock should be cognizant of the company's substantial relative valuation premium to peers, not to mention its relatively weak ROIC measures in light of troubling consolidated earnings performance the past few years. The Oracle of Omaha is far from perfect, and investors should not follow blindly without doing their own homework first. Our fair value estimate implies shares are overpriced, but consumer staples stocks continue to roar higher thanks to buying interest from dividend seekers.

Treasury Erects Iron Tax Curtain

By Brian Nelson, CFA

"If history is any guide, it would seem that tax lawmakers may want to think about the current political agenda's similarities with respect to that of a "new" Berlin Wall--not one built of barbed wire but of prohibitive, restrictive tax laws--and whether such measures make sense in light of the events of the late 1980s." – Valuentum Securities

Late Monday April 4, the US Department of the Treasury launched an all-out attack on companies pursuing tax inversion deals and a technique called earnings stripping, the latter used as a means to minimize taxes after an inversion. Stating in no uncertain terms that such companies have only been successful due to the "benefits of being based in the United States," not due to their entrepreneurial spirit, their ingenuity, grit, and perseverance, or efforts to create opportunities and jobs for Americans, Treasury noted that it is "taking further action to make it more difficult to invert," accusing some companies of "seriel inverting" and "shifting a greater tax burden to American families," some of them such companies employ. Has Treasury gone off the deep end?

Certainly the agenda is politically charged, and there will be as many opinions on this topic as there are those that can opine, but one thing is clear. The political pressure to tax to replenish government coffers may not stop during the current administration. For one, Democratic presidential frontrunner Hillary Clinton has announced a serious plan to "crack down on inversion deals." Republican presidential frontrunner Donald Trump seems more sympathetic to businesses, even more understanding, revealing that the flaw rests in the tax code itself and that by cutting the US corporate tax rate to 15%, there'd be no need for companies to move abroad at all. Problem solved? Mr. Trump's tax plan would also levy a reasonable one-time tax of 10% on overseas profits of US corporations, something that cash-rich entities such as Apple (AAPL) and Cisco (CSCO) may find amenable, in light of the alternative of keeping their cash stashes outside the US. Apple CEO Tim Cook has said repeatedly the US tax code on foreign income is "broken," but Treasury's new rules seem to continue to favor anti-business policies.

What's more, Treasury's issuance of "formal regulations" aims squarely at one of the largest deals in the pipe: the ~$160 billion transaction involving Pfizer's (PFE) plans to merge with Ireland-based Allergan (AGN). The new rules by Treasury would "disregard three years of past mergers with US corporations in determining the size of the foreign company…(and)…because Allergan is itself a product of several US inversions," the deal's arithmetic wouldn't make the new combined entity immune to US taxes. Shares of Allergan are cratering ~15% on the trading session April 5 as many speculate the Pfizer tie-up is all but dead. We don't expect legal action against Treasury by the two companies, and while we're not discounting further pathways to completion, a merger withdrawal may be forthcoming. We plan to publish an updated report and fair value estimate on Pfizer and Allergan soon.

The number of ways that government agencies can "bust" transactions from anti-competitive means to now making them uneconomical for tax reasons has become startling to say the least. Has the culture in Washington become one in which government officials believe they own all companies in the US in that they have a claim on all future profits via taxes, or is it still one that facilitates the free-flow of commerce through global trade in a truly connected world? In the context of the FBI's recent demands on Apple, could one finally say in fairness the US government is starting to overstep boundaries and freedoms? No matter one's opinion of whether businesses should have some protection, federal and state government budgets remain strapped, debt loads have become tremendously burdensome, and social agendas have probably never been more in vogue. You don't have to get that far into the morning paper to learn about a state raising the legal smoking age to 21, cities trying to ban sugary colas, and the momentum behind the "Fight for $15" movement. The world is changing fast, and in light of yesterday's announcement, so too are the laws.

Treasury Erects Iron Tax Curtain…continued on next page

*Treasury Erects Iron Tax Curtain ...*from previous page

Medtronic (MDT) and Burger King (QSR) are examples of recent tax inversion deals that "made it through," but if you recall, several other tax-inversion deals were scrapped due to last-minute IRS rule-changes in 2014, perhaps the most notable being Abbvie's (ABBV) axed deal for Shire, but there was also Walgreens (WBA) where, as the Huffington Post put it: "Americans Scared Walgreens Out of a $4 Billion Tax Dodge." Believe it or not, there was actually a threat of a consumer boycott against the age-old household company. Certainly US government officials and consumers know that Walgreens is a holding in the S&P 500, and most retirement accounts, pensions, and index funds have exposure to the company? In some ways, by blocking tax inversion deals, Treasury is preventing wealth creation for Americans in retirement as the equities that would have benefited from such transactions are punished: Allergan case in point. Is it truly American to restrict the freedom of businesses, and by extension, mobile capitalism in a global economy?

If history is any guide, it would seem that tax lawmakers may want to think about the current political agenda's similarities with respect to that of a "new" Berlin Wall--not one built of barbed wire but of prohibitive, restrictive tax laws--and whether such measures make sense in light of the events of the late 1980s. For example, why can't companies leave the US under existing tax laws? And should politicians really be able to change laws ex post-facto, or once a deal or spinoff is announced, as they have now done with the PFE-AGN transaction? Don't the shareholders own the business, and aren't the shareholders consumers, too? Isn't everything inter-connected, and don't tax inversion deals benefit US-based investors and consumers as arguably incremental capital is filtered through R&D instead of the tax bill? These are great questions.

It's certainly a tough environment to be a business owner these days, and things will only get more stringent on business freedoms in coming decades, if the pace of social change is any indication. However, if there is one undeniable fact, the US corporate income tax at 35% is the highest in the developed world. In this respect, can one really blame US businesses for wanting to leave to countries that may treat them more "fairly," or more competitively? Shouldn't lawmakers' approach to the "right" answer be more about making America the place where businesses want to stay, to flock to, than erecting tax walls to prevent businesses from leaving? Aren't there examples in history that teach us that a "Berlin-Wall" type tax code may not be the best approach? It's for each person to decide.

We'll keep monitoring developments.

Removal of Gilead Does Not Stop Portfolio from Setting All-Time Highs

By Brian Nelson, CFA

When we removed Gilead (GILD) from the portfolio of the Best Ideas Newsletter, we just knew something wasn't right. Sure the introduction of Merck's (MRK) once-daily single-tablet combination therapy, Zepatier, a significantly less expensive therapy to Gilead's prized hepatitis C franchise was one major concern at the time, but the market is often not this inefficient when valuing equities. Almost counter intuitively, it became worrisome to us that for a company that was generating so much free cash flow and had just initiated a dividend that the market wasn't even coming close to assigning it a mere market multiple. We had been holders of Gilead for some time, and the recent stock-price performance just wasn't adding up.

One could have written off the weak share price action to "political badgering" from the ongoing election coverage or from capital-flight to safer assets amid concerns of global growth, but there had to be more. The information contained in the market price was telling us something that couldn't be pulled from the recent quarterly report or management's latest outlook, or anything you might find in the backward-looking GAAP financials. Of course Gilead has tremendous product concentration with its

*Removal of Gilead...*continued on next page

*Removal of Gilead…*from previous page

hepatitis C franchise, but that alone couldn't be responsible for its significantly below-market multiple, something that could be remedied in part as the company puts its outsize cash balance to work via diversified growth through acquisitions.

There wasn't even anything wrong with Gilead's fourth-quarter results, announcing a new share buyback program and upping its dividend 10% in the press release. Sure we were a bit concerned about management's gross-margin guidance for 2016 in that it didn't, in our view, logically capture the pricing pressure from Zepatier, which is set at $54,600 for a 12-week regimen, a fraction of Gilead's Harvoni at $94,500, but there was nothing that told us to run for cover. In many ways, it was the pricing action that told us something was wrong. We lost the stomach to hold a company with a very product-concentrated business, one that generates 60% of total sales from Harvoni/Solvadi alone. How could we possibly forget what happened to AbbVie (ABBV)?

Then the story arc continued.

On February 5, the FDA cleared the expanded use of Bristol-Myers' (BMY) hepatitis C offering Daklinza for "additional challenging-to-treat patients with genotype 1 or genotype 3 chronic hepatitis C," revealing even more competition in the hepatitis C space. Bristol Myers HCV combinations revealed cure rates as high as 99% in certain patient demographics. Then, on February 27, Regulus Therapeutics (RGLS) announced that a phase II trial of a key hepatitis C offering received positive interim results, implying even more choices for patients with chronic hepatitis C virus infection. Regulus' HCV candidate showed a respectable 97% cure rate after eight weeks in the mid-stage study. Certainly the hepatitis C "cure" space was becoming more and more crowded by the day. It seems that even if Gilead is able to retain its dominance in the HCV space, pricing pressure and share loss can only be expected in coming years, and that's without the prospect of politicians exerting even more weight on drug pricing practices.

Then on March 18, we got word that one of Gilead's top cancer executives would step down after just a 15-month stint, coming shortly after noting it would halt half-dozen clinical trials, exposing a significant roadblock in Gilead's efforts to expand beyond its anti-viral offerings. Then the beginnings of the outcome of the courtroom brawl with Merck's sofosbuvir patents began to surface. Sofosbuvir is a critical nucleotide used in Gilead's Harvoni/Solvadi franchise, and Merck has been claiming for some time that Gilead has been infringing on its intellectual property, pointing to a patent that Merck published in 2002. The jury concluded that Merck's patents were valid, and an award to Merck could be in the billions, not including a royalty of 10% that may be applied to Gilead's sofosbuvir sales going forward, inevitably pressuring margins.

Gilead is a fine company, with a fortress balance sheet, and throws off a tremendous amount of free cash flow. Cash and cash equivalents stood at ~$26.2 billion at the end of 2015, and the drug maker generated a whopping $20.3 billion in operating cash flow during the year. It's still possible Merck may get more than it wants, but the impact to Gilead will still be marginal, in our view, taking a few billion of cash off the books and squeezing its margins by a few percentage points going forward. The big question, however, is how the future of the hepatitis C "cure" market shapes out, and whether the judgment paves the way for future growth in Zepatier. Gilead's revenue is already expected to fall, its margins are being squeezed, and the company is resorting to buybacks and dividend increases to appease shareholders. Overpaying for an acquisition won't solve its ills, and the company's pipeline, while promising, took a big blow in oncology recently.

Gilead's market capitalization is nothing to scoff at $130+ billion, and while a forward earnings multiple of ~8 times may look enticing on the surface, there's still a lot to be cautious about. We're sleeping better at night not including shares in the Best Ideas Newsletter portfolio, and we're pleased that shares of its high-grade replacement, Johnson & Johnson (JNJ), continue to rally nicely. That won't stop the critics, however. In hindsight we probably should have inched out of the position more slowly, but we're looking forward, not backward, and we can't be too displeased with all-time highs in the Best Ideas Newsletter portfolio (especially as the market struggles to breach new heights itself).

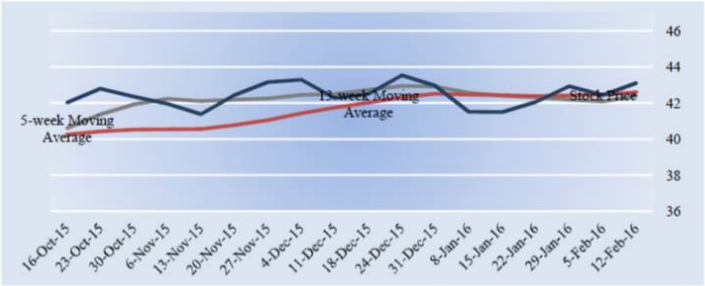
Technical Analysis: It's Not What You Think

A sample of the technical work found in the 16-page reports.

By Brian Nelson, CFA

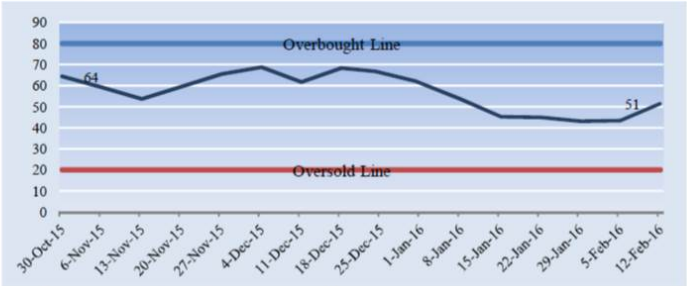
Technical Analysis

Technical Evaluation — VERY BULLISH



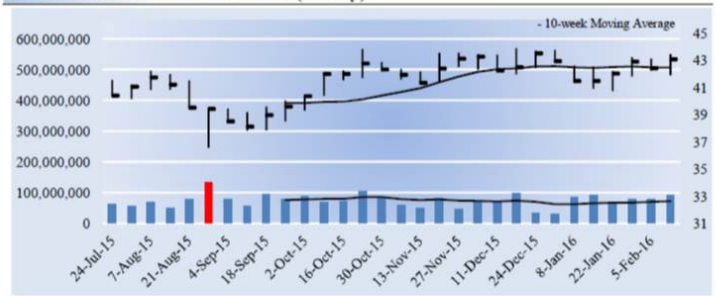
The firm's near-term moving average (5-week, grey line) and medium-term moving average (13-week, red line) are shown in the chart above. Typically, when a shorter-term moving average crosses a medium- or longer-term moving average from below, it represents a bullish signal. If the short-term moving average crosses from above, traders often view this as bearish. Coca-Cola's 5-week moving average will soon cross above its 13-week moving average if current price levels hold. Such activity is often called a golden cross, which we view as VERY BULLISH.

Money Flow Index (MFI) — NEUTRAL



The Money Flow Index (MFI) is an oscillator that uses price and volume to measure buying and selling pressure. Chartists often look for overbought (above 80) and oversold (below 20) levels to warn of unsustainable near-term price extremes. Coca-Cola's MFI of 51 is neutral, suggesting the firm's stock is neither overbought nor oversold at this time. However, a score over 50 tends to favor bulls. The MFI can also be used to gauge the strength or weakness of a firm's price trend. In Coca-Cola's case, its stock price and money flow neither reveals a bullish nor bearish divergence, further supporting our neutral view on its money flow action.

30-week Price and Volume Chart (weekly)



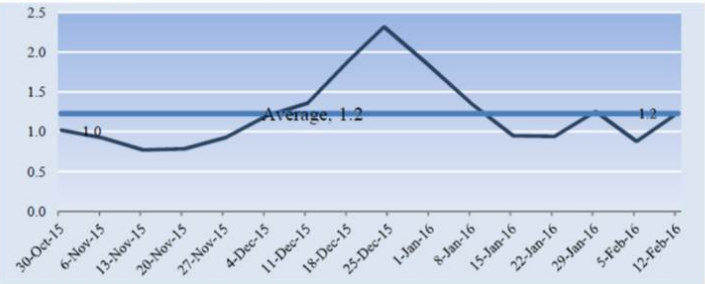
In the chart above, we pinpoint the heaviest accumulation or distribution week of the firm, determined by the week with the highest trading volume during the past 30 weeks. A heavy accumulation (buying) or distribution (selling) week often determines the future near-term direction of the firm's share price, as money managers continue to move in or out of the stock in the days and weeks ahead driving the stock up or down, respectively. For Coca-Cola, the week with the highest trading volume out of the last 30 weeks was a week of heavy selling, or distribution (red bar). Such market activity could indicate a reversal of an uptrend or further confirmation of a downtrend.

Relative Price Strength — STRONG

A firm's relative price strength can be assessed over any number of time horizons. We show the firm's performance over the past 5 weeks, 13 weeks, and 30 weeks below. In arriving at our relative strength rating for each company, we assess the past 13 weeks, which includes the market's reaction to the firm's most recently reported quarter, where applicable, and other more recent economic events. During the past 13 weeks, Coca-Cola's shares returned 4.1%, while the market benchmark returned -5.2%. We think Coca-Cola's 13-week relative price performance is STRONG.

5-week Company Performance	3.7%
5-week Market Benchmark Performance	-5.0%
5-week Relative Performance vs. Market Benchmark	8.7%
13-week Company Performance	4.1%
13-week Market Benchmark Performance	-5.2%
13-week Relative Performance vs. Market Benchmark	**9.3%**
30-week Company Performance	4.3%
30-week Market Benchmark Performance	-9.4%
30-week Relative Performance vs. Market Benchmark	13.7%

Upside/Downside Volume — BULLISH



The level and trend of the Upside/Downside (U/D) volume ratio reveals whether institutional participation has been bullish or bearish as of late. Coca-Cola's U/D volume ratio of 1.2 is not only greater than 1 but also is better than its trailing average, indicating BULLISH institutional interest during the past several weeks.

Timeliness Matrix™

Equity Valuation

Relative Strength	Overvalued	Fairly Valued	Undervalued
Strong			
Neutral			
Weak			

Firms that are undervalued and currently showing near-term pricing strength score near the top right of the matrix.

Companies that are undervalued and showing near-term relative price strength could represent timely buys, as the stock may be attractive to both value and momentum investors. A cross section of the firm's equity valuation and its relative share price strength is shown in the matrix above. We tend to prefer undervalued stocks that have strong pricing momentum, also called Valuentum stocks.

Image shown: Page 7 of each firm's 16-page stock valuation report

*Technical Analysis...*continued on next page

Technical Analysis...from previous page

I once spent most of a morning trying to figure out who was first to say 'technical analysis is like reading tea leaves.' After being unsuccessful, I gave up looking and moved on to more important items. However, whoever first uttered those words -- and those that repeat it mindlessly -- may have done (and are doing) a great disservice to the novice investor. Let me explain why technical analysis in some form should be a part of your stock-selection arsenal.

Even if you do not buy into the traditional "pattern" or "breakout" nomenclature that many associate with technical analysis, a stock chart is extremely valuable in a number of different ways: 1) to assess the historical volatility of the equity 2) to evaluate the performance of the equity through the course of the economic cycle 3) to uncover correlations of the equity with other assets and 4) to assess the materiality of historical events that may repeat in the future – these are just four items, and all four of these examples are fundamentally-linked (not cup-and-handle speak, for example). A stock chart is so valuable to some that many buy-siders I know first-hand do not even know how other investors can purchase a stock without looking at one first. A stock chart and its price hold valuable forward-looking information that synthesizes market opinion, and as investors, we want to be cognizant that such information is available, and where appropriate, apply it.

There is a substantial amount of misinformation on the topic of technical analysis in the investment publishing business. For example, there are herds of individuals that repeat the "tea leaves" catch-phrase on technical analysis -- perhaps in many cases without even thinking about it. Many fundamentally-based writers may also misrepresent the concept of technical analysis to support their view that it is taboo, an opinion that they themselves may not be able to support. It may be true that writers that readily dismiss technical analysis are the ones that may have no experience using it, applying it, or even observing it. These individuals may not understand how buy and sell transactions impact a firm's share price – or how stock prices move. But if these things don't matter to them, should readers be taking their opinion on a topic they know nothing about? It's a good question.

I can't speak for all technicians (nor do I want to) -- as there may be a *distinct* difference between how traditional technicians apply the discipline and how technical analysis is applied at Valuentum. I view technical analysis (solely) as a window into future buying or selling behavior by market participants on the basis of a firm's stock price performance, much like value analysis is used as a window into future buying and selling behavior by market participants on the basis of a firm's intrinsic valuation. The firm's future stock price is difficult to predict to a degree, and the firm's future fundamental cash-flow stream is difficult to predict to a degree. Both are mechanisms used to assess future stock price performance, and in this light, they are equally important market drivers -- no more, no less.

To an unbiased onlooker, for example, there might not be much more to chart-reading other than investors using charts to assess the future price of stocks, and by their own actions, drive stocks higher or lower (via buying or selling) to their *target prices*. Equivalently, this unbiased onlooker may also conclude that there might not be much more to fundamental and value analysis other than investors using it to assess the future price of stocks, and by their own actions, drive stocks higher or lower (via buying or selling) to their *fair value estimates*. There is a 'self-fulfilling' dynamic to both disciplines – they work because other investors apply them and make them work. Interesting perspective, no?

So why do investors have such a difficult time accepting this *law* of the stock market as it relates to technical/momentum analysis? I personally think it comes down to the immediate dismissal of the view without independent examination and absent of experience. Thinking back to my undergraduate days, when I first started reading about investing, most of the classically-accepted books I came across made the art of chart reading out to be some kind of witchcraft, often pointing fun at some of its well-supported tenets. For example, some skeptics of technical analysis might say, "Do you really think that a stock is going to advance because it had a bullish moving average pattern?" But let's try this question as well, "Do you really think that a stock is going to advance because it is undervalued?"

Technical Analysis...continued on next page

Technical Analysis...from previous page

The answers to both might be, "Yes, because such a characteristic will attract more buyers and therefore drive the stock higher." An undervalued stock may take much longer to converge to intrinsic value than a technical "breakout" to complete, but the conceptual underpinnings of technical and value investing processes are the same: both seek to anticipate future buyer behavior.

There are two distinct ways technical analysis is applied to investment decisions at Valuentum. The first is a systematic representation within the context of the Valuentum Buying Index, the third pillar of the process (following a robust discounted cash flow and relative valuation determination). The systematic technical overlay considers a variety of technical indicators from moving averages to upside-downside volume, relative strength, and money flow assessments and beyond (as shown in the previous image). The second way our team applies technical analysis is within the context of add or remove considerations with the newsletter portfolios. Using the Valuentum Buying Index, fair value estimates, fair value ranges, Economic Castle and Dividend Cushion ratio assessments, among many other parameters, we then intently look for opportunistic technical breakouts of downtrends on some of the most undervalued stocks with the strongest business models, and where appropriate, the safest dividends (as in the case of the Dividend Growth Newsletter portfolio, for example). Our technical process is as systematic in the methodology as it is hands-on in the newsletter portfolios.

I hope you found this brief introduction on how we apply technical/momentum analysis at Valuentum helpful. Part of me hopes the skeptics will never come around to accepting technical analysis' conceptual underpinnings, as I believe it is partly because of the pure value investor's immediate dismissal of technical and momentum analysis that Valuentum stocks generate such great outperformance. If you might imagine, very few pure value investors are anticipating technical breakouts, while very few technicians are doing the depth of valuation work that we are doing. When strategic "gaps" such as these occur, the opportunity to generate alpha becomes considerable. Even if you are not convinced that applying technical analysis is right for you, at the most basic level, please don't ignore the charts, as in doing so, you are ignoring valuable, publicly-available information, a large portion of which is fundamentally-linked. If applying technical analysis in conjunction with a robust valuation process is something that you are already exploring, you are well on your way to reaping the benefits of cross-methodological work.

Financial Analysis 501: Understanding Stock Splits

By Brian Nelson, CFA

There are few financial topics more misunderstood in my opinion than stock splits. Some investors believe that a stock split is a value-creating endeavor brought about by "market forces" that have blessed their company's stock for one reason or another. They believe that they will get more shares of the company at the same price, thereby doubling their investment value as a result.

Unfortunately, this is not correct. In reality, a stock split is a move made at the complete discretion of the company's board to reduce the nominal price of the company's shares such that more individual investors can "afford" to buy more of the stock (increasing its ownership base). The primary reason stems from the common belief that (psychologically) the individual investor has an easier time digesting the purchase of, let's say, 100 shares of stock for $10 each than the purchase of 1 share of stock for $1,000--even though both of the cash outlays are equivalent to $1,000.

As we'll show below, a stock split does nothing to create fundamental economic value for the company and is nothing more than a superficial move akin to that of cutting a $100 bill in half: no matter how many times you cut the bill, it's still only going to be worth $100. In stock-market parlance, a company is worth the same market capitalization (its aggregate price) no matter how may slices (shares) are outstanding. For example, when a 2-for-1 stock split is executed, the number of

Financial Analysis 501...continued on next page

Financial Analysis 501...from previous page

shares are increased by a factor of 2, while the price of these shares is reduced by half, preserving the original market capitalization (price) of the firm (all else equal).

Market Capitalization (total price of the company) = Price per Share x Shares Outstanding

Let's walk through an example. In December 2013, MasterCard (MA) announced a 10-for-1 stock split. Effectively, holders of MasterCard's stock received 9 additional shares for each share they held as of a certain date, the record date (in this case, the record date was January 9, 2014). On the date following the ex-split date (January 21, 2014), the number of MasterCard shares outstanding increased 10-fold, and the initial price of MasterCard's stock was reduced by a factor of 10. Specifically, total shares of common stock outstanding increased from approximately 120 million to 1.2 billion as a result of the move, and the price of the firm's stock was reduced from $818.48 to $81.848.

Let's see what happened to MasterCard's market capitalization as a result of this move:

120 million x $818.48 = $98,217.6 billion

1.2 billion x $81.848 = $98,217.6 billion

It becomes obvious when walking through the calculation that MasterCard, in performing the stock split, has merely decided to divvy up the company into smaller pieces--and that no aggregate value has actually been created. Holders of MasterCard's stock simply received 10 times as many shares, and the individual shares of stock were reduced to one-tenth of the pre-split price. MasterCard, the company, is not worth one-tenth of its pre-split value--only the company's individual shares are after the split. Holders of MasterCard's shares are made whole because they now own ten times as many shares as before. The total value of their positions in MasterCard has not changed. MasterCard's intrinsic value calculation is adjusted in similar fashion: the number of shares outstanding is increased by a factor of 10, reducing the fair value estimate per share of the firm to one-tenth of its pre-split value.

Note: At times the announcement of a stock split may generate interest in the firm as a result of the psychological dynamic noted above: Investors tend to like stocks that don't trade for hundreds or thousands of dollars per share and feel more comfortable with comparatively lower-priced stock. This may cause the shares of a company that has announced a stock-split to rise temporarily (due to buying activity), but no economic value has actually been created by the company as a result of the announcement.

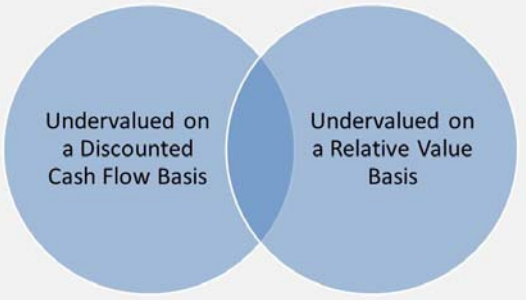
Valuentum's Take

Just like you can't create money by cutting a $100 bill in half, companies can't create value by performing stock splits. After the ex-split date, the fair value estimate per share of MasterCard was adjusted downward by a factor of 10. In all cases, the size of the fair value estimate adjustment depends on the details of the stock split. For example, 2:1 stock splits result in the fair value estimate being halved, while 7:1 stock splits result in the fair value estimate being reduced by a factor of 7, and so on. We hope this article helps clarify one of the most misunderstood topics in finance. Thanks for reading!

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).



"By overlaying a relative valuation process on a robust forward-looking discounted cash flow valuation methodology, "pure" value investors add an extra degree of conviction to their undervalued ideas. For the ideas in this screen to register the highest rating on the Valuentum Buying Index, however, the market would also have to agree that shares are undervalued, as evidenced by an advancing stock price, one that has good momentum." – Valuentum's Brian Nelson, CFA

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
Supervalu	SVU	Consumer Staples	UNDERVALUED	ATTRACTIVE	0.45
Huntsman	HUN	Materials	UNDERVALUED	ATTRACTIVE	0.50
Astronics	ATRO	Industrials	UNDERVALUED	ATTRACTIVE	0.53
Owens-Illinois	OI	Materials	UNDERVALUED	ATTRACTIVE	0.56
Michael Kors Hldg	KORS	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.57
American Axle	AXL	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.58
Synchronoss	SNCR	Information Technology	UNDERVALUED	ATTRACTIVE	0.59
Libbey Inc	LBY	Consumer Staples	UNDERVALUED	ATTRACTIVE	0.60
Hanger Orthopedic	HGR	Health Care	UNDERVALUED	ATTRACTIVE	0.63
Richemont	CFRUY	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.63
GNC	GNC	Consumer Staples	UNDERVALUED	ATTRACTIVE	0.65
Xerox	XRX	Industrials	UNDERVALUED	ATTRACTIVE	0.67
QUALCOMM	QCOM	Information Technology	UNDERVALUED	ATTRACTIVE	0.68
Viacom	VIA	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.68
InvenSense	INVN	Information Technology	UNDERVALUED	ATTRACTIVE	0.70
Verint	VRNT	Information Technology	UNDERVALUED	ATTRACTIVE	0.71
Skyworks	SWKS	Information Technology	UNDERVALUED	ATTRACTIVE	0.72
Avis Budget	CAR	Industrials	UNDERVALUED	ATTRACTIVE	0.72
USG Corp	USG	Industrials	UNDERVALUED	ATTRACTIVE	0.73
Computer Sciences	CSC	Information Technology	UNDERVALUED	ATTRACTIVE	0.73
AIG	AIG	Financials	UNDERVALUED	ATTRACTIVE	0.73
Oracle	ORCL	Information Technology	UNDERVALUED	ATTRACTIVE	0.76
MetLife	MET	Financials	UNDERVALUED	ATTRACTIVE	0.77
Mylan	MYL	Health Care	UNDERVALUED	ATTRACTIVE	0.77
Priceline.com	PCLN	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.78
Korn/Ferry	KFY	Information Technology	UNDERVALUED	ATTRACTIVE	0.78
Prudential Financial	PRU	Financials	UNDERVALUED	ATTRACTIVE	0.78
Jarden	JAH	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.78
Global Payments	GPN	Information Technology	UNDERVALUED	ATTRACTIVE	0.78

*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.

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

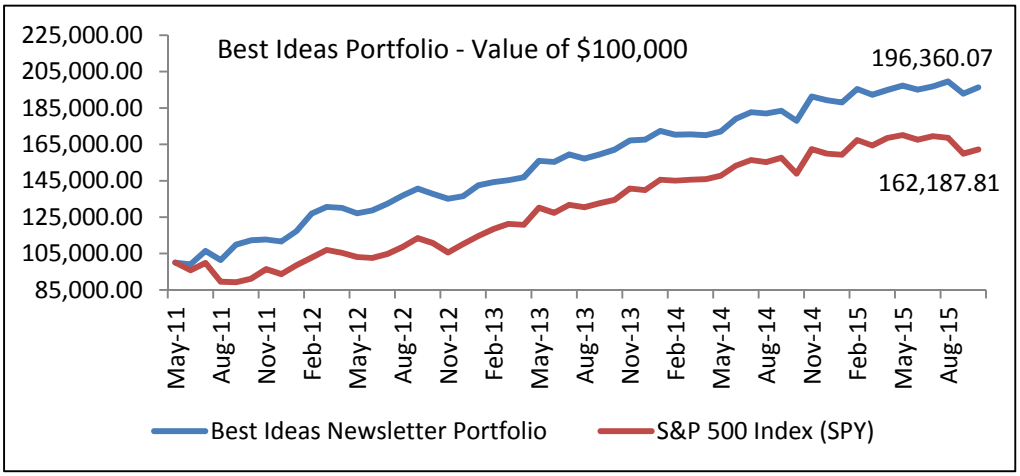
Company Name	Symbol	Industry	VBI	Fair Value Estimate
Korn/Ferry	KFY	Staffing Services	9	$38.00
Xerox	XRX	Commercial Services	9	$16.00
AIG	AIG	Insurance - Property & Casualty	8	$72.00
Avis Budget	CAR	Rental and Leasing	8	$35.00
Libbey Inc	LBY	Household Products	8	$26.00
Mylan	MYL	Pharma - Generic/Other	8	$69.00
Richemont	CFRUY	Luxury - Ultra & Aspirational	8	$10.00

Federal Realty	FRT	REIT - Retail	2	$122.00
VeriSign	VRSN	Software - security	2	$70.00
Amazon.com	AMZN	Internet & Catalog Retail	1	$439.00
Bright Horizons Family	BFAM	Personal Services	1	$49.00
Brown-Forman	BF.B	Beverages - alcoholic	1	$65.00
Hyatt	H	Hotels	1	$39.00
J&J Snack	JJSF	Food Products	1	$76.00
Manhattan Associates Inc	MANH	Software	1	$34.00
Mettler-Toledo	MTD	Medical Instruments	1	$231.00
National Beverage	FIZZ	Beverages - nonalcoholic	1	$22.00
Neogen	NEOG	Diagnostic Substances	1	$40.00
Netflix	NFLX	Specialty Retailers	1	$59.00
NewMarket	NEU	Chemicals - mid/small	1	$311.00
Rollins	ROL	Chemicals - mid/small	1	$19.00
Starbucks	SBUX	Restaurants - Fast Food & Coffee	1	$47.00
Stonemor	STON	Personal Services	1	$17.00
Under Armour	UA	Luxury - Established Brands	1	$56.00

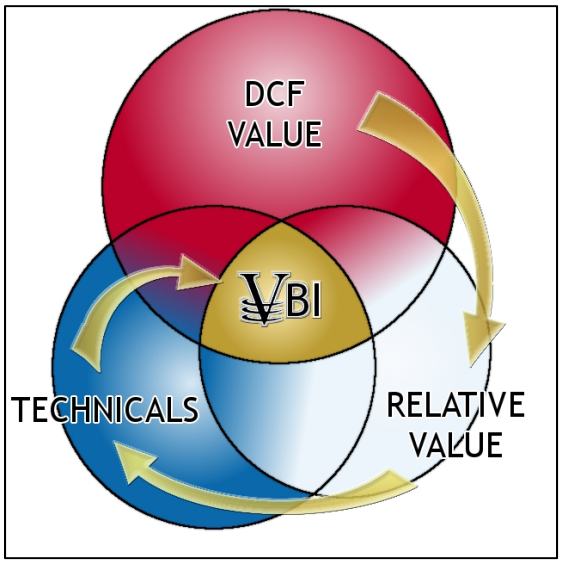
Our Methodology – The Valuentum Buying Index (VBI)

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.

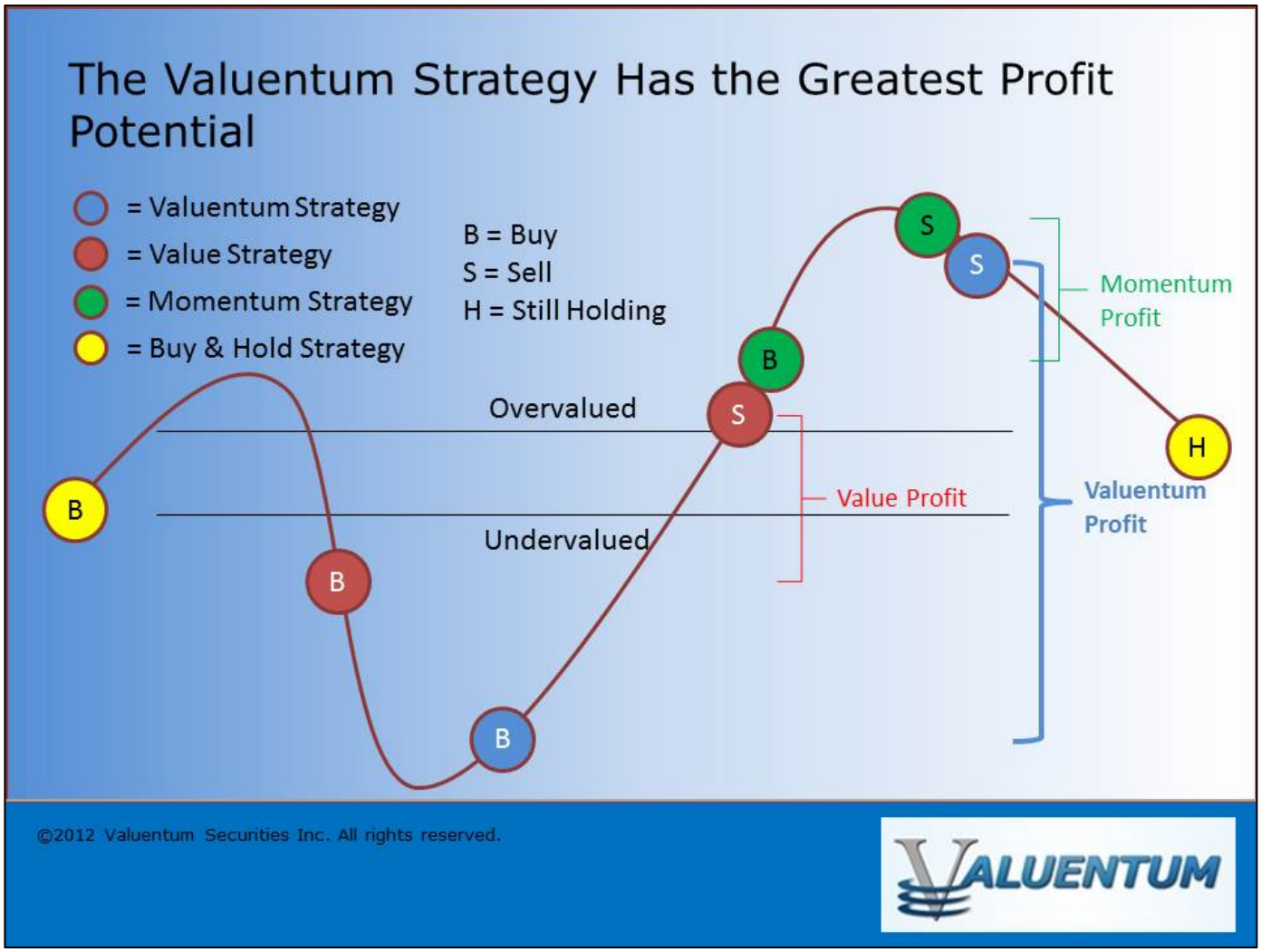


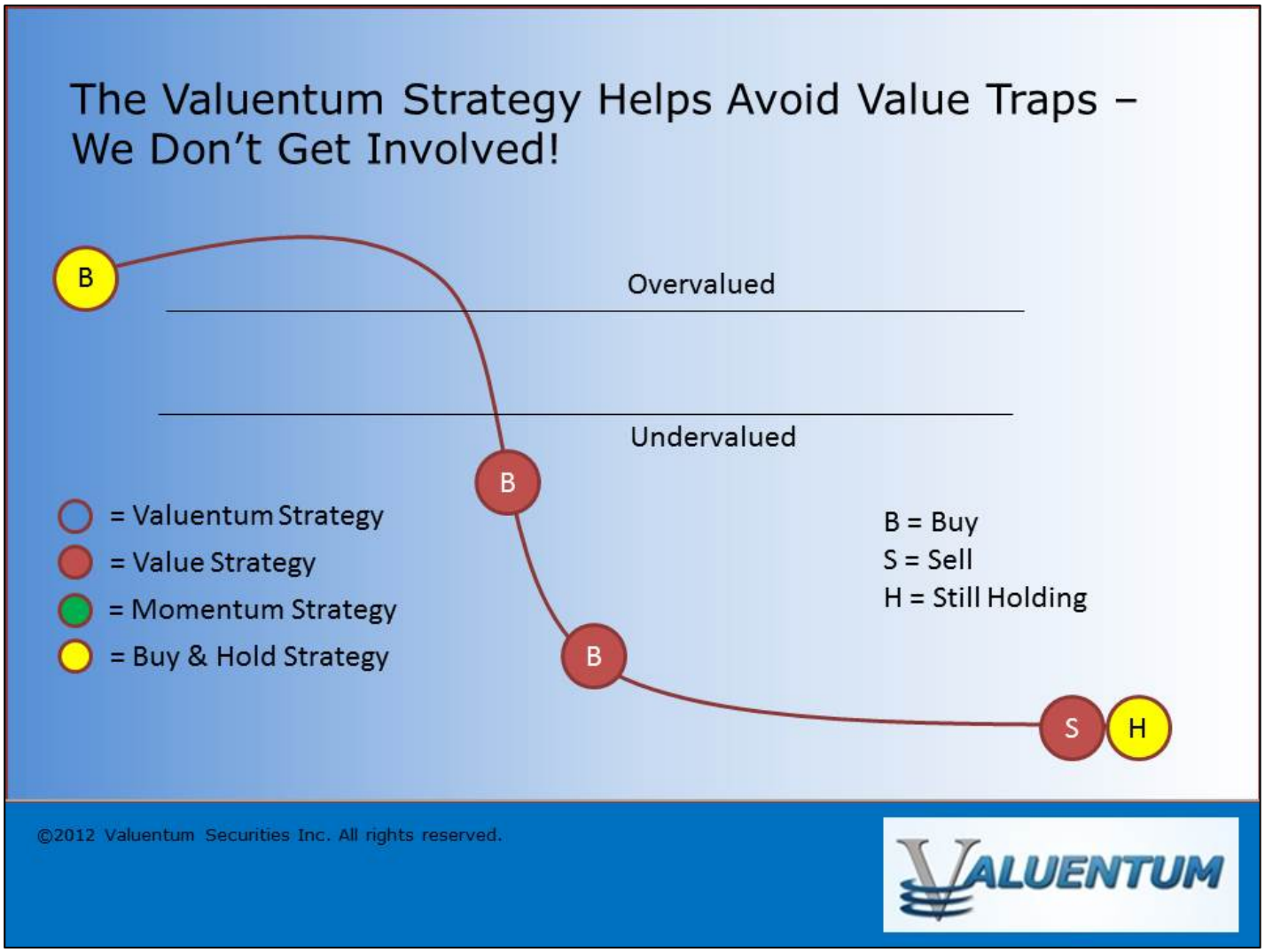
Illustration for educational purposes only.

Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

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.

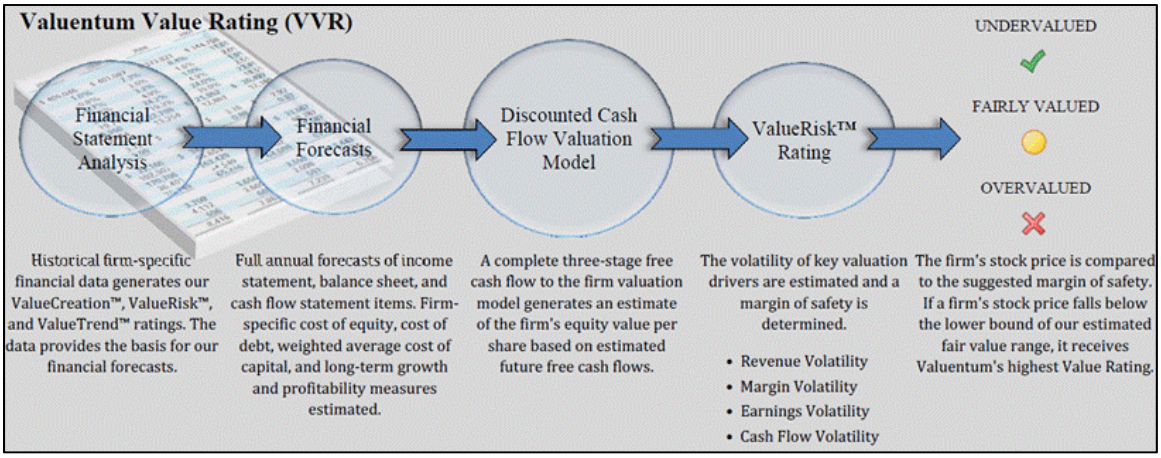


Our Methodology – The Valuentum Buying Index continued on next page

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.



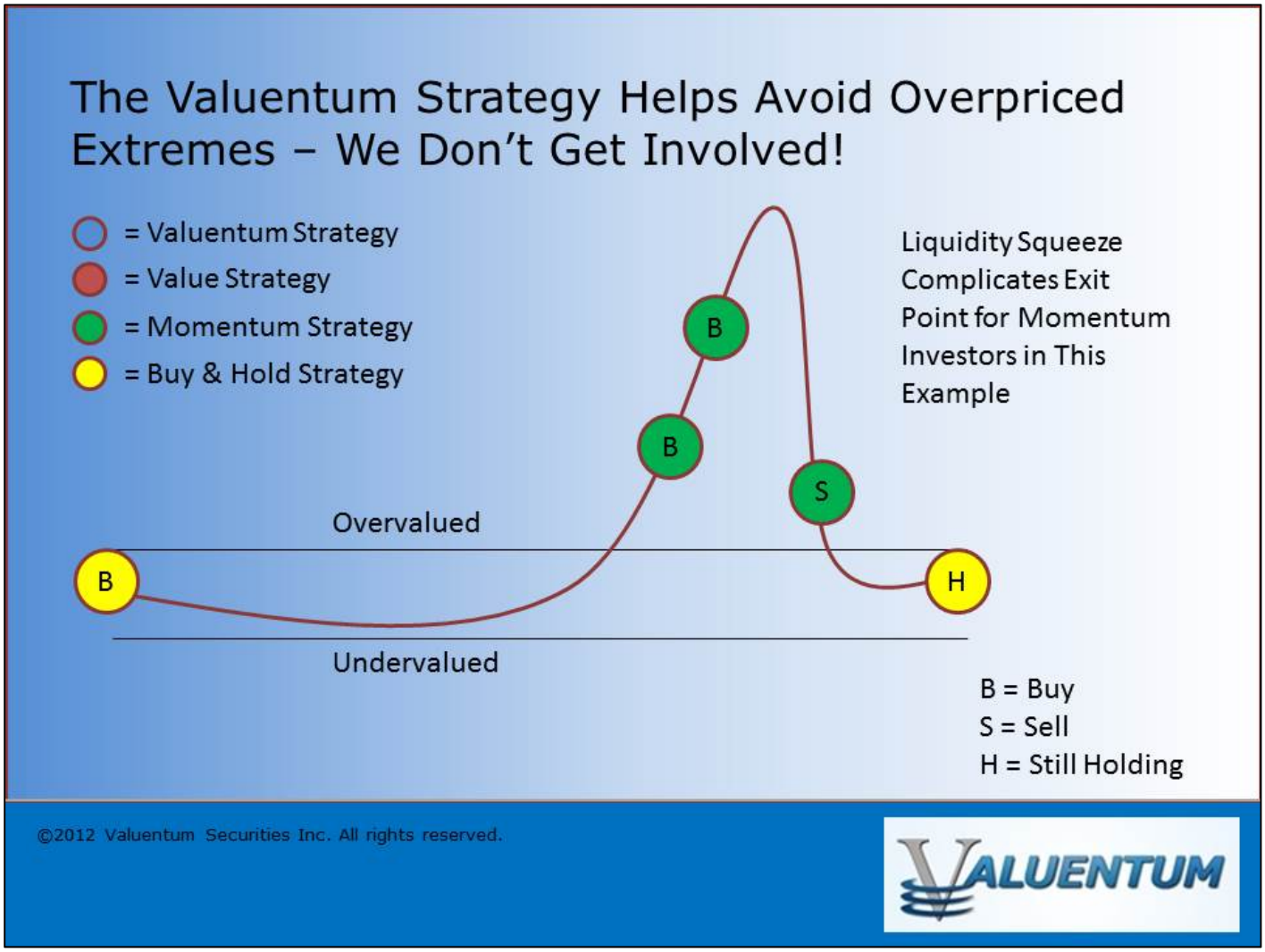
After evaluating historical trends, we then make full annual forecasts for each item on a company's income statement and balance sheet to arrive at a firm's future free cash flows. We derive a company-specific cost of equity (using a fundamental beta based on the expected uncertainty of key valuation 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

Our Methodology – The Valuentum Buying Index continued from previous page



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

Our Methodology – The Valuentum Buying Index continued from previous page

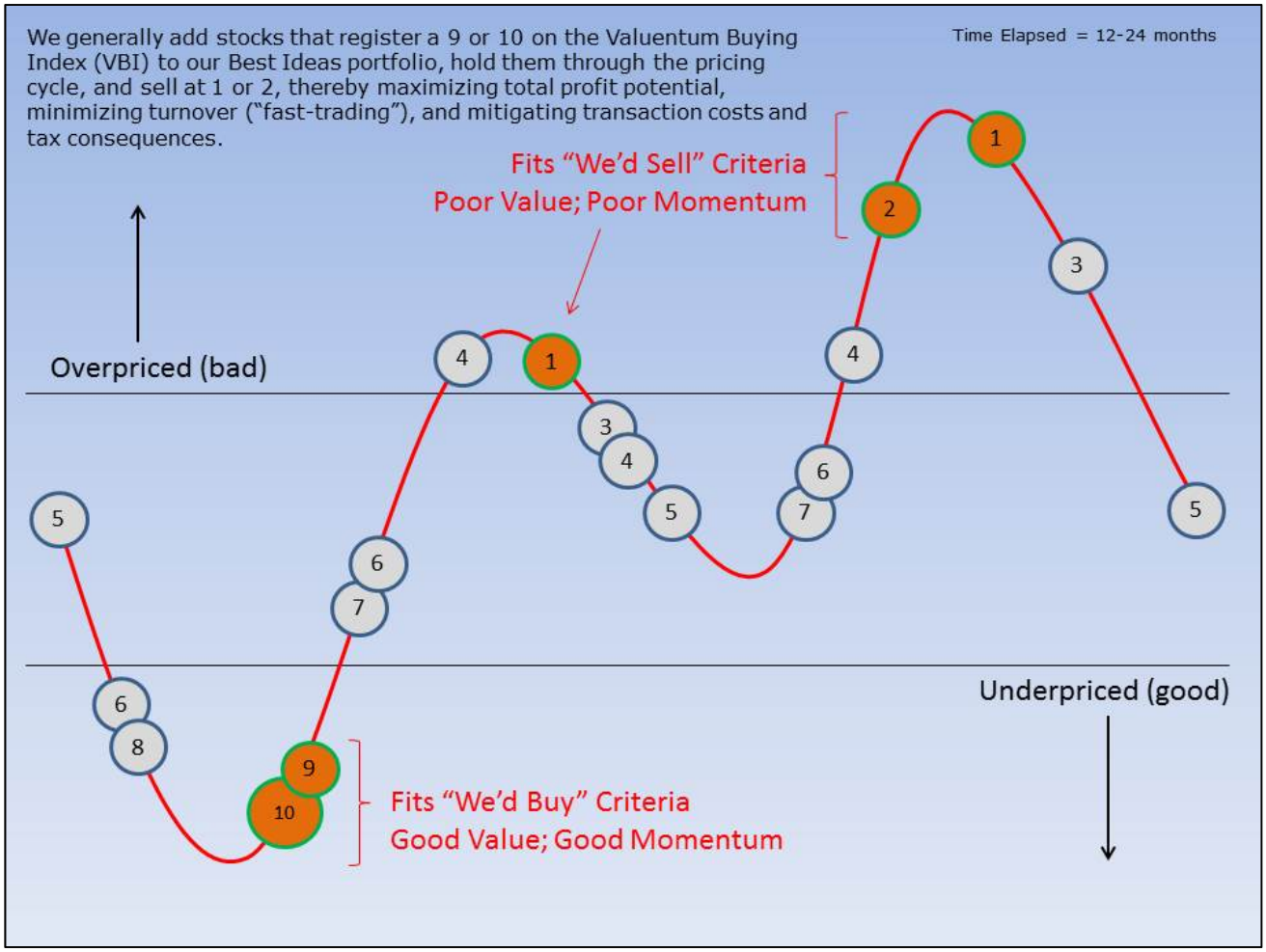
valuation criteria). Rigorous valuation analysis and technical analysis are not mutually exclusive, and we believe both can be used together to bolster returns. An evaluation of a stock's moving averages, relative strength, upside-downside volume, and money flow index are but a few considerations we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

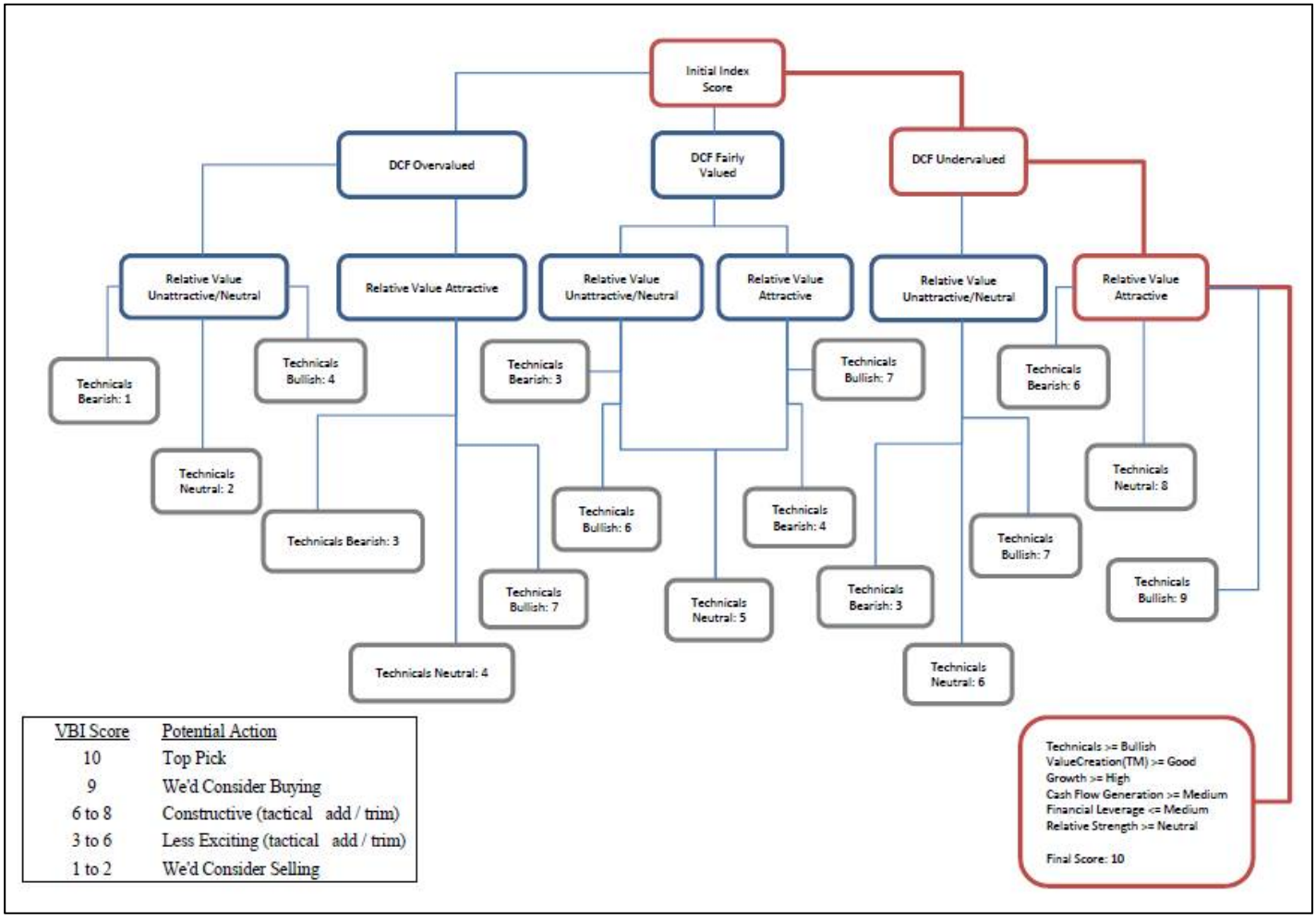


Our Methodology – The Valuentum Buying Index continued on next page

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.



VBI Score	Potential Action
10	Top Pick
9	We'd Consider Buying
6 to 8	Constructive (tactical add / trim)
3 to 6	Less Exciting (tactical add / trim)
1 to 2	We'd Consider Selling

Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

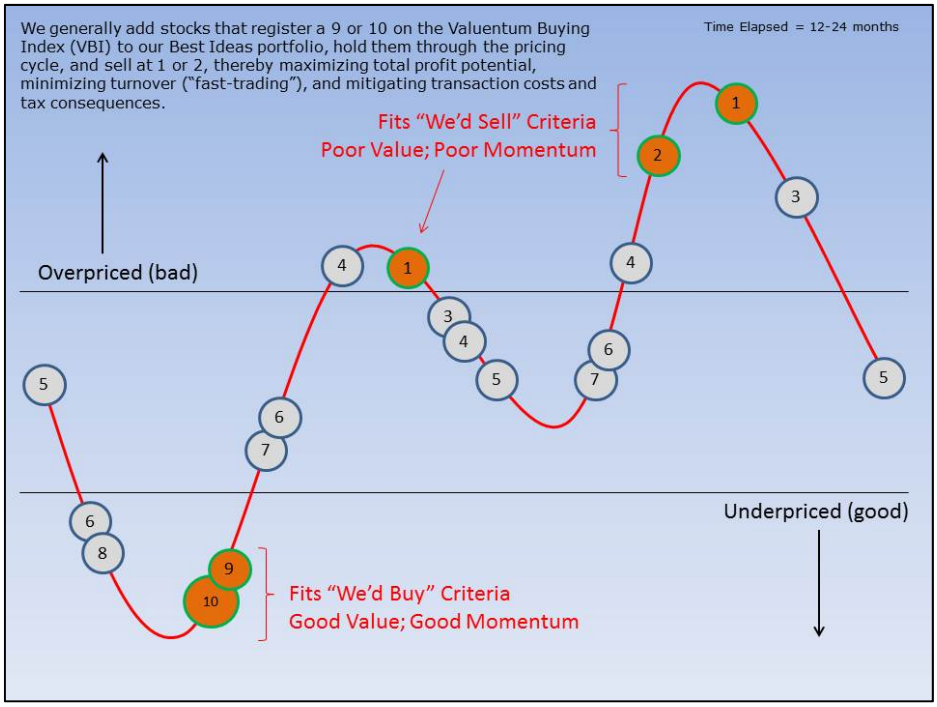
How We Use the Valuentum Buying Index in the Best Ideas Newsletter Portfolio

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.



Our Methodology – The Valuentum Buying Index continued on next page

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 pre-split eBay (EBAY), which included PayPal (PYPL) as another example of our process in action. The firm initially flashed a rating of 10 in late September 2011, 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, but 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/PayPal 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. We no longer include eBay in the newsletter portfolio, but its split-off PayPal is retained.

There have been more straight-forward opportunities in our Best Ideas portfolio, especially in the case of EDAC Tech (EDAC), which had tripled since we added it to the portfolio (never registering below a 9 along the way). The VBI ratings on our most recent 16-page reports, downloadable directly from our website, reflect our current opinion on the company.

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

About Our Name

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

-- Warren Buffett, Berkshire Hathaway annual report, 1993

At Valuentum, we take Buffett's thoughts one step further. We think the best opportunities arise from a complete understanding of all investing disciplines in order to identify the most attractive stocks at any given time. Valuentum therefore analyzes each stock across a wide spectrum of philosophies, from deep value to momentum investing. And a combination of the two approaches found on each side of the spectrum (value/momentum) in a name couldn't be more representative of what our analysts do here; hence, we're called Valuentum.

Valuentum Best Ideas Newsletter: Volume 6, Issue 4

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

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