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
100.0%	69.8%	30.2pts

The Best Ideas Portfolio (see page 8): AAPL, MO, BWLD, BRK-B, CSCO, FB, XLF, GE, GOOG, GOOGL, XLV, INTC, JNJ, KBE, KMI, KORS, PYPL, PCLN, RSG, SDY, SPY-puts, TEVA, UNP, XLE, XLU, V

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Goals of the 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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"When it comes to equity analysis, however, there may not be data more important than what we generate internally at Valuentum for members."
- Brian Nelson, CFA

See page 8.

5 Years Strong!

By Brian Nelson, CFA

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Image source: Andy Maguire

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.

This month was an important one for our investment research firm, Valuentum, and its flagship newsletter, the Best Ideas Newsletter. The June 2016 edition means that we have now surpassed the 5-year anniversary of the inception of this newsletter's portfolio (page 8). This is a critical time horizon that we and many others believe is a good one to assess the quality of any money manager.

Money managers can be lucky or unlucky over very short periods of time, as in the case of perhaps a 12-24 month period, but those that can generate and retain outperformance over a 5-year period and longer typically are doing a lot of things right, even if they get some things wrong. Remember, the performance of the Best Ideas Newsletter portfolio is not cherry-picked – it reflects all of our winners, all of our losers, transaction costs, and all of the decisions with respect to asset allocation and individual equity weighting within the newsletter portfolio since inception. There's no better yardstick: in this no-called strike game of investing, it only matters when we swing.

That said, we're never satisfied with the results of the newsletter portfolio, of course, as there is always room for improvement, but in light of the valuation

Reserve the Nelson Exclusive today: http://www.valuentum.com/articles/20160505

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risk embedded in the broader equity markets today and the frothy characteristics of some of the stocks with even the strongest business models, as in the case of the consumer staples sector (XLP), which is trading at nearly 21 times forward earnings, we're quite happy. We've done a lot of things right in the portfolio--adding undervalued stocks that are going up, or Valuentum stocks. Altria (MO) and Visa (V) are two great examples, with those positions nearly tripling since being added. We've also missed the mark a few times--Gilead (GILD) and Alibaba (BABA) are the latest two examples, unfortunately. We've cut those losses quickly, however. Prudence and care, as I say.

Sometimes our readers forget that on the website we actively cover thousands of stocks in full financial detail, too (our very own analysis), generating discounted cash-flow valuation models, fair value estimates, fair value ranges, Valuentum Buying Index ratings, and Dividend Cushion ratios and more. Though we're not a financial advisor, we are truly a robust investment research provider, and we put everything out there in full view to the reader. Some of the data in the reports is not pretty; some of the numbers may not be intuitive--the negative growth rates when companies hit positive inflection points, our application of the risk-free rate, for example, but it's all there (and you can ask to see our models to tweak our assumptions to reflect yours and even derive your own fair value estimate!). We don't hide anything; all of our assumptions are in the 16-page valuation reports, our archived fair value estimates and Valuentum Buying Index ratings are on page 16 of each report. Is there another way?

The 5-year anniversary probably marks a good time to remind readers of the goals of the Best Ideas Newsletter portfolio (page 8), which differ from the goals of the Dividend Growth Newsletter portfolio (the newsletter that contains the latter is released on the 1st of the month); the Best Ideas Newsletter (this one) is released on the 15th of the month. Depending on the content and publishing cycle, these newsletters can be issued early in the morning or late in the evening, but they always are emailed to the email address we have on file. The Best Ideas Newsletter portfolio seeks to find firms that have good value and good momentum characteristics and typically holds each idea from a Valuentum Buying Index rating of a 9 or 10 (consider buying) to a rating of a 1 or 2 (consider selling). Just like a value manager may not include every single undervalued company in his/her portfolio, not all highly-rated companies on the Valuentum Buying Index are included in the portfolio either. We may tactically add to or trim existing positions in the portfolio on the basis of sector or broader market considerations, but we seek to capture a stock's entire pricing cycle (from being underpriced with strong momentum to being overpriced with poor momentum). Valuentum is low-turnover, low-transaction costs--not to be confused with momentum strategies that differ greatly.

Let's talk more about the metrics we use in our work. You may be familiar with factor models that use proxies for 'value' and 'momentum' indicators based on historical, widely-available information. Such analysis may be insightful, to a degree, in explaining relationships of the past, but such analysis is of little use in gauging future expected equity price direction, and it may even fall short of truly explaining past relationships, too. Metrics such as book-to-market, often used in academic work, by definition, use accounting book value (shareholders' equity), but the metric for the vast majority of operating companies (i.e. non-financial companies) is near-meaningless. Here's a snippet from Boeing's (BA) balance sheet (2010, 2009) that illustrates how silly blindly using accounting data can be, for example.

Total Boeing shareholders' equity	2,128	(1,294)
Noncontrolling interest	97	152
Total shareholders' equity	2,225	(1,142)
Total liabilities and shareholders' equity	$ 62,053	$ 53,779

Image source: Boeing's 10-K, 2009

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In the image above, Boeing's accounting book value (i.e. Total Boeing shareholders' equity) fell to -$1.3 billion (negative $1.3 billion) in 2009, and the measure today continues to be dwarfed by the actual market capitalization of the equity, the market capitalization being what the market believes the cash-flow generating assets of the company are actually worth, not the accounting representation. Can you imagine how many investors are still relying on accounting book value in their investment process for industrial operating companies, or worse yet, the measure return on equity, which applies the often-meaningless measure of accounting book value in the denominator, to make decisions? How many money managers on television have you seen mention ROE, or return on equity?

Please never focus on accounting book value or return on equity outside of the financial sector--the measure is near-meaningless, and ROE considers leverage which tells us little about the operating returns a company can generate (look up DuPont equation). Now that said, we make an important distinction regarding book value for financial companies. Book value in the case of banks, insurers, and other entities in the financial sector, including Berkshire Hathaway (BRK.A, BRK.B) is meaningful, because, unlike industrial operating entities, these companies use money to make money and capital strength (book capital) is very important to them. Industrial operating companies, on the other hand, use assets such as property, plant and equipment to make inventory to generate earnings and free cash flow, so book value is not relevant. In fact, the more capital needed to run their business, the less attractive the business is, all else equal.

But to the point, historical back-tested factor models that use less-meaningful information, as in the case of book value, aren't as robust as they could be. That's why we spend the vast majority of our time generating data that we think is much more relevant to the investment-decision making process on a forward-looking basis. Said another way, we're not just throwing widely-available value and momentum data together and calling it 'Valuentum.' This is absurd. Within our fair value estimate calculation, for example, we add a company's existing net balance sheet impact (its net cash), what it has today, to our expectations of the present value of its future enterprise cash flows, what it will generate tomorrow, to arrive at what we describe to be a fair representation of the equity's value.

We then divide that equity value by diluted shares outstanding to get a fair value estimate per share, and then we compare that fair value estimate per share to the company's stock price to see if there is a valuation opportunity. We're bargain hunters. If there is a valuation opportunity, we put the stock on our radar, and if we like the company's business model, as evidenced by our expectations for future economic value creation (ROIC>WACC), we may look to add the company's equity to the newsletter portfolio, assuming its technical and momentum indicators are strong. The latter we use as evidence that the company is not a "value-trap." Stocks that look cheap but keep going down often become "value-traps," and because strong technical and momentum indicators suggest the latter can't be true (i.e. the stock is going up!), the Valuentum process helps avoid such "value-traps." Simple is often better, no?

There's a lot of data out there--there's probably too much. When it comes to equity analysis, however, there may not be data more important than what we generate internally at Valuentum for members: a free-cash-flow derived intrinsic value estimate and return on invested capital (ROIC) to assess the worth of a company and its ability to generate value for shareholders on the basis of its operating assets, respectively (not multiples or ROE). These two metrics, a fair value estimate and ROIC, are front-and-center when it comes to the information and data we present in the 16-page valuation reports. We're not providing widely-available information that is and should be free on the web; instead we're focused intensively on delivering value-added opinion and data to our members – and that's in addition to the newsletters, ETF analysis, and beyond. Hope you like it!

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The broad US equity markets continue to hold up well, all things considered. We've been very concerned about the probability of a rather large potential pullback, but falling interest rates continue to play into our thesis behind adding the SPDR S&P Dividend ETF (SDY) to the newsletter portfolios. On June 15, the 10-year Treasury yield fell to its lowest level since 2012 (~1.6%), and many are pointing to continued expectations of slow global economic growth and a central-bank playbook that is running short of options as the reasons for the fall (Treasuries are bought during uncertain/concerning times, driving their yields lower). Most of the globe is dealing with negative interest rates (Germany the latest instance), and yield-seeking investors have to go somewhere for income. Our thesis continues to be that, as yields on fixed-income instruments continue to fall, dividend growth equities will become more and more attractive, further inflating the "dividend growth" bubble. The 10-year Treasury yield (TBT, TLT) is approaching the record lows of ~1.4% set in July 2012. Here's what we said when we added the SPDR S&P Dividend ETF to the newsletter portfolios April 20:

> The dividend growth "track record" craze continues to be on in a big way, and we can't help but feel there are similarities to the outcome of the 'Nifty Fifty' craze in the late 1960s and 1970s as there might be to dividend growth investing today. For those that may not be familiar, the 'Nifty Fifty' was a group of "buy-and-hold" large cap stocks that were largely credited with driving the market to new heights during the early 1970s. Many called these stocks with stable earnings one-decision stocks -- they were to be bought and held forever. We have believed for some time that the proliferation of dividend growth investing may very well have the same effect on today's market, propelling it ever higher, much like the "Nifty Fifty" did on the market some decades ago now.
>
> Even if the strong performance of dividend growth equities may be more a result of the prospect of continued low interest rates (no alternative sufficient yield growth instruments), the question remains: Who is going to sell these dividend growth equities en masse in order for these stocks to experience abnormal and drastic declines? Overhead resistance is minimal and the very core of the dividend growth strategy centers on dividend reinvestment, which itself offers a solid backbone for even future advances of the equity. Most of the 'Nifty Fifty' underperformed during the bear market of the late 1970s, early 1980s, after their run higher, but they had their time. Dividend growth equities could similarly make a striking run higher for the next few years, until interest-rate and/or global growth expectations are inevitably reset, or not. They could run even longer.
>
> To address this lingering idea, we are augmenting the already-strong Dividend Growth Newsletter portfolio with a 5% position in the SPDR S&P Dividend ETF, and we are also adding a 5% position in the SDY to the Best Ideas Newsletter portfolio ($81.33). We don't necessarily prefer ETFs over individual stocks, but given the thematic nature of this thesis, we think an ETF makes the most sense. In the case of the SPDR S&P Dividend ETF, diversified exposure to over 100 equities that individually boast dividend track records of consecutive annual increases for the past 20 years hits directly on what's in vogue in the market today. As more and more income investors pile into equities with long dividend growth track records, we believe most will be buying baskets of such stocks, or this ETF or another one like it, so there is little reason for us to have to take on incremental firm-specific risk with this idea to broadly target the outcome of this particular thesis.
>
> That is not to say that other current holdings in the Dividend Growth Newsletter aren't the best fit for a dividend growth strategy, but they are already in the portfolio. The SDY, in particular, has performed fantastically since the beginning of 2016, and with the quality of companies in the ETF, it may eventually turn into a long-term position in both portfolios. We expect alpha to continue to be generated by the collective portfolio constituents of both newsletter portfolios, and the ETF will also increase our equity exposure in light of the market's ongoing push forward, reducing the drag of an outsize cash position.

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What to make of broader market valuations? They're not good. According to the latest Earnings Insight from FactSet, the forward 12-month price-to-earnings ratio of S&P 500 stocks is now nearly 17 times, well above its 5-year average of 14.6 and the 10-year average of 14.3. Valuations are being stretched and stretched, not because underlying fundamentals are improving significantly, but because the interest rate used within the market's discount mechanism is fast-approaching zero, generating what we describe to be a magnified, sometimes exponential, impact on equity values. Under such a scenario, long-duration cash flows are worth more and more as their present value is enhanced from the lower expected interest rates. Here's more about what we mean, from April 15:

> 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 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 arena.
>
> Shares of Coca-Cola (KO) are now trading hands at ~$45 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 (KMB) 21 times fiscal 2017 earnings, McDonald's

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> (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. [Remember net debt is subtracted from enterprise value to arrive at equity value.]

Let's update members on a few developments in the portfolio. First, our hearts and prayers go out to the families of the victims in the tragedy that happened at the Pulse nightclub in Orlando, Florida, early the morning June 12. We'll be monitoring the Obama administration's response to the attacks, and while we've generally been of the opinion that the impact on leisure and travel from terrorist activity is transitory, attacks have unfortunately become recurring, with the tragedies in San Bernardino, California, and Paris still fresh on the minds of many. Priceline (PCLN) is the holding in the Best Ideas Newsletter portfolio that is most exposed to such dynamics, but the company is so attractively-priced from a valuation standpoint and has such a long runway of growth ahead of it that we're sticking with the company. We're also monitoring rumors swirling about a potential tie-up with TripAdvisor (TRIP). Note that our valuation information for each company in our coverage universe can be found in each company's 'Stock Report (pdf)' on its stock landing page. The vast majority of our analyst team's efforts are focused on getting our fair value estimates and fair value ranges "correct."

Apple (AAPL) is now approaching $100 per share again, and while we're glad that we took some profits north of current levels, we're even happier that we didn't overreact on the pullback that sent shares to ~$90 a few weeks ago. It would take a lot for Apple to be completely removed from the Best Ideas Newsletter portfolio in light of the company's fortress balance sheet and substantial free cash flow generation. We just hope Apple doesn't do something as silly as Microsoft (MSFT) did in scooping up LinkedIn (LNKD). Microsoft CEO Satya Nadella "got sold" on a very, very bad deal, and fell for the oldest trick in the book--just because a firm's stock price has fallen, as in the case of LinkedIn before the deal announcement, it doesn't mean shares are cheaper. It's going to take a while for us to get over this transaction. I still can't believe it.

A widely-read short-seller wrote about Facebook (FB) recently, but there wasn't anything meaningful in the report, and we're going to let the financials do the talking when it comes to our investment thesis on the social network--its balance sheet and free cash flow generation are simply fantastic! Berkshire Hathaway seems to be involved in a "bidding war" to acquire some of Yahoo's (YHOO) assets, and frankly, we're not sure what the Oracle of Omaha is doing--he has to know of the concept of the winner's curse--usually the company that wins the bid for assets significantly overpays for them (and returns are sour). Business at Johnson & Johson (JNJ) continues to hum along nicely (it raised its dividend ~7% late April), and we got confirmation of Intel's (INTC) increased exposure via 4G baseband models to Apple's iPhone 7--news we liked a lot. GE (GE) continues to hover near multi-year highs, and Michael Kors' (KORS) results have been as volatile as ever, as the markets sift through the disaster that is mall-based retail at present. We continue to be impressed with Altria's equity-price performance – shares are now ~$65 each!

In closing of this June 2016 edition of the Best Ideas Newsletter, I wanted to say thank you for sticking with us these past 5 years. I know the best is still ahead at Valuentum, and I hope that you'll be a part of it! Oh – if you haven't yet considered the 'Nelson Exclusive,' we're now just a couple weeks from launch. Don't forget. Always my very best.

Sincerely,

Brian Nelson, CFA

Learn more about the Nelson Exclusive: http://www.valuentum.com/articles/20160505

What?!?! Microsoft Acquires LinkedIn; NO!

By Brian Nelson, CFA

Image source: LinkedIn

It's almost hard to believe that Microsoft (MSFT) CEO Satya Nadella would throw ~$26.2 billion of cash in the form of shareholder capital that could potentially go toward one of the best future dividend growth streaks in history at a large, Internet-based acquisition such as LinkedIn (LNKD), but it happened June 13. *Unbelievable.* We think most of the news outlets had to do a double-take before reporting the news (we did, too), and we're not surprised that Microsoft's shares are selling off on the announcement. Some are painting the deal optimistically, but we're bummed out. We're removing half of our position in Microsoft from the Dividend Growth Newsletter portfolio on the news at ~$50.18 per share for one of the biggest gains in the newsletter portfolio yet.

We probably should have known something big was brewing. Microsoft's latest quarterly report, released April 22, left a lot to be desired, but we looked past many of the negatives in light of the company's fantastic free cash flow conversion rate, and that it has one of the strongest balance sheets in the world gave us comfort that its dividend would grow for many, many years to come. Management seemed a bit distracted to have put up a report where earnings-per-share fell short of consensus in light of the flexibility brought about by a hefty share repurchase program. Something wasn't right. Though Microsoft remains very, very healthy from a financial standpoint, we simply can't justify Microsoft's gamble with unproven LinkedIn, and the cash (in the form of new debt) going out the door is not resonating with income investors, us included. We're not sure what happened in the boardroom at Microsoft, but clearly, the software giant is stretching for growth.

Synergies of the transaction may be limited. LinkedIn will remain independent, Jeff Weiner will remain the CEO of LinkedIn, and its brand will remain untouched. What in the world is Microsoft thinking? Couldn't they have done a strategic partnership and saved ~$26.2 billion in shareholder capital? Even on a fundamental basis, we're concerned. Our corporate interaction with LinkedIn hasn't been helpful at all (where LinkedIn has refunded our ad money), and the website, in the opinion of many, has turned into an extension of the social interactions that can be found on Facebook (FB) – it's no longer professional, but more social. LinkedIn users are confused – content is not unique, from what we can tell, and professional networks have grown so large that job-seeking may not be as clandestine as desired for many up-and-comers looking to move up the ladder. In 10 years, Facebook may be eating LinkedIn's lunch. #RIPLinkedIn

CEO Satya Nadella believes that "together (MSFT-LNKD) can accelerate the growth of LinkedIn, as well as Microsoft 365 and Dynamics as we seek to empower every person and organization on the planet."

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The Best Ideas Portfolio

By Valuentum Analysts

Portfolio Return	Benchmark Return	Outperformance
100.0%	69.8%	30.2pts

Below we outline the constituents of the portfolio and their respective weightings and returns thus far (please note that many stocks have been removed since inception). 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 ~17% 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 June 15, 2016 — **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	7	$148.00	0.66	17-Jun-11	51.92	107	5,569.33	97.14	10,393.98	1,028.84	5.2%	105.1%
Altria Group	MO	8	6	$55.00	1.19	28-Jun-11	28.39	157	4,471.86	65.33	10,256.81	2,284.02	5.1%	180.4%
Berkshire Hathaway	BRK-B	6	6	$156.00	0.90	20-Apr-16	146.13	69	10,089.97	140.45	9,691.05		4.8%	-4.0%
Buffalo Wild Wings	BWLD	6	3	$190.00	0.76	27-Aug-15	179.81	16	2,876.90	143.77	2,300.32		1.2%	-20.0%
Cisco	CSCO	9	7	$37.00	0.77	14-Nov-14	26.33	221	5,831.87	28.65	6,331.65	160.46	3.2%	11.3%
Energy Select SPDR	XLE	NR	NR	NA	NMF	6-Oct-15	67.14	143	9,608.02	66.97	9,576.71	142.14	4.8%	1.2%
Facebook	FB	6	6	$130.00	0.88	29-Jan-16	112.10	50	5,612.00	114.60	5,730.00		2.9%	2.1%
Financial Select SPDR	XLF	NA	6	NA	NMF	9-Jan-11	13.46	150	2,026.00	22.69	3,403.50	238.95	1.7%	79.8%
General Electric	GE	7	6	$32.00	0.96	21-Oct-13	25.99	375	9,761.75	30.59	11,471.25	814.50	5.7%	25.9%
Google - Class C	GOOG	10	7	$854.00	0.84	23-Oct-12	450.92	7	3,170.42	718.92	5,032.44	10.35	2.5%	59.1%
Google - Class A	GOOGL	10	7	$854.00	0.84	4-Apr-14	Split	7	Split	732.19	5,125.33		2.6%	+++
Health Care ETF	XLV	9	6	NA	NMF	22-May-12	36.60	125	4,582.00	70.83	8,853.75	456.63	4.4%	103.2%
Intel	INTC	6	3	$38.00	0.83	12-Sep-11	20.48	150	3,086.50	31.61	4,741.50	556.50	2.4%	71.7%
Johnson & Johnson	JNJ	6	6	$111.00	1.05	29-Jan-16	104.18	54	5,632.72	116.41	6,286.14	83.70	3.1%	13.1%
SPDR S&P Bank ETF	KBE	NR	NR	NA	NMF	9-Jan-12	21.07	100	2,114.00	31.28	3,128.00	218.40	1.6%	58.3%
Kinder Morgan	KMI	5	6	$21.00	0.84	17-Feb-16	17.29	157	2,721.53	17.65	2,771.05	19.63	1.4%	2.5%
Michael Kors	KORS	8	6	$62.00	0.80	27-Aug-15	43.44	68	2,953.80	49.88	3,391.84		1.7%	14.8%
PayPal	PYPL	UR	UR	UR	UR	17-Jul-15	Spin-off	100	Splt	36.84	3,684.00		1.8%	+++
Priceline	PCLN	10	7	$1467.00	0.89	26-Feb-15	1239.49	6	7,450.91	1305.42	7,832.52		3.9%	5.1%
Republic Services	RSG	8	7	$40.00	1.23	19-May-11	31.42	201	6,329.42	49.34	9,917.34	1,098.48	5.0%	74.0%
SPDR S&P Dividend ETF	SDY	NR	NR	NA	NMF	20-Apr-16	81.33	124	10,091.92	82.17	10,189.08		5.1%	1.0%
Teva Pharma	TEVA	6	4	$59.00	0.89	24-Jul-13	41.22	77	3,180.94	52.39	4,034.03	311.73	2.0%	36.6%
Union Pacific	UNP	6	6	$87.00	1.01	24-Jul-13	79.67	40	3,193.80	87.54	3,501.60	218.00	1.8%	16.5%
Utilities Select SPDR	XLU	NR	NR	NA	NMF	18-Mar-14	41.12	83	3,419.96	50.46	4,188.18	259.71	2.1%	30.1%
Visa	V	7	6	$75.00	1.04	30-Nov-11	26.86	188	5,064.39	78.17	14,695.96	305.35	7.3%	196.2%
SPY -- put option contracts, $200 strike, June 30 expiration						29-Apr-16	3.51	4	1,393.00	136.00	544.00		0.3%	NMF
Latest changes: SPY put options were added April 29. SDY and BRK-B were added on April 20.														
Cash -- changes in monthly cash balance reflects dividends received and trading gains/losses, where applicable.											32,905.63		16.5%	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 -->	**199,977.66**			**100.0%**
S&P 500 Index (SPY)						17-May-11	132.69	754	100,000.00	207.75	156,567.94	13,240.64	92.2%	
Cash											13,240.64		7.8%	
Benchmark Portfolio Value											**169,808.58**			**69.8%**
Relative Outperformance														**30.2 pts**

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

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This may be true, but why use up a considerable amount of shareholder capital to do so? What a nightmare! LinkedIn is adding members and growing mobile usage, but we're just not seeing a tremendous strategic fit, especially if LinkedIn itself will remain independent with little to no change at the top. It seems like Microsoft made the deal for the sake of making a deal, and LinkedIn, after one of its worst quarters arguably since going public, was only happy to oblige. LinkedIn shares are rallying considerably on the news, and we expect to raise our fair value estimate to the takeout price.

Microsoft will finance the transaction primarily through the issuance of new debt as it seeks to complete its $40 billion buyback program by the end of 2016, but income investors have been left in the cold with this transaction; it raises a big question about the board's long-term commitment to the pace of dividend growth, even if future increases are assured. *We want big increases to Microsoft's dividend, not marginal ones.* The numbers are terrible: LinkedIn's near-$3 billion revenue stream in 2015 is but a fraction of Microsoft's $90+ billion mark, and the professional networking entity's negligible net income is sad: -$166.1 million (negative, 2015), -$15.3 million (negative, 2014), $26.8 million (2013), $21.6 million (2012), and $11.9 million (2011). By comparison, Microsoft generated, on average, $19 billion in net income during the past three years. Free cash flow at LinkedIn averaged ~$160 million during the past three years (2013-2015), while this mark has been nearly $25 billion on average at Microsoft during its past three fiscal years (2013-2015).

Microsoft is paying for potential and maybe long-term relevance, but we doubt the software giant will make good on this deal, if only through the lens of tangible financial statement analysis. It's just too much money, too late into this phase of the economic cycle, for too little in profits and free cash flow. My goodness -- $26+ billion at Microsoft effectively out the door! Start the clock for a coming impairment charge in coming years, even if this deal looks a lot different than the Nokia (NOK) fiasco of year's past. Our valuation of Microsoft is full anyway, and it's time for us to cash in, in part, on this tremendous winner over the past four years. We expect a modest downward revision to our fair value estimate of Microsoft on the news.

Recent Coverage Additions

By Kris Rosemann

First Data (FDC)

First Data Corp provides e-commerce solutions for merchants, financial institutions, and card issuers across the globe through its three operating segments: Global Business Solutions (58% of 2015 revenue), Global Financial Solutions (21% of 2015 revenue), and Network & Security Solutions (21% of 2015 revenue).

The firm limits its customer concentration risk through its diversified revenue base, and the majority of its revenue (particularly that of its Global Business Solutions segment) is of the recurring variety. The Global Business Solutions segment provides commerce solutions for businesses of all sizes and has an unparalleled distribution network. Management is particularly excited about what its Clover line can do for small business owners in the areas of point-of-sale hardware and software solutions. The Global Financial Solutions segment is a global leader in issuer processing, while the Network & Security Solutions segment provides necessary functions of security and fraud prevention to merchants and financial institutions.

The largest drawback for First Data lies on its balance sheet. As of the end of the first quarter of 2016, the firm had nearly $19 billion in long-term debt on its balance sheet, $8.3 billion of which is scheduled to mature before the end of 2020, compared to ~$300 million in cash and cash equivalents. Management continues to work to refinance this debt, and it being able to do so at attractive interest rates will be key to its financial position moving forward. The company refinanced $4.6 billion in debt in the first quarter of 2016 alone and has cut its annual cash interest expense from ~$2 billion in 2013

*Recent Coverage Additions...*continued on next page

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to an expected ~$1 billion in 2016. We like the progress, but success is still a ways off. Rising interest rates will not help in this regard.

All things considered, we think shares are fairly valued at the moment for 2015's biggest IPO, based on our fair value range.

Allegion (ALLE)

Allegion is a leading global provider of security products and solutions, serving both residential and non-residential markets through notable brand names such as Schlage and Interflex. As security issues in today's world grow increasingly complex, security solutions will have to follow suit, which is where Allegion's long-term strategy fits in. The ongoing convergence between mechanical and electronic security solutions provides the firm with a compelling opportunity for growth, as long as it is able to execute its growth strategy in electronics efficiently. Execution risk will be prevalent for the company moving forward, and we see little valuation opportunity in shares at the moment, based on our fair value range.

Edwards Lifesciences (EW)

Edwards Lifesciences is a global provider of patient-centric medical innovations, specializing in the area of structural heart disease, as well as in critical care and surgical monitoring. The majority of the firm's growth strategy is focused on its leading position in the Transcatheter Aortic Valve Replacement (TAVR) market, which it expects to expand to a $5 billion opportunity by 2021 from ~$1.8 currently. Nearly half of the company's sales in 2015 came from its Transcatheter Heart Valve Therapies, and it has high hopes for its up and coming Sapien 3 TAVR, which it believes will become the new benchmark for treatment of medium-risk aortic stenosis patients and further establish it as a leader in the TAVR market. However, shares aren't very attractive at the moment from both a discounted cash flow and relative valuation standpoint.

UnitedHealth Group (UNH)

As the largest health insurance provider in the US, UnitedHealth Group has plenty going for it. Top-line growth has been impressive as of late, driven by its Optum businesses, which focus on improving the healthcare system. However, steady growth in its larger UnitedHealthcare segment cannot be discounted. The firm made headlines recently as it announced its plans to exit the vast majority of its 34 Affordable Care Act markets it serves to only a handful in 2017. Consistent losses on exchanges led the company to believe the business proposition was not an effectively sustainable one. However, this area of weakness has done little to slow the firm's reported results and future expectations as it was only a small portion of its business. UnitedHealth is expecting robust top and bottom-line growth in 2016, but we think the market has shares accurately priced based on our fair value range.

Silicon Motion Technology (SIMO)

Silicon Motion Technology is a fabless semiconductor company, providing semiconductor solutions for the mobile storage and mobile communications markets. The semiconductor industry is a rapidly evolving one, and continuous innovation is key to success. The firm has a degree of concentration risk; its largest customer, SK Hynix, accounts for ~30% of total revenue. Additionally, Silicon Motion's revenue is not generated through purchase orders and not contracts, meaning that there is no guarantee that a competitor will not be able to substantially erode this revenue stream. Through SK Hynix, Silicon Motion supplies each of the global top 10 Android smartphone OEMs, so demand of and developments relating to Android smartphones are worth monitoring very closely. Shares are fairly valued at the moment, based on our fair value range, and concentration risk in such a competitive industry gives us reason for pause. Should a falling out with SK Hynix take place, there will likely be material downside to our fair value estimate.

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Swift Transportation (SWFT)

Swift Transportation is the largest full-truckload motor carrier in North America, and its scale offers it a material competitive advantage in a highly fragmented market. The company has the largest fleet among US for-hire truckload operators and still only has ~1.3% market share. Nevertheless, the firm boasts an impressive customer base filled with blue-chip customers such as Walmart, Amazon, MillerCoors, Procter & Gamble and many more. Its scale also offers strong operating leverage moving forward, and minor efficiency improvements can result in material increases in profitability. Specific operating efficiency metrics that may be worth watching include loaded miler per tractor per week, rate per mile, and deadhead miles percentage. We like the company's focus on reducing leverage and the reduction it has produced in interest expense in recent years.

Surgical Care Affiliates (SCAI)

Surgical Care Affiliates owns and operates a network of ambulatory surgical centers and surgical hospitals in the US, offering facilities, equipment, and medial support staff to physicians for non-emergency procedures. The company's ambulatory surgical center offerings can present a ~45% discount for physicians to certain traditional hospital outpatient procedures. It has put up an impressive streak of EBITDA less non-controlling interest growth over the past 8 years, and the firm expects a similar trajectory to continue for the foreseeable future. Surgical Care Affiliates has multiple levers for continued growth, including the optimization of same-site performance, acquisitions and ongoing development of relationships with existing partners, and adding new partnerships and acquisitions. Upside opportunity exists in the expansion of service lines.

Hawaiian Holdings (HA)

We generally like Hawaiian Holdings' unique niche in the airline industry, but we've always cast a cautious eye on any airline, particularly in light of traditionally volatile fare and jet fuel prices, which can cause relatively large swings in profitability through the course of the economic cycle. To a large degree, airlines have been benefiting from a benign environment of low fuel costs and resilient economic growth, but this will ebb and flow.

Though airlines can be fantastic trading vehicles (as they have revealed in the past few years of the ongoing upswing), we generally don't view them as long-term investments in light of their material operating leverage and intensity of rivalries, though the latter is somewhat subdued in the case of Hawaiian. We'd like to share an interesting quote from Warren Buffett on the airline group, if only on the chance you haven't heard it before:

> *"The worst sort of business is one that grows rapidly, requires significant capital to engender the growth, and then earns little or no money. Think airlines. Here a durable competitive advantage has proven elusive ever since the days of the Wright Brothers. Indeed, if a farsighted capitalist had been present at Kitty Hawk, he would have done his successors a huge favor by shooting Orville down."*
>
> -- Warren Buffett, annual letter to Berkshire Hathaway shareholders, 2008.

Stay In Tune with Our *NEW* Dividend Analysis

By Brian Nelson, CFA

You may have noticed that, as we've been updating our dividend reports, we have been adding an additional page to the report (page 2) that focuses on pointed dividend analysis from the perspective of the income investor. There are several new sections on page 2 of the dividend report, but in this article we wanted to highlight the 'Assessment of Company Dividend Strategy' section. What we set out to accomplish in the two incremental paragraphs of this particular section is somewhat unique, and we wanted to offer a couple themes that will help explain the following unique perspective: what is good for the company over the long haul isn't always good for the income investor in the near term.

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Let's provide a couple examples. Acquisitions, if value-creating, can be very good for the long-term investor, but they aren't always great for the income or dividend growth investor, at least in the near term. Several companies, perhaps none other with a higher profile than Pfizer (PFE) in 2009, have cut their dividends to pursue acquisition-related growth. In the event of M&A activity, cash often goes out the door, and this cash could otherwise have gone to the income investor. Of course, it could be a great transaction with tremendous opportunity, but when cash goes out the door, the strength of the dividend is often reduced.

Another example occurs with share buybacks. Warren Buffett is a fan of gaining a larger piece of the companies he owns when those companies buy back stock, but when it comes to the income investor, a capital allocation policy that is heavily weighted toward share repurchases can actually be detrimental to the long-term potential dividend growth prospects of the company. Just like a creditor doesn't like it so much when a company engages in a large buyback program as it reduces credit quality, income investors often don't like that buybacks are absorbing capital that otherwise could have gone to supporting the dividend. The company could even be getting a great deal on its own stock.

The analysis behind the dividend is sometimes different than the analysis backing the valuation of the company itself. As in the two examples above, both acquisitions and share buybacks can certainly be value-creating moves by the executive team and applauded by long-term investors, but because they draw down capital that could otherwise be used as either a safety net to the existing payout or to facilitate ongoing growth in the dividend, from the income investor's perspective, such activity isn't always welcome. There are a plethora of other examples just like these, and our dividend analysis would not be complete without an in-depth discussion of them for each company.

We hope you enjoy the new page 2, and our team continues to add this unique perspective with each industry update. Please stay in tune with our dividend work! Thank you for reading. Here are some examples from the Machinery & Tools industry.

There are several new sections on page 2 of the dividend report, but in this article we wanted to highlight the section titled: 'Assessment of Company Dividend Strategy.'

Briggs & Stratton (BGG)

Briggs & Stratton's Dividend Cushion ratio is strong for the size of its annual yield, but the firm halved its dividend in 2009.

Key Strengths

Briggs & Stratton's 100+ year history speaks of sustainability, and as the world's largest producer of gasoline engines for outdoor equipment (lawn mowers, snow throwers), its industry ties with top customers (Deere, Toro) and brand recognition would be hard for any new entrant to replicate. Perhaps its 20,000+ dealers globally for product service, parts and customer support is its biggest competitive advantage, however. The company pursues a capital-deployment balance: invest in core business, acquire new businesses and return cash to shareholders. Share buybacks have accounted for large portion of cash returns as of late, however. Free cash flow has averaged ~$86 million during the past three years, but it did trough at $16 million in fiscal 2012. It cut its dividend in 2009.

Potential Weaknesses

Briggs & Stratton's primary top-line driver is its engine business, which accounts for more than 60% of sales. The division, however, has seen better days, with segment revenue falling to ~$1.2 billion in fiscal 2015 from $1.4 billion in fiscal 2011 as segment margins dipped more than 200 basis points during the same time. The company recently entered the job site and rental markets with its acquisition of Allmand Bros (maker of commercial light towers and industrial heaters), and we'll continue to monitor how management deals with challenges to its core engine operations. Though its business is tied to the housing market (as evidenced by its dividend cut during the housing crisis), strong new home sales lately haven't been a savior either. The company retains a net debt position, but total debt to EBITDA is manageable at less than 2x.

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Crane (CR)

We're expecting continued growth in Crane's dividend in coming years.

Key Strengths

It has been fun to watch Crane's dividend march ever higher during the past decade or so after a period of stagnation following the dawn of this century. The payout has nearly tripled from 2006, and its Dividend Cushion ratio suggests further increases are on the horizon, even as it navigates a challenging near-term environment. The company is a diversified maker of highly-engineered products, and we're big fans of its exposure to aerospace and electronics (20%+ segment margin), an end market that accounts for about 25% of sales. Though recent results have faced pressure due to energy-market weakness, the company's performance continues to be resilient. Its history of productivity and cost control offers a nice buffer to the dividend, in our view. Management is targeting a total payout ratio of 40%-50%, suggesting upside to the payout.

Potential Weaknesses

Crane is tied to the energy market, and the recent collapse in energy resource pricing has not left the company unscathed. 2015 was much more difficult than management had originally expected, with net sales, operating profit and free cash flow falling across the board, the latter by 14%, to $190 million (free cash flow is targeted to grow in 2016, however). Management will have to continue its laser-focus on productivity and cost savings, while pursuing disciplined pricing to preserve margins. Capital spending has inched up in recent years, but it remains manageable at less than 2% of sales. We'll be watching Crane's credit quality in light of end market weakness and its evaluation of inorganic growth opportunities, which may come with a hefty price tag.

Dover (DOV)

Dover has an impressive record of consecutive annual dividend increases.

Key Strengths

Dover is a Dividend Aristocrat, but its exposure to the volatile US oil and gas related end markets may eventually challenge its long track record of consecutive annual dividend increases, if not this year then perhaps in coming years. Management has a number of options to keep the streak going, of course, but the operating environment has perhaps never been more difficult for the company. Free cash flow has remained robust at ~$800 million per annum during the past three years (2013-2015), roughly 10%-12% of sales, a very impressive margin in light of its manufacturing-related operations (free cash flow in 2016 is targeted at ~11% of sales). The company retains a very healthy investment-grade corporate credit rating as well, but it does hold a rather hefty net debt position of $2.4 billion, as of the end of 2015. Continuing its consecutive annual dividend growth streak, while achievable, won't be easy, in our view.

Potential Weaknesses

The biggest challenge to Dover's performance as of late has been the collapse in the energy resource pricing environment. Its Energy segment, once accounting for 35% of total segment earnings in 2013, has been pummeled as of late as energy customers scale back investment in the current uncertain times. Management is targeting annual organic sales growth of 3%-5% over a long-term business cycle but it will come up significantly short in 2016 (expectations are for internal growth to fall 5%-8%). Earnings expectations are being ratcheted lower, and the company is pursuing restructuring activities to shore up performance. A continued focus on operating efficiencies through its Dover Excellence Program will be par for the course to ensure ongoing dividend expansion in the current difficult environment, which cannot be guaranteed.

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Flowserve (FLS)

Flowserve's dividend was suspended around the turn of the century, but has grown significantly since it was reinstated in 2007.

Key Strengths

Flowserve's position as a leading maker and aftermarket service provider of flow control systems is an attractive one, and its long-term customer relationships speak to resilience. Quite possibly the most attractive portion of its operations, however, is the recurring nature of its aftermarket services (40%+ of sales), which helps to mitigate its cyclical risk profile. Free cash flow has averaged ~$340 million during the past three years (2013-2015), and management expects to cut capital spending to $105-$115 million in 2016 (was $180+ million in 2015) to shore up the metric in the current difficult environment. Flowserve's capital allocation policy is to return 40%-50% of running 2-year average net earnings to shareholders, though buybacks will be a part of this distribution. It has raised its dividend at a 16% CAGR since 2007, but shares outstanding have been reduced by ~20% over roughly the same time.

Potential Weaknesses

Flowserve cut its dividend in 1999 in part to aid in acquisition financing, and while we don't think management will put the payout in jeopardy again for the sake of growth, there are myriad other factors that may pressure the pace of dividend expansion. Revenue for 2016 is expected to decline by as much as 7%-14% due in part to weakness in its oil and gas segment (~40% of bookings), and while the long term may be bright, strategic priorities over the next few years will center on right-sizing its cost structure to current market conditions. Management is targeting $200+ million in annualized run-rate savings by 2018, and an ongoing focus on high-margin aftermarket opportunities while maintaining pricing and margin discipline will be critical to preserving dividend health during the present cyclical demand trough. Long-term debt continues to swell.

Graco (GGG)

Graco's Dividend Cushion ratio is excellent. Its special dividend in 2004 makes historic comparisons difficult.

Key Strengths

Graco operates a fantastic business model (operating margins are 20%+), and its specialization in providing solutions for difficult-to-handle materials with high viscosities makes it a niche, differentiated player within the industrial universe, in our view. The company's targets for 10% top-line growth and 12% consolidated net earnings growth per annum won't be easy to achieve given the cyclical end markets it serves, and it may cause the company to stretch for acquisitions. Graco has spent nearly $200 million acquiring new businesses in each of the past two years. Free cash flow was much stronger in 2013 and 2014 (north of $200 million), though the $145+ million mark in 2015 wasn't too shabby (annual dividend obligations are ~$70 million at the current run rate). Management is targeting a dividend payout ratio of ~30%.

Potential Weaknesses

Graco is tied to the vicissitudes of the macroeconomic cycle, with residential and non-residential construction, automotive, industrial and machinery end markets collectively accounting for ~75% of sales. Income investors can't forget that Sherwin Williams remains a key customer at ~10% of sales, so Graco will have to keep that relationship in good standing. Long-term debt stood just north of $390 million at the end of 2015, down from $615 million in the year prior as it used proceeds from asset sales to pay down debt. Management is focused on the dividend, but both opportunistic acquisitions and share repurchases could absorb capital that otherwise could go to income investors. Its strong Dividend Cushion ratio is supported by resilient free cash flow generation.

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IDEX (IEX)

IDEX's dividend is on solid ground.

Key Strengths

IDEX seems to have it all figured out. The company is targeting organic growth in the range of 2%-4% per annum, a pace that will be bolstered by mergers, to drive a high-single-digit annual top-line growth rate. It expects to leverage such growth into incremental operating margins north of 30%, helping to drive earnings per share as much as 10%-15% higher each year. Dividend growth will follow, as the executive team targets the payout at ~30% of net income. Of course, nothing will come this easy, but we like the ambitious targets – IDEX wants to double its enterprise by 2020. The company has been paying a dividend for 85+ consecutive years, and its Dividend Cushion implies investors should expect this to continue with some growth to boot. Free cash flow has been solidly above $300 million the past few years (annual dividend obligations are less than $100 million).

Potential Weaknesses

Perhaps the biggest threat to the pace of dividend growth at IDEX may be something that comes from within the organization. Acquisitions remains a key top-line driver at the company, with the firm completing nearly 30 acquisitions during the past decade, collectively accounting for ~40% of IDEX's current revenue. The risk is that management may overpay for growth and use capital that otherwise may have been better distributed to shareholders in the form of a higher dividend (it recently acquired Akron Brass for $220+ million). Management continues to emphasize its disciplined approach to M&A, but we're cautious. Even Warren Buffett makes a bad deal every now and then. Share repurchases will absorb capital, but we're not concerned with a balance sheet that reveals net leverage of just 1x at the end of 2015.

Illinois Tool Works (ITW)

Illinois Tool Works' dividend has many years of growth ahead of it.

Key Strengths

Dividend Aristocrat ITW's performance goals are enough to get any investor excited. Organic expansion is targeted at 200+ basis points above global GDP, while the executive team's focus on keeping operating margins above 23% should translate into 20%+ after-tax ROIC, one of our very favorite metrics. ITW carries out a proprietary 80/20 business process (80% of the revenues/profits come from 20% of customers/products), and the company's commitment to this focus is as strong as ever. Management is targeting 100% free cash flow conversion (from net income) and a disciplined capital allocation strategy, which includes an "attractive dividend" at 20-30% of operating cash flow. The company has raised its dividend in each of the past 50+ years. Free cash flow has averaged ~$1.8 billion during the past three years (2013-2015).

Potential Weaknesses

There aren't a lot of bad things to say about ITW and its dividend. In many ways, the company's business processes are among the best not only in our industrial coverage but also across our entire analytical universe. ITW's dividend has experienced a nice 10% CAGR since 2012, but we think income investors would like to see a greater percentage of cash flow from operations allocated to the payout. Roughly half of cash flow from operations will go to strategic acquisitions and buybacks, more than double that which will go to the dividend, on average, through the economic cycle. Buybacks absorbed more than $8 billion in capital since 2012, and while its total debt to EBITDA ratio of ~2x isn't bad, long-term debt stood at over $7.4 billion at the end of 2015.

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Ingersoll-Rand (IR)

Ingersoll-Rand has recovered from its dividend cut, and we're expecting fairly significant growth in coming years.

Key Strengths

Ingersoll Rand's products speak to innovation, but what we like most is its maintenance, parts, and services business (~30% of revenue), which we view as largely repeatable. As of late, the company has made dividend growth a priority, with the dividend payout advancing at an astronomical rate of 24% annually since 2011. Ingersoll Rand's Dividend Cushion ratio suggests strong growth will continue. Management is targeting 2016 full-year adjusted free cash flow of $950 million to $1 billion, in-line with the $985 million it raked in during 2015, which was north of 100% of adjusted net income. Our free cash flow calculations don't align with management's internal measures, but traditional free cash flow generation of ~$730 million on average during the past three years is a multiple of its annual dividend obligations.

Potential Weaknesses

One wouldn't know it by the recent performance of the company's dividend, but Ingersoll Rand's end markets are cyclical in nature, particularly new installations for commercial and residential HVAC systems. Accelerated declines in business activity forced it to lower its dividend in 2009, amid the housing crisis. Net debt stood at ~$3.5 billion at the end of 2015, but the company has no meaningful debt maturities until 2018 and sports a BBB corporate credit rating. Share repurchases have eaten up capital that otherwise could go to income investors, with the company retiring over 100 million shares from 2011-2015. Dividend payments have only accounted for about one third of the company's free cash flow generation during the past 5 years, so upside to the dividend payment may be material.

Lincoln Electric (LECO)

Lincoln Electric's dividend is on solid ground.

Key Strengths

Lincoln Electric has stepped up its willingness to increase the dividend, with payout growth accelerating as of late. Consumables (filler metals) account for more than 60% of Lincoln's net sales, and the company is one of a few that can meet the rising complexity involved in providing a complete solution in the global arc welding market, a massive $23 billion industry. Innovation remains Lincoln's lifeblood in its mature industry with roughly one third of consolidated sales coming from products launched within the past 5 years. Management is targeting an average 35% payout of adjusted net income through the cycle. Free cash flow has averaged ~$280 million during the past three years (2015), nearly three times that of annual dividend obligations.

Potential Weaknesses

There's not much that is going to derail Lincoln Electric, a company founded in 1895 with a capital investment of just $200. It's fair to say that the firm has seen its share of economic cycles, both in magnitude and duration, and has come out on top. Lincoln Electric has become synonymous with "welding experts," but Colfax and ITW are rivals nipping at it heels when it comes to share grab. Buybacks have absorbed considerable capital in the past few years, and management is looking to buy more of its stock in 2016. We weren't happy to see Lincoln's long-term debt load expand to ~$350 million from just ~$2.5 million in 2014, and we're watching management's financial decisions closely as a result.

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Simpson (SSD)

As with many of its peers, Simpson's Dividend Cushion ratio is strong.

Key Strengths

Simpson makes things stronger, and we think management is working to do the same with respect to its dividend. The company's wood construction products (connectors, truss plates, fasteners) are used across the engineering and construction end market, and its Simpson Strong-Tie brand is well-recognized among architects and engineers. Things haven't worked out so well in China, Thailand or Dubai, but lean initiatives and product innovation have kept the company's financials resilient. Free cash flow has averaged ~$70 million during the past three years (2013-2015), more than double its annual dividend obligations (~$30 million). Sharon Simpson, who owns ~15% of the outstanding shares of common, has an influence over how much she would like to get paid with each dividend check. Simpson is effectively debt free.

Potential Weaknesses

By far, the biggest risk to the growth of Simpson's dividend rests in its exposure to the cyclicality of its key end market, housing. As much as 65% of its business rests on selling products that are dependent on housing starts. We can't find much fault with its long history and brand recognition, and the company's ~$260 million cash and cash equivalents balance offers a significant cushion against any operating weakness. It doesn't have to worry much about creditors either – Simpson is effectively debt free. Strong free cash flow and a solid balance sheet translates into a very, very solid Dividend Cushion ratio. We expect strong dividend growth.

Snap-on (SNA)

Snap-on's dividend strength is undeniable.

Key Strengths

You may know about Snap-on's interchangeable socket set and its pioneering of mobile tool distribution, but did you also know that Snap-On has a dividend track record like few others? The company has paid a dividend without interruption or reduction since 1939, and we think the payout has only gotten stronger in recent years as conditions in the automotive repair market remain quite favorable (auto techs rate Snap-on as a highly preferred brand). Its franchised mobile van network continues to perform well, and incredibly, consolidated operating margins, before financial services, have expanded to 17.7% in 2015 from just 6.5% in 2005. 2015 marked the sixth consecutive year that Snap-on raised its quarterly cash dividend. Free cash flow totaled more than $400 million in 2015, several times the ~$130 million in cash dividend payments.

Potential Weaknesses

The dividend remains a key component of Snap-on's capital allocation policy, and we doubt it will do anything to disrupt its near-80 year track record of not reducing it. Income investors should be aware that more than 40% of the company's consolidated revenues are tied to the success of its franchisees, so it must maintain good relationships with this line of distribution. Though a small portion of its business at ~6% of operating revenues, Snap-on's financial services operations could pose challenges to the pace of dividend expansion during difficult times of credit. Total debt stood at ~$880 million at the end of 2015 versus a cash balance of ~$90 million, revealing a rather large net debt position, but free cash flow generation is robust.

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Stanley (SWK)

Stanley has an impressive dividend track record of increases.

Key Strengths

From a building products company with $2 billion in sales in 2000 to a diversified industrial entity with $11+ billion in revenue, it's been an amazing journey for Stanley Black & Decker. But there is a bigger story to tell for income investors. Stanley Black & Decker has paid a dividend for ~140 consecutive years, and it has increased the payout in each of the past ~50 years. The company is #1 in tools and storage, #1 in engineered fastening, and a top player in commercial electronic security services, and we can't say enough about its established, global franchises. Management points to a strong and growing dividend as a key reason to invest in its company, and frankly, the company's track record speaks for itself.

Potential Weaknesses

A focus on cost containment and ongoing price/mix management will be par for the course to keep operating results and its dividend moving in the right direction. The company has been active with share buybacks as of late, but we think this speaks more of the cushion it has with respect to the dividend than anything else. A lot would have to go wrong for management to simply decide not to raise the payout in any given year, in light of its near half-century dividend growth track record. The company has a rather large net debt position of $3.4 billion, but free cash flow generation of ~$740 million during the past five years has been solid (dividend obligations are ~$320 million per annum). We expect strong coverage to continue.

The Nelson Exclusive

From President of Investment Research Brian Nelson every month, receive three exclusive stock selections for consideration (one for income, one for capital appreciation, and a "short" idea), fully-laid out in thesis form. FOR YOUR EYES ONLY! Offer is limited to the first 1,000 Valuentum members. Reserve your spot today. Product launches July 1.

We can't be more pleased with the reception we have received from the investment community the past 5+ years, and we continue to create products to meet various needs and requests. We're very lucky to be in high demand.

What we are rolling out in the coming weeks, July 1, may be one of our best features yet, and it's purely incremental, an add-on to your existing subscription, if you want it. We understand some members may not want to replicate the newsletter portfolios to capitalize on their respective overall returns (which have been great!), and we know that the Valuentum Buying Index may not be their cup of tea either.

Warren Buffett is famous for saying, "The stock market is a no-called-strike game. You don't have to swing at everything—you can wait for your pitch. The problem when you're a money manager is that your fans keep yelling, "Swing, you bum!" We're never going to jeopardize our laser-focus on achieving the newsletter goals by adding idea after idea (just for the sake of doing so), but we know members still want new ideas – and they want the very best ones at that! But we can't force ideas into a portfolio just for the sake of doing so.

So we're going to do one better. Having managed the Best Ideas Newsletter portfolio and Dividend Growth Newsletter portfolio to continued strong returns during the past 5+ years, President of Investment Research Brian Nelson will now be highlighting in a brand new publication The Nelson Exclusive three new ideas each month for you to consider, one for income, one for capital appreciation, and a "short" idea (all three will be outside our existing coverage universe). Fresh, underfollowed and new ideas -- outside our coverage universe -- every month! Nothing will be held back.

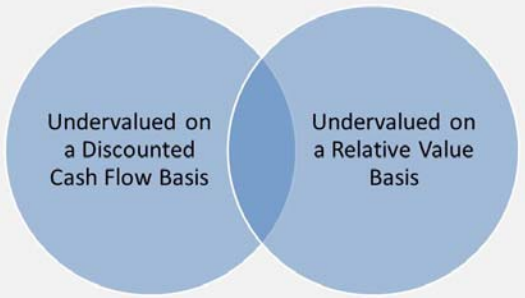
$1,000/year. No refunds offered. Product will close after the first 1,000 members, so reserve your spot in advance of the first edition, to be released July 1.

Please visit the following page for more info >> http://www.valuentum.com/articles/20160505

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	Date
Supervalu	SVU	Consumer Staples	UNDERVALUED	ATTRACTIVE	0.45	1/15/2016
Owens-Illinois	OI	Materials	UNDERVALUED	ATTRACTIVE	0.56	2/5/2016
Michael Kors Hldg	KORS	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.57	1/15/2016
American Axle	AXL	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.58	1/29/2016
Synchronoss	SNCR	Information Technology	UNDERVALUED	ATTRACTIVE	0.59	2/5/2016
Libbey Inc	LBY	Consumer Staples	UNDERVALUED	ATTRACTIVE	0.60	1/15/2016
Harman Intl	HAR	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.61	5/6/2016
Hanger Orthopedic	HGR	Health Care	UNDERVALUED	ATTRACTIVE	0.63	1/8/2016
Jabil Circuit	JBL	Information Technology	UNDERVALUED	ATTRACTIVE	0.65	6/3/2016
Xerox	XRX	Industrials	UNDERVALUED	ATTRACTIVE	0.67	3/18/2016
QUALCOMM	QCOM	Information Technology	UNDERVALUED	ATTRACTIVE	0.68	2/5/2016
InvenSense	INVN	Information Technology	UNDERVALUED	ATTRACTIVE	0.70	2/12/2016
Verint	VRNT	Information Technology	UNDERVALUED	ATTRACTIVE	0.71	2/26/2016
Skyworks	SWKS	Information Technology	UNDERVALUED	ATTRACTIVE	0.72	2/12/2016
Avis Budget	CAR	Industrials	UNDERVALUED	ATTRACTIVE	0.72	1/15/2016
Computer Sciences	CSC	Information Technology	UNDERVALUED	ATTRACTIVE	0.73	1/29/2016
AIG	AIG	Financials	UNDERVALUED	ATTRACTIVE	0.73	3/17/2016
Oracle	ORCL	Information Technology	UNDERVALUED	ATTRACTIVE	0.76	1/29/2016
MetLife	MET	Financials	UNDERVALUED	ATTRACTIVE	0.77	3/17/2016
Korn/Ferry	KFY	Information Technology	UNDERVALUED	ATTRACTIVE	0.78	3/18/2016
Prudential Financial	PRU	Financials	UNDERVALUED	ATTRACTIVE	0.78	3/17/2016
Mylan	MYL	Health Care	UNDERVALUED	ATTRACTIVE	0.78	6/3/2016
Global Payments	GPN	Information Technology	UNDERVALUED	ATTRACTIVE	0.78	3/11/2016
Boardwalk Pipeline	BWP	Energy	UNDERVALUED	ATTRACTIVE	0.79	4/8/2016
PVH Corp	PVH	Consumer Discretionary	UNDERVALUED	ATTRACTIVE	0.80	6/10/2016

*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.

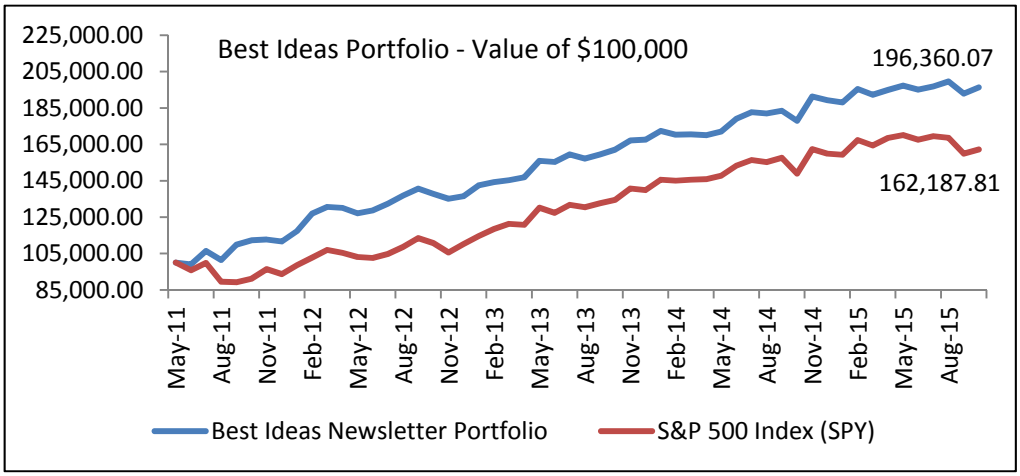
Company Name	Symbol	Sector	VBI	Date	Fair Value Est.
Boardwalk Pipeline	BWP	Energy	9	4/8/2016	$19.00
Jabil Circuit	JBL	Information Technology	9	6/3/2016	$30.00
Korn/Ferry	KFY	Information Technology	9	3/18/2016	$38.00
PVH Corp	PVH	Consumer Discretionary	9	6/10/2016	$121.00
Xerox	XRX	Industrials	9	3/18/2016	$16.00
AIG	AIG	Financials	8	3/17/2016	$72.00
Avis Budget	CAR	Industrials	8	1/15/2016	$35.00
Libbey Inc	LBY	Consumer Staples	8	1/15/2016	$26.00

Federal Realty	FRT	Financials	2	3/18/2016	$122.00
Intl Flavors	IFF	Materials	2	6/3/2016	$91.00
Rayonier	RYN	Industrials	2	6/10/2016	$17.00
Vulcan Materials	VMC	Industrials	2	6/10/2016	$89.00
Bright Horizons Family	BFAM	Consumer Discretionary	1	1/15/2016	$49.00
Brown-Forman	BF.B	Consumer Staples	1	2/12/2016	$65.00
J&J Snack	JJSF	Consumer Staples	1	3/18/2016	$76.00
Manhattan Associates Inc	MANH	Information Technology	1	2/5/2016	$34.00
McDonald's	MCD	Consumer Discretionary	1	6/6/2016	$94.00
Mettler-Toledo	MTD	Health Care	1	2/26/2016	$231.00
Morningstar	MORN	Financials	1	5/20/2016	$67.00
National Beverage	FIZZ	Consumer Staples	1	2/12/2016	$22.00
Neogen	NEOG	Health Care	1	1/22/2016	$40.00
Netflix	NFLX	Consumer Discretionary	1	2/26/2016	$59.00
Stonemor	STON	Consumer Discretionary	1	1/15/2016	$17.00

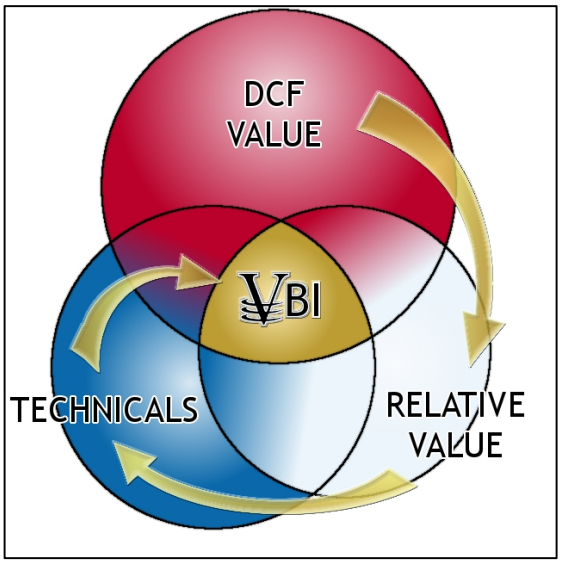
Our Methodology – The Valuentum Buying Index (VBI)

By Valuentum Analysts

At Valuentum, we think the best opportunities arise from a complete understanding of all investing disciplines in order to identify the most attractive stocks at any given time. Valuentum therefore analyzes each stock across a wide spectrum of philosophies, from deep value through momentum investing. We think companies that are attractive from a number of investment perspectives--whether it be growth, value, income, momentum, etc.--have the greatest probability of capital appreciation and relative outperformance. The more deep-pocketed institutional investors that are interested in the stock for reasons based on their respective investment mandates, the more likely it will be bought and the more likely the price will move higher to converge to its true intrinsic value (buying a stock pushes its price higher). On the other hand, we think the worst stocks will be shunned by most investment disciplines and display expensive valuations, poor technicals and deteriorating momentum indicators.



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



Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

The center of the Venn diagram on the previous page, the Valuentum Buying Index (VBI) combines rigorous financial and valuation analysis with an evaluation of a firm's technicals and momentum indicators to derive a score between 1 and 10 for each company (10=best). Because our process factors in a technical and momentum assessment after we evaluate a firm's investment merits via our rigorous DCF and relative-value process, we're better able to pinpoint the best entry and exit points on the most undervalued stocks.

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

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

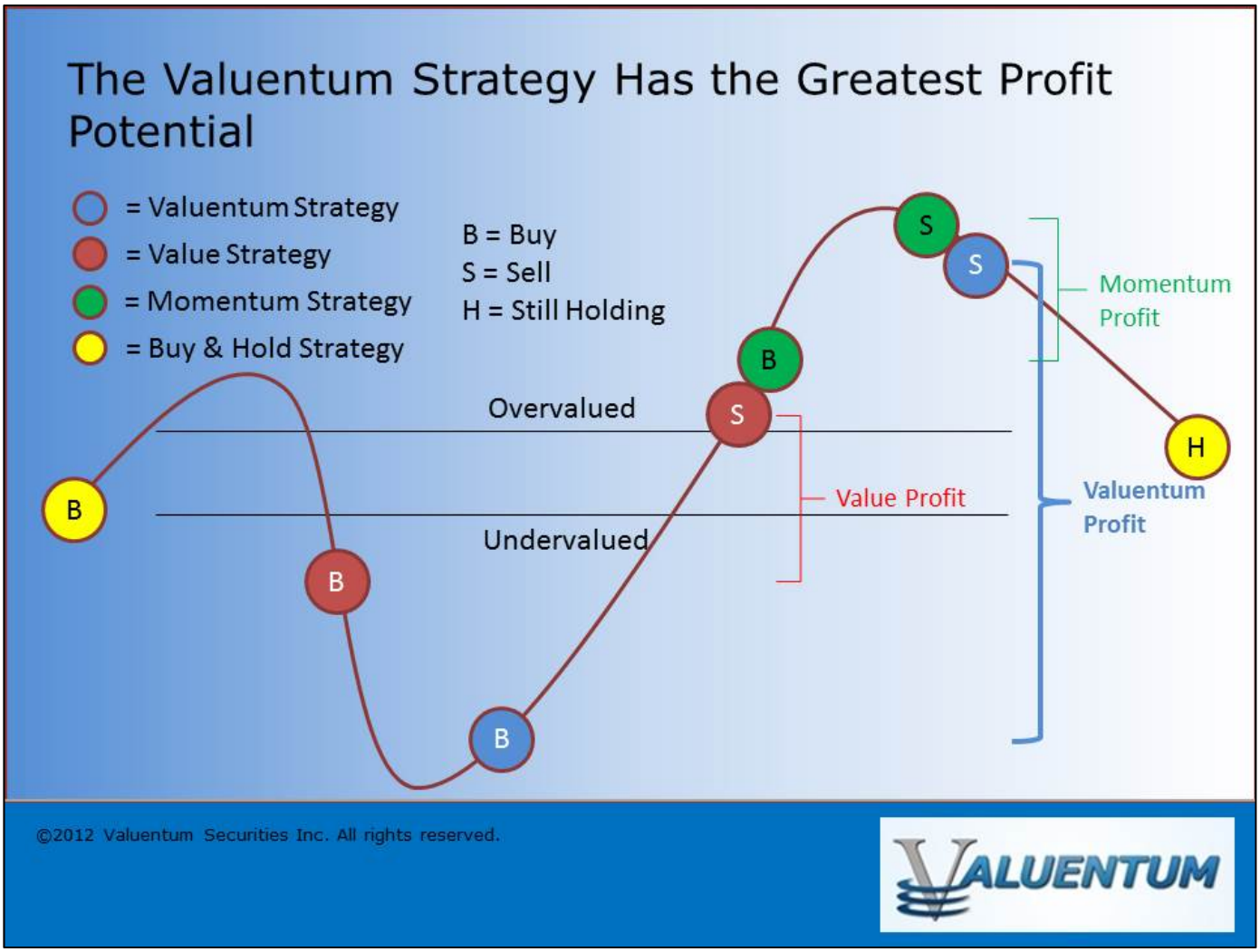


Illustration for educational purposes only.

Our Methodology – The Valuentum Buying Index continued on next page

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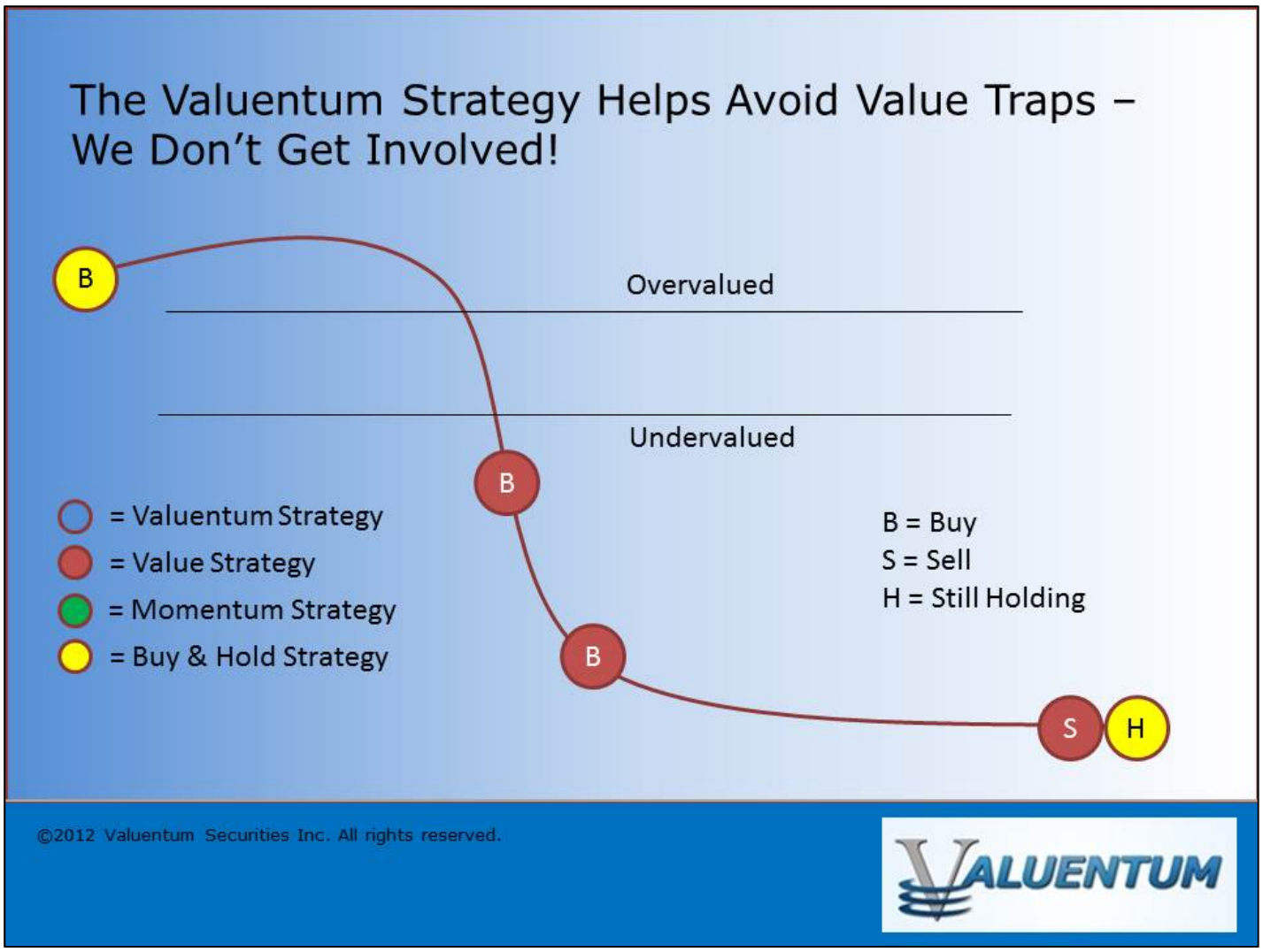
Furthermore, Valuentum subscribers are less likely to be involved in value traps because we demand material revenue and earnings growth for firms to earn a 10 on our Valuentum Buying Index. Value traps often occur as a result of secular declines in a firm's products or services, resulting in deteriorating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

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

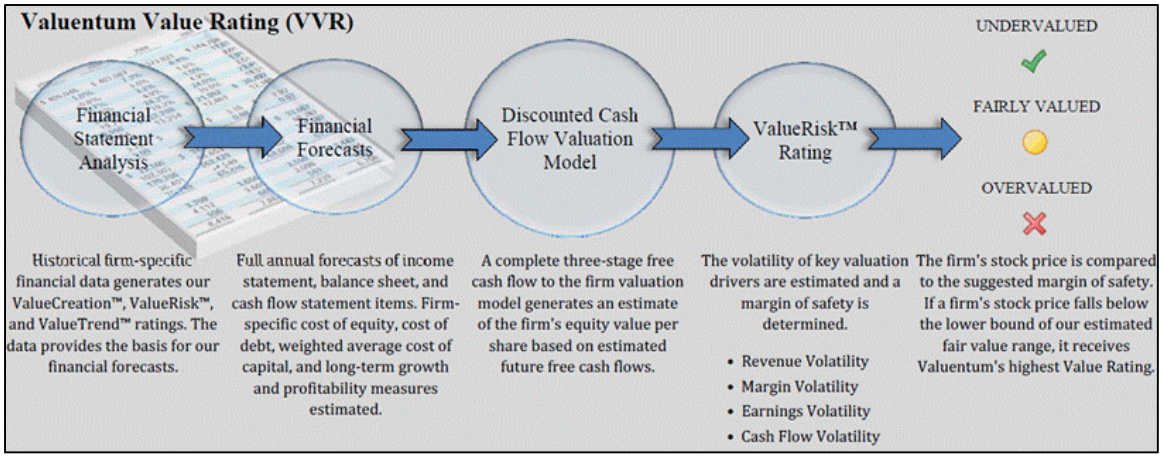


Our Methodology – The Valuentum Buying Index continued on next page

Our Methodology – The Valuentum Buying Index continued from previous page

I. We Use a Rigorous Discounted Cash Flow Valuation Process

Our methodology starts with in-depth financial statement analysis, where we derive our ValueCreation, ValueRisk, and ValueTrend ratings, which together provide a quantitative assessment of the strength of a firm's competitive advantages. We compare a company's return on invested capital (ROIC) to our estimate of its weighted average cost of capital (WACC) to assess whether it is creating economic profit for shareholders (ROIC less WACC equals economic profit). Firms that have improving economic profit spreads over their respective cost of capital score high on our ValueCreation and ValueTrend measures, while firms that have relatively stable returns score well with respect to our ValueRisk evaluation, which impacts our margin-of-safety assessment.



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

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

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

Our Methodology – The Valuentum Buying Index continued on next page

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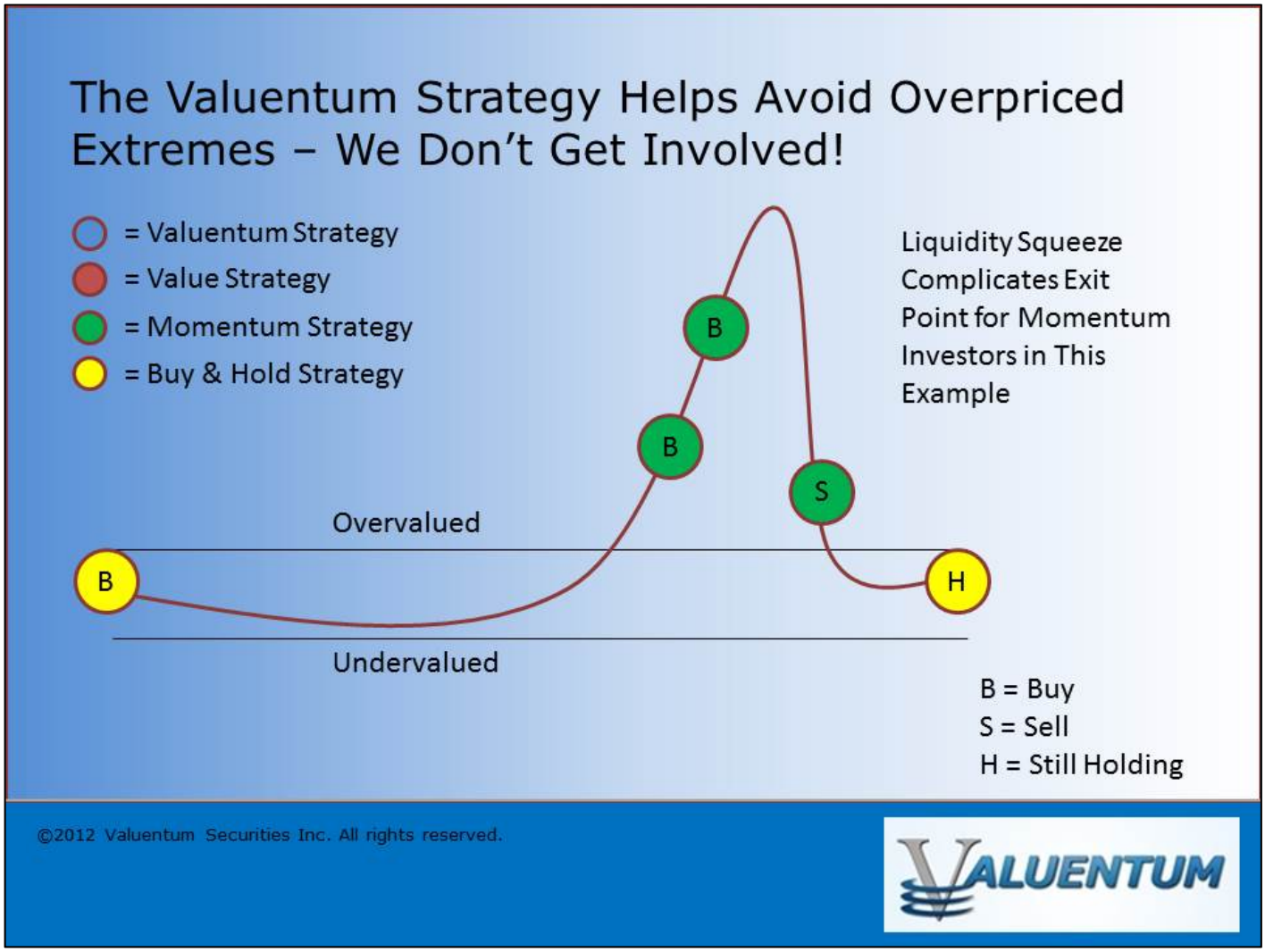

II. We Perform a Forward-Looking Relative Value Assessment

Our discounted cash-flow process allows us to arrive at an absolute view of the firm's intrinsic value. However, we also understand the critical importance of assessing firms on a relative value basis, versus both their industry and peers. Many institutional money-managers--those that drive stock prices--pay attention to a company's price-to-earnings (PE) ratio and price-earning-to-growth (PEG) ratio in making buy/sell decisions. With this in mind, we have included a forward-looking relative value assessment in our process to further augment our rigorous discounted cash-flow process. If a company is undervalued on both a price-to-earnings ratio and a price-earnings-to-growth (PEG) ratio versus industry peers, we would consider the firm to be attractive from a relative value standpoint.

III. We Seek to Avoid Value Traps, Falling Knives and Opportunity Cost

Once we have estimated a firm's intrinsic value on the basis of our discounted cash-flow process, determined if it is undervalued according to its firm-specific margin of safety bands, and assessed whether it has relative value versus industry peers, we then evaluate the company's technical and momentum indicators to pin-point the best entry and exit points on the stock (but only after it meets our stringent

Our Methodology – The Valuentum Buying Index continued on next page

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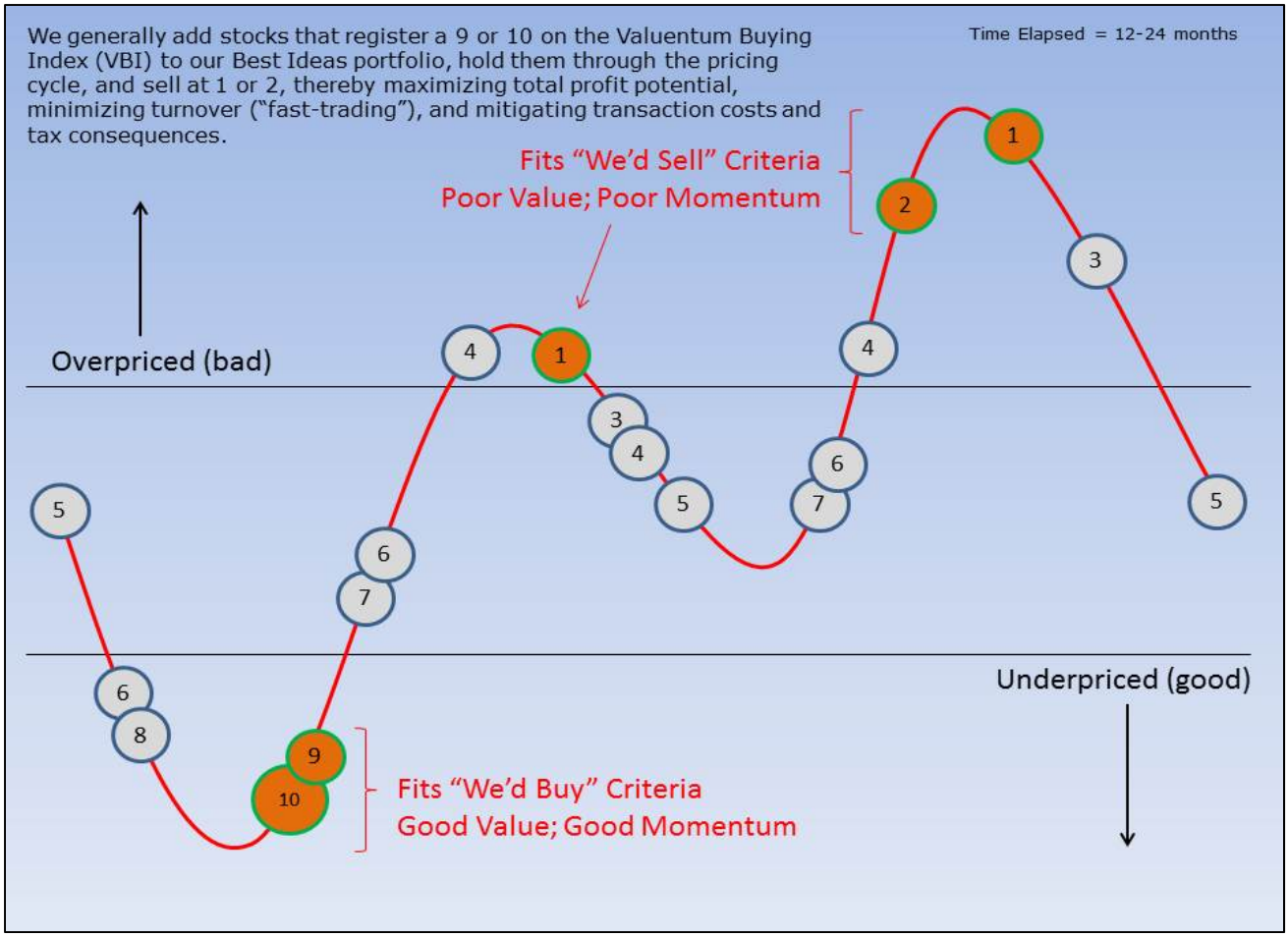
valuation criteria). Rigorous valuation analysis and technical analysis are not mutually exclusive, and we believe both can be used together to bolster returns. An evaluation of a stock's moving averages, relative strength, upside-downside volume, and money flow index are but a few considerations we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

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

Putting It All Together - the Valuentum Buying Index

Though the time frame varies depending on each idea, we expect our best ideas to work out over a 12-24 month time horizon (on average) -- any shorter than that is mostly luck, in our view. We tend to add firms to our Best Ideas portfolio when they register a 9 or 10 on our Valuentum Buying Index (VBI) and tend to remove firms from our Best Ideas portfolio when they register a 1 or 2 on our VBI.

We like to maximize profits on every idea, with the understanding that momentum does exist and that prices over and under shoot intrinsic value all of the time. A value strategy (10 --> 5) truncates potential profits, while a momentum strategy (4 --> 1) ignores profits generated via value assessments. We're after the entire profit potential, as shown below.



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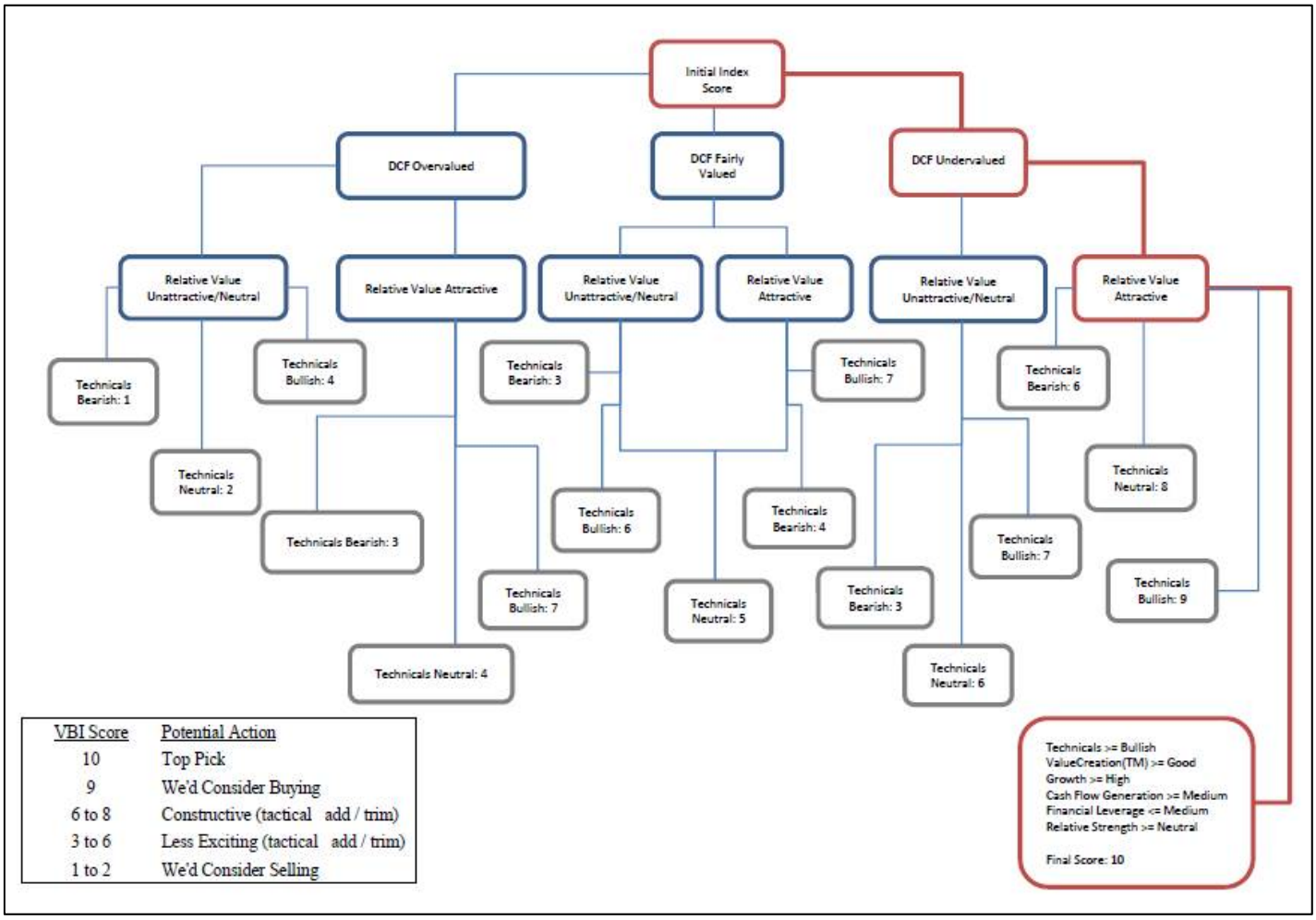
Our Methodology – The Valuentum Buying Index continued from previous page

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

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



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

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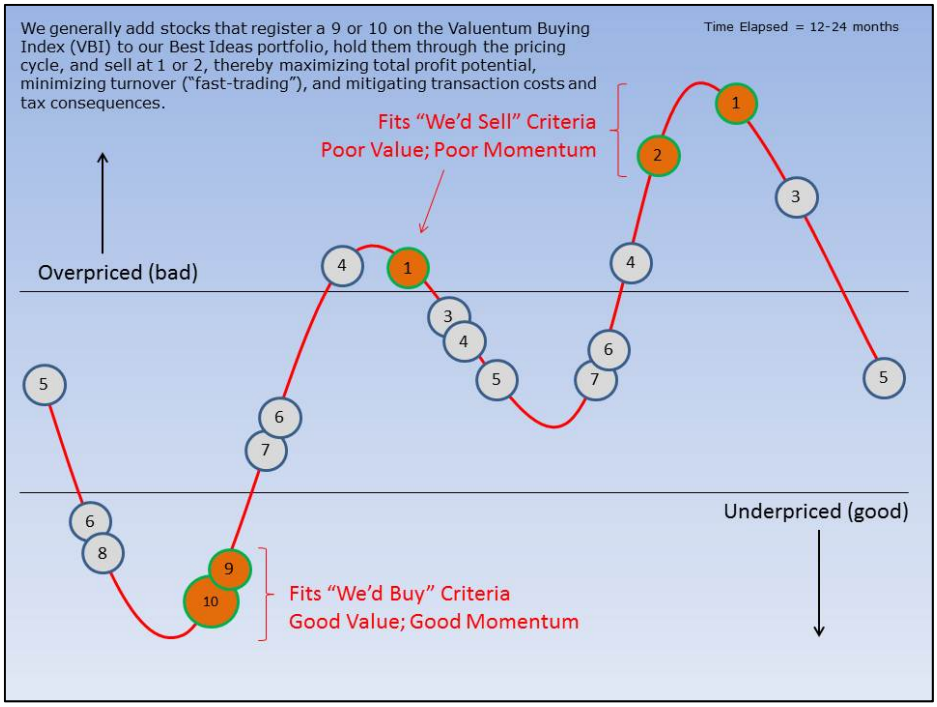
How We Use the Valuentum Buying Index in the Best Ideas Newsletter Portfolio

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

Let's talk about how the Valuentum Buying Index (VBI) informs which ideas we include in our actively-managed portfolios. We've noticed via our statistical backtesting that the momentum factor behind our process tends to be much more pronounced (powerful) over longer periods of time. This was one of the interesting findings of our academic white paper study. We try to replicate this dynamic with the update cycle of our reports (and the time horizon for our ideas to work out). That's why our reports are updated regularly (at least quarterly) or after material events and not daily or weekly. We don't want to whipsaw our membership, nor do we think churn is the way to generate outperformance.

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

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



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 6

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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