OUR BEST IDEAS NEWSLETTER

Valuentum Securities
Stock Analysis: From Value through Momentum Investing

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

| Portfolio Return | Benchmark Return | Outperformance |
|---|---|---|
| 109.8% | 79.4% | 30.5pts |

See page 8.

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

## Inside This Issue



**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.



"Buffett did not become the third wealthiest person on the planet via exposure to the broader market."
- Kris Rosemann

# Berkshire Hathaway Hits All-Time Highs

*By Kris Rosemann*

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

Kris Rosemann
Associate Investment Analyst
kris@valuentum.com


**KEY CONCEPT**: Stocks 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 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). Contact us for more details about how the team utilizes the Valuentum Buying Index to run the portfolio.

We added a 5% position in Warren Buffett's Berkshire Hathaway (BRK.B) in the Best Ideas Newsletter portfolio in April of this year at ~$146 per share with the idea of gaining exposure to high quality businesses in an overheated market. The idea has worked out as planned, as Berkshire Hathaway has been a relatively stable holding in the Best Ideas Newsletter portfolio in a time of uncertainty in the broader market before breaking out to all-time highs following a solid third-quarter report, released November 4, and a business-friendly Presidential election. We continue to be fans of a range of businesses included in the Berkshire portfolio, particularly its recent addition of Precision Castparts, a long-time Valuentum favorite in the aerospace supply chain.

Berkshire Hathaway's third quarter profit levels weren't nearly as bad as year-over-year comparisons indicate, as its 'Investments and Derivatives Gains/Losses' suffered from a tough comparable period due to the merger of Kraft Foods and HJ Heinz (KHC) in July of last year, which resulted in Berkshire reporting an after-tax non-cash holding gain of $4.4 billion in the third quarter of 2015. Operating earnings in the firm's sprawling portfolio of businesses advanced 6.5% from the year-ago period thanks in part to gains in its 'Utilities and Energy' and 'Manufacturing, Service and Retailing' businesses, the latter of which was pushed higher by the additions of Precision Castparts and Duracell. Its 'Financial and Financial Products' businesses performed well in the period, though the segment makes up a much less material portion of its overall operating portfolio.

***Berkshire Hathaway…continued on next page***

***Berkshire Hathaway…*from previous page**

Businesses providing a drag on Berkshire's profits in the quarter, aside from the tough comparisons in 'Investments and Derivatives Gains/Losses,' were its 'Insurance-Underwriting' (KIE, IAK) and 'Railroad' businesses. The firm's underwriting operations are evaluated separately from the resulting investment income or gains that may come from the investment of premiums received, which has been the core driver of Berkshire's expansion over the past several decades. The timing and amount of property losses can produce material periodic volatility in its insurance businesses' underwriting results, and we do not view its 34% drop in underwriting earnings as a cause for concern due to such a dynamic. Its 'Railroad' business, Burlington Northern Santa Fe, continues to feel the pressure of volume declines commonly seen across the US railroad industry as of late, "Tough Times for Rails."

What's made the difference for Berkshire Hathaway shares--and CEO Warren Buffett's net worth, which now sits above $70 billion and ranks him as the world's third richest person--are expectations surrounding the results of the Presidential election. The idea that Donald Trump winning the election is what has pushed Berkshire and Buffett to new heights is an interesting consideration due to the fervor with which Buffett spoke out against the now President-elect. For Valuentum's dive into how the election will impact the markets, please read, "Assessing Reactions to Trump's Victory." The note covers a lot of ground.

It's no surprise that such a high-quality name would participate in a broader market rally, but certain portions of Berkshire's portfolio found themselves in the middle of the excitement, too. Its railroad operations, which accounted for 15% of Berkshire's profits in the third quarter of 2016 despite continued volume declines, figure to benefit from Trump's promises to revive the coal market (KOL) by easing regulations and boosting spending on energy and infrastructure projects. The banking and financial services industry (XLF) is another area that expects to prosper under the coming Trump administration, and Berkshire's material exposure to the industry, namely through its 10% stake in the currently embattled Wells Fargo (WFC), has boosted investor sentiment surrounding its shares following the election. Berkshire Hathaway's businesses in energy, consumer-facing sectors, and portions of manufacturing, such as Precision Castparts in aerospace (ITA), expect to benefit from Trump's agenda as well.

Following the election, Mr. Buffett reminded investors of his high level of confidence in the performance of equities over the long-run, no matter who may win a Presidential election between now and then, "The stock market will be higher 10, 20, 30 years from now. It would have been with Hillary, and it... will be with Trump." While we are not debating 'The Oracle's' opinion on the general trajectory of the market, we do note that stock selection is still key: Buffett did not become the third wealthiest person on the planet via exposure to the broader market. He most certainly has an eye for quality, and that's exactly what investors get when they take a position in Berkshire Hathaway. We're going to stick with our position in the firm for the foreseeable future, and we continue to expect it to be a solid anchor for the Best Ideas Newsletter portfolio while providing the potential for a pop in shares, just as we have seen in the past week.

# Opinion: China-US Trade Augmented, Not Paralyzed Under Trump

*By Brian Nelson, CFA*

*"(Trump's) tough rhetoric may just be setting the negotiations table with China (and Mexico, too), and Negotiations 101 says you start far away from the middle, and then you compromise to get what you truly want."*

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***Opinion…*from previous page**

Nobody wins from a trade war, and business tycoon and President-elect Donald Trump knows this. It's Business 101. Many believe, including us, that imposing steep tariffs on imports from China (MCHI, EWH, FXI) had been merely campaign rhetoric to win over votes, but many market participants are still positioning themselves for some degree of fallout nonetheless.

China itself is not taking chances either. The country's state-backed newspaper Global Times fired a shot across the bow November 13, alerting the soon-to-be-President Trump that slapping outsize tariffs on Chinese imports would be met in kind:

> China will take a tit-for-tat approach… A batch of Boeing (BA) orders will be replaced by Airbus (EADSY). US auto (F, GM) and iPhone (AAPL) sales in China will suffer a setback, and US soybean and maize imports will be halted. China can also limit the number of Chinese students studying in the US.

But let's be reasonable.

To make it as far as Trump has in business, life, and politics, a student of history he must be, and if history is any guide, he'll do what he can to work with China for the best interests of all, even as he puts America's interests first. For example, the Chinese newspaper pointed out that just a few years ago when the Obama administration announced a rather sizable tariff on the importation of tires made in China, the country responded by imposing tariffs on chicken and automotive products from the US, with neither country truly benefiting. Certainly it takes harsh talk to win an election, especially in this day and age when most (not all) have become desensitized, but it takes a deal-maker with charisma to achieve goals and win, and that's what Donald Trump has. The voters voted.

In some ways, we believe that China-US trade relations will be augmented under a Trump administration, not paralyzed. An individual cannot attend such a prestigious business school as University of Pennsylvania's Wharton and not have heavily debated the pros and cons of trade, for example. His tough rhetoric may just be setting the negotiations table with China (and Mexico, too), and Negotiations 101 says you start far away from the middle, and then you compromise to get what you truly want. His tactics are clear to us -- and the very idea that he will launch an all-out trade war with China continues to be a far-fetched one, in our view. Mr. Trump knows that China's ~1.4 billion people dwarf that of the ~320 million in the States, and that over the long haul, the US needs China much more than China needs the US. It's just math.

Furthermore, the very idea that a Sino-US trade war may impair the order books of three of the greatest manufacturers in US history—Boeing, General Motors, and Ford—means that Trump's stance to promote US manufacturing simply doesn't jive with aggressive trade tactics, but rather more cooperative trade policies. If Boeing, General Motors and Ford lose business as a result of a trade war with China, surely Mr. Trump knows that layoffs at these companies are to come, and that wouldn't help American manufacturing jobs at all. As Abraham Lincoln's Lyceum Address in 1838 outlined, "If destruction be our lot, we must ourselves be its author and finisher." A student of history and perhaps Abraham Lincoln himself (as his victory speech conveyed in "binding up the wounds of division"), Trump will not be our author and finisher of destruction.

When the political dust finally settles and we look back on the Trump Presidency, it is my view that many will eventually say that "The Donald" was one of the best things ever to happen to Sino-US relations.

# Assessing Reactions to Trump's Victory

*By Kris Rosemann and Brian Nelson, CFA*

***Donald Trump will be the 45th President of the United States of America. Let's dig into some of the reactions across the market. We're keeping our cool.***

The global markets often don't know what to make of surprises, a characteristic that was on full display as news came rolling in that Donald Trump would soon become the 45th President of the United States, "trumping" Secretary Hillary Clinton in a decisive electoral college victory, despite the popular vote eventually going to the Democratic candidate. In the wee hours of the morning Wednesday, November 9, major markets across the globe were in shock, showing red almost across the board. At one point early Wednesday, futures on the Dow Jones Industrial Average (DIA) had plummeted as much as 800 points.

But what a change in sentiment brought about by Trump's victory speech to "bind up the wounds of division," perhaps borrowing a phrase from Abraham Lincoln's second inaugural address, where the 16th President had sought to "bind up the nation's wounds" after years of conflict that pitted brother against brother in one of the worst catastrophes of the 19th century. Embracing Trump's assuring words, major market indices in the US (SPY) rallied back hard and have since reversed heavy losses and then some, suggesting the initial reaction by market participants was not driven by careful consideration of Trump's policies but rather by a knee-jerk reaction to an election result that few had thought was possible (including almost all the pollsters). Since the initial scramble to assess the aftermath of the surprise Republican victory, stocks have continued to rally Thursday, November 10, as a Trump Presidency is being viewed as business-friendly, despite protests by disenchanted Democrats across major cities in the US.

Even as markets continue to price in better-than-even odds of a rate hike before the year's end, many market observers continue to question just how aggressive contractionary monetary policy will be in light of the Trump camp expressing differing views at differing times, sometimes claiming support for low rates, and at other times, accusing the Fed of aligning itself too closely with the Democratic party. Regardless, the 10-year Treasury yield (IEF) has jumped considerably in light of the election news, now sitting north of 2%, a move that has sent the bond markets (BND) and most REITs (VNQ) tumbling. We continue to be mindful of the inverse relationship of interest rates and REIT equity prices, the latter having many bond-like qualities. We also note that a rising 10-year Treasury yield, often the benchmark rate used across most stock valuation models, will have a negative impact on equity values, provided future growth rates in such models are not changed for the better.

Internationally, the President-elect has also stated plans to renegotiate or withdraw from NAFTA and the Trans-Pacific Partnership, potentially impacting global trade and economic activity. Kansas City Southern (KSU), which owns the most direct rail route between Mexico City and Laredo, where more than half of all rail/truck traffic between the US and Mexico cross the border, is facing the greatest potential negative outcome, while others such as cement-maker Cemex (CX) may have a mixed fate as fewer multi-national entities expand into Mexico, offset in part by increased construction demand to build a controversial wall between Mexico and the US, a priority in President-elect Trump's first 100 days in office. Relative to the US dollar, the Mexican Peso (MXN) has fallen to all-time lows following the election results as capital leaps out of the country (EWW) in light of comments made on the campaign trail by the President-elect. A cheaper Mexican peso, however, may be a boon for passenger air travel demand, specifically into vacation destinations in Mexico (namely Cancún), which could be a surprise source of upside for Grupo Aeroportuario del Sureste (ASR), even as currency impacts weigh on shares. The firm's airport in Cancún accounts for ~80% of its revenue and is the second most frequented in Mexico after only Mexico City.

The Asian markets, those impacted by Trump's comments on the Trans-Pacific Partnership and his suggestions of a 'trade war' with China (FXI), saw some of the most drastic sell-offs immediately following the news that Trump would win the election. On the campaign trail, he accused China of

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currency manipulation, and Trump's economic adviser Peter Navarro has been a proponent of taking a stronger stance against the country. However, Chinese markets have turned from their declines and have also participated in a meaningful rally, which can be attributed in part to the President-elect's victory speech, where he promised to deal fairly with all people and all nations, while continuing to put America's needs first and foremost. It appears as though his speech has assuaged the idea that President-elect Trump would destroy global trade agreements, more specifically, with China. We're of the opinion, however, that his previously inflammatory rhetoric may very well have been a part of negotiating tactics, where it is commonplace to start far from the middle, only to later compromise to get what one truly desires.

Still, industries feeling the negative impact of Trump's Presidential victory are many. Concerns over reimbursement rates in the event that a Republican Congress, soon to be headed by a Republican President, will dismantle the Affordable Care Act (Obamacare), or certain parts of it, have hospital shares (IHI), namely those of HCA Holdings (HCA), Community Health Systems (CYH), and Tenet Healthcare Corp (THC), shuddering. The auto industry and General Motors (GM) and Ford (F) specifically had been investing a significant amount of capital on globalized production and fuel-efficiency initiatives, but Trump's plans to return auto manufacturing jobs to the US may bring the feasibility of incremental non-US manufacturing capital investments into question. Other business-friendly plans could help offset such negativity, however, and while we generally believe Trump's victory is an overall positive for Rust Belt States, we'll be monitoring the impact on the auto industry closely.

The President-elect's opinions of climate change and proposal to eliminate a subsidy on electronic vehicles could also impact those targeting energy optimization in the auto sector. Tesla's (TSLA) shares continue to face pressure, for one, and we continue to believe that the electric-car maker's equity is a speculative lotto ticket that is not likely to pay off. Solar and alternative energy stocks (TAN) have also been hit due to the anticipation that the President-to-be will allocate more resources to traditional energy sources such as oil, gas (NGAS), and coal (KOL). This is more bad news for a solar sector that continues to face a glut of overcapacity, at least from the perspective of bellwether First Solar (FSLR), which struggled tremendous during the third quarter of 2016 amid an industry surplus of panels.

Tech stocks (XLK), including giants Apple (AAPL) and Microsoft (MSFT) and other players such as Advanced Micro Devices (AMD) and Qualcomm (QCOM) and their peers, are feeling the pain of Trump's victory, as he has negatively commented on the likes of Apple manufacturing products in China. A large portion of the tech supply chain is located in the Greater China region and surrounding areas, and our brief mention only begins to scratch the surface of the President-elect's volatile rhetoric on the area leading up to his victory. Participants in the industry are certainly paying close attention to Mr. Trump's trade plans with the region, the end game very difficult to handicap at the moment.

Not all sectors of the market are taking the surprise election result in a negative light, however. Not surprisingly, prison stocks, Corrections Corp (CXW) and the GEO Group (GEO) are benefiting from the Republican candidate's victory, as many believe that Trump will push to keep private prisons open. The aerospace and defense industry (ITA) may witness a bump in military spending during Trump's time in office. The cybersecurity (HACK) arena figures to be a big winner, in particular, as Trump has called for a review of all US cyber defenses and vulnerabilities. Gun stocks, Smith & Wesson (SWHC) and Sturm, Ruger & Co (RGR), however, have seen declines as a result of decreased near-term demand as potential gun buyers feel less urgency to purchase a firearm due to Trump's pro-gun policies.

The beleaguered biotech industry (IBB) may be finding its way out of hot water as fears of the government meddling in its affairs have been eased with the defeat of Hillary Clinton, arguably a positive for companies that sport high-priced drugs, including Gilead Sciences (GILD), Merck (MRK), and Vertex (VRTX), among others. Expectations for the repeal of Obamacare reforms mean a shakeup for the healthcare industry in aggregate, as a growing number of healthcare providers have been pulling out of

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the program in recent years. Congressional Democrats continue to have swagger, however, as even tweets (TWTR) by Bernie Sanders can still send shares of major drug companies tumbling, as was the case more recently with Eli Lilly (LLY) related to its price increase on diabetes-treatment Humalog. We doubt shares of Valeant (VRX) will find much reprieve under a new administration, however, in light of its more-troubling business activity. We continue to believe the Healthcare Select Sector SPDR (XLV) is the best way to gain diversified exposure to the secular trend of rising healthcare spending as a percentage of GDP, without taking on too much risk of any one entity's drug pipeline or possible changes to existing Obamacare legislation.

Crude oil prices (USO) initially dropped following the release of the election results as some expected Trump's victory to lead to weaker economic growth in an already questionable global economy, which would cause additional pressure on energy-resource demand across the world. However, such weakness was eventually reversed as some of the President-elect's proposed plans could benefit oil prices, such as his opposition of the US nuclear deal that has allowed Iran to help flood the globe with crude oil. In any case, we continue to believe that the days of $100 per-barrel crude oil prices may be over in the intermediate-term, as around any corner, either US producers or Russia or OPEC will seek to fill any demand void with surplus supply. Exxon Mobil (XOM) and Chevron (CVX) remain the strongest US producers, though much of the E&P industry will still have to scale back capital spending to keep traditional measures of free cash flow in positive territory. We like the Energy Select Sector SPDR (XLE) in that it allows us to avoid dividend "blow-ups" as in the case of concentrating in any one entity, as in what happened to Kinder Morgan (KMI) and ConocoPhillips (COP) recently.

Additionally, major US oil companies are breathing a sigh of relief on hopes for reduced regulation, which has weighed on the industry throughout the Obama administration and may spark an increase in both spending on and the likelihood of the approval of more infrastructure projects, which bodes particularly well for midstream entities. Trump has explicitly supported projects such as the Keystone Pipeline (TRP), though in light of rising interest rates, we continue to cast a cautious eye on the capital-dependent nature of most master limited partnership business models (AMLP), which are prevalent across the energy midstream space in entities such as Energy Transfer Partners (ETP) and Enterprise Products Partners (EPD), for example. Refiners such as Phillips 66 (PSX) and Valero (VLO) may also benefit from a more favorable regulatory environment. Other commodities, such as copper (JJC, CPER), iron and other metals, have caught a bid thanks in part to the potential for production restrictions being lifted in the US and expectations for increased demand related to an uptick in infrastructure projects (IGF). Equipment and infrastructure building companies such as Caterpillar (CAT) and Deere (DE) and engineering and construction companies including Fluor (FLR) and Jacobs Engineering (JEC) are hoping for better times to come.

Perhaps the most interesting aspect of "The Donald's" proposed changes is his corporate tax plan. He has vowed that no corporation will pay more than a standard 15% tax rate, a significant drop from current levels of 35%, the highest in the world. Trump has also called for a repatriation tax reduction in which trillions dollars in corporate cash sitting overseas could be brought back to the States at just a 10% tax rate. Such a move would benefit major US corporations holding massive amounts of cash overseas, many stocks of which are held in the newsletter portfolios such as Apple, Microsoft, Alphabet (GOOG, GOOGL), and Cisco (CSCO). A reduction in personal taxes for the middle class coupled with job-boosting initiatives could drive consumer spending higher, which could lead to heightened demand for products and services in the struggling consumer discretionary (XLY) and staples (XLP), retail (XRT), and restaurant sectors (BITE). However, there may be no saving grace for department stores such as Sears (SHLD) and J.C. Penney (JCP), which run the risk of obsolescence.

In financial sector (XLF) news, with the 10-year Treasury yield passing the 2% mark for the first time since January 2016, thanks in part to speculation that a Trump Presidency will take the country

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further into debt, thereby impacting the perceived credit-quality of the US' sovereign debt (and stimulating selling of Treasuring bonds), banks and money centers now have more wiggle room with respect to net interest margin capture, though the slope of the yield curve will remain the more-critical driver. Regardless, the financial sector had its best trading day since 2011 on November 9, as speculation that a decrease in regulation, key legislative changes, and an inflow of fresh funds--thanks in part to the aforementioned repatriation tax reduction--are all on the way to help fuel financial performance for major banks (KBE). Perhaps most important for the big banking industry, however, is Trump's critical history on Dodd-Frank, which, if reevaluated, could make the operating environment much easier for banking entities to earn a better return on equity. The thought of former Goldman Sachs (GS) banker Steven Mnuchin as the next Treasury Secretary is only good news for banking stocks, too.

Other important decisions made across the nation include four states voting to approve minimum wage increases. Arizona, Colorado, and Maine have voted to boost the minimum wage in their states to $12 per hour while the state of Washington approved raising its minimum wage to $13.50. The first three states plan to raise the wage floor gradually, and Washington intends on hitting its target by 2020. The already frustrated restaurant and retail spaces are not welcoming the news, and many operators may find their margins under continuous pressure as a result of rising labor costs. Franchisors such as McDonald's (MCD), Dunkin' Brands (DNKN) and DineEquity (DIN) may be better able to handle such adversity as operational risk is pushed primarily to the franchisee, while Walmart (WMT), Target (TGT) and others may not fare as well.

All of this said, we continue to note the uncertainty surrounding a large number of President-elect Trump's plans, and as a result, we're not doing much at all in light of the election news. Incremental information will continue to come to light in coming weeks and months as the Trump camp details its plans for the next four years, but the newsletter portfolios continue to be well-positioned under any political environment. Though we may pursue tactical tweaks in the newsletter portfolios in coming months, we think the most valuable takeaway from the far reaching, knee-jerk reaction immediately following the conclusion of the election is that volatility may be back to the markets…in a big way. We'll be looking to capitalize on any mispricings that may surface. Stay tuned.

## VBI Case Study -- Priceline's 3Q Earnings Insight

*By Kris Rosemann and Brian Nelson, CFA*

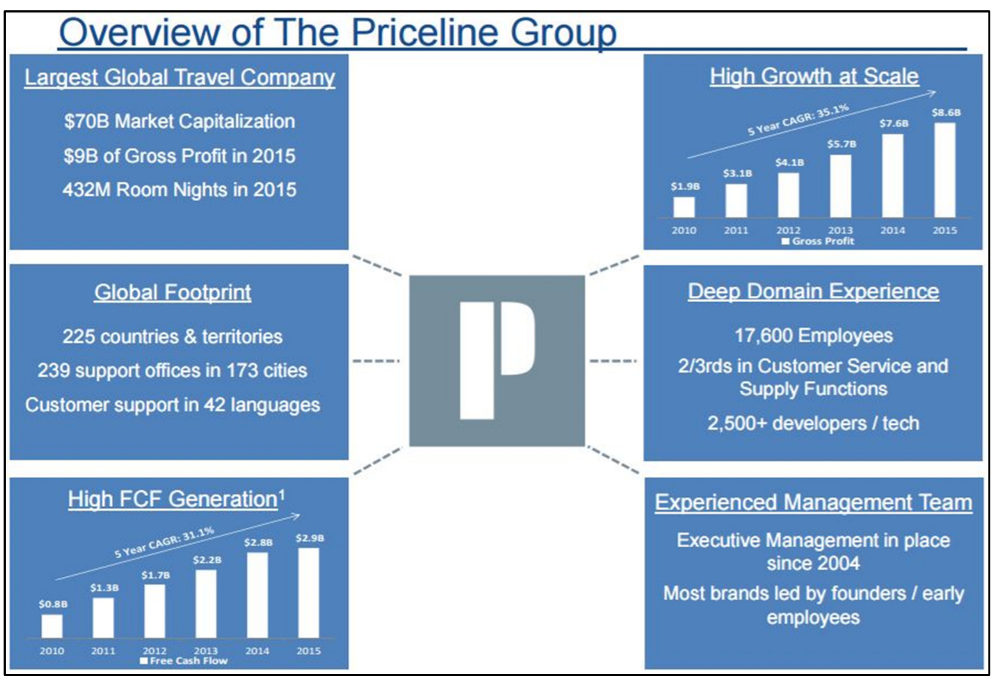



Image Source: Priceline

*VBI Case Study…*continued on page 9

# The Best Ideas Portfolio

| Portfolio Return | Benchmark Return | Outperformance |
|---|---|---|
| 109.8% | 79.4% | 30.5pts |

*By Valuentum Analysts*

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 ~15% of the portfolio in cash, a level we're looking to bring down in coming months. Tactically, we like to have the most cash when the market is making new highs and fully invested when the market is putting in short-term lows.

Our investment process is completely transparent and easy to implement in your own portfolio. The goal of our Best Ideas portfolio is to outperform the S&P 500 Index and to generate positive returns each year regardless of the market environment. Firms added to our Best Ideas portfolio are the cream of the crop based on our stock-selection methodology, the Valuentum Buying Index.

THE BEST IDEAS PORTFOLIO -- as of November 15, 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 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Bullish* | | | | | | | | | | | | | | (dividends included) |
| Apple Corp. | AAPL | 10 | 7 | $147.00 | 0.73 | 17-Jun-11 | 51.92 | 107 | 5,569.33 | 107.11 | 11,460.77 | 1,150.82 | 5.5% | 126.4% |
| Altria Group | MO | 8 | 6 | $58.00 | 1.07 | 28-Jun-11 | 28.39 | 157 | 4,471.86 | 61.81 | 9,704.17 | 2,379.79 | 4.6% | 170.2% |
| Berkshire Hathaway | BRK-B | 6 | 5 | $160.00 | 0.98 | 20-Apr-16 | 146.13 | 69 | 10,089.97 | 157.46 | 10,864.74 | | 5.2% | 7.7% |
| Buffalo Wild Wings | BWLD | 6 | 6 | $190.00 | 0.86 | 27-Aug-15 | 179.81 | 16 | 2,876.90 | 164.00 | 2,624.00 | | 1.3% | -8.8% |
| Cisco | CSCO | 9 | 7 | $39.00 | 0.81 | 14-Nov-14 | 26.33 | 221 | 5,831.87 | 31.70 | 7,005.70 | 275.38 | 3.3% | 24.8% |
| Energy Select SPDR | XLE | NR | NR | NA | NMF | 6-Oct-15 | 67.14 | 143 | 9,608.02 | 71.82 | 10,270.26 | 263.26 | 4.9% | 9.6% |
| Facebook | FB | 6 | 6 | $142.00 | 0.83 | 29-Jan-16 | 112.10 | 50 | 5,612.00 | 117.20 | 5,860.00 | | 2.8% | 4.4% |
| Financial Select SPDR | XLF | NA | 6 | NA | NMF | 9-Jan-11 | 13.46 | 178 | 2,405.83 | 22.18 | 3,952.90 | 271.05 | 1.9% | 75.6% |
| General Electric | GE | 7 | 6 | $32.00 | 0.96 | 21-Oct-13 | 25.99 | 375 | 9,761.75 | 30.75 | 11,531.25 | 987.00 | 5.5% | 28.2% |
| General Motors | GM | 6 | 6 | $43.00 | 0.78 | 26-Aug-16 | 31.65 | 132 | 4,184.80 | 33.43 | 4,412.76 | 50.16 | 2.1% | 6.6% |
| Google - Class C | GOOG | 10 | 7 | $855.00 | 0.89 | 23-Oct-12 | 450.92 | 7 | 3,170.42 | 758.49 | 5,309.43 | 10.35 | 2.5% | 67.8% |
| Google - Class A | GOOGL | 10 | 7 | $855.00 | 0.89 | 4-Apr-14 | Split | 7 | Split | 775.16 | 5,426.12 | | 2.6% | +++ |
| Health Care ETF | XLV | 9 | 6 | NA | NMF | 22-May-12 | 36.60 | 125 | 4,582.00 | 70.47 | 8,808.75 | 491.44 | 4.2% | 103.0% |
| Intel | INTC | 6 | 6 | $42.00 | 0.83 | 12-Sep-11 | 20.48 | 150 | 3,086.50 | 34.91 | 5,236.50 | 634.50 | 2.5% | 90.2% |
| Johnson & Johnson | JNJ | 6 | 7 | $121.00 | 0.96 | 29-Jan-16 | 104.18 | 54 | 5,632.72 | 116.32 | 6,281.28 | 126.90 | 3.0% | 13.8% |
| SPDR S&P Bank ETF | KBE | NR | NR | NA | NMF | 9-Jan-12 | 21.07 | 100 | 2,114.00 | 40.20 | 4,020.00 | 247.76 | 1.9% | 101.9% |
| Kinder Morgan | KMI | 5 | 6 | $20.00 | 1.09 | 17-Feb-16 | 17.29 | 157 | 2,721.53 | 21.83 | 3,427.31 | 58.88 | 1.6% | 28.1% |
| Michael Kors | KORS | 8 | 9 | $66.00 | 0.71 | 27-Aug-15 | 43.44 | 68 | 2,953.80 | 46.90 | 3,189.20 | | 1.5% | 8.0% |
| PayPal | PYPL | UR | 4 | UR | UR | 17-Jul-15 | Spin-off | 100 | Split | 38.94 | 3,894.00 | | 1.9% | +++ |
| Priceline | PCLN | 10 | 6 | $1551.00 | 0.97 | 26-Feb-15 | 1239.49 | 6 | 7,450.91 | 1497.45 | 8,984.70 | | 4.3% | 20.6% |
| Republic Services | RSG | 8 | 6 | $44.00 | 1.25 | 19-May-11 | 31.42 | 201 | 6,329.42 | 54.91 | 11,036.91 | 1,223.10 | 5.3% | 93.7% |
| SPDR S&P Dividend ETF | SDY | NR | NR | NA | NMF | 20-Apr-16 | 81.33 | 124 | 10,091.92 | 84.41 | 10,466.84 | 123.77 | 5.0% | 4.9% |
| Teva Pharma | TEVA | 6 | 3 | $58.00 | 0.65 | 24-Jul-13 | 41.22 | 77 | 3,180.94 | 37.60 | 2,895.20 | 337.91 | 1.4% | 1.6% |
| Union Pacific | UNP | 6 | 6 | $87.00 | 1.14 | 24-Jul-13 | 79.67 | 40 | 3,193.80 | 99.11 | 3,964.40 | 240.00 | 1.9% | 31.6% |
| Utilities Select SPDR | XLU | NR | NR | NA | NMF | 18-Mar-14 | 41.12 | 83 | 3,419.96 | 46.74 | 3,879.42 | 328.41 | 1.8% | 23.0% |
| Visa | V | 7 | 6 | $82.00 | 0.96 | 30-Nov-11 | 26.86 | 188 | 5,064.39 | 78.57 | 14,771.16 | 331.67 | 7.0% | 198.2% |
| **Latest changes: XLF stock dividend adjustment (9/19). 132 shares of GM purchased (8/26).** | | | | | | | | | | | | | | |
| Cash -- changes in monthly cash balance reflects dividends received and trading gains/losses, where applicable. | | | | | | | | | | | 30,553.24 | | 14.6% | 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 --> | **209,831.01** | | | **109.8%** |
| S&P 500 Index (SPY) | | | | | | 17-May-11 | 132.69 | 754 | 100,000.00 | 218.28 | 164,503.73 | 14,868.87 | 91.7% | |
| Cash | | | | | | | | | | | 14,868.87 | | 8.3% | |
| **Benchmark Portfolio Value** | | | | | | | | | | | **179,372.61** | | | **79.4%** |
| **Relative Outperformance** | | | | | | | | | | | | | | **30.5 pts** |

Data as of November 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.

*VBI Case Study*...from page 7

**What management said:**

"The Priceline Group brands executed well during our peak summer travel season," said Jeffery H. Boyd, Chairman and Interim Chief Executive Officer of The Priceline Group. "Globally, our accommodation business booked 150 million room nights in the 3rd quarter, up 29% over the same period last year. The acceleration in room night growth demonstrates the favorable market in which we operate as well as the value of our diverse global platform."

*Shares broke out after the report...*


**The scoop:**

Priceline executed fantastically in its peak summer travel season, turning in 25% gross travel bookings growth in the third quarter of 2016 on a year-over-year basis. Gross profit leapt 22% in the quarter, led by its international operations, which reported a 25% increase in gross profit from the year-ago period.

Non-GAAP net income per diluted share came in at an impressive $31.18 in the quarter, a 23% jump from the comparable period in 2015 and a favorable comparison to consensus estimates of $29.92. However, an impairment charge of OpenTable's goodwill of $941 million related to a change in business strategy resulted in GAAP net income per share being more than halved compared to the third quarter of 2015.

Free cash flow generation continues to be a strong point for Priceline; through the first nine months of 2016, the firm advanced free cash flow by nearly 27%, to $2.7 billion (or ~31.6% of revenue). What we find almost hard to believe is how capital-light Priceline's business truly is, even for a dot-com entity. Capital expenditures as a percentage of cash flow from operations were a mere 6% through the first nine months of 2016.

Since 2010, free cash flow has increased at an astounding 30%+ clip!

*VBI Case Study*...continued on next page

*VBI Case Study…*from previous page

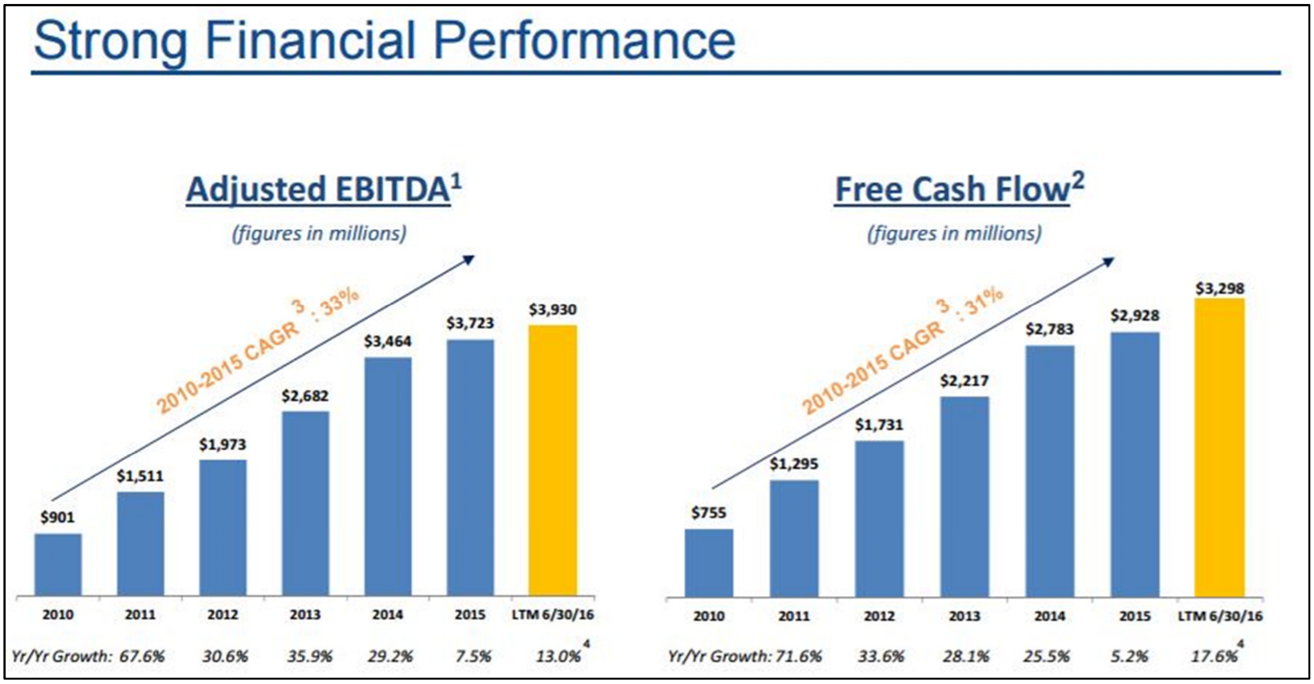



Image Source: Priceline

**Insight from the quarterly conference call:**

*"So yes, room night performance was strong in the quarter. I said it was strong across all of our key geographic regions. I'd say it was broadly strong across all our demand channels too, so there's nothing I could call out in particular for you there and it was broad-based strength, the macro environment feels relatively healthy for us. That same story has continued thus far in Q4." – CFO Daniel Finnegan*

*"Q4 is off to a solid start, with gross bookings continuing to grow nicely across our key geographic regions. Our guidance assumes that our growth rates will decelerate as we progress through the quarter, ... Our guidance also reflect a difficult comp starting in December and running through Q1 2017 ... For Q4 guidance, we are forecasting booked room nights to grow by 20% to 25% and total gross bookings to grow by 16% to 21% in U.S. dollars … We expect gross profit to grow by 13% to 18% in U.S. dollars and by 14% to 19% on a constant currency basis. We forecast GAAP EPS between $11.40 and $12.00 per share for Q4, which at the midpoint is up about 17% versus prior year." – CFO Daniel Finnegan*

**Are we changing our mind with our position?:**

| PCLN Rating History | Price | Fair Value | VBI |
|---|---|---|---|
| 5-Sep-16 | $1,413.90 | $1,499.00 | 6 |
| 29-Apr-16 | $1,343.66 | $1,467.00 | 7 |
| 8-Jan-16 | $1,136.96 | $1,459.00 | 3 |
| 17-Jul-15 | $1,216.00 | $1,681.00 | 7 |
| 20-Feb-15 | $1,216.23 | $1,612.00 | 10 |

No, Priceline will remain a holding in the Best Ideas Newsletter portfolio. The company is probably one of the best more recent examples of the Valuentum Buying Index in practice. Registering a pristine 10 in February 2015, the equity now has been a strong winner in the portfolio of the Best

*VBI Case Study…*continued on next page

*VBI Case Study…*from previous page

Ideas Newsletter in a relatively flat market. Our fair value estimate had resided significantly above the stock price until its more recent break-out yesterday. We expect a bump in our fair value estimate of Priceline upon our next update as a result of the better than expected bookings performance.

Priceline benefited from a favorable operating environment in the third quarter of 2016, and concerns over global terrorism seemed to be generally non-existent when it came to robust travel demand. What is really pushing shares higher following the report is management's optimistic guidance for the fourth quarter compared to its guidance in the same period in 2015, "Investors Punish Priceline for Conservative Guidance (November 2015)." The firm seemed to have made a habit of under-promising and over-delivering, "Priceline Sets Up for Second-Quarter Beat (May 2015)," "The Priceline Group Soars!!! (August 2015)," "Priceline Shares Under Pressure… Again (May 2016)," "Priceline Higher After Outperforming Conservative Guidance (August 2016)," giving us confidence in management's comparatively stronger targets for the fourth quarter of 2016.

Further, the online travel giant continues to generate substantial free cash flow as it grows at an impressive rate, and we love its net cash position, inclusive of long-term investments, of nearly $6.4 billion as of the end of the third quarter of 2016. Management's comments regarding fourth-quarter momentum were also quite reassuring to the pace of global economic resilience in the wake of uncertainly caused by Brexit. International business accounts for ~90% of gross bookings, with the US making up the balance. Such a cash-rich business eases our concerns with the risk involved in holding an entity so sensitive to the economic cycle at this mature point in the global economy's recovery.

Shares will continue to have some room to run based on the upper bound of our fair value range, and we see little to no reason to change our opinion of the firm's strong fundamentals. For one, its virtuous cycle, image shown below, is still firmly intact and represents one of the strongest competitive advantages a company could ever have. Facebook (FB) and Visa (V), two other Best Ideas Newsletter holdings, benefit from a similar dynamic. We expect Priceline to continue to be a strong performer, though we are aware of the heightened risk of its cyclical tendencies.

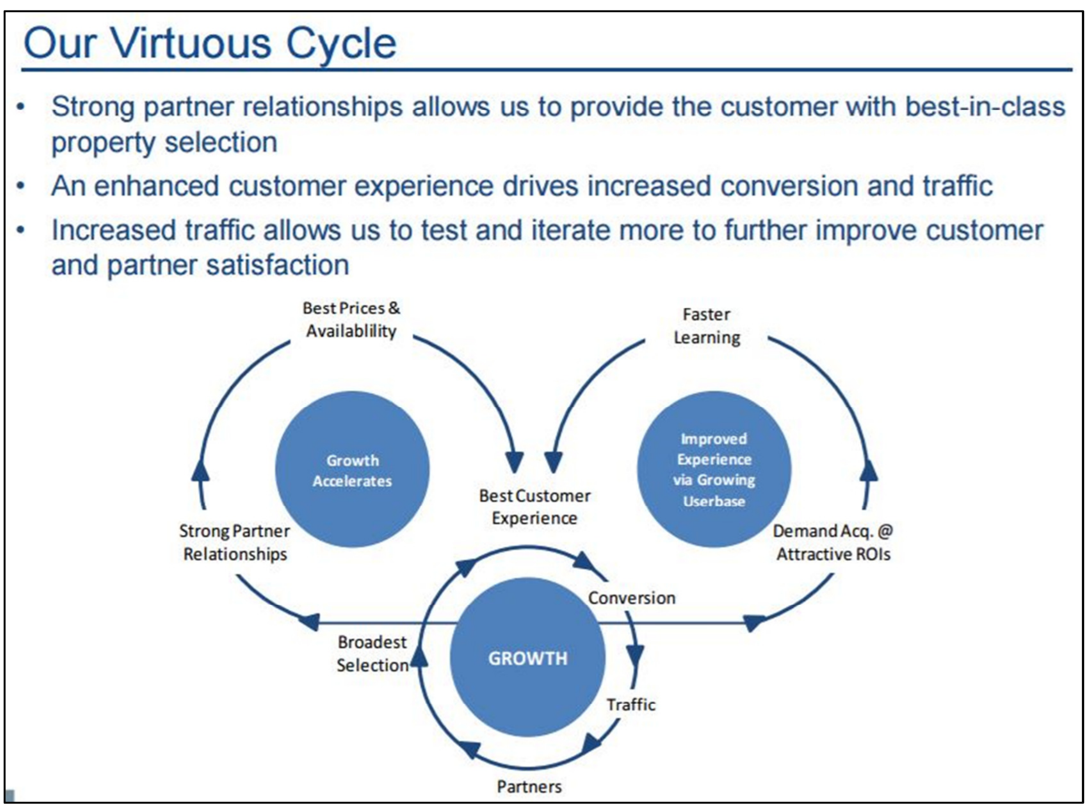



Image Source: Priceline

# Earnings Insight – Facebook

*By Kris Rosemann*

*Let's dig into Best Ideas Newsletter holding Facebook's third-quarter results, released November 2.*

**What management said:**

"We had another good quarter," said Mark Zuckerberg, Facebook (FB) founder and CEO. "We're making progress putting video first across our apps and executing our 10 year technology roadmap."

**The scoop:**

Though shares of Facebook sold off on worries about slowing revenue growth after its third-quarter report, released November 2, the social media giant continues to grow at a tremendous rate. On a year-over-year basis, advertising revenue jumped 59% in its third quarter thanks to mobile advertising revenue growth of 78%. Mobile advertising revenue now accounts for roughly 84% of total advertising revenue. Declining total payments and fees revenue is a non-issue, in our view, as it made up less than 3% of total revenue in the quarter. Revenue in this area is largely generated via games played on personal computers, which has been on the decline and is expected to continue to do so.

The growing share of mobile advertising as a portion of total revenue helped boost profitability in the period, as higher mobile ad demand allows Facebook to charge more for mobile ads than traditional ones. The firm's operating margin exploded to 45% in the third quarter of 2016 from 32% in the comparable period of 2015. Diluted earnings per share leapt to $0.82 from $0.31, while free cash flow generation, as measured by cash flow from operations less all capital expenditures, came in at ~$2.5 billion, up from $1.41 billion in the year-ago period. Through the first nine months of 2016, Facebook has hauled in ~$6.5+ billion in free cash flow, or nearly 35% of total revenue.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Net cash provided by operating activities | $ 3,577 | $ 2,192 | $ 9,758 | $ 5,772 |
| Purchases of property and equipment | (1,095) | (780) | (3,222) | (1,831) |
| Free cash flow | $ 2,482 | $ 1,412 | $ 6,536 | $ 3,941 |

Image Source: Facebook

**Insight from the quarterly conference call:**

*"We had another good quarter. Our community continues to grow around the world. We're pleased to see nearly 1.8 billion people now use Facebook every month and nearly 1.2 billion people use it every day. It's also great to see the continued growth and strength of engagement on our platform, and our ads growth is growing at a healthy rate as well." – CEO Mark Zuckerburg*

*"We also took some important steps forward on virtual reality to help people experience the world in richer and more immersive ways. At Oculus Connect, we announced that touch controllers for Rift will ship in early December with 35 games and experiences exclusively built for touch. And since we believe the next phase of VR is great software experiences, we're investing another $250 million in virtual reality content on top of the money that we've already invested." – CEO Mark Zuckerburg*

*"I…want...to provide some brief comments on 2017. First on revenue, as I mentioned last quarter, we continue to expect that ad load will play a less significant factor driving revenue growth after mid-2017. Over the past few years, we have averaged about 50% revenue growth in advertising. Ad load has been one of the three primary factors fueling that growth. With a much smaller contribution from this important factor going forward, we expect to see ad revenue growth rates come down meaningfully." - CFO David Wehner*

*"Secondly on expenses, though it is premature to provide specific expense guidance, as Mark mentioned, we anticipate 2017 will be an aggressive investment year. Adding top engineering talent remains one of our key investment priorities as we continue to execute on our 3, 5, and 10-year roadmap. ... In addition, we expect to grow capital expenditures substantially, as we continue to fund*

*Facebook*…continued on next page

***Facebook…*from previous page**

*the ongoing data center expansion effort that we have underway." – CFO David Wehner*

**Are we changing our mind with our position?:**

In short, no; Facebook remains a core holding in the Best Ideas Newsletter portfolio. This isn't the first we've heard of slowing growth for the company--as CFO David Wehner alluded to a similar dynamic playing out in the firm's conference call following the second quarter of 2016--but we're not worried. The law of large numbers, as in the primary driver behind Facebook's potentially slowing growth rate, has little bearing on the magnitude of free cash flow generation that forms the basis of our valuation processes.

That said, our current fair value estimate of $142 assumes a slowdown in top-line growth in 2017 that is slightly below consensus estimates—a relatively conservative assumption. Facebook's strong free cash flow generation and fortress-like balance sheet—it has a cash position of over $26 billion compared to no long-term debt on the books—helps put our mind at ease with respect to its financial health. Though we expect volatility in Facebook's margins as it continues to invest in the business, both its operating and free cash flow margin will remain impressive for the foreseeable future. We believe Facebook stands alone among social media behemoths.

# Earnings Insight -- Amazon

*By Brian Nelson, CFA*

Let's cover some ground on Amazon's (AMZN) third-quarter report, released October 27.

**What management said:**

"Alexa may be Amazon's most loved invention yet — literally — with over 250,000 marriage proposals from customers and counting," said Jeff Bezos, founder and CEO of Amazon. "And she's just getting better. Because Alexa's brain is in the cloud, we can easily and continuously add to her capabilities and make her more useful — wait until you see some of the surprises the team is working on now." -- CEO Jeff Bezos

**The scoop:**

The game has changed at Amazon. No longer is the company struggling to generate meaningful free cash flow; in fact, it is now throwing off copious amounts. During the trailing twelve months ended September 30, 2015, operating cash flow jumped nearly 50%, to $14.6 billion, while free cash flow jumped to $8.6 billion from $5.4 billion during the same time period a year ago. Operating income and net income continue to be marginal (in relative terms), however, even as Amazon's top line continues to grow like a weed. Net sales of $32.7 billion advanced nearly 30% in the third quarter on a year-over-year basis, a very impressive showing.

Amazon Web Services (AWS) continues to announce increased availability (now operating in 38 'availability zones' across 14 technology infrastructure 'regions' globally), and AWS' partnership with VMware (VMW) looks promising. Amazon Studios is expecting big things from the second season of The Man in the High Castle, the first season of which was the most watched original series on Prime Video. The company continues to dedicate developer resources to build new skills for Alexa, and management had positive comments about its tablet Fire HD 8 and its Fire TV Stick. The expansion of AmazonFresh continues unabated, with the grocery delivery service now serving northern Virginia, Dallas, Maryland and Chicago. This is Amazon's busiest time of year, with 120,000 seasonal jobs to be added in customer-related functions this holiday season.

**Insight from the quarterly conference call:**

*"...specifically to International, we are seeing expansion to support selection, expansion at fulfillment network increases. We're also investing in digital content and additional Prime benefits, fresh location*

***Amazon…*continued on next page**

***Amazon***…**from previous page**

*Prime Now. But by far the biggest individual thing is the investment in India (INDA, EPI, INDY, PIN) that we continue to make and very excited about it, the initial reaction in India from both the customers and also sellers." – CFO Brian Olsavsky*

*"...we continue to believe consumables, groceries are a key part of the offer to customers and we are playing with very different models to see which works and for what needs. So we're very happy with the AmazonFresh and we've now expanded quite a bit as you see in this year." – CFO Brian Olsavsky*

*"...The thing I can tell you about (AWS) pricing is that…price reductions are a core part of our philosophy, of course. We had a price decrease in Q3, and that was our 52nd since we started this business. So we are comfortable with price decreases. Not only did we lower the prices of our products but we also create new services that are cheaper that customers can switch to…why do people choose AWS…basically what we hear are the functionality and pace of innovation is greater than our competition. We have added more new significant features and services this year already than we had all of last year…We have a partner and customer ecosystem. You've read about the VMware deal that we signed this quarter. So we continue to extend with partners and build ecosystems that better can support customers. And finally experience. We've been in this business a long time, longer than anyone else, and we've used that time to make our products and services better. So there are going to be a lot of winners in this space as we said, but we are very happy with our position and the customer reception to our products." – CFO Brian Olsavsky*

*"As far as long-term operating margins, I can't forecast that right now. I can't forecast that for our AWS business either." – CFO Brian Olsavsky*

**Are we changing our minds with our position?:**

We don't include Amazon in either newsletter portfolio, and we're fine with that. The company's ~$375 billion market capitalization implies that it is trading at more than 40 times trailing twelve month free cash flow, too steep of a price for us to consider, even for a fast-growing entity like that of Amazon. It's also difficult for us to get comfortable with a company that offers such wide forecasting ranges in its guidance. The future may be great for Amazon, but is this already embedded in its price? -- and how might Google (GOOG, GOOGL), Facebook (FB), and Microsoft (MSFT) fit in to the long-term competitive landscape, and how might initiatives they haven't even dreamed of yet hurt Amazon? Nobody truly knows -- uncertainty reigns supreme.

For example, looking at Amazon's expected fourth-quarter net sales performance alone, the top line is expected to come in between $42-$45.5 billion, a large range implying between 17% and 27% growth. This quarter's guidance range for operating income may be even more telling of the unpredictable nature of Amazon's business--operating profits are expected to come in at break-even ($0) or as much as $1.25 billion. It seems that Amazon believes only that it will be profitable this quarter, but we know that even that can't be guaranteed. Pegging a meaningful point fair value estimate on Amazon's shares, in light of the variability of next quarter's results, *let alone without knowing what long-term operating margins look like*, is practically a near-impossible task.

That said, we're huge fans of AWS, its balance sheet, free cash flow generation, and we're expecting some big things from Prime Video, but the company is a "trading" stock in light of the financials, a stock for speculators that put their faith in the view that the long-term will be bright, despite cash-rich rivals, fast-paced changes in technology, and the fickleness of the consumer. Of course our view doesn't mean shares won't continue to "run," however. After all, if the market accepts a trading price of 40+ times trailing free cash flow for Amazon's shares, why not 60 or 80 times? You know where we stand though: We won't be chasing shares of Amazon anytime soon.

# Trouble Developing for Generic Pharma Stocks?

*By Kris Rosemann*

Though difficult to say in light of the poor stock performance of generic pharmaceutical makers of late, we continue to be positive on the long-term secular theme of ongoing growth in the availability of low-priced drugs around the globe, a trend that plays favorably into their hands. Yet another regulatory-related blow, however, was dealt to the pharma space November 3, and surprisingly to those exact firms that work tirelessly to reduce the price of more expensive branded drugs, generic pharma.

Reports surfaced that the US Justice Department could file charges before 2016 is over stemming from a two-year antitrust investigation. The probe is seeking to identify whether executives from more than a dozen companies committed price collusion on roughly two dozen drugs. Companies involved in the investigation include Teva (TEVA), Mylan (MYL), Lannett (LCI), Impax Laboratories (IPXL), Sun Pharmaceutical Industries (SMPQY), and a subsidiary of Endo International (ENDP), among others.

Though the first cases against some of the above listed firms could potentially be brought to court before the end of the year, the exact timing of the situation remains up in the air. People familiar with the situation have likened it to the Justice Department's probe into potential auto parts cartels, which resulted in $2.8 billion in penalties and brought charges against 46 companies and 65 individuals. 31 of those individuals received prison sentences. Prosecutors have typically had a low rate of success in price collusion cases, however, as the courts have established rather high barriers required to prove that companies have conspired in pricing strategies.

Two of the drugs involved in the pricing investigation are digoxin, a heart failure drug, and doxycycline, a popular antibiotic, both of which are made by multiple companies. Medicaid spent well over twice as much as on doxycycline in the twelve month period ending with June 2014 than it did in the prior twelve months despite a 38% drop in prescriptions; the agency also spent nearly double on digoxin in 2014 compared to 2013 despite a 16% decline in prescriptions. Additionally, a report from the Government Accountability Office in August 2016 revealed that more than 300 of 1,441 established generic drugs had seen their prices at least doubled between 2010 and 2015.

Part of the allure of generic medicines is the idea that they are supposed to be competitive alternatives to more pricey branded drugs and are meant to be a part of the fight in helping patients and insurers lower healthcare costs. However, if the suggested price collusion did take place, the firms involved would be effectively undercutting a driver of the appeal of their products. It's also worth noting that many like Teva also have branded drugs such as multiple sclerosis drug Capaxone, so the outcome of the probe won't have pricing implications across their entire drug portfolios, though we note in Teva's case, Capaxone is fighting off generic rivals itself. In any case, share prices of companies involved have fallen on the news of the potential for charges being filed in 2016.

Frankly, we had been downright puzzled by Teva's share price performance this year, in particular. But after the news today, we now can posit why shares had been under pressure: someone must have known something about the outcome of this pending investigation (the investigation itself wasn't news as most had received subpoenas), and they had been selling big before the announcement. We don't think the prior sell-off was merely de-risking activity. That the market price (and share-price action) can hold important information about the fundamentals of a company is why we pay very close attention to technicals in our work. We didn't act when we probably should have, and we were blinded by the positive long-term view on generics proliferation coupled with the comfort of holding a rather small weighting in Teva in the Best Ideas Newsletter portfolio.

That said, we're not going to overreact now, and we plan to continue to ride things out as Teva continues to make up less than 2% of the Best Ideas Newsletter portfolio's total value. The amount of uncertainty

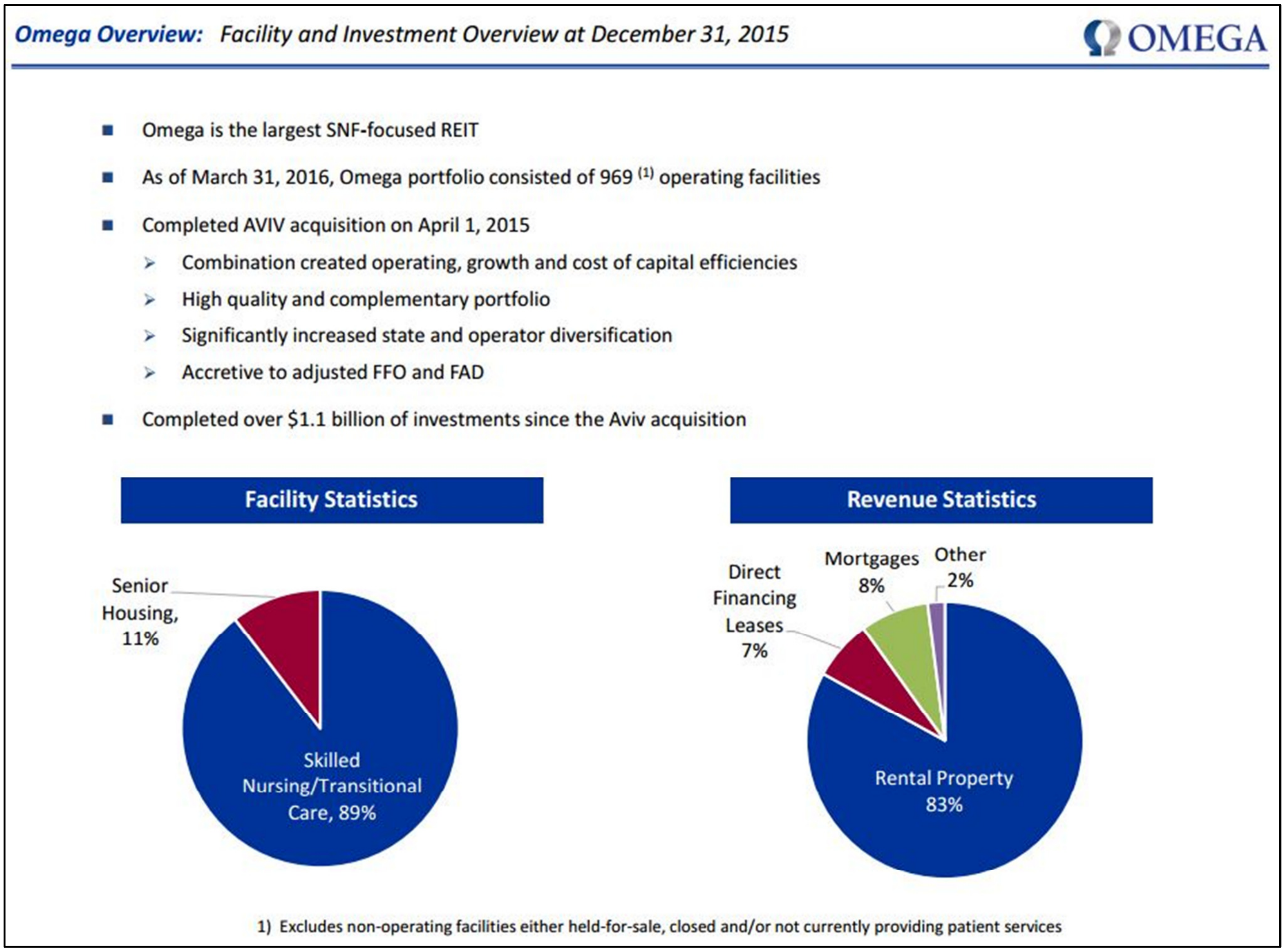
*Trouble Developing…*continued on next page

*Trouble Developing…*from previous page

surrounding the investigation is unsettling to a degree, but we're not ready to make a call on whether the outcome of the charges will materially alter the favorable long-term landscape of generics, particularly with respect to volume growth dynamics and their competitive advantages in low-cost manufacturing. Teva's shares make up such a minor portion of the market-beating Best Ideas Newsletter portfolio's value that we're willing to take on the added risk, even as we keep a keen eye out for any developments that may hit the wires. We're still not happy with the developments November 3, of course.

# Top-Rated OHI: Not Adding It But Why?

*By Brian Nelson, CFA*




"In my opinion, a golf club is only as good as the player that uses it, and in a similar light, a financial model or a rating system is only as good as the user that applies it." -- Brian Nelson, CFA

**Summary**

**We stake so much on the performance of the portfolios in the Best Ideas Newsletter and Dividend Growth Newsletter. They represent the outcome of all of the work we do on the website, rolled into one final assessment: our best ideas for each respective strategy.**

**We value the human, qualitative overlay, which captures a wealth of experience and common sense. The thoughts behind the weighting of each idea and the portfolio management process revealed in full transparency on a month to month basis may be worth the cost of a membership alone, even if you're not using the portfolios!**

*Top-Rated OHI…*continued on next page

*Top-Rated OHI…*from previous page

**The ideas in the portfolios in the Best Ideas Newsletter and Dividend Growth Newsletter have undergone a painstaking process with our analyst team to ensure that we're delivering the very best to members within a portfolio setting.**

**Regarding the Valuentum process, as it is executed in the Best Ideas Newsletter portfolio, we do not add all firms that register a 9 or 10, nor do we add the ones we do immediately thereafter. There are always tactical and sector weighting considerations in any portfolio construction, yet another reason why the human touch remains a vital aspect of the Valuentum process.**

**The VBI rating helps to inform the process, but the Valuentum team makes the allocation decisions of the newsletter portfolio on the basis of a number of other firm-specific and portfolio criteria.**

**When it comes to Omega Healthcare, a lot is going right at the REIT, but we currently have exposure to the Vanguard REIT ETF and Realty Income in the Dividend Growth Newsletter portfolio, and we're not reaching for REIT exposure in the Best Ideas Newsletter portfolio at this time.**

**Sometimes, under certain market conditions, we may have to relax the VBI criteria entirely in order to achieve newsletter portfolio goals.**

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Omega Healthcare (OHI) is a healthcare REIT that recently registered a high rating of a 9 on the Valuentum Buying Index (VBI), but we didn't add it to the newsletter portfolios. We often receive questions about how we use the VBI rating system, but I think it is equally important to mention that it is only one of the many facets of our website and services. For example, if you haven't checked out the Dividend Cushion ratios on the stocks in your portfolio or the dividend growth product (from individual reports to the newsletter and beyond), surely you are not maximizing your membership! We love dividends, but you can also trust us to make sure you're aware of the real risks of any dividend strategy in today's market.

No matter your strategy or process though, the Valuentum Buying Index rating system is still a helpful tool to have at your disposal, even if you are not using it. Admittedly, the VBI, as we call it, is not as easy to use as 1, 2, 3, or even buying 9s and 10s and selling 1s and 2s until their VBI changes upon the next update. Within any quantitative process, we value the human, qualitative overlay, which captures a wealth of experience and common sense. We want to make sure that we're surfacing the best ideas for members, and flying blind is never a good strategy, in my opinion. With prudence and care, the VBI process is carried out.

In probably one of the most obvious cases, for example, an experienced investor knows when a price-to-earnings (P/E) ratio isn't informative (as in the case of negative or negligible earnings), but a quantitative rating system that uses a P/E ratio, which the VBI does, may not know any better. Of course the VBI has checks and balances to adjust for such instances, but I believe the human, qualitative overlay is still extremely important, especially when considering various business models and unique "un-modelable" risks (particularly with respect to the banks). In my opinion, a golf club is only as good as the player that uses it, and in a similar light, a financial model or a rating system is only as good as the user that applies it.

That said, we stake so much on the performance of the portfolios in the Best Ideas Newsletter and Dividend Growth Newsletter. They represent the outcome of all of the work we do on the website, rolled into one final assessment: our best ideas for each respective strategy. Sure we have other screens on the website, but those are just screens -- listings of companies with similar data and information. The ideas

*Top-Rated OHI…*continued on next page

*Top-Rated OHI...*from previous page

in the portfolios in the Best Ideas Newsletter and Dividend Growth Newsletter have undergone a painstaking process with our analyst team to ensure that we're delivering the very best to members within a portfolio setting. The thoughts behind the weighting of each idea and the portfolio management process revealed in full transparency on a month to month basis may be worth the cost of a membership alone, even if you're not using the portfolios!

Here's why. In a market environment where more than 90% of large-cap funds have trailed the S&P 500 since 2011 through August of this year, the Best Ideas Newsletter portfolio has exceeded the market return by 33 percentage points over a similar time period. Absolutely phenomenal. What's more, we didn't hide behind standard quarterly reviews and updates either, sending out pre-packaged information to members. We showcased this performance in full transparency, and we had to write every single day to capture interest! When patience is the secret to success in investing, do you know how much could have gone wrong when having to produce daily? Obviously, we're very disciplined, but we also credit the portfolio outperformance to the VBI methodology itself.

Let's talk about how the VBI helps to inform which ideas we include in the Best Ideas Newsletter portfolio (not the Dividend Growth Newsletter portfolio as additional criteria must be met, namely as it relates to yield and Dividend Cushion ratio). That's such an important word, "informs." Notice how we didn't say "dictate" in this reference. For starters, 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 (generally on a quarterly basis) or after material events and not daily or weekly. Perhaps most practically though, we don't want to whipsaw our membership, nor do we think churn is the way to generate outperformance.

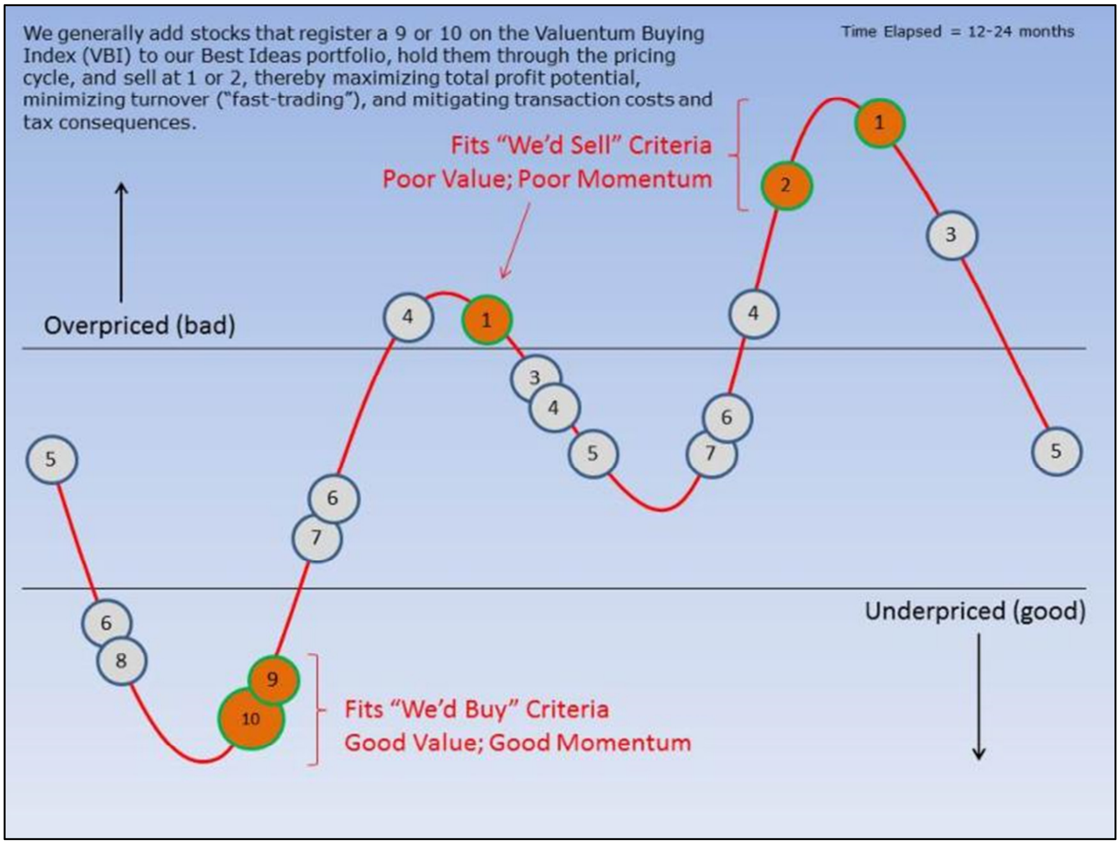
Though the time frame varies depending on each idea that we consider for the Best Ideas Newsletter portfolio, we expect our best ideas to generally work out over a 12-24 month time horizon (on average). Our holding period is targeted to be much, much longer for some ideas in the Dividend Growth Newsletter portfolio, however. Here is where the VBI rating system becomes somewhat more advanced than a simple 1, 2, 3. We tend to add stocks to the Best Ideas Newsletter portfolio when they register a 9 or 10 on the Valuentum Buying Index (VBI), hold them for some time depending on a number of variables (the VBI, market conditions, sector weightings within the portfolio itself), and then we tend to remove stocks from our Best Ideas Newsletter portfolio when they register a 1 or 2 on the VBI.You'll notice that we have a qualitative overlay for the Best Ideas Newsletter portfolio (and one for the Dividend Growth Newsletter portfolio, too, though it is based on dividend-related considerations).

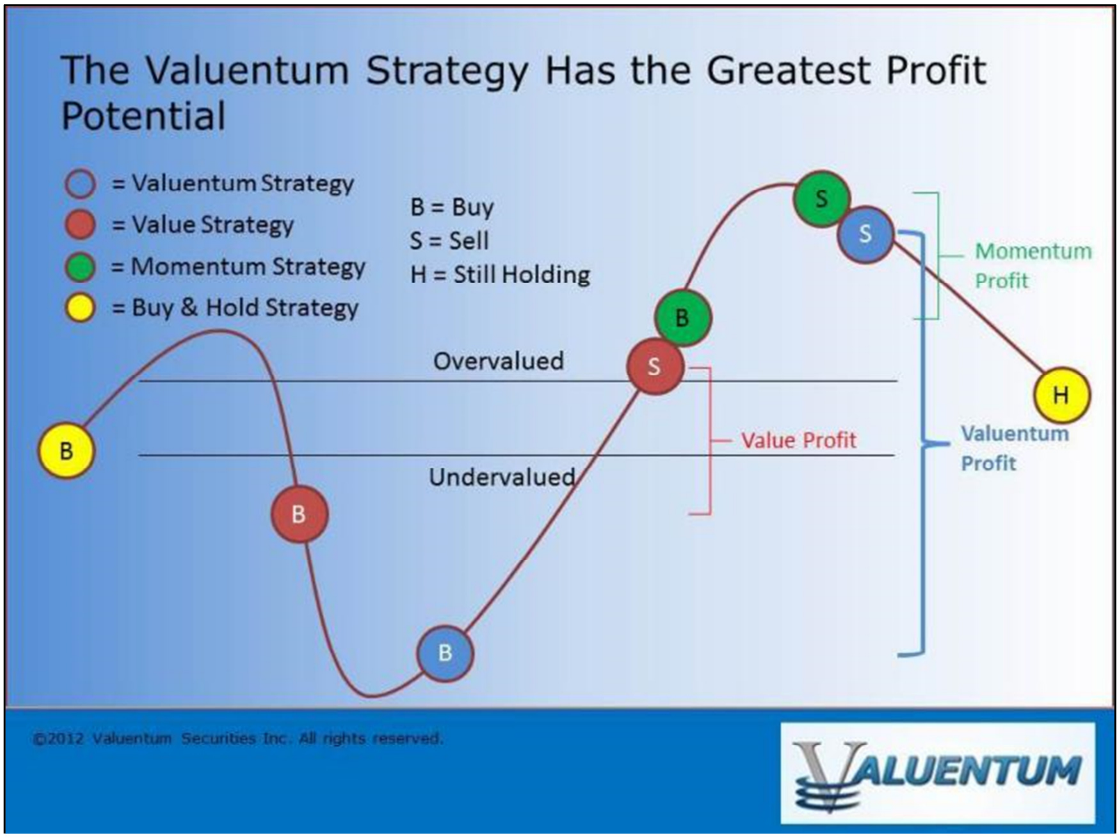
But why don't we churn and burn by updating daily and trading a lot? Obviously, we don't think that's the secret to success. In quite the opposite approach, we like to maximize profits on every idea that we pursue, with the understanding that momentum does exist and that prices over and under shoot intrinsic value all of the time. For example, as shown in the image above, a value strategy (10 --> 5) truncates potential profits, while a momentum strategy (4 --> 1) ignores profits generated via value assessments. At Valuentum, we're after the entire profit potential of each idea. So, for example, if a firm is added to the Best Ideas Newsletter portfolio as a 10 and is removed as a 5, we would have truncated profit potential by not letting it run to lower ratings. Most of our highly-rated Valuentum Buying Index rated stocks have generated the vast outperformance of the Best Ideas portfolio, but these stocks' ratings declined over time as they were held (a good thing -- a declining VBI rating generally means the share price has advanced, assuming all else is well).

*Images on following page shown for educational purposes only.*

*Top-Rated OHI...*continued on next page

*Top-Rated OHI*...from previous page




*Top-Rated OHI*...continued on next page

***Top-Rated OHI…*from previous page**

Critically, regarding the Valuentum process, as it is executed in the Best Ideas Newsletter portfolio, we do not add all firms that register a 9 or 10, nor do we add the ones we do immediately thereafter. For example, Google (GOOG, GOOGL), now Alphabet, a current Best Ideas Newsletter portfolio holding, registered a 10 on the Valuentum Buying Index, but we remained patient and didn't add the company to our portfolio until after it reported earnings at the time, providing us with an even better entry point (as new information came to light). There are more "structural/timing" instances like the one with Alphabet, for example, that are extremely difficult to capture in any model, and understandably aren't as obvious to those outside looking in.

But why not add every highly-rated stock to the Best Ideas Newsletter portfolio? Think of it as if you were to imagine a value investor not adding and holding every undervalued stock to his/her portfolio. He or she wants the very best ones -- obviously, that means having to leave some good ideas behind. And then, of course, there are always tactical and sector weighting considerations in any portfolio construction, yet another reason why the human touch remains a vital aspect of the Valuentum process.

At the core of how we use the VBI in the Best Ideas Newsletter portfolio, however, is a qualitative portfolio management overlay. The VBI rating helps to inform the process, but the Valuentum team makes the allocation decisions of the newsletter portfolio on the basis of a number of other firm-specific and portfolio criteria. When it comes to Omega Healthcare, a lot is going right at the REIT, but we currently have exposure to the Vanguard REIT ETF (VNQ) and Realty Income (O) in the Dividend Growth Newsletter portfolio, and we're not reaching for REIT exposure in the Best Ideas Newsletter portfolio at this time. Under certain market conditions, we may even have to relax the VBI criteria entirely in order to achieve newsletter portfolio goals.

Okay, a couple more examples. Take pre-split eBay (EBAY), which many years ago included PayPal (PYPL), as an example of our process in action. The stock initially flashed a rating of 10 in late September 2011, and we added it to the Best Ideas Newsletter 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 the Best Ideas Newsletter portfolio. In the case of pre-split eBay, we sought to capture the entire pricing cycle and avoided truncating it as most pure value investors often do (and what we would had done, if we had removed the stock at that time). In many ways, pre-split eBay/PayPal has become one of the better examples to use for illustrating the prolonged outperformance driven by undervalued stocks that are beginning to generate good momentum. [We no longer include eBay in the newsletter portfolio, but its split-off PayPal is retained.]

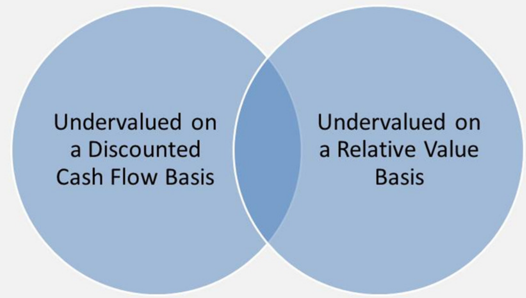
There have been more straightforward opportunities in the Best Ideas Newsletter portfolio, too, especially in the case of EDAC Tech, which had tripled since it was added to the newsletter portfolio (never registering below a 9 along the way), and then of course, Apple (APPL), Visa (V) and Altria (MO), but it is usually through the nuances of the process that one truly comes to understand it. The VBI ratings on each stock's most recent 16-page report, downloadable directly from the website at www.valuentum.com, reflect our current opinion on the company. The VBI rating system, as with all methodologies, helps to inform the investment decision process, but in constructing the newsletter portfolio, a qualitative overlay is not only necessary, in my view, but helps to optimize performance. If the returns of the Best Ideas Newsletter portfolio during the past 5+ years are any measure of the VBI rating system, it is performing fantastically well.

Thank you so much for reading!

# The Watch List

*By Valuentum Analysts*

The Valuentum Buying Index (VBI), which places a considerable emphasis on a firm's valuation, is the primary driver behind companies included in our Best Ideas portfolio (see page 8). However, the size of our coverage universe lends itself to a plethora of new ideas beyond the ones we seek to capitalize on. Below, we provide a unique screen that sorts companies we feel are undervalued on both a DCF and relative value basis (the first two pillars of our VBI; the third is a technical assessment).




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

We update this screen monthly and deliver it to you in our newsletter (for your added convenience, we also post it on our site). You'll see we often hold a number of these firms in our portfolio, and we continue to monitor the remainder for the most opportune time to add them. The names on this list are the cream of the crop for the value investor and can supplement your "shopping list" of new ideas.

| Company Name | Symbol | DCF Valuation | Relative Valuation | P/FV | Fair Value Estimate |
|---|---|---|---|---|---|
| Supervalu | SVU | UNDERVALUED | ATTRACTIVE | 0.46 | $10.00 |
| Virtu Financial | VIRT | UNDERVALUED | ATTRACTIVE | 0.56 | $29.00 |
| Omega Healthcare | OHI | UNDERVALUED | ATTRACTIVE | 0.61 | $48.00 |
| Corrections Corp | CXW | UNDERVALUED | ATTRACTIVE | 0.64 | $21.00 |
| Xerox | XRX | UNDERVALUED | ATTRACTIVE | 0.64 | $16.00 |
| Prudential Financial | PRU | UNDERVALUED | ATTRACTIVE | 0.67 | $116.00 |
| Viacom | VIA | UNDERVALUED | ATTRACTIVE | 0.67 | $66.00 |
| Bed Bath & Beyond | BBBY | UNDERVALUED | ATTRACTIVE | 0.69 | $63.00 |
| CNO Financial | CNO | UNDERVALUED | ATTRACTIVE | 0.69 | $23.00 |
| Synaptics | SYNA | UNDERVALUED | ATTRACTIVE | 0.69 | $76.00 |
| Celgene | CELG | UNDERVALUED | ATTRACTIVE | 0.70 | $141.00 |
| Korn/Ferry | KFY | UNDERVALUED | ATTRACTIVE | 0.71 | $33.00 |
| Mylan | MYL | UNDERVALUED | ATTRACTIVE | 0.72 | $53.00 |
| Corporate Executive Board | CEB | UNDERVALUED | ATTRACTIVE | 0.72 | $72.00 |
| Jabil Circuit | JBL | UNDERVALUED | ATTRACTIVE | 0.73 | $30.00 |
| Juniper Networks | JNPR | UNDERVALUED | ATTRACTIVE | 0.73 | $31.00 |
| Buffalo Wild Wings | BWLD | UNDERVALUED | ATTRACTIVE | 0.74 | $190.00 |
| Super Micro | SMCI | UNDERVALUED | ATTRACTIVE | 0.74 | $29.00 |
| Express Scripts | ESRX | UNDERVALUED | ATTRACTIVE | 0.75 | $91.00 |
| MetLife | MET | UNDERVALUED | ATTRACTIVE | 0.75 | $56.00 |
| Regal Beloit | RBC | UNDERVALUED | ATTRACTIVE | 0.75 | $76.00 |
| AIG | AIG | UNDERVALUED | ATTRACTIVE | 0.76 | $78.00 |
| Michael Kors Hldg | KORS | UNDERVALUED | ATTRACTIVE | 0.76 | $66.00 |
| Red Robin | RRGB | UNDERVALUED | ATTRACTIVE | 0.76 | $60.00 |
| VMware | VMW | UNDERVALUED | ATTRACTIVE | 0.77 | $81.00 |
| Interface | TILE | UNDERVALUED | ATTRACTIVE | 0.79 | $21.00 |
| Cracker Barrel | CBRL | UNDERVALUED | ATTRACTIVE | 0.79 | $171.00 |

*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 | Industry | VBI |
|---|---|---|---|---|
| Jabil Circuit | JBL | Information Technology | Electronic Suppliers | 9 |
| Michael Kors Hldg | KORS | Consumer Discretionary | Luxury - Ultra & Aspirational | 9 |
| VMware | VMW | Information Technology | Business Services | 9 |
| Xerox | XRX | Industrials | Commercial Services | 9 |
| AIG | AIG | Financials | Insurance - Property & Casualty | 8 |
| Bed Bath & Beyond | BBBY | Consumer Discretionary | Specialty Retailers | 8 |
| Corrections Corp | CXW | Information Technology | Management Services | 8 |
| Prudential Financial | PRU | Financials | Insurance - Life | 8 |

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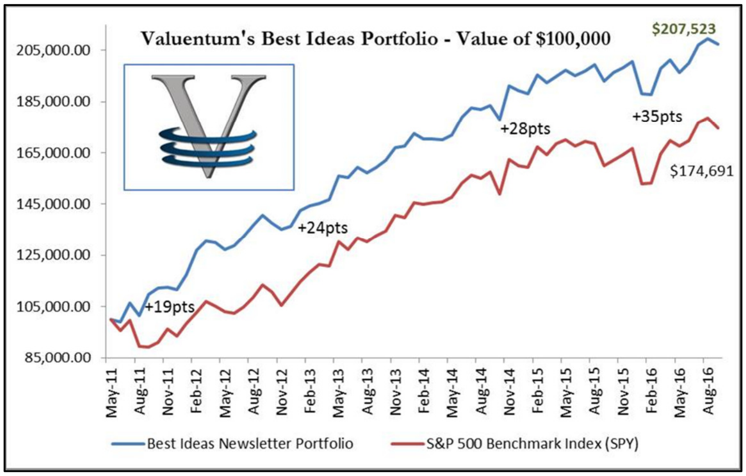
| | | | | |
|---|---|---|---|---|
| Amphenol Corp | APH | Information Technology | Electronic Suppliers | 2 |
| AO Smith Corp | AOS | Industrials | Electrical Equipment - industrial | 2 |
| Arch Capital | ACGL | Financials | Insurance - Property & Casualty | 2 |
| Church & Dwight | CHD | Consumer Staples | Household Products | 2 |
| Drew Indust | DW | Industrials | Recreational Vehicles | 2 |
| Infinity | IPCC | Financials | Insurance - Property & Casualty | 2 |
| Lancaster Colony | LANC | Consumer Staples | Food Products | 2 |
| New Oriental Education | EDU | Consumer Discretionary | Education Services | 2 |
| Nordson | NDSN | Industrials | Machinery & Tools | 2 |
| Northern Trust | NTRS | Financials | Banks & Money Centers | 2 |
| Nu Skin | NUS | Consumer Discretionary | Luxury - Established Brands | 2 |
| NuVasive | NUVA | Health Care | Medical Instruments | 2 |
| Quad/Graphics Inc | QUAD | Consumer Discretionary | Book Publishing | 2 |
| South Jersey | SJI | Energy | Utilities | 2 |
| State Auto | STFC | Financials | Insurance - Property & Casualty | 2 |
| Amazon.com | AMZN | Consumer Discretionary | Internet & Catalog Retail | 1 |
| American Electric | AEP | Energy | Utilities - Large | 1 |
| Badger Meter | BMI | Industrials | Electrical Equipment | 1 |
| Cogent Comm | CCOI | Telecom Services | Wireless Telecom Services | 1 |
| Federal Realty | FRT | Financials | REIT - Retail | 1 |
| General Mills | GIS | Consumer Staples | Food Products - Large | 1 |
| Hyatt | H | Consumer Discretionary | Hotels | 1 |
| IDEX | IEX | Industrials | Machinery & Tools | 1 |
| IDEXX | IDXX | Health Care | Diagnostic Substances | 1 |
| Illinois Tool Works | ITW | Industrials | Machinery & Tools | 1 |
| Jack in the Box | JACK | Consumer Discretionary | Restaurants - Fast Food & Coffee | 1 |
| Kraft Heinz | KHC | Consumer Staples | Food Products - Large | 1 |
| Lockheed Martin | LMT | Industrials | A&D Prime | 1 |
| McDonald's | MCD | Consumer Discretionary | Restaurants - Fast Food & Coffee | 1 |
| Neogen | NEOG | Health Care | Diagnostic Substances | 1 |
| Netflix | NFLX | Consumer Discretionary | Specialty Retailers | 1 |
| Northrop Grumman | NOC | Industrials | A&D Prime | 1 |
| Pool Corp | POOL | Consumer Discretionary | Sporting Goods | 1 |
| Rayonier | RYN | Industrials | Building Materials | 1 |
| Toro Co | TTC | Industrials | Machinery & Tools | 1 |
| Ulta Salon | ULTA | Consumer Discretionary | Personal Services | 1 |

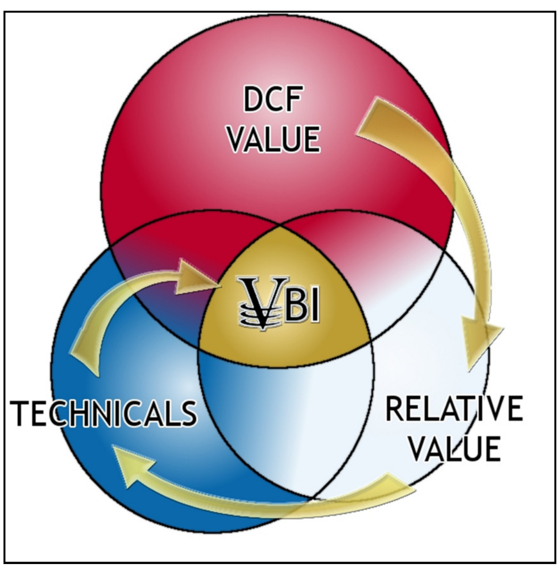
# Our Methodology – The Valuentum Buying Index (VBI)

*By Valuentum Analysts*

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




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




*Our Methodology – The Valuentum Buying Index* continued on next page

***Our Methodology – The Valuentum Buying Index* continued from previous page**

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

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

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

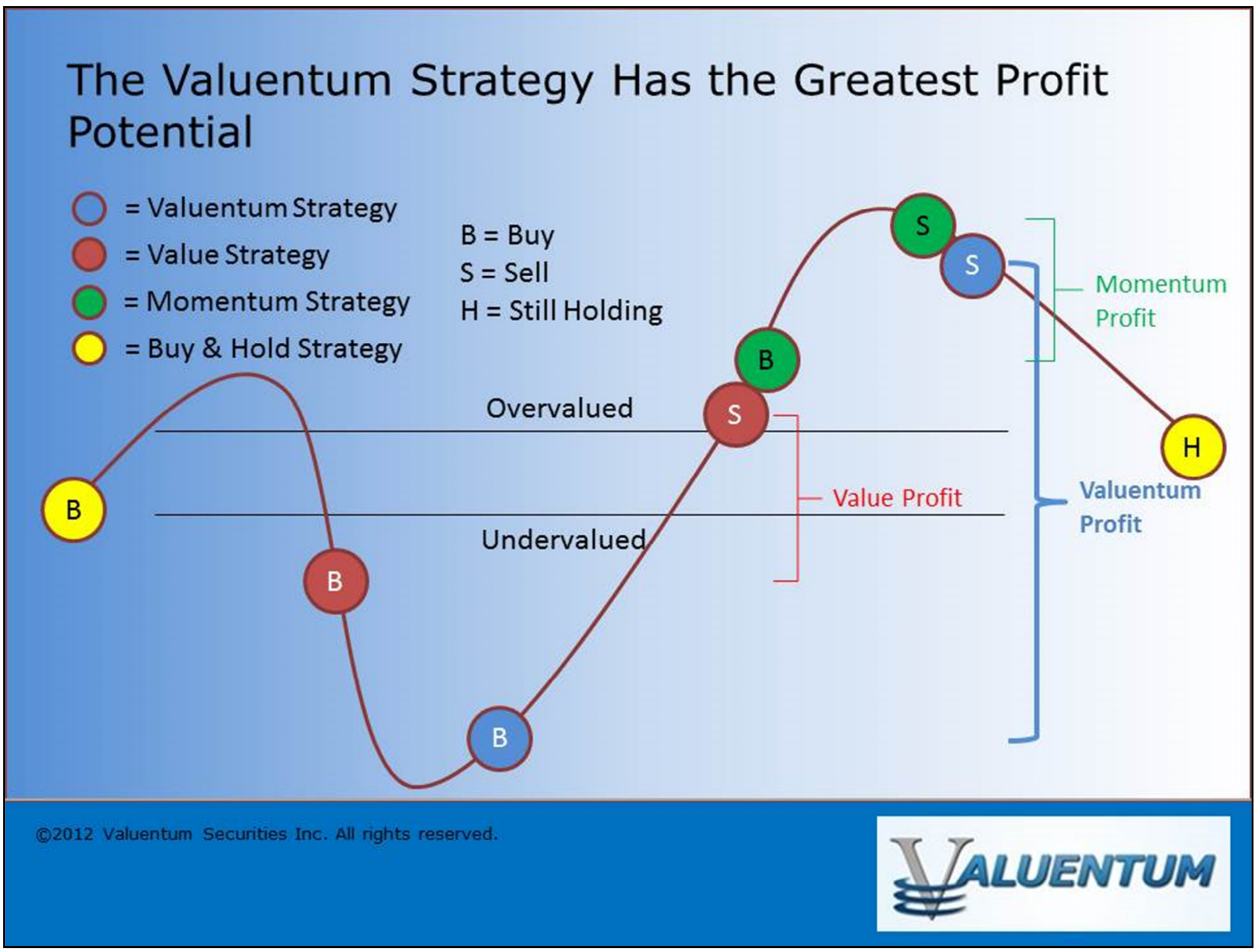


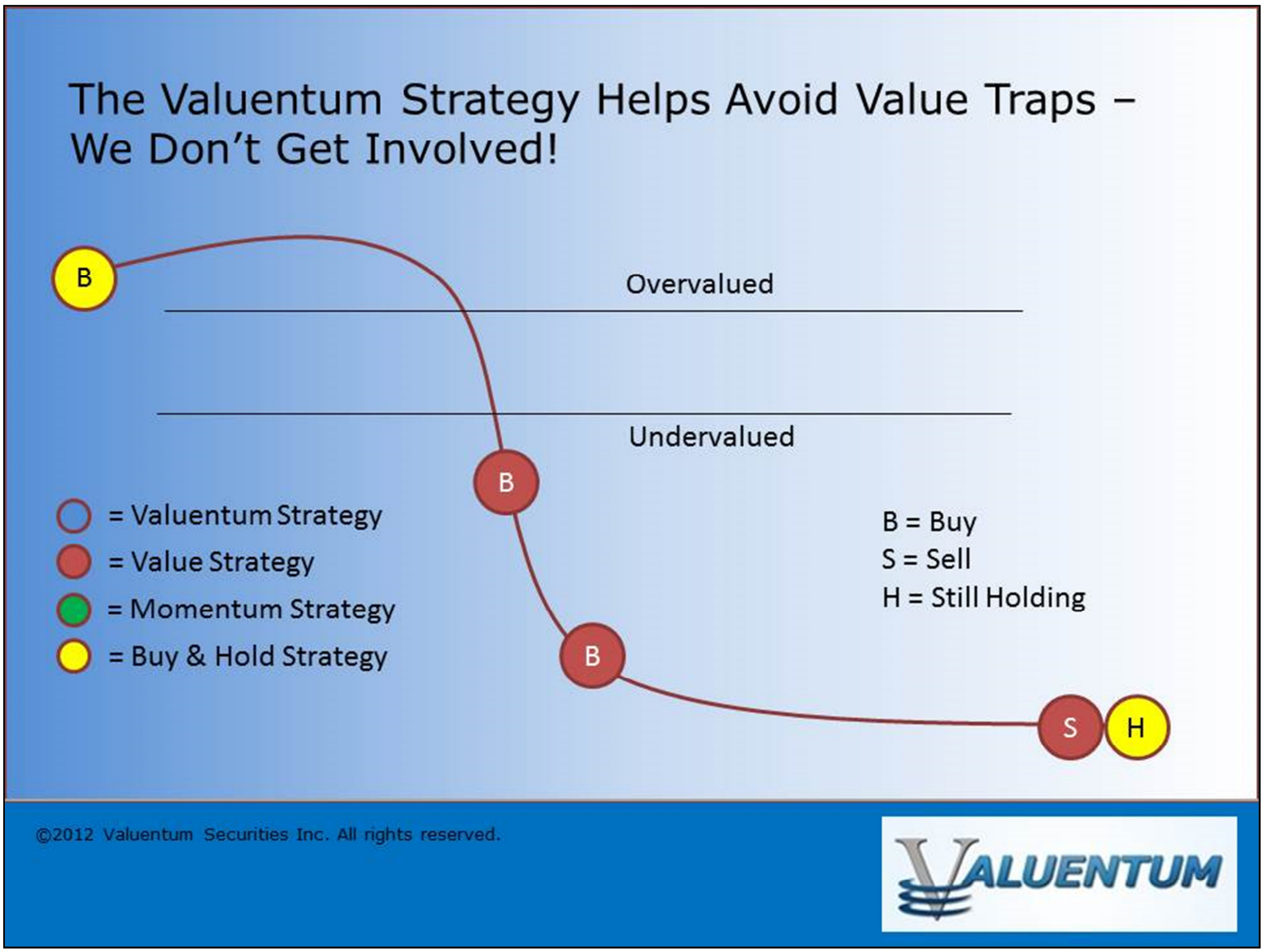

Illustration for educational purposes only.

***Our Methodology – The Valuentum Buying Index* continued on next page**

*Our Methodology – The Valuentum Buying Index* continued from previous page

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

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

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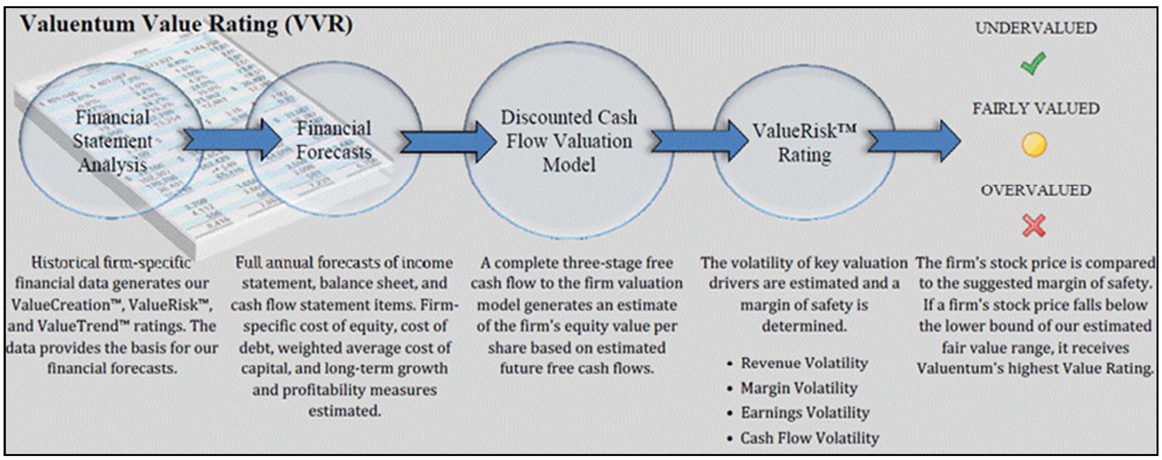
*Our Methodology – The Valuentum Buying Index* continued from previous page

## 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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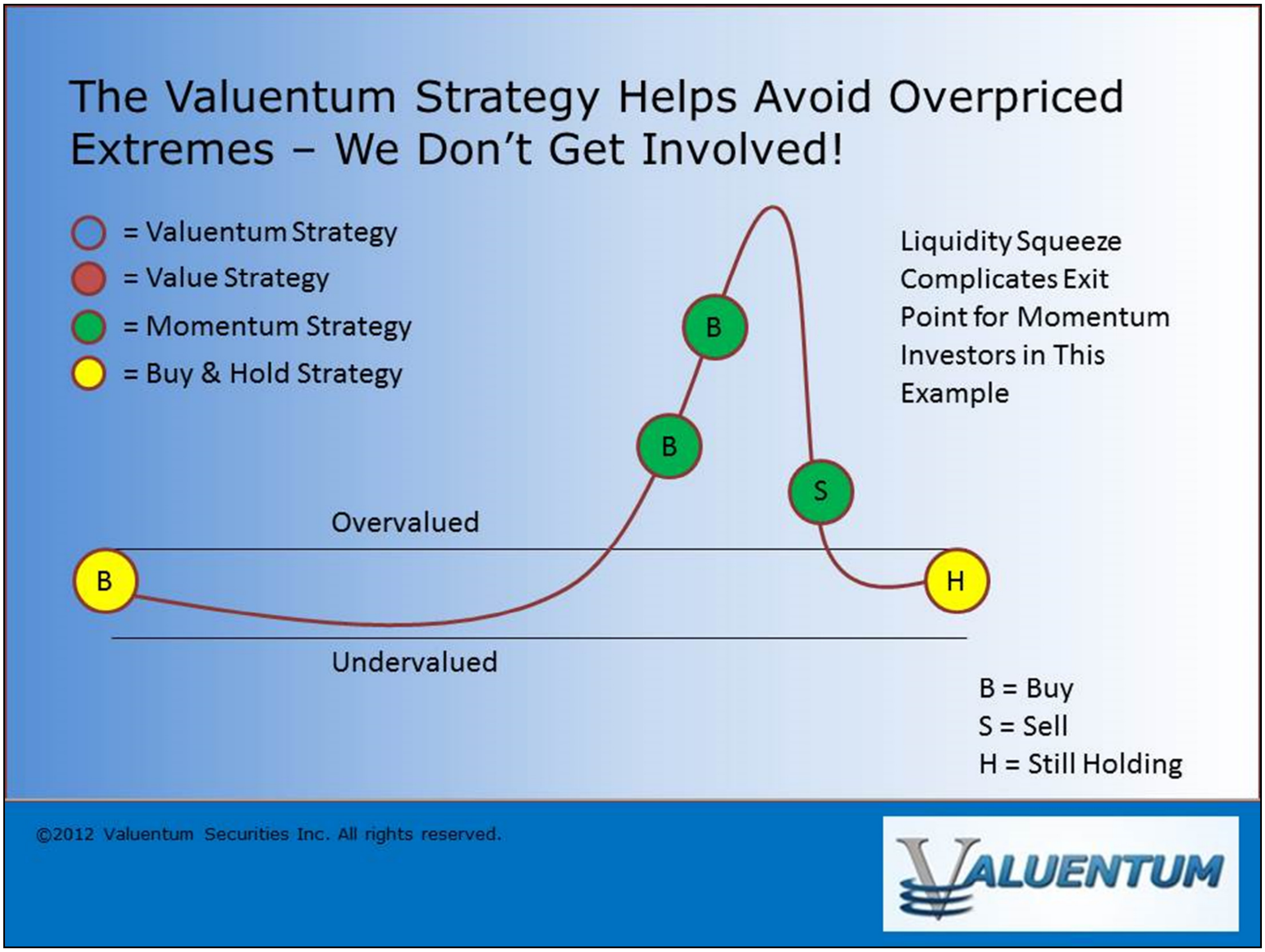



## II. We Perform a Forward-Looking Relative Value Assessment

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

***Our Methodology – The Valuentum Buying Index* continued from previous page**

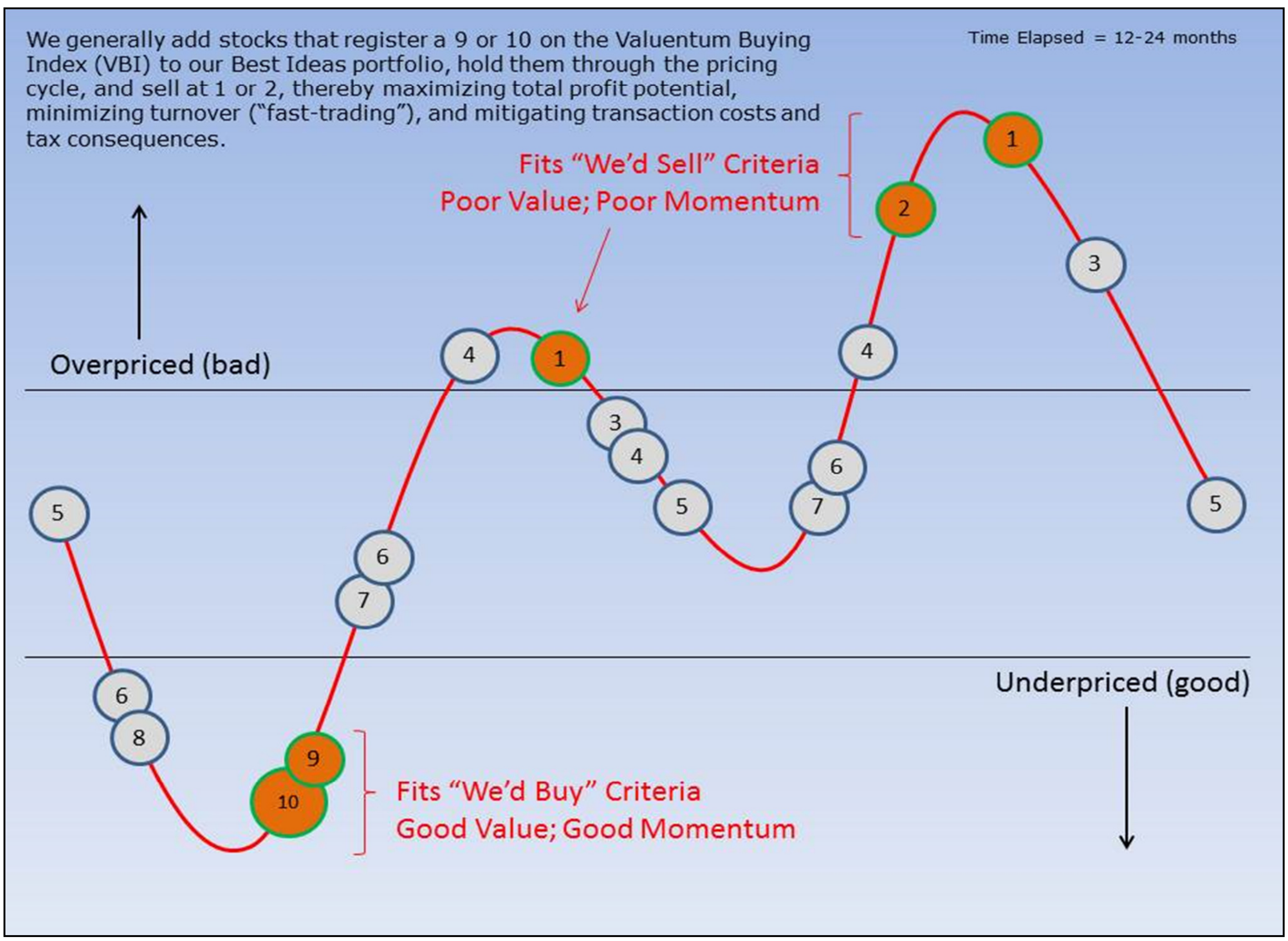
valuation criteria). Rigorous valuation analysis and technical analysis are not mutually exclusive, and we believe both can be used together to bolster returns. An evaluation of a stock's moving averages, relative strength, upside-downside volume, and money flow index are but a few considerations we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

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

## Putting It All Together - the Valuentum Buying Index

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

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

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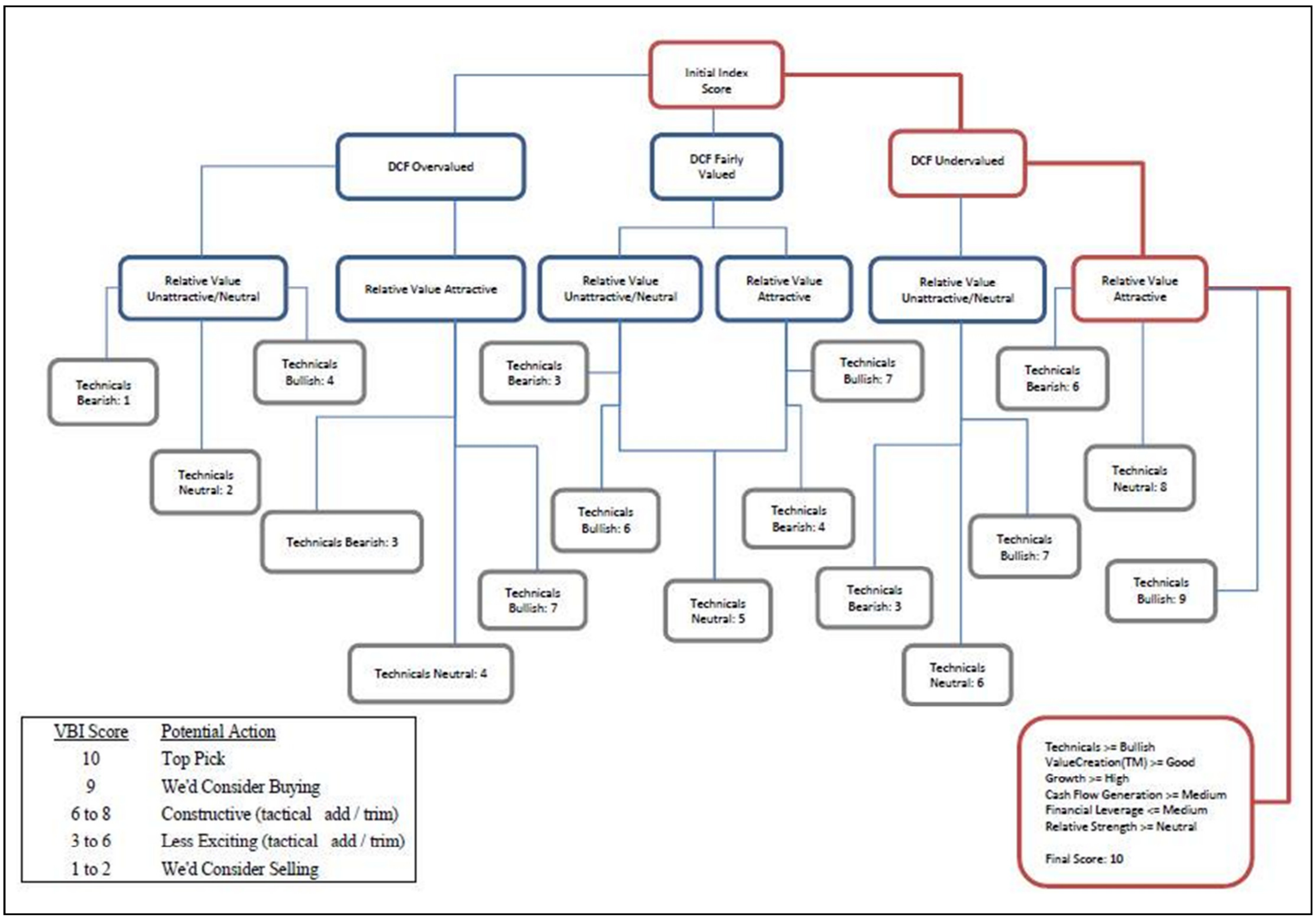
*Our Methodology – The Valuentum Buying Index* continued from previous page

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.




*Our Methodology – The Valuentum Buying Index* continued on next page

# About the Fair Value Range

*By Valuentum Analysts*

## Understanding the Fair Value Range and Why It's Important

**FAQ: Why do you use such a wide fair value range for certain companies?**

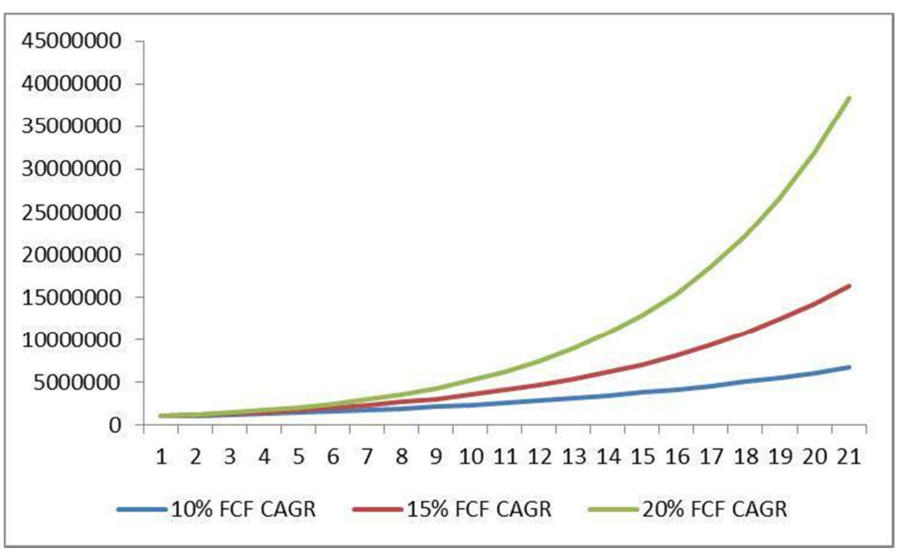
One of the most important concepts of the Valuentum methodology (and valuation in general) is the understanding that the value of a company is a range of probable valuation outcomes, not a single point estimate. Even well-seasoned stock analysts are guilty of saying that a company's shares are worth exactly $25 or a firm's stock is worth exactly $100. The reality is that, in the first case, the company's shares are probably worth somewhere between $20 and $30, and in the latter case, the stock is worth somewhere between $75 and $125.

Why? Because all of the value of a company is generated in the future (future earnings and free cash flow), and the future is inherently unpredictable (unknowable). If the future could be predicted with absolute certainly (knowable), then a stock analyst could say a company's shares are worth precisely this, or that a firm's stock is worth precisely that. Not *because he or she would know where the stock would be trading at*, but because he or she would know precisely what future free cash flows would be (and all other modeling facts-not assumptions in this case) and arrive at the exact and **non-debatable** value of the firm.

But the truth of the matter is that nobody knows the future, and analysts can only estimate what a company's future free cash flow stream will look like. Certain unexpected factors will hurt that free cash flow stream relative to forecasts, while other unexpected factors will boost performance. That's how a downside fair value estimate and an upside fair value estimate is generated, or in the words of Warren Buffett and Benjamin Graham how a "margin of safety" is generated. Only the most likely scenario represents the point fair value estimate. Any stock analyst that says a company is worth a precise figure--whether it's $1 or $100--falls short of understanding one of the most important factors behind valuation.

But why the large range in many cases?

Well, there are many firms in our coverage universe that have a very large range of outcomes in their future free cash flow growth. And because discounting free cash flows is an integral part of calculating the fair value estimate of a company, the range of fair values will also be large. To illustrate this point, let's take a look at the difference between the levels of free cash flows in Year 20 under three different future growth rates: 10%, 15%, and 20%. Though the growth rate between each scenario is but 5 percentage points, the magnitude of the free cash flow difference is astounding many years into the future, and our discounted cash-flow process considers the long-term intrinsic value of firms.




*About the Fair Value Range* continued on next page

***Yeah – About the Fair Value Range*** **continued from previous page**

Under these future free-cash-flow scenarios, if we assume an 8% discount rate and 100,000 shares outstanding (and no debt), the difference in the fair value estimate between the upside case (green line) and downside case (blue line) would be an incredible $68 per share ($82 per share less $14 per share). That's a huge fair value range (80%+), and all because of just a 10 percentage point difference in a future free cash flow growth assumption. For firms that are growing cash flows at 200% or 300% per annum, a large range of fair value outcomes is not only inevitable but also very reasonable. In other words, the Valuentum framework provides an avenue to quantify the upside and downside risks investors are taking in high uncertainty and fast-growing enterprises.

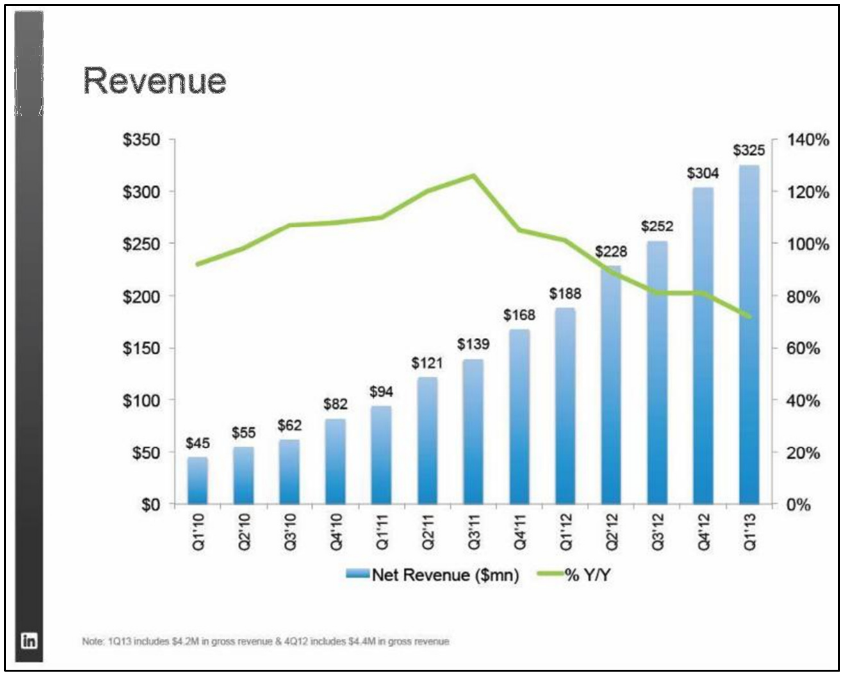



Image Source: LinkedIn

To really hit this point home, shown above is a slide of LinkedIn's (LNKD) revenue from the first quarter of 2010 through the first quarter of 2013. The green line (mapped to the right axis) shows LinkedIn's revenue growth rate. Let's assume revenue expansion translates into similar free cash flow growth expectations (not exactly a precise assumption, given the leverage in LinkedIn's business model), but bear with us for simplistic illustrative purposes. Will LinkedIn's revenue/cash flows expand at a 20% rate, a 40% rate, or a 60% rate (or an even greater pace) through year 20?

It's a very, very difficult question to answer. Remember how significant that 10 percentage point spread was in the hypothetical example above? Well, it's even more significant for LinkedIn. We know LinkedIn's free cash flows will expand, and expand fast, but just how fast is certainly debatable. To a very large extent, that's why LinkedIn's range of probable outcomes (fair value range) is so large. Understanding the cone of fair value outcomes of a company is helpful because the size of the range tends to be positively correlated to the equity's volatility. If you recall, look at what happened to LinkedIn's stock recently when investors ratcheted down their long-term growth assumptions (and by extension, the company's intrinsic value).

Shares collapsed in a huge way.

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But it was largely because of that same weakness in equity pricing that drove Microsoft (MSFT) to take the leap to buy LinkedIn's equity outright just a few months later. Over just a very short period of time, LinkedIn's shares effectively collapsed and then surged as the chart below shows (its intrinsic value range didn't change much, however). Having a fair value range that adequately captures both the upside and downside cases for a company's shares remains an integral part of stock investing. Not only does it help hone in on the potential risk-reward profile of an equity at any given time, it also helps reveal the attractiveness of various "entry" or "exit" points using a robust free-cash-flow based and fundamentally-sound intrinsic value estimate as the anchor.


We're scouring our coverage universe for firms that are trading outside of their respective fair value ranges. A firm trading below the low end of its fair value range, for example, is undervalued, while a firm trading above its fair value range is overvalued. The fair value range for each company captures the inherent uncertainty of the trajectory of that firm's unique future free cash flow stream. For the 1,400+ companies we include in our coverage universe, we provide a discounted cash flow derived fair value estimate and a corresponding fair value range -- and a robust discounted cash-flow process is only one aspect of our service.

Valuentum Best Ideas Newsletter: Volume 6, Issue 11

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.

## Corrections & Amplifications

You may have received an October edition of the Best Ideas Newsletter, whose portfolio had subsequently been adjusted to correctly account for a special stock dividend in the Financial Select SPDR ETF (XLF). The item had been corrected during the distribution of the October edition and is also reflected correctly in this edition.