THE NELSON EXCLUSIVE

Confidential*

March 2018

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About Your Editor

Brian Nelson is the president of equity research and ETF analysis at Valuentum Securities.

He is the architect behind the company's research methodology and processes, developing the Valuentum Buying Index rating system, the Economic Castle rating, and the Dividend Cushion ratio. Mr. Nelson has acted as editor-in-chief of the firm's Best Ideas Newsletter and Dividend Growth Newsletter since their inception.

Before founding Valuentum Securities in early 2011, Brian worked as a director at Morningstar, where he was primarily responsible for training and methodology development within the firm's equity and credit research department. Prior to that position, he served as a senior industrials securities analyst covering aerospace, airlines, construction, and environmental services companies.

Before joining Morningstar, Mr. Nelson worked for a small capitalization fund covering a variety of sectors for an aggressive growth investment management firm in Chicago. He holds a Bachelor's degree in finance and a minor in mathematics, magna cum laude, from Benedictine University. Brian has an MBA from the University of Chicago Booth School of Business and also holds the Chartered Financial Analyst (CFA) designation.

Highlights:

Brian is frequently quoted in the media and has been a frequent guest on Nightly Business Report, Bloomberg TV, CNBC, and the MoneyShow.

Mr. Nelson is very experienced valuing equities, developing discounted cash-flow models used to derive the fair value estimates for companies in the equity coverage universes of two independent investment research firms, including Valuentum.

Brian worked on a small cap fund and a micro-cap fund that were ranked within the top 10th percentile and top 1st percentile within the Small Cap Lipper Growth Universe, respectively, in 2005.

Mr. Nelson led the charge in developing Morningstar's issuer credit ratings, creating and rolling-out one of the firm's proprietary credit metrics, the Cash Flow Cushion.

The Nelson Exclusive Is A Fantastic Resource

A version of this article was sent to members February 18.

I have to admit that I was quite worried about launching the Nelson Exclusive May 2016. I didn't know what to expect, and as we've progressed with new ideas each and every month, I've been working hard to incorporate feedback.

For starters, we're going to be moving to tracking the income characteristics of the income ideas on a go-forward basis as a measure of their success. Many members have voiced this long-term income-oriented preference, and frankly we think it makes a lot of sense.

Not one income idea in the Exclusive has cut its dividend!

But what about the capital appreciation ideas? I think there is some wiggle room on how to think about these ideas, and we think measuring them still makes sense from time of highlight to the current or close price.

Through February 2, 2018, 15 ideas out of 19 capital appreciation ideas have worked out, moving in the direction of our thesis (including dividends/distributions), **good enough for a near-80% success rate*.** Excluding the two biotech-related ideas added for diversity, we're looking at a success rate close to 90%.

But it's been a bull market, you may say -- of course a large percentage of our ideas would do well. But let's look at how the short idea considerations have done.

You might have guessed it: 15 out of 19 ideas short-idea considerations have worked out, too, moving in the direction of our thesis (including dividends/distributions), **again good enough for a near-80% success rate.**

Given this bull market, you might be surprised if only a handful of short-idea considerations would have worked out. But a large percentage of them already have, and we're still waiting for our thesis to play out with respect to many of those that haven't, too!

This is not meant to be an overly-gratuitous self-congratulating commentary. We're working hard to deliver top-notch investment ideas to our members, and at no point will we rest on our laurels. This is also not to say there will not be bumps in the road. If 2018 has reminded us of anything thus far, it is that *nothing is guaranteed*, and the reintroduction of meaningful volatility in the financial markets has us on high alert. That is high alert in the sense of highlighting each and every noteworthy pocket of risk we can find, not in overly dramatized language aimed at frightening investors.

We don't get everything right, but we think The Nelson Exclusive is simply one of a kind, and we hope you do, too.

**Success rate: The percentage of ideas highlighted in the Nelson Exclusive that have moved in the direction of our thesis (i.e. up for capital appreciation ideas and down for short idea considerations) through the current price or closed price, with consideration of cash and stock dividends. Success rates do not consider trading costs or tax implications.*

Top 10 Recent Developments -- Exclusive Ideas

Our members are savvy. Since we've launched the Nelson Exclusive publication, many of our members have told us that we may not be thinking about measuring the income ideas correctly, as we've viewed them more like total return ideas, evaluating them from highlight price to close or current price. For income investors, a longer-term view may be required (preferred), and while we've been aware of this, our concerns about overall market valuations may have gotten the better of us. We think the new presentation of the income ideas to reflect income sustainability and growth reflects our commitment to meeting our members' requests and incorporating feedback as this publication matures.

1. What a Run in Qualys (QLYS)

One of the most interesting ideas in the cybersecurity market, September 2017 capital appreciation idea **Qualys (QLYS)**, hasn't had much trouble pleasing the market of late. The company's shares closed at $77.50 on March 2, significantly above the highlight price of $51.50, and we trust you are pleased. It's been tough navigating the markets the past couple months with the uptick in volatility, but we think Qualys has the "right" business model in the "right" end market. It issued revenue and earnings guidance for 2018 that came in far ahead of expectations when it released fourth-quarter results February 12.

2. Moelis & Co (MC) Knocking the Cover Off the Ball

When it comes to income growth, the previous income ideas that were highlighted in the Exclusive have been on a roll. February 2017 income idea **Moelis & Co (MC)** raised its payout 27% on February 27 thanks in part to higher after-tax cash flows emanating from corporate tax reform. Shares now have a forward expected yield of ~3.7%, and its equity price has been on a tear, advancing north of $50 from the $35 highlight price. Given where we closed the idea, we're glad that many of our members have longer term horizons. In any case, it was great to see this idea deliver in a big way, no matter how it is measured.

3. Ennis Inc (EBF) Not Backing Down from Income

November 2016 income idea **Ennis Inc (EBF)** was one that we had been cautious about, and one that we closed too early (it seems). Last December Ennis declared a $0.10 per share special dividend that only augments its already hefty dividend yield that is approaching ~4% on a run-rate basis. Shares have rocketed to almost $20 each from their $14.60 highlight price, and we're glad to see the company continue to deliver for income-oriented investors.

4. B&G Foods (BGS) – One of Our Worst Calls

We make mistakes, and unfortunately, August 2016 income idea **B&G Foods (BGS)** is a high-profile error. I thought the company would turn the corner with the *Green Giant* brand, and even though I didn't like its debt load, I thought today's frothy market environment would be forgiving for these near-7% yielding shares, but it hasn't. B&G Foods recently hit a 52-week low after setting fiscal year 2018 earnings per share guidance in the range of $2.05-$2.25, while consensus had been expecting a mark above the high end of the range. I feel really bad about this one.

5. Douglas Dynamics (PLOW) Hikes Dividend

October 2016 income idea **Douglas Dynamics (PLOW)** delivered a nice dividend increase February 27, raising its payout to $0.265 per share, which reflects a 10%+ increase over the prior pace. The company's annualized forward yield now stands at ~2.5%. The dividend hike followed news of a strong fourth-quarter report that sent both sales and earnings per share higher than expectations. The company notes that 2018 will be a year of transition, and it has set adjusted earnings per share guidance in the range of $1.60-$2.20 per share for the year, a rather wide range. Nonetheless, we like the direction of the dividend.

6. Northwest Natural Gas Company (NWN) Faces Rising Interest Rate Headwind

May 2017 income idea **Northwest Natural Gas (NWN)** put together an in-line fourth-quarter when it reported results February 23. During 2017, adjusted net income per share advanced modestly over 2016 levels, and the company raised its dividend for the 62nd consecutive year, to an annualized rate of $1.89 per share. The utility initiated earnings guidance in the range of $2.10-$2.30 per share for 2018, implying roughly flat earnings performance. Management is navigating through the ongoing "shale revolution," which has impacted the "value of gas storage in California," but what may be weighing most on shares is rising interest rates, something that continues to pressure both utilities and REITs across our coverage.

7. Bloomin' Brands (BLMN) Shows Life

July 2016 capital appreciation idea **Bloomin Brands (BLMN)** has shown some life of late with shares advancing to nearly $24 each. It was a long time coming, but we finally think that investors are taking note of the value of its portfolio of brands. Jana Partners has taken an active interest in the company, and we thought it was only a matter of time before the company caught a bid. Bloomin Brands also raised its dividend 12%+ March 1, but we note that its yield of 1.5% won't turn many heads. In any case, we were happy to see this inaugural capital appreciation idea still do well (it, too, has been closed for some time).

8. No Stopping Wingstop (WING)

Shares of August 2017 capital appreciation idea **Wingstop (WING)** have been hovering in the mid-$40s, even after the company issued relatively disappointing guidance for 2018 relative to consensus expectations. The "wing joint" is forecasting 10%+ system-wide unit growth on low-single-digit domestic same-store sales growth, and adjusted EBITDA expansion in the 13%-15% range. Fully-adjusted earnings per share for 2018 of $0.75 came in below expectations, however. For a fast-growing restaurant like Wingstop, however, one might expect some pressure on earnings as it continues to grow units. We still like the company, and with Buffalo Wild Wings (BWLD) having been taken over by Roark Capital (acquisition closed February 5), we might see Wingstop catch some interest from private buyers.

9. Nice Pop In Square (SQ)

What drew us in about December capital appreciation idea **Square (SQ)** was its end market, and we think it has a unique niche in financial payment technology. The company is also embracing Bitcoin, for better or worse, but we think this will only lead to greater adoption of its platform. Though shares have done well since we highlighted them, there is a big "bear" out there in BTIG, but we think there is plenty of room for a lot of players within the financial technology space.

10. The Shorts

It's hard to be disappointed with the plethora of short idea considerations that have worked out (a very large percentage of them), but it's important to emphasize that we have missed a couple--and of course, we're not happy about it! The two big misses have been December 2016 short idea consideration **Royal Bank of Scotland (RBS)** and July 2017 short idea consideration **Deutsche Lufthansa (DLKAY)**. We're closing November short idea consideration **Fogo de Chao (FOGO)**, as of today, March 3, as it was taken out higher than our highlight price, but we simply can't be too hard on ourselves.

For new members, don't fret. Our team is working hard to establish functionality to access the archives, a tremendous value and ongoing resource of your membership to the Nelson Exclusive publication.

Tracking Nelson Exclusive Idea Simulated Performance

Highlight Date	Company (symbol)	Highlight Price	Annual Divs per Share at Highlight	Current Fwrd Dividends per Share	Current Fwrd Exp Dividend Yield	Time Horizon	Notes - Data as of March 2, 2018
Income Ideas							
Jul, 16	Universal Corp (UVV)	57.74	2.12	2.20	3.4%	Closed - 2/12/2017	Universal has years of dividend growth ahead of it, but we closed this big winner for the time being. We still like it!
Aug, 16	B&G Foods (BGS)	51.54	1.68	1.86	6.3%	Closed - 7/17/2017	B&G Foods has taken its share of lumps, the latest coming from Amazon's entrance into the grocery business with the proposed purchase of Whole Foods. We closed the idea.
Sep, 16	Maxim Integrated (MXIM)	41.12	1.32	1.68	2.7%	Closed - 2/12/2017	We closed position due to fickle nature of tech. Solid net cash position, strong free cash flow -- ~3% yield. May re-establish idea in future.
Oct, 16	Douglas Dynamics (PLOW)	31.94	0.94	1.06	2.5%	Closed - 2/12/2017	We closed as stock had been suspiciously volatile on little news. Insider buying though. We still like it and may re-establish in future.
Nov, 16	Ennis Inc. (EBF)	14.60	0.70	0.80	4.0%	Closed -- 11/12/2016	We captured more than 2 years' worth of income via capital appreciation in a very short period of time. Unfortunately, this ended in a quick "trade."
Dec, 16	Watsco, Inc. (WSO)	150.57	4.20	5.00	3.0%	Closed - 2/12/2017	We closed this idea. Investors have been assessing impact on demand from HVAC price hikes at key customer Carrier (UTX). We still like it, but it is a cyclical industrial.
Jan, 17	Star Gas Partners (SGU)	11.21	0.41	0.44	4.7%	0-2 yrs	Star Gas raised its dividend 7%+ in late April 2017. Fiscal first quarter performance showed a 13.7% increase in total revenue thanks to solid volume growth and per-gallon price increases.
Feb, 17	Moelis & Co (MC)	35.00	1.28	1.88	3.7%	Closed - 7/22/2017	We continue to like shares of Moelis & Co, but we have closed the idea for now. Special dividends are the cherry on top of this income generator and are not included in our measure of its yield.
Mar, 17	Park National (PRK)	108.59	3.76	3.76	3.6%	0-20 yrs	The bank's loan book advanced slowly in 2017, and management is optimistic about customer service initiatives implemented in the year. It recently declared a $0.94/share quarterly dividend.
Apr, 17	American Software (AMSWA)	10.44	0.44	0.44	3.4%	Closed - 7/22,23/2017	An email delay by us caused a notication to be delayed until after material information impacted AMSWA's stock. As a result, price adjusted from price in email to the low price of the next trading day to reflect conservative, punitive accounting ($12.04 --> $10.57).
May, 17	NW Natural (NWN)	59.20	1.88	1.89	3.6%	0-20 yrs	Nice dividend yield. Customer growth ensues, and returns have been solid. It issued 2018 EPS guidance ($2.10 - $2.30 per share), and 2017 marked its 62nd consecutive year of annual dividend growth
Jun, 17	Japan Tobacco (JAPAY)	19.03	0.60	0.63	4.5%	0-20 yrs	Tobacco stocks have done well during this multi-year bull market. Japan Tobacco is an interesting idea, but regulatory changes could be on the horizon in Japan that may pose challenges.
Jul, 17	Vectren Corp (VVC)	58.21	1.68	1.80	3.0%	Closed 8/30/2017	Takeout speculation drove Vectren's price significantly higher, and we closed the position as a result. Recent results show its utility performance is on track, and its non-utility group is performing well.
Aug, 17	National Retail Properties (NNN)	40.50	1.90	1.90	5.0%	0-20 yrs	2017 results were solid. Core FFO per common share increased more than 7% during the period, and occupancy remains impressive at 99.1% as of the end of 2017.
Sep, 17	STORE Capital (STOR)	25.72	1.16	1.24	5.2%	0-20 yrs	On September 12, STORE Capital increased its quarterly dividend ~7%, to $0.31 per quarter. 2018 AFFO per share is expected to be $1.78-$1.84, up from $1.71 in 2017.
Oct, 17	Fortis (FTS)	36.14	1.60	1.70	5.2%	0-20 yrs	Management recently announced an increase to its 5-year capital spending plan. Its rate base is expected to increase at an annual rate of 5% over the next five years, while annual dividend growth guidance has been set at 6% for the same period.
Nov, 17	Black Hills (BKH)	61.23	0.45	1.90	3.7%	0-20 yrs	Black Hills raised its dividend nearly 7% November 15. The company initiated 2018 earnings per share guidance of $3.35-$3.55 when it reported third-quarter results November 2, but it raised this to a range of $3.35-$3.55 one quarter later.
Dec, 17	Four Corners Propety Trust (FCPT)	26.03	0.97	1.10	4.9%	0-20 yrs	We continue to have high hopes for this young REIT as a dividend payer as it currently offers a ~4.8% yield. We're encouraged by management's ~13% dividend hike in November.
Jan, 18	TransCanada Corp (TRP)	49.47	1.98	1.98	4.5%	0-20 yrs	TransCanada offers investors a ~4.5% yield, and annual dividend hikes have become common. News related to the Keystone pipeline can have an impact on share price performance.
Feb, 18	Siemens (SIEGY)	71.13	3.86	2.29	3.6%	0-20 yrs	The 'German GE' could benefit from GE's recent missteps, and we expect its industrial technology portfolio to play a meaningful role in the proliferation of the Industrial Internet of Things. Dividends can be impacted by currency exchange rates.

Many members have said that they prefer to focus on the long-term income-oriented dynamics of our income ideas, and we think this makes sense.

We have subsequently changed the formatting of the table to include a focus more on the trajectory of the dividend as well as the current forward expected annualized dividend yield.

We hope that you find this layout more helpful as you sort through the prior income ideas.

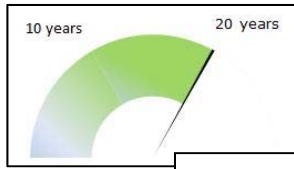
The information provided in the tables is offered for the convenience of the reader, for illustrative purposes only, and no actual trading is taking place. Actual results may differ from the simulated information being presented. Valuentum is a publisher of financial information, not a money manager, broker, or financial advisor.

Highlight Date	Company (symbol)	Highlight Price	Current or "Close" Price	Div's Received	'Hypothetical' 'Closed'Gain %	Time Horizon	Notes - Data as of March 2, 2018
Capital Appreciation Ideas							
Jul, 16	Bloomin Brands (BLMN)	17.87	19.28	0.07	8.3%	Closed -- 11/12/2016	We took what the market gave us. We may re-open idea again. We still believe in long term. Stock very cheap.
Aug, 16	Healthcare Srvs Group (HCSG)	38.91	41.02	0.369	6.4%	Closed - 2/12/2017	We closed this one. Nice streak of consecutive quarterly dividend increases. Very strong end market, and we may re-open in the future.
Sep, 16	Grupo Aeroportuario (ASR)	157.87	181.61	-	15.0%	Closed - 4/5/2017	We closed this idea. The strength in the US dollar had hurt. We still love the long-term picture though. Travel to Cancún not going away.
Oct, 16	Swedish Match (SWMA.ST)	314.80SEK	354.40SEK	8.5	-	0-20 yrs	Tobacco (snus) demand is about as resilient as it gets through the economic cycle. Currency had been hurting shares, but stock has rallied back in a meaningful way more recently.
Nov, 16	Symrise AG (SYIEY)	16.25	16.34	-	0.6%	Closed - 4/5/2017	We closed this idea, but we still like it. EBITDA margins don't get much steadier than Symrise's (18-22% from 2006-2015) though.
Dec, 16	Tootsie Roll (TR)	37.80	34.87	0.18	-	0-20 yrs	A fantastic company with excellent financials. Potential big dividend growth story with takeout catalyst as a growing possibility. Stock dividend adjustment (3/3/17) reflected in price.
Jan, 17	Texas Capital Bancshares (TCBI)	78.05	85.10	-	9.0%	Closed - 2/12/2017	Stock grew too extended, so we closed with expectations to re-establish. It's important to gain your trust -- and simulated profits go a long way in doing so.
Feb, 17	Arconic (ARNC)	25.90	29.62	-	14.4%	Closed - 2/12/2017	We closed this idea. We may re-establish again, but this type of gain in one week is hard not to be prudent with.
Mar, 17	Tesaro (TSRO)	180.84	122.62	-	-32.2%	Closed - 7/7/2017	Very risky biotech. Not for everybody. We highlighted this one to fill an industry void among considerations. We have closed it.
Apr, 17	Yum China (YUMC)	31.15	37.67	-	20.9%	Closed - 5/23/2017	The long-term potential of Yum China is amazing. If you haven't read our thesis on shares, please do so. We closed this idea on strong share-price performance, but we may look at it again.
May, 17	Galapagos (GLPG)	87.67	76.13	-	-13.2%	Closed - 7/7/2017	Another very risky biotech. Shares are not for everybody, and principle could be completely wiped out if things go wrong with this consideration. We closed the idea.
Jun, 17	Huntington Ingalls (HII)	193.79	206.39	-	6.5%	Closed 8/18/2017	The Navy needs more ships with more advanced capabilities, and Huntington Ingalls is at the center of this need. We closed it, but the company is a compelling idea.
Jul, 17	Orbital ATK (OA)	102.33	104.65	-	2.3%	Closed 8/18/2017	The geopolitical environment is becoming more heated, and it seems that tensions with North Korea have only heightened. We closed it, but we like Orbital's position to benefit.
Aug, 17	Wingstop (WING)	32.28	43.97	0.14	-	0-20 yrs	Buffalo Wild Wings' younger cousin may be taking a bite out of its share. We like Wingstop's long-term opportunity, and shares rallied considerably after an impressive third quarter report.
Sep, 17	Qualys (QLYS)	51.10	77.50	-	-	0-20 yrs	One of the most interesting cybersecurity ideas on the market today. We continue to like shares, which received a nice boost from a strong third-quarter report.
Oct, 17	Guidewire Software (GWRE)	78.24	82.97	-	-	0-20 yrs	We like this indirect "play" on the insurance business. Its fundamentals are top notch. Guidance for fiscal 2018, released November 29, was mixed though, but we're focused long term.
Nov, 17	Ferrari N.V. (RACE)	117.43	121.11	-	-	0-20 yrs	Ferrari's shares may not be as cheap as we would like, but it's hard to argue with the company's brand strength. Shares will continue to be extremely volatile.
Dec, 17	Square (SQ)	38.22	46.02	-	-	0-20 yrs	This financial technology company has a long runway of growth ahead of its, but execution risk and competition should not be taken lightly. Its Bitcoin product could take the market by storm.
Jan, 18	Planet Fitness (PLNT)	33.70	37.71	-	-	0-20 yrs	Planet Fitness recently hit milestones of 1,500 locations in all 50 states, and it has more than 10.5 million members in all. It is now moving into the Mexican market.
Feb, 18	Insulet Corp (PODD)	75.84	73.07	-	-	0-20 yrs	Insulet expects top-line growth to remain robust in 2018 with revenue growth guidance coming in at 21%-25% for the year. Recent strategic milestones include gaining Medicare coverage for its Omnipod System.

Success rate: *The percentage of ideas highlighted in the Nelson Exclusive that have moved in the direction of our thesis (i.e. up for income or capital appreciation ideas and down for short idea considerations) through the current price or closed price, with consideration of cash and stock dividends. Success rates do not consider trading costs or tax implications.*

Highlight Date	Company (symbol)	Highlight Price	Current or "Close" Price	Div's Received	'Hypothetical' 'Closed'Gain %	Time Horizon	Notes - Data as of March 2, 2018
Short Idea Considerations							
Jul, 16	Lands' End (LE)	16.76	16.10	NA	3.9%	Closed -- 12/2/2016	We were worried Eddie Lampert may start buying more heavily. Very volatile equity. Not being greedy, so we closed position.
Aug, 16	Vivint Solar (VSLR)	2.94	2.85	NA	3.1%	Closed -- 12/2/2016	Stock wasn't acting right despite an ongoing negative solar backdrop. We locked gain in as a result.
Sep, 16	Lloyds Banking (LYG)	3.31	2.78	NA	16.0%	Closed -- 11/4/2016	We didn't like Lyolds' leverage and were worried about Brexit. We picked our spot to take profits.
Oct, 16	GoPro (GPRO)	16.68	11.12	NA	33.3%	Closed -- 11/4/2016	This was a big winner. We continue to have concerns, and the stock keeps falling. We're not looking back, however.
Nov, 16	Seritage Growth Properties (SRG)	44.31	42.13	-0.25	4.4%	Closed -- 1/6/2017	The REIT continues to trade on euphoric expectations, but we closed this for a gain. Dividends work against us as it relates to short performance. Buffett is watching.
Dec, 16	Royal Bank of Scotland (RBS)	4.91	7.34	-	-	0-2 yrs	The stock rallied alongside financials peers. We're watching it closely as Brexit looms. The bank is nearing a multi-billion dollar settlement with US regulators related to the Financial Crisis.
Jan, 17	Sequential Brands Group (SQBG)	4.62	4.18	-	9.5%	Closed 2/12/2017	We locked this short idea in. Retail continues to get pummeled, and we picked the right spot at the right time.
Feb, 17	Sportman's Warehouse (SPWH)	6.85	6.11	-	10.8%	Closed 2/12/2017	As with Sequential Brands, we picked the right spot at the right time. We locked in this big gain, too.
Mar, 17	Fitbit (FIT)	6.07	5.71	-	5.9%	Closed 4/5/2017	Very timely short idea again. We locked this in. The success rate on short idea considerations remains fantastic.
Apr, 17	Santander Consumer (SC)	12.51	11.65	-	6.9%	Closed 5/23/2017	Subprime auto may be in for a rough landing. We're expecting continued tough times, but we're going to lock this idea in.
May, 17	Snap, Inc (SNAP)	23.19	17.19	-	25.9%	Closed 5/10/2017	Fantastic timing! Another short idea consideration homerun! See May 10 email: 'Another Exclusive Homerun: Oh SNAP'
Jun, 17	Mallinckrodt (MNK)	42.65	36.41	-	14.6%	Closed - 8/18/2017	There's a lot of hair on this one. Famed short seller Jim Chanos doesn't like it. We locked in this winner.
Jul, 17	Deutsche Lufthansa AG (DLAKY)	23.05	33.00	-	-	0-20 yrs	We think Ryanair will be a thorn in Deutsche Lufthansa's side in the coming years, and the cyclical nature of the airline industry won't ever go away.
Aug, 17	Del Frisco's (DFRG)	14.35	11.93	-	16.9%	Closed - 10/16/17	We locked in a solid gain after its third-quarter results left a good deal to be desired. Restaurant traffic continues to face pressure.
Sep, 17	Fiesta Restaurant Group (FRGI)	15.90	18.00	-	-	0-2 yrs	Fiesta continues to close units in the overheated restaurant space. Geographic concentration adds to risk. Buyout rumors have been helping smaller restaurant shares of late, however.
Oct, 17	Ingles Markets (IMKTA)	26.50	24.20	-	8.7%	Closed - 10/16/17	We closed this idea quickly as shares faced pressure due to industry-wide concerns over margin performance. The idea worked out well.
Nov, 17	Fogo de Chao (FOGO)	10.85	15.62	-	-44.0%	Closed - 3/3/2018	Fogo de Chao has accepted a buyout offer from Rhone Capital for $15.75 per share. Takeout risk is a key consideration for short sellers, and should not be taken lightly.
Dec, 17	TrueCar (TRUE)	12.07	10.84	-	10.2%	Closed - 12/27/17	We closed this idea quickly for a solid 'gain' as shares continue to face pressure due in part to poor recent performance and concerns surrounding its relationship with the USAA persist.
Jan, 18	Shake Shack (SHAK)	44.17	39.55	-	-	0-2 yrs	Weak traffic trends across the restaurant space, a saturated burgers and fries market, and meaningful execution risk are key considerations working against Shake Shack.
Feb, 18	iShares Core US Aggregate Bond ETF (AGG)	107.20	106.46	0.235	-	0-2 yrs	Rising interest rates continue to work against long-duration fixed income vehicles. We expect such a development to persist in the near term, but the monthly yield of this idea should be noted.
	Average Capital Efficiency* for 'Closed' Positions					Varies	Performance information is hypothetical and "trading" is simulated. Information provided in table for illustrative purposes only.

The tables above are provided for the sole purpose of transparency, to allow readers to measure Nelson Exclusive ideas in a way they feel is most appropriate. Ideas within the Nelson Exclusive are not constructed as a portfolio, nor should they be viewed as a portfolio, and performance information is hypothetical and "trading" is simulated. "Hypothetical annualized returns," now labeled "Capital Efficiency," cannot be achieved and are provided for the sole purpose of rightsizing each idea to a common measurement period (one year), to compare ideas 'closed' within one year to ones 'open' longer than one year, taking into account capital efficiency. A reader, for example, may view a 20% hypothetical return over a period of five weeks as much better than a 20% hypothetical return over a period of five years. Whereas both represent 20% hypothetical returns, hypothetical annualized performance is much different under each case. Readers may have different views and time horizons. To retain independence, neither Valuentum nor Brian Nelson own any shares, nor do they plan to own any shares, of any companies highlighted in the Nelson Exclusive. Importantly, shorting stocks involves a number of abnormal risks, including theoretically the infinite loss of capital, and is not for everyone. Valuentum is a financial publisher not a financial advisor. Please contact your personal financial advisor to determine if any idea in the Nelson Exclusive may be appropriate for you.



Time Horizon: Long-term

Phillips 66 Partners (PSXP)

“With this latest addition, we are near our $1.1 billion 2018 year-end run rate EBITDA target. And we remain on track to deliver our 30% five-year distribution CAGR. Our Board of Directors approved a fourth quarter distribution of $0.678 per common unit which is 5% higher than last quarter. Our distribution coverage was 1.33x this quarter. Since our 2013 IPO, we have increased distributions 17 consecutive quarters at a compound annual growth rate of 31%.” – Kevin Mitchell, Executive Vice President and CFO, Phillips 66 Partners fourth quarter 2017 conference call

Thesis

Looking for a growth-oriented master limited partnership (MLP) with expectations for top-notch distribution growth? Look no further than this month’s income idea!

Phillips 66 Partners is a young MLP, created in 2013 via a separation from Phillips 66 (PSX), its general partner, that has an impressive, albeit limited, track record of distribution growth. Through the end of 2017, the MLP has grown its payout at a 31% CAGR since the third quarter of 2013 (its IPO) thanks to 17 consecutive quarterly distribution increases, and it remains on track to deliver on its 5-year target distribution CAGR of 30% through 2018. Though no specific targets for growth in the payout have been made beyond 2018, management expects to be in the top-quartile of its peers in terms of distribution growth. Distribution coverage as measured by the industry-specific metric of distributable cash flow came in at 1.33x in the fourth quarter of 2017, a relatively healthy level. Units yield ~5.4% as of this writing.

Corporate Profile

Phillips 66 Partners is a growth-oriented midstream master limited partnership (MLP) with an asset base consisting of transportation and storage assets for oil, refined petroleum products, and natural gas liquids. The MLP was created in 2013 as a separation of Phillips 66’s, its general partner, midstream operations and is headquartered in Houston, Texas.

Key Statistics	
Last Close	$49.63
52-week range	$44.40-$56.48
Market Cap	$5.975 B
Avg Daily Vol (30 wks)	275,648
Annual Dividend Yield	5.46%
Trailing Dividend Payout Ratio	105%
Trailing P/E	19.2
Credit rating	Ba1

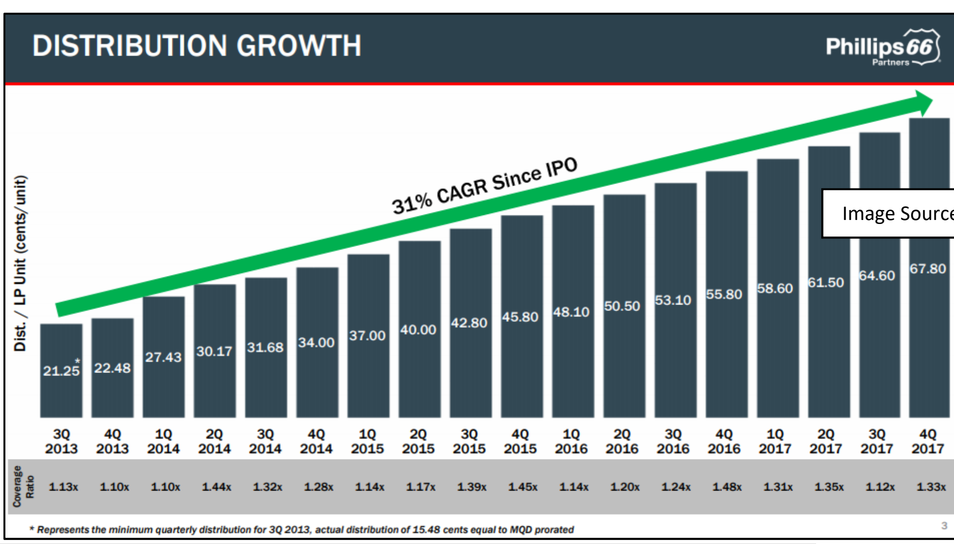
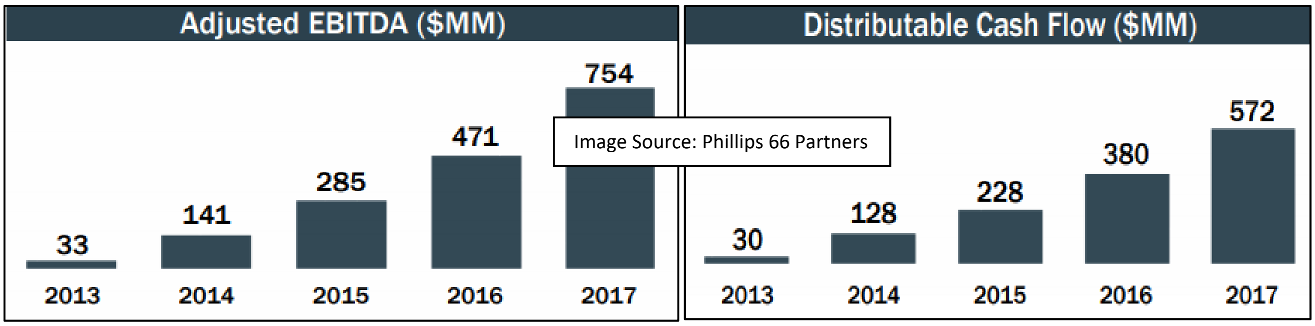


Image Source: Phillips 66 Partners

Phillips 66 Partners' impressive distribution growth has been backed by impressive financial growth since its inception. Adjusted EBITDA has grown at a 75% annual rate since 2014, hitting $754 million in 2017, and distributable cash flow has advanced ~65% annually over the same time period, reaching $572 million in 2017. Adjusted EBITDA run rate was ~$950 million as it exited 2017, putting the MLP on track to achieve its 2018 target of $1.1 billion. Though it has not been the norm historically, free cash flow was positive in 2017, a rarity for most MLPs, and management's total capital budget for 2018 of $595 million suggests it could turn in another year of positive free cash flow in 2018, assuming it delivers a similar level of cash flow from operations in 2018 as it did in 2017 ($724 million).



Though its overall credit rating leaves a bit to be desired--Moody's rates it as Ba1, a notch below investment grade--its most recent debt issuance received a Baa3 rating thanks to its close relationship with Phillips 66. Nevertheless, we like Phillips 66 Partners' debt metrics relative to its peers. Management quoted its debt-to-EBITDA ratio as 3.2x at the end of 2017, but using its reported adjusted EBITDA number for 2017 and net debt of $2.76 billion at years end leads us to a net debt-to-adjusted EBITDA ratio of 3.66x. Regardless, its financial leverage looks to be quite manageable, especially after considering recent and expected EBITDA growth. The MLP could receive a credit rating upgrade if it is able to continue increasing scale while maintaining a leverage ratio below 4x and demonstrate EBITDA is sustainably above $1 billion (unadjusted EBITDA was $743 million in 2017).

$MM *(unless otherwise noted)*	2017
Cash and cash equivalents	185
Total assets	5,334
Total liabilities	3,173
Revolving credit facility availability	750
Debt to EBITDA ratio*	3.2x

Image Source: Phillips 66 Partners

Phillips 66 Partners' relationship with Phillips 66, which owns a ~55% limited partner interest in addition to its general partner interest and boasts an A3 credit rating, is a key consideration for this idea. The MLP generates roughly 95% of its revenue from agreements with its general partner, and most of these contracts are fee-based minimum volume agreements with some having a minimum service fee agreement. Such a relationship helps to stabilize cash flows from quarter to quarter.

Phillips 66 Partners' asset base is operationally and strategically vital to the operations of its general partner, which is responsible for the operation and management of the limited partner's operations. Its midstream transportation asset base is integrated with Phillips 66's refinery operations, and it also serves as a growth and financing vehicle for the general partner. For example, the two entities completed a drop down transaction valued at ~$1.7 billion in late 2017 that resulted in Phillips 66 Partners acquiring a 100% interest in Merey Sweeny and a 25% interest both Dakota Access and Energy Transfer Crude Oil Company (collectively the Bakken Pipeline). The transaction resulted in materially increased scale for the MLP, and its combination of debt and equity financing allowed it to maintain a modest level of financial leverage.

Further implicit backing for Phillips 66 Partners comes via the relationship of Phillips 66 with Berkshire Hathaway, which held a 14.9% stake in Phillips 66 as of the end of 2017. Phillips plans to buy back 35 million shares from Berkshire in the near future, but Berkshire will still hold 45.7 million shares after the deal closes. Warren Buffet stated the move was motivated by a "desire to eliminate regulatory requirements" in its ownership interests that exceed 10%. Berkshire will remain one of Phillips 66's largest shareholders and expects to continue holding shares for the long haul.

Phillips 66 Partners' close ties with its general partner also mitigate some of the competition currently being experienced across the US midstream space, but it clearly has a heightened level of concentration risk given the significant level of revenue generated from their agreements. This concentration should not be taken lightly given the risky nature of the refining business, which is dependent upon the realization of attractive spreads as it purchases crude oil and sells refined products. Both of these markets are subject to material levels of volatility, and operators within the space have very little control over the successful recognition of attractive margins. Timing risk should not be understated as price fluctuations of the aforementioned products between the time of feedstock purchases and the sale of the resulting refined products can have a meaningful impact on profitability. As a result, Phillips 66 Partners is exposed to the volatility of crude oil prices, though on a somewhat limited basis.

Beyond the heightened concentration risk resulting from close ties with a single refiner, an investment in Phillips 66 Partners comes with the inherent risks associated with any MLP. Despite its recently positive free cash flow generation, the health of its distribution remains dependent upon adequate access to the capital markets, as is the viability of its future growth plans.

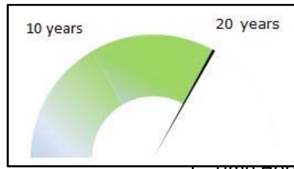
However, we like the visibility in Phillips 66 Partners' growth trajectory, which will consist mostly of further drop downs of assets covered by fee-based (and often minimum volume) contractual agreements from its general partner. Since it is a relatively young MLP, its general partner's incentive distribution rights, which give the general partner the rights to an increasing level of its distributable cash flow, have a relatively minimal impact on its cost of capital, keeping it competitive in this area with its peers. Management does not expect to have to take on a potentially dilutive simplification transaction, which have grown increasingly popular in the MLP space of late, in the foreseeable future.

In addition to Phillips 66 Partners' attractive overall and distribution growth prospects, the MLP is currently trading at ~14.8 times 2018 consensus earnings estimates. This compares favorably to energy sector members of the S&P 500, which are trading at an average of 18.8 times forward earnings according to third party sources. Operators in the oil and gas refining and marketing space are trading at 11.8 times forward earnings, suggesting the MLP's close ties to one single refiner, and the inherent risks of such a relationship, may be playing a role in its lower price-to-earnings ratio.

All things considered, Phillips 66 Partners is in a strong position to continue delivering top-tier distribution growth in coming years, and though we are not fond of the industry specific measure of distributable cash flow, the MLP looks to have solid coverage of its high-yielding payout. We like the backing its relationship with Phillips 66 offers, as well as its indirect relationship with Berkshire Hathaway via the firm's stake in Phillips 66. Its overall growth trajectory looks sound moving forward, and we like its potential to receive a credit rating upgrade at some point. MLPs aren't without substantial risk, however.

Kris Rosemann contributed to this article.

Capital Appreciation



Time Horizon: Long-term

Preferred Bank (PFBC)

"2017 has been a good year for Preferred Bank. For the year, total assets grew 17%, loans grew 16% and deposits grew by 18%. On a pre-tax basis, income increased by approximately 39% from 2016 and is more indicative of our performance against 2016 and previous years. All of these numbers substantially exceeded our internal expectations as well as market consensus. During the year, we also increased our work force by 11% largely in administrative areas such as compliance, electronic banking and BSA to prepare ourselves for 2018 and beyond. "With good profit metrics, a highly asset-sensitive balance sheet and a lower corporate tax rate, we are quite optimistic for the year 2018." – Preferred Bank's Fourth Quarter Earnings Release

Thesis

With interest rates on the rise, we see opportunity for the banks. The yield curve will always be something to pay attention to, of course, but with the US economy still holding up strong, banking entities may have some good times ahead, especially those with a unique niche, market share opportunities, and multiple catalysts.

Enter Preferred Bank (PFBC). The company is a leading community banking franchise in Los Angeles, and while it has expanded into what it describes as the diversified mainstream market, it continues to benefit from its niche roots. Management emphasizes its "deep ties to the Chinese American…banking communities, and we like this differentiated factor:"

1) San Gabriel Valley area of Southern California (Alhambra, Arcadia, Diamond Bar, City of Industry)
2) South Bay (Torrance)
3) Orange County (Irvine)
4) San Francisco (Business District and coming soon, Geary Street)
5) Flushing, NY

Source: Raymond James US Bank Conference, September 6, 2017

Corporate Profile

Preferred Bank is an independent commercial bank in California, chartered by the state. Its main office is in Los Angeles, and it operates more than a dozen full-service banking businesses in the country (11 in California, 1 in New York). The company was originally founded as a Chinese-American Bank, but most of its customers are now from the diversified mainstream market. The company believes it is "The Preferred Way to Bank," and it has been operating since 1991.

Key Statistics	
Last Close	$64.01
52-week range	$46.88 - $67.65
Market Cap	$932 M
Avg Daily Volume (30 wks)	78,433
Book Value per Share	$24.13
Price/Book	2.65
Return on Equity	14.56%
Net Interest Margin	3.80%
Annual Dividend Yield	1.4%
Trailing Dividend Payout Ratio	29.7%

The company's strategy mixes what it describes as "ultra high-touch service" from frontline personnel with a keen eye toward hiring new senior level lenders that can boost prudent, organic expansion. Preferred Bank lists its core competencies in business banking and commercial and multi-family real estate lending, and while the Financial Crisis of last decade reminded us of all the hazards of the banking enterprise, we have no reason to believe Preferred Bank is engaging in risky lending, just for the sake of growth. The management team averages more than 30 years' experience.

The bank notes that its business allows for a high level of automated banking, too, and it prides itself on two metrics that speak of operational proficiency: an efficiency ratio and assets-per-employee that are among the best in the US. When it comes to banking, pursuing efficiency is one way of driving returns higher relative to peers, and we like that Preferred Bank is focused heavily in this area.

Since 1991, the company has accumulated a long history of organic growth augmented by acquisitive activity, but it still has a lot of growth potential ahead of it, too. Looking at deposit market share in the L.A. Long Beach MSA, Preferred Bank is ranked just 25th, and we think as it expands into diversified mainstream clientele, there is considerable upside to this market-share tally. Unemployment rates in Los Angeles are ultra-low, too, as with the general US population at the moment, and we think the state of California continues to boom with economic activity.

As shown in the image below, Los Angeles County is estimated as a $490+ billion deposit market, levels that we expect to grow in coming years, too. We also like Preferred Bank's relative market-share positioning, particularly given that one of the largest competitors in the Los Angeles area, Wells Fargo, faces a host of negatively given recent scandals. Even if Wells Fargo loses but a small fraction of its business to Preferred Bank, it would be a big needle-mover for the company, given relative market shares.

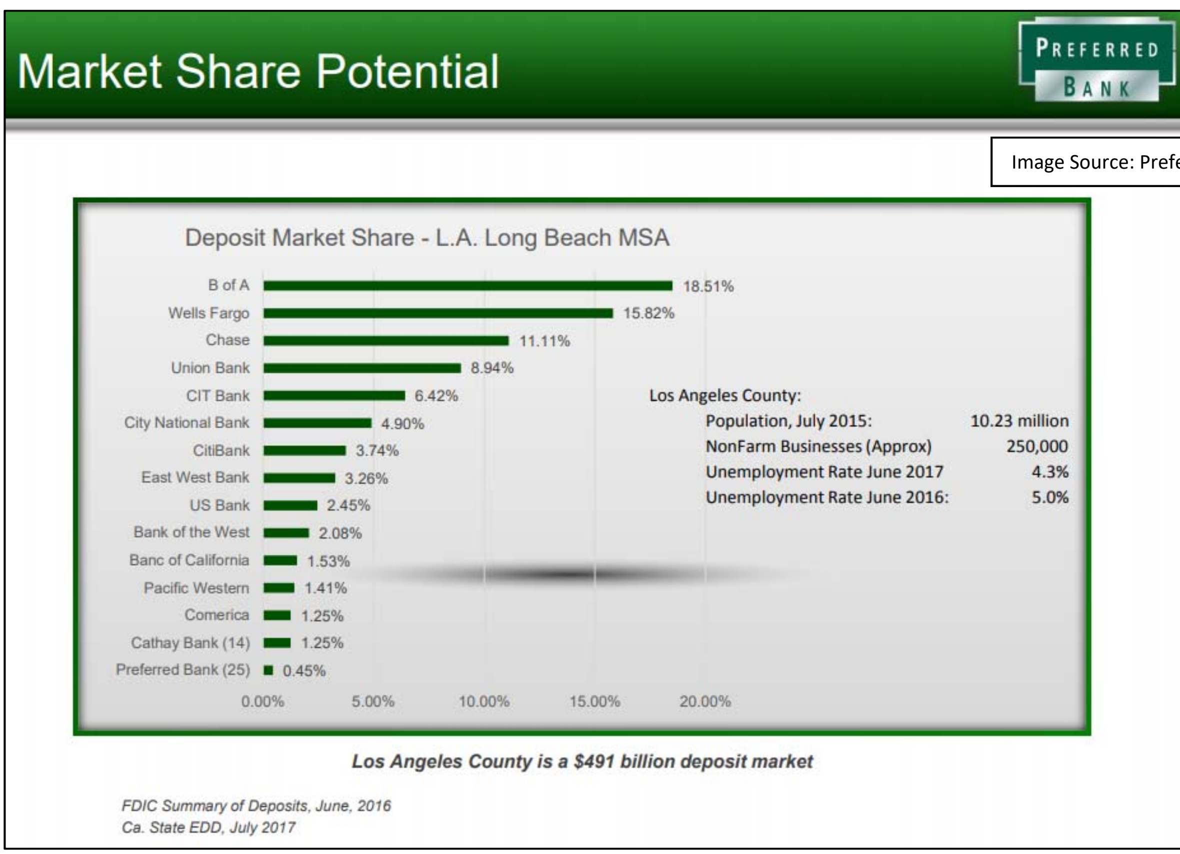


Image Source: Preferred Bank

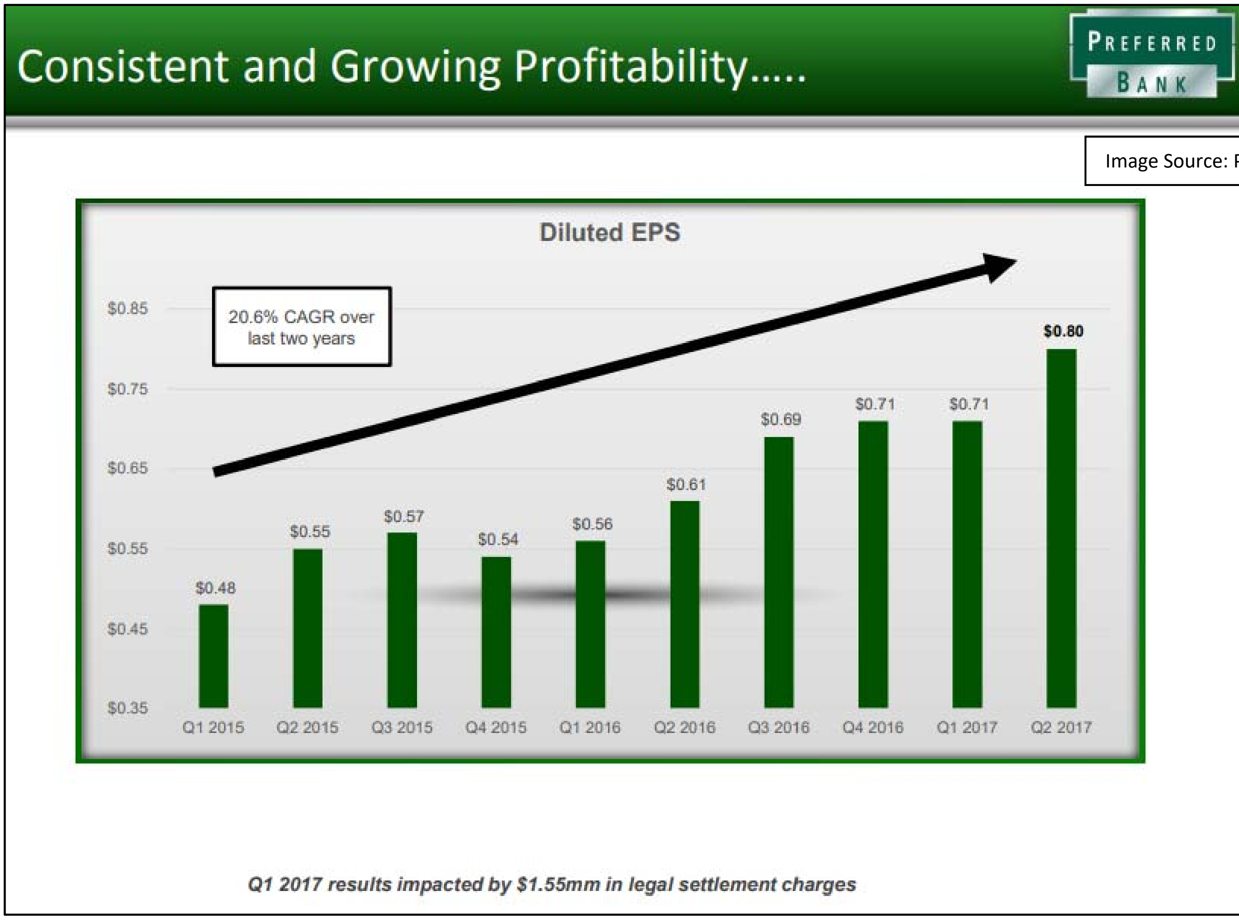


Image Source: Preferred Bank

Image Source: Preferred Bank

Preferred Bank's pace of earnings expansion and relative return profile versus peers is rather impressive for a small bank that may not have as much scale, but its loan growth is probably even more exciting. The company has experienced a 5-year total loan compound annual growth rate of 18.5% (excluding acquisitions), as of the second quarter of 2017, and deposits have followed suit at a similar pace. Deposit-funded banks have a lower risk profile than other banking entities that depend on riskier levels of funding. Having a strong and growing deposit base is a key asset. If all of this weren't enough, management has material "skin in the game," the company recently upped its dividend payout 10%, to $0.22 per share on a quarterly basis (~1.4% annualized yield), and its capital ratios remain very well-capitalized with respect to regulatory guidance.

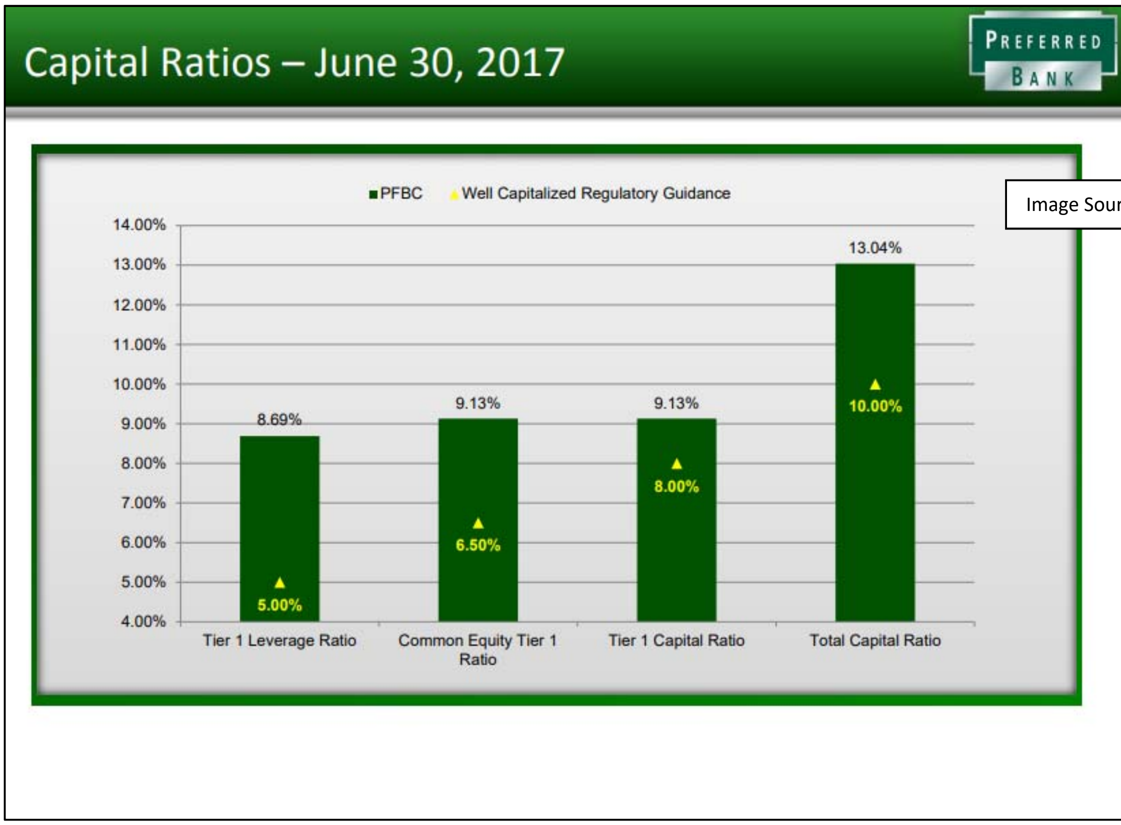


Image Source: Preferred Bank

There's a lot to like about Preferred Bank, so what are the risks?

For starters, this fast-growing bank with catalysts (rising interest rates, the scandals at Wells Fargo) has had a tremendous run, with shares of the bank more than doubling since the end of 2016. That's quite the share-price performance for any equity, let alone a banking enterprise, so investors might expect some technical pullback due or profit-taking. On a diluted basis, shares are trading at roughly 22 times trailing earnings, not cheap, but this multiple could come down quite a bit if Preferred Bank continues its earnings trajectory. There's geographic concentration risk in California (think natural disaster or energy shortage), and the business/credit cycle is worth watching, particularly the real estate cycle.

It would be quite foolish to proclaim that we will never experience another Financial Crisis again either (shares were punished in 2007/2008), but management is quite seasoned. All in, we think Preferred Bank fits the profile for a long-term capital appreciation consideration, and according to management's take on interest rates, its "asset-sensitive balance sheet is poised for a rising rate environment – earnings acceleration." The company is a neat, little small/micro-cap bank that has a lot of things going for it, and we think Preferred Bank is a solid addition to the plethora of Nelson Exclusive ideas already revealed. We hope you have enjoyed this read!

Our combined construction and real estate loans by type of collateral are as follows:

Image Source: Preferred Bank

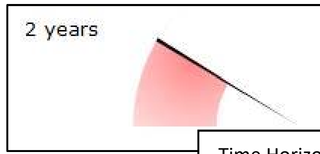
Property Type	At December 31, 2016 Amount (Dollars in thousands)	Percentage of Loans in Each Category in Total Loan Portfolio
Commercial/Office	$ 243,886	9.59%
Retail[(1)]	340,670	13.40
Industrial	209,136	8.22
Residential 1-4	424,980	16.71
Apartment 4+	217,024	8.54
Land	16,575	0.65
Special purpose[(2)]	331,299	13.03
Total	$ 1,783,572	70.14%

(1) Includes shopping centers, strip malls or stand-alone properties which house retailers.
(2) Examples include hospitality and self-storage.

Image Source: Preferred Bank

	At or for the Year Ended December 31, 2016	2015	2014	2013	2012
	(Dollars in thousands, except per share data)				
Financial Condition Data:					
Total assets	$ 3,221,598	$ 2,598,846	$ 2,054,154	$ 1,768,959	$ 1,554,856
Total deposits	2,763,724	2,286,559	1,776,259	1,529,314	1,357,527
Investment securities held-to-maturity	10,337	5,830	7,815	—	979
Investment securities available-for-sale, at fair value sale	199,833	169,502	150,539	142,670	210,742
Loans and leases, gross[(1)]	2,543,549	2,059,392	1,604,149	1,323,431	1,131,703
Cash and cash equivalents	403,830	309,175	240,194	246,615	151,995
Other real estate owned[(2)]	4,112	4,112	8,811	5,602	28,280
Subordinated debt issuance, net	98,839	—	—	—	—
Shareholders' equity	298,065	264,145	235,026	206,916	187,838
Statement of Operations Data:					
Interest income	$ 122,913	$ 94,702	$ 80,327	$ 69,726	$ 61,542
Interest expense	18,734	10,856	9,340	7,729	7,783
Net interest income	104,179	83,846	70,987	61,997	53,759
Provision for credit losses	6,400	1,800	3,350	3,250	19,800
Net interest income after provision for loan and lease losses	97,779	82,046	67,637	58,747	33,959
Noninterest income	5,459	3,892	3,621	2,003	3,508
Noninterest expense	43,538	35,710	30,411	29,261	34,178
Income before provision for income taxes	59,700	50,228	40,847	31,489	3,289
Provision (benefit) for income taxes	23,331	20,485	16,255	12,290	(20,583)
Net income	$ 36,369	$ 29,743	$ 24,592	$ 19,199	$ 23,872
Income allocated to participating securities	(428)	(410)	(270)	(201)	(323)
Dividends allocated to participating securities	(119)	(126)	(30)	—	—
Net income available to common shareholders	$ 35,822	$ 29,207	$ 24,292	$ 18,998	$ 23,549

Short Consideration



Time Horizon: Short term

HYG

iShares iBoxx $ High Yield Corporate Bond ETF (HYG)

Thesis

This month's short idea consideration, the iShares iBoxx $ High Yield Corporate Bond ETF (HYG), is very much in a similar vein as February's idea, the iShares Core US Aggregate Bond ETF (AGG), so let's begin with a quick overview of recent developments in the fixed income arena.

The rise of the 10-year US Treasury yield, which sits just above 2.8% as of this writing, continues to be one of the most meaningful developments in domestic financial markets of late, and the risk free rate is expected to continue its upward trajectory thanks to a number of factors, including expectations for US economic growth and potentially increasing inflationary pressures, and this has many investors rethinking their strategies as they consider the implications of such a development on the discount rate and valuation of equities and the pricing of fixed income instruments.

Corporate Profile

The iShares iBoxx $ High Yield Corporate Bond ETF offers investors exposure to a broad range of US high yield corporate bonds as it seeks to track an index made up of US-dollar denominated, high-yield corporate bonds. Key selling points include diversified exposure to above-average income generation. Its inception date is April 4, 2007.

Key Statistics	
Last Close	$85.75
52-week range	$84.07-$89.04
Assets Under Management	$15.18 B
Avg Daily Vol (30 wks)	12,732,765
Annual Dividend Yield	5.12%
Net Expense Ratio	0.49%
Effective Duration	3.87 years

Newly appointed Fed Chairman Jay Powell has stated that the Fed will remain on its trajectory of gradual rate hikes in 2018, but the meaning of gradual may not be exactly what investors had previously assumed it to be. While three rate hikes in 2018 were previously the general consensus, more recent commentary suggests four rate hikes still fits its definition of gradual. Such a change in trajectory becomes even more likely given the recent strength observed in the US economy, as indicated by measures such as unemployment, wage increases, and consumer confidence.

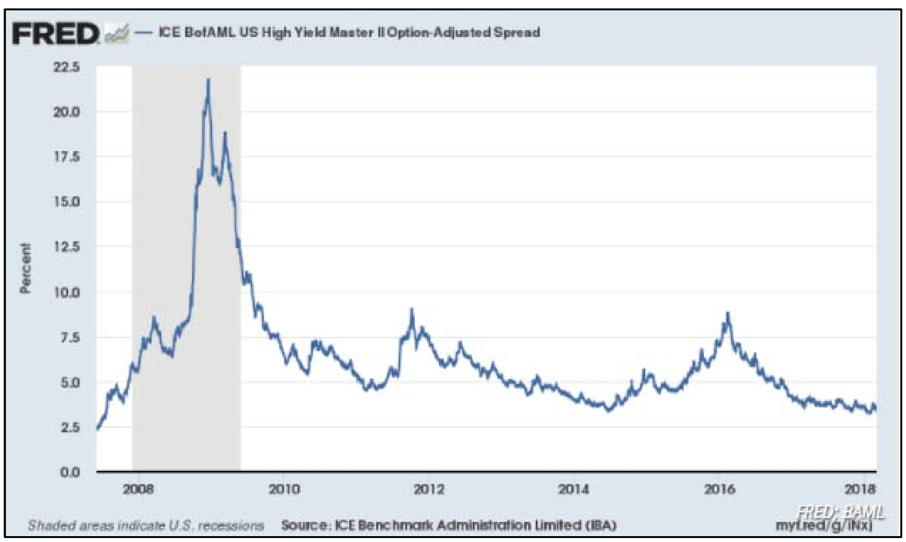
Bond prices and interest rates have an inverse relationship, meaning as interest rates rise bond prices generally fall, holding all else equal, which is due to the discounting of future coupon and settlement payments being done at a higher discount rate. Another important concept worth nailing down as it relates to bonds is duration, a measure of price sensitivity of fixed-income instruments to changes in interest rates that is expressed in years. Duration effectively measures the number of years it will take for bond inflows to repay an investor's initial principal invested. Interest rate risk and credit rating risk are two key considerations in the fixed-income arena.

Credit spreads have been near relative lows of late as investors have been chasing yield in a low-return environment, but such suppressed spreads are often viewed as an indicator of investor complacency. This complacency could come back to bite investors in the high-yield space, especially after considering the tightening credit conditions brought about by rising interest rates. Highly leveraged companies are likely to face the most pressure, and the number of companies fitting this description is at an elevated level following a prolonged period of "easy money" brought about by suppressed borrowing costs. The percentage of global corporations with debt-to-earnings ratios above 5x hit 37% in 2017, well above the 32% seen in 2007, immediately prior to the Financial Crisis. Such elevated levels of corporate debt have meaningfully increased the sensitivity of borrowers to climbing costs of financing.

We've previously highlighted the relatively low default rates as an indicator of relative strength in the high yield arena, but the discrepancy between actual leverage and default rates also brings to light the potential for a meaningful deterioration in credit profiles for highly leveraged companies. Though corporate earnings have been strong of late, this may not be enough to offset the elevated levels of debt held by corporations around the world as interest rates look set to rise at a faster than previously expected rate, at least in the US.

Also weighing on the outlook for high yield is the lag seen in the relationship between volatility and changes in the value of high yield bond ETFs. According the Deutsche Bank's volatility model, a 1 point rise in the CBOE Volatility Index (VIX) should correlate with a negative 1.3% move in high yield funds. However, this relationship has not held in the early going of 2018, suggesting an overdue adverse event could be in store for ETFs like the HYG. The core of the concern for credit investors is nicely summed up by the following statement from Deutsche Bank, "if credit spreads do indeed reprice to higher volatility, the drawdown in credit ETFs could trigger meaningful liquidation, resulting in further pressure on spreads."

Investors require a certain level of compensation for taking on additional risk, and the heightened volatility has not been matched by a repricing in the high yield space, at least not yet. The credit spread, or the relative compensation demanded by investors for holding junk bonds over Treasuries, sat at 3.47% as of February 28, just above pre-recession levels of 3.23% and significantly lower than the recent high of 8.67% seen when the rout in energy resource pricing shellacked bonds in the highly leveraged energy sector.



The illiquidity risk mentioned by Deutsche Bank is a result of shares of high yield bond ETFs being easier to trade than the underlying securities. If investors begin to cash out of their positions, a subject we will touch on shortly, a meaningful liquidity mismatch could develop. If the ETF does not have ample liquidity to meet the needs of those investors, we could see a situation similar to the "blow up" in the XIV earlier this year, though perhaps not of that magnitude.

If the junk bond market faces material headwinds, high yield ETFs such as the HYG very well could take the brunt of the pain, at least in part because of the ease with which they can be traded. It appears as though many investors share our concerns regarding the high yield space moving forward, as short interest in high yield ETFs recently hit an all-time high, with the HYG having an all-time high short interest of 29% as of February 26. Short sellers everywhere should be aware of the ETF's lofty yield, which checked in at 5.12% as of March 2. The fund has also experienced a high level of outflows since the end of 2017, when assets under management (AUM) was ~$17.6 billion compared to $15.2 billion as of March 1. This fund is not alone in this regard, as its peer, the SPDR High Yield Bond ETF (JNK), has seen its AUM fall to less than $9.1 billion as of March 1 from nearly $13.9 billion at the start of 2018.

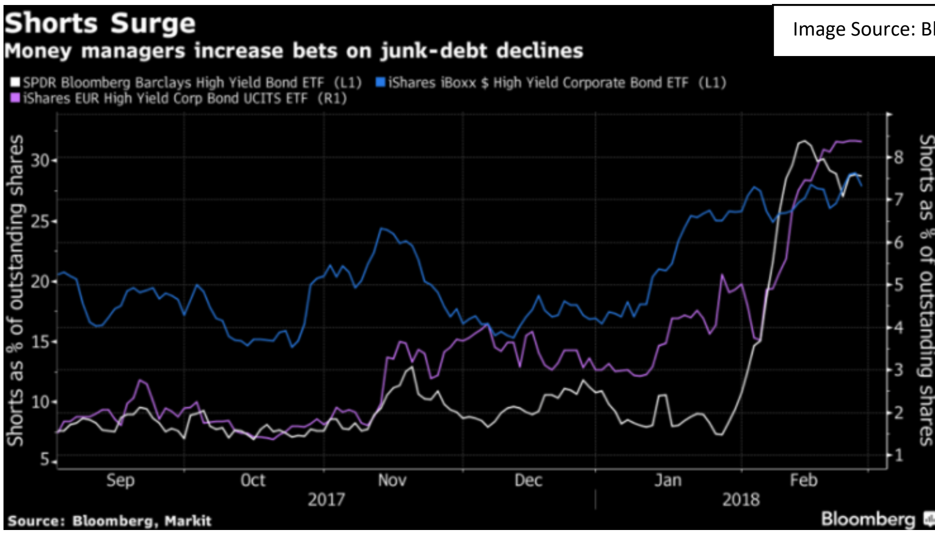


Image Source: Bloomberg

The HYG's effective duration has also risen since the end of 2017, which makes it a more attractive short candidate within the context of rising interest rates. As of March 1, its effective duration has risen to 3.87 from 1.86 at the end of 2017. High yield bonds often have lower durations than their investment grade brethren (a result of the higher coupon payments). However, high yield bonds are often more sensitive to credit ratings than interest rates, and given the recent developments highlighted above, credit negative events may begin to pile up, ultimately impacting the attractiveness of the high yield space.

Some investors might aim to capture a similar dynamic we are targeting with this short idea by going long in an inverse ETF. However, shorting a long ETF gives investors a realized return that is much more closely correlated to the actual inverse of the performance of the ETF due to the fact that many inverse ETFs target daily returns that are the inverse of that of the underlying index with daily rebalancing. This rebalancing often results in returns that do not correlate to the identified objective of the fund over longer periods of time.

Shorting a market capitalization-weighted ETF--the index that the iShares iBoxx $ High Yield Corporate Bond ETF tracks is cap-weighted--comes with other benefits for investors as well. According to Fidelity, ETFs based on cap-weighted indices typically have larger levels of assets under management, are the most actively traded, and have the largest short interests, and the opportunity for these weighting strategies to result in a short squeeze for investors is quite small, absent the impact of the HYG's lofty yield.

Sector | Maturity | **Credit Quality**

as of Mar 01, 2018

% of Market Value

Type	Fund
BBB Rated	0.51
BB Rated	48.58
B Rated	38.21
CCC Rated	10.82
CC Rated	1.10
D Rated	0.03
Not Rated	0.04
Cash and/or Derivatives	0.72

Image Source: iShares

Sector | Maturity | Credit Quality

as of Mar 01, 2018

% of Market Value

Type	Fund
Communications	24.36
Consumer Non-Cyclical	13.94
Energy	13.74
Consumer Cyclical	13.07
Capital Goods	7.50
Technology	7.46
Basic Industry	5.17
Finance Companies	3.23
Electric	3.16
Banking	2.28
Insurance	1.24
Transportation	1.08

Image Source: iShares

Sector | **Maturity** | Credit Quality

as of Mar 01, 2018

% of Market Value

Type	Fund
0 - 1 Years	6.10
1 - 2 Years	7.42
2 - 3 Years	14.01
3 - 5 Years	27.91
5 - 7 Years	23.38
7 - 10 Years	19.83
10 - 15 Years	0.39
20+ Years	0.24
Cash and Derivatives	0.72

Kris Rosemann contributed to this article.

July 1, 2016

Inaugural Letter to Members

Dear Valued Member,

Welcome! You are one of a very limited number of members that will ever bear witness to the pages that follow.

The launch week of the Nelson Exclusive coincided with news that Britain has voted to leave the European Union. The decision, while sending the European banks tumbling violently, does little to muddy the context setting the background of the inaugural edition of this publication.

Broader stock market valuations are at frothy levels, and interest rates continue to hover near all-time lows. The investment-decision landscape is more complicated today than ever before for all types of investors, from those seeking long-term capital appreciation to those that are targeting certain income goals. Cyclicals today are trading at peak multiples on peak earnings, and even consumer staples equities have reached valuation levels that may be more appropriate for aggressive growth equities, not mature operators. *Said differently, the market has laid down the gauntlet.*

The next few years in the markets may be among the most difficult witnessed since the Great Recession. Even a broader market pullback 20% from current all-time highs wouldn't be abnormal given that the collective market valuation of S&P 500 companies has effectively tripled from the March 2009 panic bottom. The launch of the Nelson Exclusive in such conditions can be considered perilous as broader market performance inevitably will act as ballast to the returns of ideas surfaced. In this spirit, I want to remind you that not all ideas in this publication will be successful, and some that are eventually may encounter tough sledding over extended periods of time. As a swimmer cannot achieve his best time swimming against the current, a stock selector cannot achieve his best performance in a down market. Regardless, the value placed on a steady hand during challenging times is priceless.

Let's first cover what the Exclusive is and then we'll talk about what it is not. As you know, the Valuentum investment coverage universe is vast, and what we're seeking to deliver in this publication is ideas that fall outside its reach. We're breaking down the traditional barriers of equity coverage to identify underfollowed gems across the investing spectrum, delivering in each monthly edition one idea for income investors, one idea for readers seeking long-term capital appreciation, and a bonus idea for those looking for a "short" consideration (1). Underfollowed doesn't mean obscure, however, and the ideas that we're targeting will be investable ones, avoiding thinly-traded instruments and penny stock "traps." We'll clearly define our expected time horizon for each consideration, and where applicable, we'll update our theses in subsequent editions. We'll keep score, tracking performance over time.

Let's talk about what the Exclusive isn't. The Exclusive does not constitute individual investment advice, and the ideas within it are not personal recommendations. Each of you reading should always work with your personal financial advisor who knows your individual goals and risk tolerances. I do not. Only you and your personal financial advisor know what's best for your life circumstances. The personal financial advising markets and what we do at Valuentum via financial publishing are two different verticals in the same industry, but they are different nonetheless. I just want to be very clear about this because I can never tell you to buy or sell anything at any time, even if this may be what you want. It's not that I don't have conviction in my work – it's the rules of the business.

Within the twelve editions of the Nelson Exclusive each year, we'll be highlighting in total 36 ideas for consideration with varying investment parameters. That's a lot. Depending on the time horizon set forth with each idea, fantastic performance might mean a success rate of 60%, great performance might be 55%, average performance might be 50%, while anything below that mark may constituent a poor showing. Obviously, I'm aiming for a 100% success rate, but I also have to be realistic. The great Joe DiMaggio may have hit safely for 56 consecutive games in the last baseball season before the United States was thrust into World War II, but he "only" hit .357 that year. That season of '41, the great Ted Williams would be the last player to hit .400, meaning that one of the best hitters in baseball…ever…was still called out ~60% of the time.

The greatest investors face a similar paradigm. Stock selection is a process where there will be homeruns and strikeouts. You know me. The Exclusive is not a "get-rich-quick" product, and you should keep a close eye on your wallet if you encounter anyone promising anything of the sort. In the inaugural edition of the Nelson Exclusive, I'm going to take 36 swings – they are going to be hard and through the zone, and I'm not going to pull my shoulder out or take my eye off the ball. Market conditions are expected to be stormy in coming years as "reversion-to-the-mean" dynamics rain down, and a crafty lefthander with great "stuff" may be on the mound, but we're stepping up to the plate and digging in.

Batter up!

Sincerely,

Brian Nelson, CFA
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P.S. On a very personal note, I wanted to thank you for your continued support. Without you, neither the Nelson Exclusive publication nor Valuentum would exist. This fact is not lost on me. I thank you deeply.

The Nelson Exclusive: Volume 3, Issue 3

The Nelson Exclusive is published monthly. Contact us at info@valuentum.com for more information.

(1) From the SEC's website: A short sale is the sale of a stock that an investor does not own or a sale which is consummated by the delivery of a stock borrowed by, or for the account of, the investor. Short sales are normally settled by the delivery of a security borrowed by or on behalf of the investor. The investor later closes out the position by returning the borrowed security to the stock lender, typically by purchasing securities on the open market.

Investors who sell stock short typically believe the price of the stock will fall and hope to buy the stock at the lower price and make a profit. Short selling is also used by market makers and others to provide liquidity in response to unanticipated demand, or to hedge the risk of an economic long position in the same security or in a related security. If the price of the stock rises, short sellers who buy it at the higher price will incur a loss.

Brokerage firms typically lend stock to customers who engage in short sales, using the firm's own inventory, the margin account of another of the firm's customers, or another lender. As with buying stock on margin, short sellers are subject to the margin rules and other fees and charges may apply (including interest on the stock loan). If the borrowed stock pays a dividend, the short seller is responsible for paying the dividend to the person or firm making the loan (Source: SEC https://www.sec.gov/answers/shortsale.htm)

Short selling is not for all types of investors, and readers should consult their personal financial advisor that understands their individual goals and risk tolerances before considering any investment or any strategy. Potential losses for an investor engaging in a short selling strategy are theoretically infinite.

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