OUR BEST IDEAS NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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Valuentum Securities Inc.
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The Best Ideas Newsletter Portfolio (see page 8): AAPL, BRK-B, BKNG, CSCO, DG, FB, GM, GOOG, INTC, JNJ, PYPL, SDY, XLV, VNQ, V

Removed: XLE, XLF (August 14, 2019)

INSIDE THIS ISSUE

"Investors have becoming increasingly complacent that there will be both interest rate cuts from the US Federal Reserve and a positive resolution to the US-China trade war. We see only the former being likely at this stage."

- Callum Turcan

Apple Makes Its Big Push Into Services

***Image Shown:** Apple announced that Apple TV+ would launch November 1, 2019, during its big update event on September 10. This marks the beginning of Apple's transition from a hardware and software company to a hardware, software, and services giant.*

By Callum Turcan

On September 10, Apple Inc (AAPL) held its big hardware and software event but the real star of the show was services. Namely, Apple TV+ which will launch this upcoming November 1 at the relatively low price of just $4.99 per month. That's below the starting price point offered by Apple's (future) video streaming competitors including Netflix (NFLX), Walt Disney Company (DIS), and others. Apple is coming out swinging with star studded launches of its own exclusive TV shows including "The Morning Show" staring Reese Witherspoon, Jennifer Anniston, and Steve Carell along with "See" starring Jason Momoa. Furthermore, Apple is offering a free year of Apple TV+ with new purchases of iPhones, Macs, Apple TVs, and iPads.

We continue to like Apple in both our Best Ideas Newsletter and Dividend Growth Newsletter portfolios, and our fair value estimate for AAPL stands at $222/share. Apple shares yield 1.4% as of this writing.

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Goal of the Best Ideas Newsletter

The goal of the Best Ideas Newsletter is to highlight ideas with strong capital appreciation potential and to update readers about new developments in the market. A simulated portfolio of capital appreciation ideas is presented on page 8 of each edition.

Apple Makes…continued on next page

***Apple Makes…*from previous page**

The low starting price point of Apple TV+ will likely generate a lot of excitement around the offering, which we like, but we caution that Apple will probably need to raise its starting price point in the future.

Before then, Apple is launching gaming subscription service Apple Arcade on September 19, which also starts at $4.99 per month. That launch includes adding a new Arcade tab within Apple's app store, adding new games each month to the gaming subscription service, creating a personalized list of games users should consider playing, game trailers, game guides, and likely other additions as well that are related to the gaming world. These are mobile games for a broader audience, not to be conflated with the more time intensive and competitive games that are for relatively narrower audience groups. Games within Activision Blizzard (ATVI) *Call of Duty* or Electronic Arts (EA) *Battlefield* franchises, for example, are for a different crowd than those who would primarily spend their gaming hours on their phone, but there's some overlap of course.

Apple Arcade is going up against Alphabet (GOOG) (GOOGL) Google Play Pass offering, which is expected to launch soon. Just like with Apple TV+, Apple is running into some major competitors right out of the gate. However, Apple has very deep pockets and the ability to pours billions upon billions into these ventures while still adding cash to its already enormous net cash position (via its strong free cash flows). By utilizing its existing ecosystem and amazingly strong brand power, Apple has a fighting chance.

Beyond services, Apple announced that its new mobile operating system iOS 13 is coming September 19 and that iOS 13.1 will be available September 30, which comes with additional features. Apple announced three new iPhones; iPhone 11, iPhone 11 Pro, and iPhone 11 Pro Max, along with the Apple Watch Series 5. The company also reduced the price tag on some of its older offerings in order to broaden its customer base and ecosystem at-large.

Overall, the market seemed to like Apple's big update and bid shares of AAPL up on September 10, albeit only modestly. We continue to like Apple in both our Best Ideas Newsletter and Dividend Growth Newsletter portfolios. Additionally, we would like to highlight how a lot of the future value of Apple's equity comes from the expected free cash flows its services segment could generate, in our view, which will steadily become more relevant in the medium-term.

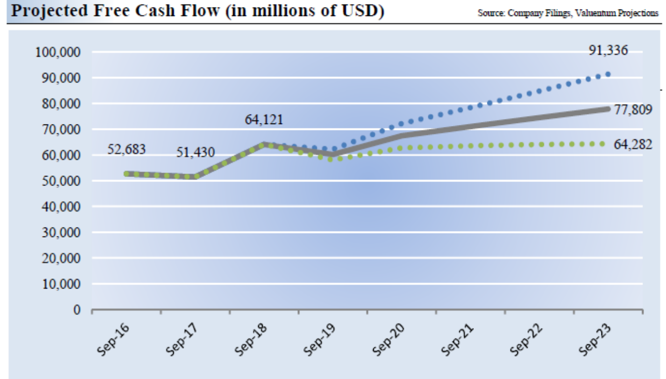
Free Cash Flow (CFO-capital expenditures)

		Last Fiscal Year FCF	3-year Historical CAGR	5-year Projected CAGR
Apple	USD	**64,121**	**-2.8%**	**3.9%**
BlackBerry	USD	51	-31.0%	55.7%
Cray	USD	96	-11.9%	-18.5%
Hewlett-Packard	USD	3,982	5.2%	-2.9%
IBM	USD	11,283	-4.9%	2.6%
Peer Median			-8.4%	-0.1%
Industry Median			-7.5%	3.3%

Apple's free cash flow expansion has been greater than that of both its peer group and industry group during the past three years. We expect the firm's free cash flow expansion to outpace its peer group and industry group during the next five years. BlackBerry sports the highest expected free cash flow growth rate among peers.

Projected Free Cash Flow (in millions of USD)

Source: Company Filings, Valuentum Projections



In the chart above, we show our baseline forecast for free cash flow as well as potential upside and downside cases.

Image Shown: *Apple's future free cash flow growth trajectory is supported by its push into high-margin services.*

Disclosure: *Callum Turcan does not own shares in any of the securities mentioned above.*

Why We Like BIN Holding Visa So Much

Image Source: *Visa Inc – 2018 Annual Report*

By Callum Turcan

One of our favorite holdings in the Best Ideas Newsletter portfolio is Visa (V), which has been included in the portfolio since November 2011. Visa's growth story is straightforward. The company is a secular growth play on the emergence of a global cashless society, one that is increasingly relying on debit and credit cards for most transactions. We think there's still an enormous amount of room left to go on this front, especially in emerging and developing markets. We assign Visa a fair value estimate of $182/share (updated in the middle of August) and the top end of our fair value estimate range sits at $218/share. **While Visa's share price has been volatile of late, we still like the company.**

Great Financial Performance

Unlike American Express (AXP) and Discover Financial Services (DFS), Visa does not take on credit risk as it doesn't issue credit cards. The payment processor issues Visa-branded cards from banks that do issue credit cards. Back in 2016, Visa completed its acquisition of Visa Europe and consolidated the business. In June 2019, Visa paid an additional €$1.1 billion as part of that deal (the firm was required to pay an additional €1.0 billion three years after closing, compounded at an annual 4% interest rate, which was agreed to when Visa acquired Visa Europe).

What makes Visa so appealing is its impressive long-term growth trajectory (supported by secular trends), strong free cash flow profile (in FY2018 that ended September 2018, Visa generated a whopping $12.0 billion in free cash flows), relatively low net debt load (at the end of June 2019 when Visa's fiscal third quarter for FY2019 concluded, the firm was sitting on $14.1 billion in cash, cash equivalents, short-term investment securities, and long-term investment securities versus $16.7 billion in total debt), ability to generate shareholder value (we give Visa a Very Attractive Economic Castle rating and an Excellent Value Creation rating), and management's disciplined capital allocation strategy.

*Why We Like...*continued on next page

***Why We Like...*from previous page**

Management prefers to allocate most of Visa's free cash flows to share repurchases (including $7.2 billion in FY2018), which we see as a good use of capital considering the intrinsic value of V continues climbing higher and given the firm's modest annual dividend commitment ($1.9 billion in FY2018). In FY2018, Visa paid down debt and that continued in FY2019 when the firm fulfilled its Visa Europe payment obligation (which was a debt-like instrument given it had a 4% interest rate). **Using free cash flows to cover capital allocation decisions (instead of relying on capital markets) and steadily trimming down its total debt load highlights Visa's focus on fiscal sustainability.** In the graphic below we highlight our enterprise cash flow analysis for Visa, which we cover further in the company's 16-page Stock Report.

Valuation Analysis

Valuation Assumptions

In Millions of USD (except for per share items)	5-year Projections	
Revenue CAGR %	11.4%	
Avg. EBIT Margin %	68.5%	
Avg. Cash Tax Rate %	15.0%	
Earnings Before Interest CAGR %	7.6%	
Earnings Per Share CAGR %	17.4%	
Free Cash Flow to the Firm CAGR %	7.6%	
Earnings before interest = Net operating profits less adjusted taxes	Long-term Projections	
Phase II --> III FCFF CAGR %	5.3% (II)	3% (III)
Cost of Equity %	9.5%	
After-tax Cost of Debt %	4.4%	
Discount Rate (WACC) %	9.2%	
Synthetic credit spread = 0.875%	Results	
Phase I Present Value	77,896	
Phase II Present Value	198,329	
Phase III Present Value	157,713	
Total Firm Value	433,938	
Net Balance Sheet Impact	-8,900	
Total Equity Value	425,038	
Diluted Shares Outstanding	2,329.0	
Fair Value per Share	$182.00	

Valuation Breakdown

In the chart below, we show the build up to our estimate of total enterprise value for Visa and the break down to the firm's total equity value, which we estimate to be about 425.04USD billion. The present value of the enterprise free cash flows generated during each phase of our model and the net balance sheet impact is displayed. We divide total equity value by diluted shares outstanding to arrive at our $182 per share fair value estimate.

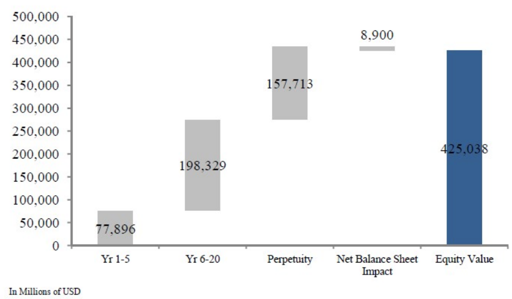


***Image Shown:** Our base case assumptions for Visa implies a total equity value of $425 billion or $182/share.*

In FY2019, Visa continued to be a free cash flow juggernaut. During the first three quarters of FY2019, Visa generated $8.2 billion in free cash flows which covered $6.5 billion in share repurchases and $1.7 billion in dividend payments. Visa has been steadily increasing its per share dividend payout, growing it from $0.12/share in early-2015 to $0.25/share by late-2018 (where it has stayed since, but another payout increase is likely on its way soon). Due to its stellar capital appreciation, Visa only yields 0.6% as of this writing on a trailing twelve-month basis.

***Image Shown:** Shares of Visa have been on a stellar run over the past few years.*

***Why We Like...*continued on next page**

*Why We Like…*from previous page

Using M&A to Augment the Growth Runway

Looking ahead, we are interested in seeing how Visa leverages its recent acquisitions to maintain its growth uptrend. The company completed its purchase of Earthport (provides cross-border payment services to banking institutions) in May 2019, announced plans to acquire Verifi (creates technology to reduce chargebacks) in June 2019, and completed the acquisition of Payworks (provides payment gateway point-of-sale software) in July 2019. These deals extend Visa's reach deeper into the payment processing and financial tech world and are relatively small for a company of its size. **Having stellar free cash flows makes investing in the future significantly easier to do while still rewarding shareholders.**

Management is targeting growth worldwide, and during a recent conference Visa mentioned that it had its eyes on Europe. The company noted that while Visa had missed out on certain trends in the European financial tech world like virtual prepaid and mobile initiatives, along with not being able to cater to affluent European travelers as well as it would have liked, Visa was beginning to gain traction on this front. Visa now sees these emerging areas representing significant growth opportunities and the company is very much open to engaging with emerging financial tech players to win new business. The company apparently has had meaningful success here, and thinks there's plenty of room to keep the momentum going (emphasis added);

> *"…around that time [of the Visa Europe acquisition] [there] was a pretty significant growth in the FinTech community and a lot of Neo banks, as they refer to [them] in Europe, that were evolving. And we missed a bit of an early growth cycle on some of those higher growth, extraordinarily innovative players that were focused on whole host of mobile initiatives, virtual prepaid, focused on affluent European travelers.*
>
> *And I think that after, I think, some early losses in some of that new business, organic business, there has been an improvement in our win rates and more of a focus that we've had on not just servicing our store clients, but being a lot more open to engaging some of these newer players.* ***And it's definitely resulting in some increased business for us****. And we've considered [this] to be a material growth opportunity.*
>
> ***In addition to that, I think, the long lead cycle you've got on selling into the credit business, which we've had some in Europe, but I think it's been underdeveloped [and] continues to be a high priority for us****. And we'll continue to look for opportunities to increase our win rate in our growth in credit and commercial products across Europe."*

We see Visa's recent acquisitions as augmenting its growth runway in Europe by giving it exposure to newer high growth areas while also bolstering its offering as it relates to winning over new credit and commercial customers. We will be watching this space closely to see how these endeavors play out.

Concluding Thoughts

Recent volatility in Visa's share price aside, the long-term trajectory of this company is sound, and shares of Visa currently trade modestly below our Fair Value Estimate of $182/share (~$177/share at of this writing). We like the strong upward momentum in Visa's share price year-to-date and expect that shares of V could test the upper bounds of our fair value range (as it stands today) over time. How the US-China trade war plays out and whether the US Federal Reserve cuts interest rates will likely play outsized roles in the performance of V in the short-term, however, in the long-term Visa is playing very strong secular growth trends with the ability to shift into different parts of the payment processing and financial tech world as needed to remain competitive. **Visa's growth runway and strong free cash flow profile are very appealing, and we continue to like V as a top holding in the Best Ideas Newsletter portfolio.**

Disclosure: *Callum Turcan does not own shares in any of the securities mentioned above.*

The Valuentum Strategy in Action: Why We Are Letting BIN Holding Dollar General Run Higher

Image Shown: *Best Ideas Newsletter holding Dollar General Corporation (DG) jumped up after posting great performance during the second quarter of its fiscal 2019 on August 29. The company has trounced the market return since it was added to the Best Ideas Newsletter in April 2017. We are letting this winner run higher.*

By Callum Turcan

On August 29, our favorite discount retailer Dollar General (DG) posted second quarter FY2019 earnings (ended August 2) that saw shares of this Best Ideas Newsletter portfolio holding fly higher after the report. GAAP net sales rose by 8.4% year-over-year and same-store sales were up 4.0% during the quarter, which we strongly appreciate, as Dollar General continues to showcase why flexibility and convenience are key to succeeding in a retail world facing threats from the rise of e-commerce. On an adjusted basis, e-commerce represented 10.7% of total retail sales in America during the second quarter of 2019, according to the US Department of Commerce, with total retail sales up 3.2% year over-year (also on an adjusted basis).

The Valuentum Strategy

Shares of Dollar General yield 0.8% as of this writing, largely a product of its stellar capital appreciation, and we are letting this winner run higher. **We recently updated our Dollar General model and increased our fair value estimate for shares of the company.**

*The Valuentum Strategy …*continued on next page

*The Valuentum Strategy …*from previous page

Valuation Analysis

Valuation Assumptions

In Millions of USD (except for per share items)	5-year Projections	
Revenue CAGR %	7.1%	
Avg. EBIT Margin %	8.8%	
Avg. Cash Tax Rate %	22.0%	
Earnings Before Interest CAGR %	9.9%	
Earnings Per Share CAGR %	12.5%	
Free Cash Flow to the Firm CAGR %	10.7%	
Earnings before interest = Net operating profits less adjusted taxes	Long-term Projections	
Phase II --> III FCFF CAGR %	4.7% (II)	3% (III)
Cost of Equity %	9.8%	
After-tax Cost of Debt %	4.3%	
Discount Rate (WACC) %	9.5%	
Synthetic credit spread = 1.18%	Results	
Phase I Present Value	7,064	
Phase II Present Value	16,633	
Phase III Present Value	12,129	
Total Firm Value	35,826	
Net Balance Sheet Impact	-2,629	
Total Equity Value	33,196	
Diluted Shares Outstanding	266.1	
Fair Value per Share	$125.00	

Valuation Breakdown

In the chart below, we show the build up to our estimate of total enterprise value for Dollar General and the break down to the firm's total equity value, which we estimate to be about 33.2USD billion. The present value of the enterprise free cash flows generated during each phase of our model and the net balance sheet impact is displayed. We divide total equity value by diluted shares outstanding to arrive at our $125 per share fair value estimate.

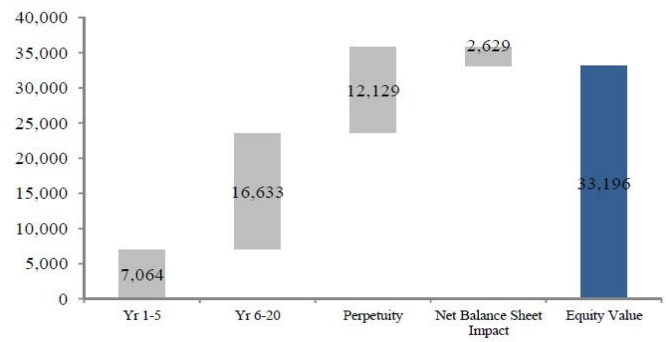


***Image Shown:** A look at how we view Dollar General's growth trajectory and how that influences the value of its estimated future free cash flows.*

Shares of Dollar General are trading at ~$158/share as of this writing, above the high end of our revised fair value estimate range ($150/share), which we see as a sign that the market is pricing in a more optimistic growth trajectory than our models suggest. **Please keep in mind that DG's favorable technicals represents a key reason why we are keeping Dollar General in our Best Ideas Newsletter portfolio.** We will cover that in greater detail at the end of this article (Page 9).

Dollar General is steadily pushing through meaningful dividend increases, a total shareholder return strategy underpinned by its growing free cash flows. From August 2015 to August 2019, Dollar General's quarterly dividend payout per share rose by over 45% to $0.32/share. The discount retailer has also been steadily chipping away at its outstanding share count via continuous share buybacks, which reduced its diluted share count by 3.4% per year over the past three fiscal years. Free cash flows of $1.4 billion in FY2018 handily covered $0.3 billion in dividend payments, allowing for $1.0 billion in share repurchases that fiscal year.

During the 2019 fiscal year that ends on January 31, 2020, Dollar General expects to post non-GAAP adjusted EPS of $6.45 - $6.60. For reference, Dollar General posted GAAP diluted EPS of $5.97 in FY2018. **The company raised its FY2019 guidance after its stellar second quarter performance.** Now Dollar General is targeting annual same-store sales growth in the low-to-mid 3% range for FY2019, versus 2.5% previously. Management also revised Dollar General's expected annual net sales (forecasted to grow by 8%) and adjusted operating income (forecasted to grow by 5% - 7%) growth upwards for FY2019 from previous estimates.

Covering Dollar General's Growth Trajectory

Dollar General's GAAP gross margins expanded by over ten basis points in the second quarter of FY2019 versus year-ago levels. **Management sees strong demand as key to supporting gross margin expansion but noted that tariffs pose a risk to internal expectations that Dollar General's gross margins will continue expanding during the second half of FY2019.** Strategic investments in Dollar General's Fresh (shifting towards self-distribution of perishables) and Fast Track (adding more self-checkout stands at its stores) initiatives are also at play.

*The Valuentum Strategy…*continued on page 9

Valuentum's Best Ideas Portfolio

By Valuentum Analysts

Latest newsletter portfolio changes
August 14: **Removed XLE, XLF**

Valuentum's BEST IDEAS -- as of September 15, 2019

Portfolio Holdings	Symbol	Div Yield %	Fair Value	Economic Castle	VBI Rating	P/FV	Last Close	% of Portfolio
Berkshire Hathaway	BRK-B	0.00%	$229.00	NA	5	0.93	213.61	7%-12%
Facebook	FB	0.00%	$227.00	Very Attractive	7	0.82	187.19	7%-12%
Alphabet - Class C	GOOG	0.00%	$1401.00	Very Attractive	3	0.88	1239.56	7%-12%
Visa	V	0.56%	$182.00	Attractive	6	0.97	177.27	7%-12%
Apple Corp.	AAPL	1.38%	$222.00	Highest Rated	6	0.99	218.75	7%-12%
SPDR S&P Dividend ETF	SDY	2.43%	NA	NA	UR	NMF	103.68	5.5%-7%
Health Care ETF	XLV	1.64%	NA	NA	UR	NMF	91.52	5.5%-7%
Cisco	CSCO	2.80%	$56.00	Very Attractive	3	0.89	50.03	4%-5.5%
Intel	INTC	2.38%	$51.00	Attractive	3	1.03	52.54	4%-5.5%
Johnson & Johnson	JNJ	2.91%	$151.00	Attractive	4	0.87	130.78	4%-5.5%
Booking Holdings	BKNG	0.00%	$2158.00	Highest Rated	6	0.96	2063.90	2.5%-4%
Dollar General	DG	0.81%	$125.00	Attractive	4	1.26	157.78	2.5%-4%
General Motors	GM	3.89%	$49.00	Attractive	6	0.79	38.86	2.5%-4%
PayPal	PYPL	0.00%	$125.00	Attractive	3	0.86	107.00	2.5%-4%
Vanguard REIT ETF	VNQ	3.29%	NA	NA	UR	NMF	91.64	2.5%-4%
Cash consideration	-	-	-	-	-	-	-	**10.0%**

UR = Under Review
This portfolio is not a real money portfolio. Data as of September 15, 2019.

The cash weighting in the Best Ideas Newsletter portfolio is now 10%. The midpoints of our respective weighting ranges sum to 100% to reflect the range of possible combinations that may result in this allocation.

Goal: The Best Ideas Newsletter portfolio seeks to find stocks that have both good value and good momentum characteristics and typically includes in the portfolio each idea from a Valuentum Buying Index rating of a 9 or 10 (consider buying) to a rating of a 1 or 2 (consider selling). Just like a value manager may not include every single undervalued company in the market in his/her portfolio, not all highly-rated companies on the Valuentum Buying Index are included in the portfolio.

We may tactically add to or trim existing positions in the portfolio on the basis of sector or broader market considerations, but we seek to capture a stock's entire pricing cycle (from being underpriced with strong momentum to being overpriced with poor momentum). The Best Ideas Newsletter portfolio puts the Valuentum Buying Index into practice.

Every person has different goals and different risk tolerances, so where before in the newsletter portfolios, we would outline the specific percentage weighting, we think providing ranges make much more sense. For example, depending on someone's risk tolerances, a larger cash position in an overheated market may be prudent. On the other hand, the longer one's time horizon, perhaps a smaller cash position may make more sense.

Ideas may not add up to 100% on either the low % or high % due to rounding and/or other combinations / permutations.

*The Valuentum Strategy…*from page 7

Going forward, management sees room for an additional 12,000 – 13,000 store locations in the US on top of the almost 15,400 locations Dollar General had at the end of its FY2018. Almost 1,000 new store openings are planned for FY2019, along with material remodeling and relocation activities as well. Capital expenditures are forecasted at $0.8 billion. Furthermore, management plans to repurchase $1.0 billion of Dollar General's stock in FY2019. **Same-store sales growth and a growing store count underpin our growth estimates for Dollar General.**

Rising net sales, rising same-store sales, stable gross margins, and an expanding physical store footprint indicates Dollar General is firing on all cylinders. Consumables represent about four-fifths of Dollar General's sales, and customers like the convenience the discount retailer offers (especially now that self-checkout stands being rolled out). Management mentioned during Dollar General's quarterly conference call that the firm experienced strong demand for both its consumable and non-consumable products (particularly seasonal and in-home goods).

Note the Valuentum strategy isn't based *only* on momentum, per se, or trying to call a top, but instead rests on using a combination of discounted cash flow analysis and proprietary metrics to find what we consider to be the best undervalued equities that are appreciating in price (indicating shares are converging towards our intrinsic value estimate). We only remove big winners when their technicals turn negative as shares are trading well above our fair value estimate, indicating the market (in that scenario) now views shares of the equity in question as fully valued (if not overvalued).

We view technical/momentum indicators as another layer to our valuation framework in that we view a rising stock price as an indication that the market believes shares should be valued higher and a falling stock price as an indication that shares should be valued lower. Just as we view an appreciating stock price on an undervalued stock as a good thing, we view a falling stock price on an overvalued stock as a bad thing.

This graphic is for illustration purposes only.

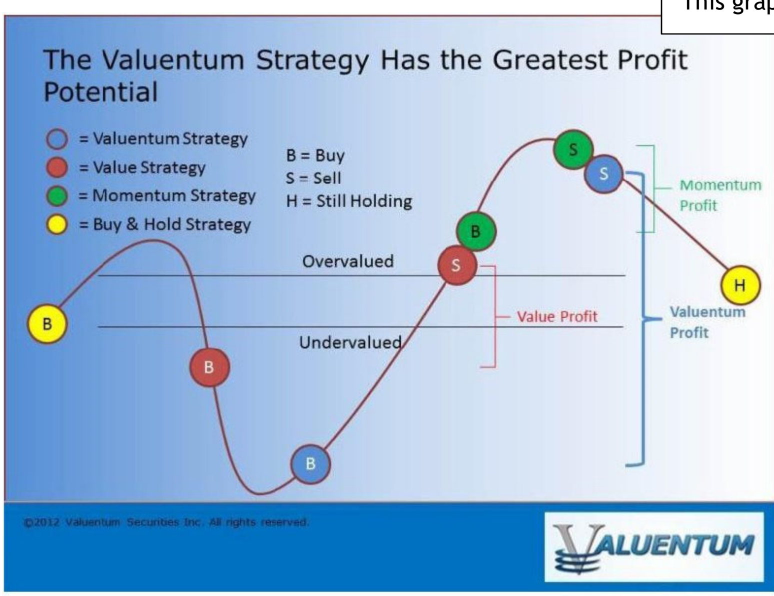


Image Shown: *A visual overview of the Valuentum strategy in action.*

Concluding Thoughts

We are letting Dollar General run higher because we think the market is just as optimistic, or maybe even more so, on the company's prospects than we are, indicating there's room for further capital appreciation. If Dollar General ever wanted to augment its dividend growth story, the firm could pare back its annual share repurchases to make room for significant per share dividend increases.

Disclosure: *Callum Turcan does not own shares in any of the securities mentioned above.*

Economic Roundtable: "Value" Versus "Growth" Rotation

"This kind of trading activity could be setting the stage for a big quant fund blow up, if the kind of leverage it takes to move the markets to this magnitude was applied. All it may take is for the B/M "value" factor to continue to suffer in the coming 12-18 months--it's possible we could see a few quant firms go belly up. My guess is that market participants are paying very close attention to this activity, and if they "smell blood," things could get ugly." – Brian Nelson, CFA

By Valuentum Analysts

A version of this article was emailed to subscribers on September 11.

Earlier this week, the markets experienced significant internal "rotation," as cyclicals and "value" stocks materially outperformed their defensive and "growth" counterparts, all the while the broader equity markets remained relatively quiet. Let's pick up where we last left off in the latest Economic Roundtable, finishing our team's views on "The Big Short" Michael Burry's views on why index funds are like subprime CDOs, from Bloomberg:

> Burry, who made a fortune betting against CDOs before the crisis, said index fund inflows are now distorting prices for stocks and bonds in much the same way that CDO purchases did for subprime mortgages more than a decade ago. The flows will reverse at some point, he said, and "it will be ugly" when they do.
>
> "Like most bubbles, the longer it goes on, the worse the crash will be," said Burry, who oversees about $340 million at Scion Asset Management in Cupertino, California. One reason he likes small-cap value stocks: they tend to be under-represented in passive funds.
>
> "Central banks and Basel III have more or less removed price discovery from the credit markets, meaning risk does not have an accurate pricing mechanism in interest rates anymore. And now passive investing has removed price discovery from the equity markets. The simple theses and the models that get people into sectors, factors, indexes, or ETFs and mutual funds mimicking those strategies -- these do not require the security-level analysis that is required for true price discovery.
>
> "This is very much like the bubble in synthetic asset-backed CDOs before the Great Financial Crisis in that price-setting in that market was not done by fundamental security-level analysis, but by massive capital flows based on Nobel-approved models of risk that proved to be untrue."
>
> "The dirty secret of passive index funds -- whether open-end, closed-end, or ETF -- is the distribution of daily dollar value traded among the securities within the indexes they mimic.
>
> "In the Russell 2000 Index, for instance, the vast majority of stocks are lower volume, lower value-traded stocks. Today I counted 1,049 stocks that traded less than $5 million in value during the day. That is over half, and almost half of those -- 456 stocks -- traded less than $1 million during the day. Yet through indexation and passive investing, hundreds of billions are linked to stocks like this. The S&P 500 is no different -- the index contains the world's largest stocks, but still, 266 stocks -- over half -- traded under $150 million today. That sounds like a lot, but trillions of dollars in assets globally are indexed to these stocks. The theater keeps getting more crowded, but the exit door is the same as it always was. All this gets worse as you get into even less liquid equity and bond markets globally."

Callum Turcan: Liquidity risk is something passive fund investors aren't taking seriously and haven't in a long time, if ever. There's far more trading volume in these passive funds than in most of the underlying equities/commodities themselves which could create the liquidity squeeze of a lifetime if things go south. Burry's example that the exit door is the same size as it always was but the crowd inside the theater is now much larger is perfect. If the theater catches fire, many will get burned as they can't leave in time.

*Economic Roundtable...*continued on next page

*Economic Roundtable…*from previous page

Callum: Additionally, there are a lot of mediocre funds out there that invest in lightly traded equities. Let's say that the fund in question is facing a lot of redemptions as the market is tanking and investors want to sell out. The fund's liquidity is quickly used up, forcing the fund to sell down its equity positions at meaningful discounts as the sudden surge in selling activity in lightly traded equities overwhelms the limited amount of buying activity. That in turn prompts more investors to seek redemptions as the value of the fund is eroding away at an even faster rate now, forcing the fund to further sell off its holdings to raise cash. This is all happening while the market is free falling, creating a snowball effect.

Matthew Warren: I think that is one of the causes of these large air pockets. If a particular stock or sector is sold down quickly because of flows at a particular point in time, it drives more action from the algos. If the comp trades down by 5-10%, the algo assumes something changed about the state of the future macro or cash flows. The comps then trade down in sympathy. That creates algo selling of still more comps. If the real-people investors pause because they are worried that the market knows something that they don't, the irrational selling continues. Given career risk, it requires a ton of courage to start buying when all of the algos are selling into light volume. I think that's what happened last December. Because the tail wags the dog and there is such a large confidence and wealth effect, a similar drawdown to December that stayed down could easily cause a recession in my opinion.

Callum: The wealth effect in America is thought to marginally enhance GDP growth when positive due to minor increases in consumer spending, but conversely can have a really adverse impact on consumption when negative. Factor in dynamic effects (a precipitous drop in the stock market leads to reduced consumption leads to reduced business investment, which was already hurting from subdued business confidence levels due to the trade war, which in turn further reduces consumption levels and leads to even sharper stock market declines and so forth) and I can see how a recession forms.

Brian Nelson: I think it is simply disingenuous to dismiss the sound reasoning behind "The Big Short" Michael Burry's take on the passive bubble and the risks of lower volume, lower value-traded stocks. Here's an excerpt from a piece I wrote last year (image as of July 2018, also published in *Value Trap*).

Indexing Moves Markets -- It is Not "Passive"

Figure 1: LongFin Corp (LFIN)[1]

Figure 1 shows how pricing action does not discriminate between the active or index buyer. Indexing drives prices, and indexing activity, itself, can create market inefficiencies, as shown in the Longfin Corp (LFIN) example.

[1] Smith, Peter. "Investors nurse $10m losses on LongFin index mistake. Financial Times. https://www.ft.com/content/acb5ddb6-3341-11e8-ac48-10c6fdc22f03

*Economic Roundtable…*continued on next page

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On February 14, 2018, FTSE Russell announced that it would add Longfin Corp (LFIN) to the Russell 2000 and 3000 indices. The news caused Blackrock and other index trackers to buy nearly half of the freely available float in Longfin, "pushing the shares up from their February low of $32 to above $71," according to the Financial Times.

Once FTSE Russell noted they made a mistake, and that Longfin did not meet the 5% free-float requirement to be included in the Russell indices, the stock was removed from the indices after the close March 28, 2018, meaning Blackrock and other index tracking funds, including Vanguard and Charles Schwab, also had to sell their shares at a loss. The idea is not necessarily whether this "mistake" was material to index fund returns, but rather it's important because it shows directly how indexing impacts pricing, causing inefficiencies.

Though this is an extreme example that shows indexing drives prices and that indexing can create inefficiencies, it is no less important of an example, and perhaps its very existence has significant implications. We hypothesize, for example, that, given this empirical evidence, not only can inefficiencies exist in the marketplace, but that some inefficiencies are driven by index investing, itself, and might be explained, in part, as a function of the company's weight in the index, and how many shares are required to be owned by index trackers versus the company's outstanding float.

Should the weight of the company in an index cause a large percentage of the float to be purchased by index trackers, there may be greater potential for index-driven inefficiencies over an undefined time period (image as of July 2018, also published in *Value Trap*).

Figure 2: Explaining Potential Price Inefficiencies Caused By Indexing

$$Index - driven\ inefficiencies = \frac{shares\ purchased\ by\ index\ trackers\ to\ achieve\ index\ weight}{shares\ in\ outstanding\ float}$$

Figure 2 states that the price inefficiencies caused by indexing are, in part, a function of the shares purchased by index trackers to achieve their respective index weightings and the shares in the outstanding float, where there may exist a positive correlation between index-driven inefficiency and the ratio over an undefined time period.

[Longfin is now a penny stock, trading for ~$0.70 per share at the time of this writing.]

Let's talk about some names in particular. It's really peculiar what is happening with Visa (V) and PayPal (PYPL), for example, and some of the profit taking in these names that is going on during this rotation.

Callum: Payment processing and financial technology names getting hurt might be due to a rotation out of growth and momentum stocks, and towards "value" plays (really blue chips and equities that are considered "safer"). I don't quite get the reasoning behind others making this trade either, particularly given the strong fundamental performance of Visa and PayPal (in terms of their financial performance and strong free cash flows).

Matthew: Given the recession uncertainty, people had flocked to safety by seeking out secular growth (and bond proxies). Those short-hand valuation metrics are WAY higher than the cyclicals, which had de-rated. The past few days is a reversal of trend, exacerbated by short covering in cyclicals and weak conviction holders of high-quality secular growers. Whether it is a partial reversal of trend or something bigger I think depends on whether we get the green light of no recession probability. I personally don't expect that. Even if the recession is 2-3 years away, I think we will worry ourselves all the way there given the 10-year bull market.

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Callum: Price-agnostic trading creates these kinds of low-conviction long equity holders, namely "weak-hands" momentum buyers who are quick to flee equities on low single-digit down days. We will have to see if interest in secular growth picks up after the most recent sell off, but I suspect substantial volatility will continue until at least the upcoming FOMC meeting on September 17-18.

If there ever were an event that could play an outsize role in helping the US economy avoid recession, it might come down to whether we get a large preemptive interest rate cut or not from the US Federal Reserve. Not so much because lower interest rates would have a large positive effect on the economy (there will be positives from lower rates, of course, but the upside is limited when rates are already low), but because a material interest rate cut might soothe capital markets and spur greater business investment as US recession fears truly begin to recede. That might not represent the green light you mentioned Matt, indicating recession fears are completely unfounded, but the light might change from a sharp orange-red to a nice yellow instead.

Really, it's a confidence game, and investors shifting into cyclicals indicates investor confidence is growing in the outlook of the global economy--oil (USO, OIL) and metals prices (XME) strengthening recently further reinforces this sentiment. Now, the US Federal Reserve needs to deliver, otherwise that paradigm shift might not last. For secular growth, those names should do well in a lower interest rate environment as their future free cash flows grow in relative value (due to the lower discount rate the market will apply to those future free cash flow streams), at least in theory, so I think caution is our best approach right now. If the US Fed doesn't cut rates, and recession fears keep building, then it's hard to say but investors would likely pile back into secular growth names.

Matthew: I don't think we'll ever be able to outguess the daily or weekly or monthly wiggles in the market marking up and down the probability of recession. To me, the best bet is to limit the fishing pond to high quality companies and then constantly sift for the best value for money being served up by Mr. Market. If SAAS valuations go nuts, you shift some money into high quality cyclicals that are beaten down, and vice versa. So--it's up to us to have high quality identified in advance and be watching valuations. You tilt the portfolio towards and away from beta based on the opportunities the market serves up.

Callum: I like that approach. As it relates to Visa and PayPal, neither company appears overvalued right now based on our discounted free cash flow analysis (Visa trades near our fair value estimate, PayPal trades at the low end of our fair value estimate range), and both are high quality names playing secular growth trends. I think that short-term volatility aside, they should continue performing well going forward, and my only real concern relates to PayPal's weak technical performance since July 2019 (Visa has shifted lower over the past few days but is still on a powerful upward trend).

Matthew: I agree that if you like the moat, the tailwind, the management and culture, the fundamental risk profile, and the valuation, then there is a lot to like and holding through volatility equals conviction in your analysis.

Brian: I get the sense that a few quant firms are making some huge leveraged bets.

I don't think this is rational buying, but more akin to what might best be described as the gambler's fallacy, doubling down after decades of losing, trying to make it all back with leverage. The traditional price-to-book (book to market, B/M) "value" factor, for example, has been underperforming so much during the past 15 to 30-year stretch, that I think the quants are expecting or rather hoping for a massive "reversion to the mean." The problem is that there's been a structural shift in the data, and book value just isn't as indicative of intrinsic value as it once was when banks and industrials ruled the S&P 500. This kind of trading activity could be setting the stage for a big quant fund blow up, if the kind of leverage it takes to move the markets to this magnitude was applied. All it may take is for the B/M "value" factor to continue to suffer in the coming 12-18 months--it's possible we could see a few quant firms go belly up.

*Economic Roundtable...*continued on next page

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My guess is that market participants are paying very close attention to this activity, and if they "smell blood," things could get ugly. I remember LTCM saying that when they tried to unwind their portfolio it was as if others had the same positions, were imitating them, or something like that. Seems like a very similar set up with just how popular the B/M "value" factor has become.

In any case, the dynamics of the past couple trading sessions seem to speak heavily to the considerable systemic risks caused by quants. Things are certainly interesting: Cross sectional dispersion of the daily standard deviation of single stock returns was near the 97th percentile, while distribution between value and momentum was phenomenal compared to baseline over the past 10 years.

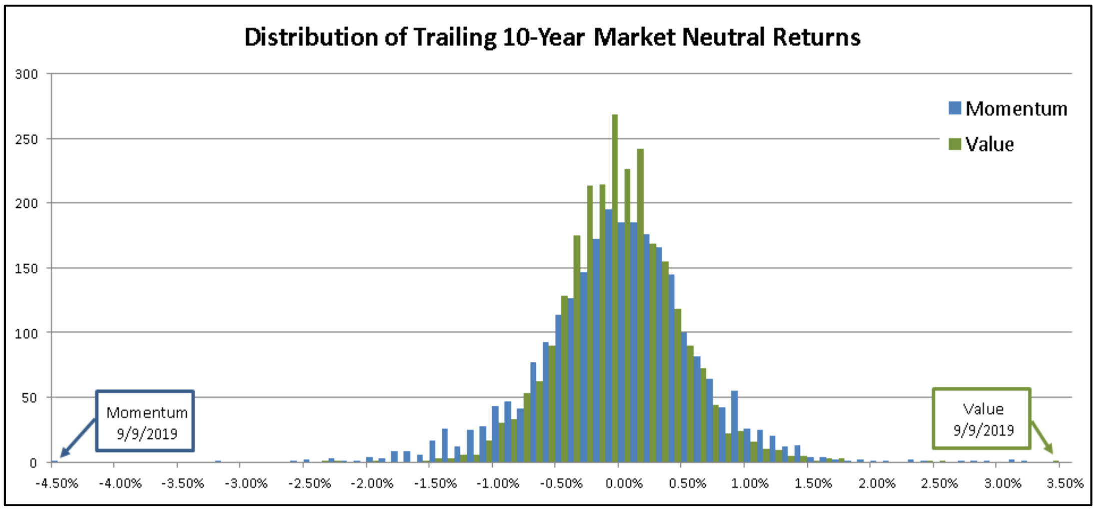


Image Source: *Josh Russell*

Matthew: Very interesting hypothesis, Brian. As for why now or why the magnitude of the move, perhaps quant funds were piling on top of each other once it started?

I very much agree with you about B/M being less relevant than when banks and industrials used to be a larger part of the index. A lot of the value-creating tech and users of tech companies that have grown up over the years in fact deserve a lower B/M ratio to reflect the return on capital spread from value creation.

Brian: Thanks Matt. As we wrap up, let's address a question from a member. Here's the question:

> *Noticed in the new Dividend Growth Newsletter that you included the table entitled "Stocks with High Valuentum Buying Index Ratings and Strong Dividend Growth Prospects" in which AmerisourceBergen (ABC) was still listed with a VBI of 9.*
>
> *Somewhat surprised, since the VBI of 9 was in the May 24 report on this stock (when its price was comparable), and in the last few weeks the opioid litigation developments in Oklahoma and Ohio have changed the outlook of liabilities for distributors like ABC. While the stock is back trading at the lower end of your fair value range, it does not have the offsetting breadth of JNJ in businesses nor its scale. Does your VBI incorporate the "one-time legal exposure"? I would consider buying this stock once its liabilities are more clarified, as the price may decline further before recovering.*

Thanks for the question.

The Valuentum Buying Index is a multi-faceted process that considers enterprise valuation (including a margin of safety that implicitly considers exogenous developments such as unexpectedly large, one-time potential liabilities), relative valuation, and share-price momentum. We use the VBI as a source of idea generation (not as the only factor in considering adding an idea to a newsletter portfolio). We took a pass on adding AmerisourceBergen to any newsletter portfolio for now, but we're still watching it.

Home Depot, Lowe's Largely Unfazed By Lumber Price Deflation

By Brian Nelson, CFA

On August 20, Home Depot (HD) reported decent second-quarter results, with total reported sales advancing 1.2% on a year-over-year basis thanks to solid comparable store sales expansion of 3% (3.1% in the U.S.). Net earnings came in at $3.17 per share, growing 3.9% from the same period a year ago. Though many viewed the comp performance as somewhat disappointing, management noted that it experienced "accelerating comp performance throughout the quarter." Home Depot did note that lumber prices and tariffs would impact full-year sales guidance, however:

> *"We are encouraged by the momentum we are seeing from our strategic investments and believe that the current health of the U.S. consumer and a stable housing environment continue to support our business. That being said,* ***lumber prices have declined significantly compared to last year, which impacts our sales growth. As a result, today we are updating our sales guidance to account primarily for continued lumber price deflation, as well as potential impacts to the U.S. consumer arising from recently announced tariffs****. We are reaffirming our earnings-per-share growth guidance for fiscal 2019."*

Home Depot now expects fiscal 2019 sales to grow ~2.3% and for comparable store sales to increase 4%. Management had been targeting sales growth of ~3.3% previously, and comparable store sales expansion in the range of 5%. The revision seems to be mostly driven by lumber price deflation, which negatively impacted comp performance during the most recently reported period by more than 100 basis points. Home Depot CFO Carol Tomé had the following to say on the conference call:

> *"While global economic pessimism has increased due to geopolitics, currently, the U.S. consumer remains healthy. Consumer confidence is near record high levels and wages are up over 3% from last year. Housing metrics are in line with the assumptions we used to build our 2019 financial plan. Nonetheless, what we didn't expect when we built our plan was the significant lumber price deflation we've experienced.* ***We are now more than halfway through the year and lumber prices are below the levels we saw in the first quarter of fiscal 2019…Additionally, the U.S. consumer is facing the impact of tariffs****. While trade discussions are fluid, consumer demand could be impacted."*

Lowe's (LOW) reported strong second-quarter results August 21 that showed total sales advance 0.5% thanks to comparable store sales growth of 2.3%, well ahead of consensus expectations of ~1.8%. The big story in the report is that Lowe's U.S. home improvement business increased 3.2% during the period, which came in better than the pace of expansion (3.1%) that Home Depot reported in the U.S. Although Home Depot's overall pace of growth is better than that of Lowe's, it seems as though the latter is starting to make some headway against Home Depot in the ultra-competitive U.S. home improvement retailing market. The second quarter of 2019 is now the second quarter in a row that Lowe's U.S. comp was better than Home Depot's. Lowe's CEO Marvin R. Ellison had the following to say about the second-quarter performance:

> *"We capitalized on spring demand, strong holiday event execution and growth in Paint and our Pro business to deliver strong second quarter results.* ***Despite lumber deflation and difficult weather, we are pleased that we delivered positive comparable sales in all 15 geographic regions of the U.S****. This is a reflection of a solid macroeconomic backdrop and continued momentum executing our retail fundamentals framework."*

Looking ahead, Lowe's is targeting total sales to increase ~2%, while comparable store sales are targeted at ~3%. Diluted earnings per share is expected in the range of $5.45-$5.65 for the fiscal year ending January 31, 2020. We've viewing the reaffirmation of the top and bottom-line guidance as almost a guidance raise in light of deteriorating lumber prices, so the quarterly report at Lowe's was very much a standout. Shares of Lowe's were up double-digits during the trading session August 21.

*Home Depot, Lowe's…*continued on next page

*Home Depot, Lowe's…*from previous page

Concluding Thoughts

The home improvement retailing market appears very, very healthy, and while consumers could have already taken advantage of ultra-low rates to do home repairs, additional Fed cuts certainly won't hurt the backdrop for home improvement retailers. Home Depot and Lowe's continue to put up solid results.

Though the trajectory of Home Depot's 2019 sales expansion has changed modestly lower, we don't view the sales revision as material enough for us to adjust our valuation model. We believe Home Depot's shares are fully priced at current levels, trading above the high end of our fair value estimate range of ~$210 per share. The firm's Dividend Cushion ratio stands at 1.2x, while it sports a healthy dividend yield of ~2.3%.

We like what we're seeing at Lowe's, especially in the strength of it U.S. operations, but shares are also fully priced, albeit not as expensive as that of Home Depot. The high end of our fair value estimate for Lowe's is $118 per share, so the company still has some room to run before we would consider shares to be significantly overpriced (shares are trading at ~$109 at the moment). The company's Dividend Cushion ratio stands at 1.9x, while it pays a dividend yield of ~1.9%.

Nvidia Beats Low Expectations and Shares are Rewarded Accordingly

By Callum Turcan

Nvidia Corporation (NVDA), like the rest of the semiconductor industry, has been on a wild ride over the past few years. On the one hand, the industry has benefited from the cloud-computing build out and the rise of smartphones, along with the emergence of autonomous driving, the internet of things ("IoT"), machine learning, and artificial intelligence. On the other hand, semiconductors are now contending with headwinds from the bust in the cryptocurrency craze, the sharp slowdown in data center investments due in part to ongoing trade wars, and other factors like excess inventory. Expectations were very low for Nvidia heading into its second quarter FY2020 earnings, released August 15, which is largely why shares moved up significantly after the report indicated things weren't as bad as feared. Shares of NVDA yield 0.4% as of this writing.

Earnings Overview

In the second quarter of FY2020 (quarter ended on July 28), Nvidia generated $2.6 billion in GAAP revenue, down over 17% year-over-year while its GAAP gross margin dropped by ~350 basis points to 59.8%. **The company is contending with declining data center demand (particularly from large-scale cloud services providers) and weaker demand for graphics cards.** Here's what management had to say during Nvidia's quarterly conference call;

> *"Moving to data center[s], revenue was $655 million, down 14% year-on-year and up 3% sequentially. In the vertical industries portion of the business, expanding AI workload drove sequential and year-over-year growth. In hyperscale portion, we continue to be impacted by relatively weak overall spending at a handful of CSPs. Sales of NVIDIA GPUs for use in the cloud were solid. While sales of internal hyperscale use were muted, the engineering focus on AI is growing."*

Part of Nvidia's rebound strategy involves building new partnerships with companies that need help modernizing operations. We don't think it would be a controversial statement to say that Walmart Inc (WMT), until more recently (seen through its improving e-commerce segment), has not made the necessary investments in technology to keep up with disruptors like Amazon Inc (AMZN), ipso facto for Amazon eating Walmart's lunch in the US e-commerce arena.

*Nvidia Beats Low…*continued on next page

***Nvidia Beats Low…*from previous page**

To keep up, Walmart teamed up with Nvidia and is utilizing the semiconductor company's GPU offerings to forecast product demand within hours in order to keep the retailer's warehouses stocked with goods in demand. Previously, it could take weeks to finish updating product demand forecasting models. Nvidia's computing power takes out a lot of the legwork and most importantly, allows for much quicker changes to Walmart's supply chain. Also, Walmart is utilizing Nvidia's computing power to optimize and augment its e-commerce offerings including enhancing its logistics and last-mile delivery processes. **More broadly, Nvidia's future is built on the integration of everything. Increasingly, investments in technology, and by extension investments in computing power, are what separate good companies from bad, well-run bureaucracies from inefficient nightmares, and so forth.**

Back in July, Nvidia launched its GeForce RTX SUPER Series to revive its gaming segment's financial performance, keeping in mind there are signs Nvidia is holding the line in the high-end PC gaming space. Looking ahead, Nintendo Co. Ltd.'s (NTDOY) upcoming Switch Lite console will be powered by an Nvidia processor, possibility its Tegra system-on-chip ("SoC") offering.

In the third quarter of FY2020, Nvidia is targeting a GAAP gross margin of ~62.0% and revenue of ~$2.9 billion, indicating management expects sequential improvement in the company's financial performance. Shares of Nvidia jumped after its latest earnings report because investors saw brighter skies ahead, highlighting how equities trade on future expectations and not their historical performance.

Acquisition in Progress

Nvidia is in the process of acquiring Mellanox Technologies Ltd. (MLNX), which makes computer networking products, in a transaction valued at $6.9 billion by enterprise value through an all-cash deal announced in March 2019. The transaction still needs approval from Chinese and European regulators, which will likely depend on the state of US-World geopolitical relations. From Nvidia's latest quarterly conference call:

> *"Regarding our pending acquisition of Mellanox, we have received regulatory approval in the U.S. and are engaged with regulators in Europe and China. The approval process is progressing as expected, and we continue to work toward closing the deal by the end of this calendar year."*

We will see how the regulatory situation plays out moving forward. **Shares of MLNX trade at approximately $108/share as of this writing, well below Nvidia's cash offer of $125/share, largely due to fears that Chinese regulators won't approve the deal.** This is a good example of how investors can use the market to gauge expectations. If investors thought the deal was going to get approved, shares of MLNX would likely trade quite close to Nvidia's all-cash offer.

Nvidia ended the second quarter of FY2020 with $8.5 billion in cash and cash equivalents on hand versus just $2.0 billion in total debt. We appreciate the company's stellar balance sheet and note that the Mellanox deal can be fully funded with cash on hand. Historically, Nvidia has been very free cash flow positive and we expect those free cash flows to continue growing going forward

Concluding Thoughts

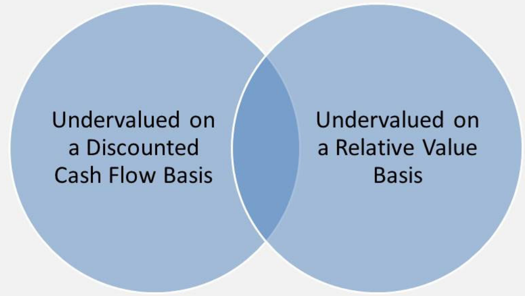
Nvidia beat low expectations and its share price was rewarded accordingly, keeping in mind NVDA trades well off its 2018 highs. Our fair value estimate for NVDA stands at $184 per share, meaningfully above where shares are trading at, as of this writing. We are staying away from the name given risks associated with its purchase of Mellanox, weakness in data center demand in the face of trade war concerns and the synchronized slowdown in global economic activity, and in light of Nvidia's low VBI rating. We think there are better investment opportunities out there, but we can respect that Nvidia is showing promising signs of improvement.

Disclosure: *Callum Turcan does not own shares in any of the securities mentioned above.*

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 the Best Ideas Newsletter 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/momentum 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. You'll see we often hold a number of these stocks 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.

[Screen expanded to include stocks with NEUTRAL and UNATTRACTIVE relative value ratings.]

You'll notice there are not many ideas in this market that pass this stringent "value" test. We continue to emphasize that some of our best ideas are included in the newsletter portfolios.

Company Name	Symbol	Industry	DCF Valuation	Relative Valuation	Price/Fair Value
Owens-Illinois	OI	Containers & Packaging	UNDERVALUED	ATTRACTIVE	0.63
Mylan	MYL	Pharma - Generic/Other	UNDERVALUED	NEUTRAL	0.63
Cardinal Health	CAH	Healthcare Products	UNDERVALUED	ATTRACTIVE	0.65
DXC Technology	DXC	IT Services	UNDERVALUED	NEUTRAL	0.65
Fluor	FLR	E&C	UNDERVALUED	ATTRACTIVE	0.65
Continental Resources	CLR	Independent Oil & Gas	UNDERVALUED	ATTRACTIVE	0.65
Lear Corp	LEA	Auto Parts Suppliers	UNDERVALUED	ATTRACTIVE	0.67
CVS Health	CVS	Food Retailers	UNDERVALUED	NEUTRAL	0.68
SMART Global Holdings	SGH	Computers & Peripherals	UNDERVALUED	NEUTRAL	0.70
General Motors	GM	Auto Manufacturers	UNDERVALUED	NEUTRAL	0.71
Gilead Sciences	GILD	Pharma - Generic/Other	UNDERVALUED	NEUTRAL	0.73
AutoNation	AN	Specialty Retail - auto	UNDERVALUED	ATTRACTIVE	0.73
EOG Resources	EOG	Independent Oil & Gas	UNDERVALUED	NEUTRAL	0.74
FedEx	FDX	Air Freight & Logistics	UNDERVALUED	ATTRACTIVE	0.76
Mosaic	MOS	Chemicals - agriculture	UNDERVALUED	ATTRACTIVE	0.77
AmerisourceBergen	ABC	Healthcare Products	UNDERVALUED	ATTRACTIVE	0.78
Discover Financial	DFS	Banks & Money Centers	UNDERVALUED	UNATTRACTIVE	0.78
Verint	VRNT	Business Services	UNDERVALUED	NEUTRAL	0.79
LG Display	LPL	Electronic Suppliers	UNDERVALUED	UNATTRACTIVE	0.79
Hillenbrand	HI	Personal Services	UNDERVALUED	ATTRACTIVE	0.79
Tapestry	TPR	Luxury - Ultra & Aspirational	UNDERVALUED	ATTRACTIVE	0.79

The price-to-fair value measures reflect the metric at the time of report publishing and may differ from today's metric.

Ideas...from previous page

Sourcing Ideas from the Valuentum Buying Index

The first table below showcases stocks that may fit the bill of the Valuentum investor, with each posting a 9 or a 10 on the Valuentum Buying Index. These are names that we may swap into the simulated Best Ideas Newsletter portfolio on the long side (if not already held) should their upside potential become greater than our current holdings, in our view.

We also show firms that register a 1 or 2 on the VBI. These names represent put-option candidates, or stocks that we might generally avoid. We provide the respective lists below, and each company's stock report can be found on our website at www.valuentum.com.

AmeriSourceBergen (ABC) is the only company in our coverage that registers either a 9 or 10 on the Valuentum Buying Index at this time (the best rating). Please note that we passed on adding ABC to the newsletter portfolios.

Company Name	Symbol	Sector	Industry	VBI
Lancaster Colony	LANC	Consumer Staples	Food Products	1
McCormick	MKC	Consumer Staples	Food Products	1
Mondelez Intl	MDLZ	Consumer Staples	Food Products - Large	1
RBC Bearings	ROLL	Industrials	Machinery & Tools	1
Brown-Forman	BF.B	Consumer Staples	Beverages - alcoholic	2
Diageo	DEO	Consumer Staples	Beverages - alcoholic	2
Ecolab	ECL	Materials	Chemicals - broad	2
Amphenol Corp	APH	Information Technology	Electronic Suppliers	2
Corning	GLW	Information Technology	Electronic Suppliers	2
Dolby	DLB	Information Technology	Electronic Suppliers	2
Waste Connections	WCN	Industrials	Environmental Services	2
MBIA Inc	MBI	Financials	Insurance - Property & Casualty	2
Selective Insurance	SIGI	Financials	Insurance - Property & Casualty	2
LVMH	LVMHF	Consumer Discretionary	Luxury - Ultra & Aspirational	2
Graco	GGG	Industrials	Machinery & Tools	2
Bright Horizons Family	BFAM	Consumer Discretionary	Personal Services	2
McDonald's	MCD	Consumer Discretionary	Restaurants - Fast Food & Coffee	2
Starbucks	SBUX	Consumer Discretionary	Restaurants - Fast Food & Coffee	2
Synopsys	SNPS	Information Technology	Semi Equipment	2
VeriSign	VRSN	Information Technology	Software - security	2
Allete	ALE	Energy	Utilities	2
MGE Energy	MGEE	Energy	Utilities	2
Sempra Energy	SRE	Energy	Utilities	2

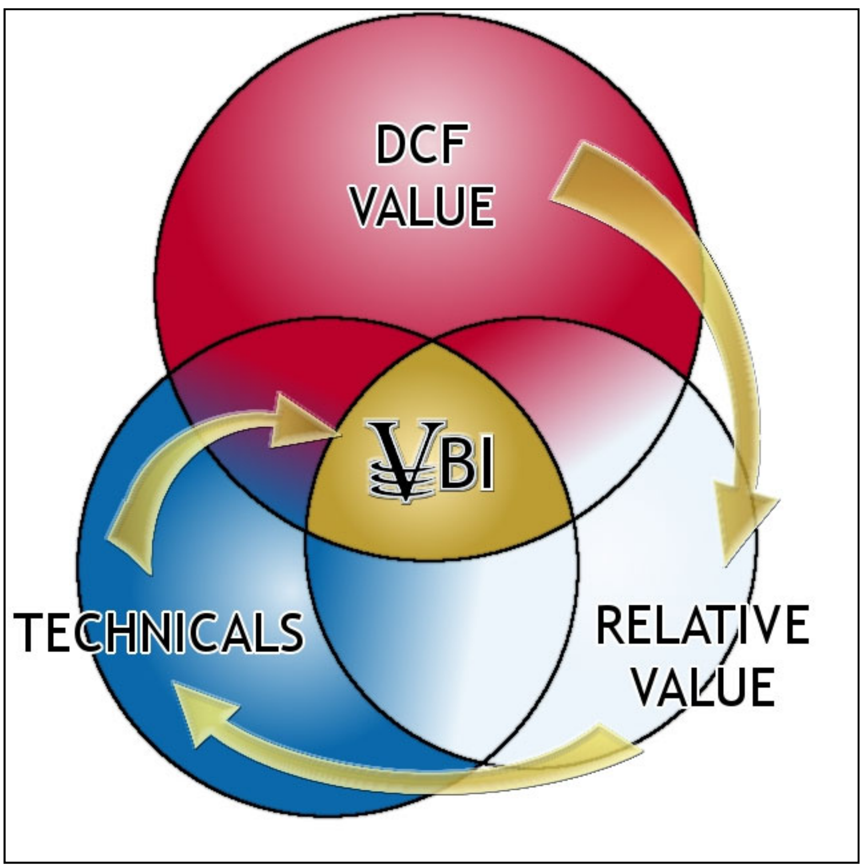
Ideas...continued on next page

Our Methodology – The Valuentum Buying Index (VBI)

By Valuentum Analysts

At Valuentum, we think some of the best opportunities arise from an understanding of a variety of 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, we posit 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.

We think 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 generally 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 discounted cash flow (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 target the long term, and we want to have a strong process to support the ideas we deliver to our subscribers.



Our Methodology – The Valuentum Buying Index continued on next page

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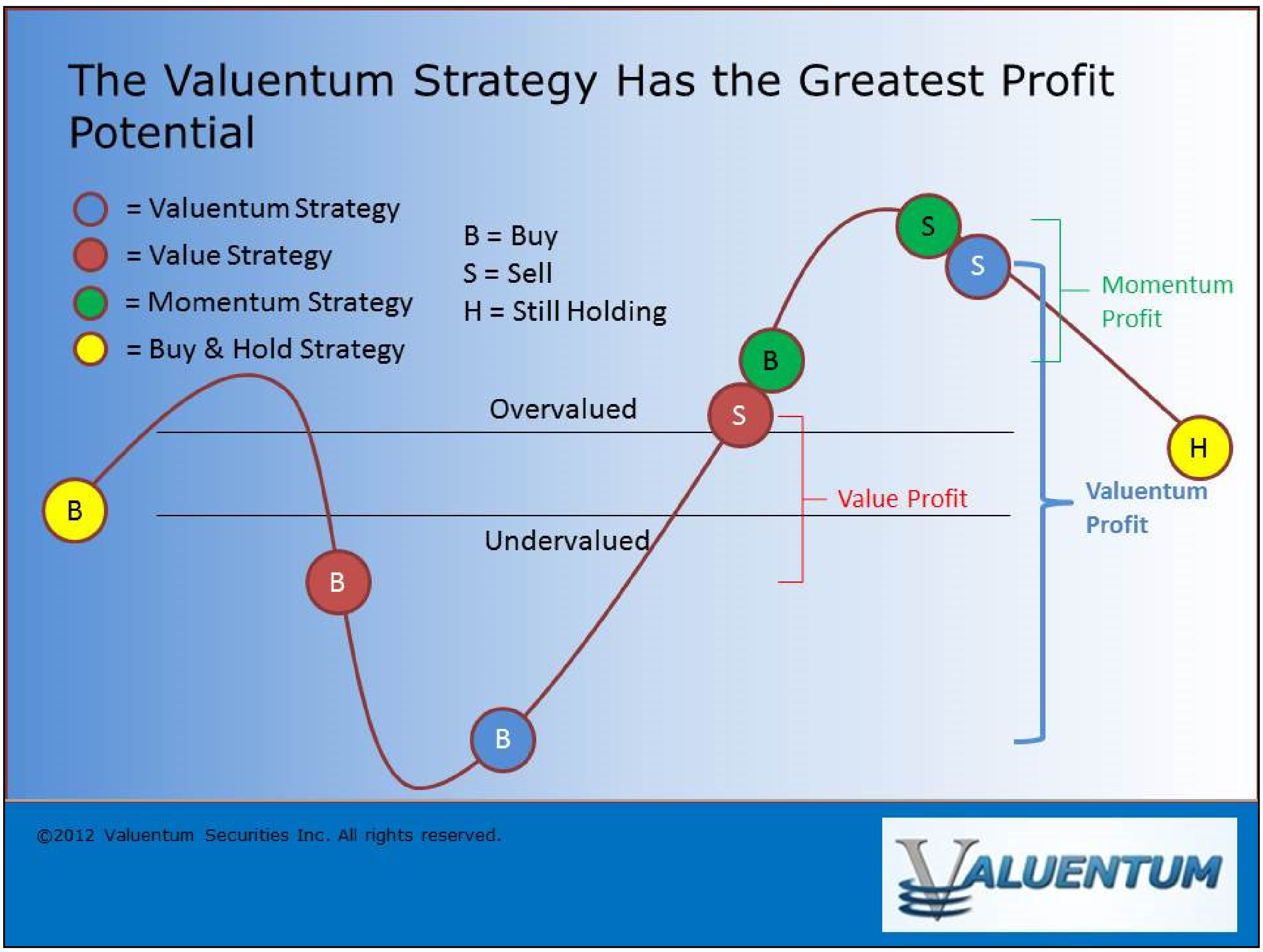
The center of the Venn diagram above, the Valuentum Buying Index (VBI) combines rigorous financial and valuation analysis with an evaluation of a firm's technicals and momentum indicators to derive a rating between 1 and 10 for each company (10=best). Because the process factors in a technical and momentum assessment after evaluating a firm's investment merits via a rigorous DCF and relative-value process, the VBI attempts to identify entry and exit points on what we consider to be the most undervalued stocks.

We think research firms that just focus on valuation may expose readers to a stock on its way down (a falling knife), while those that just use technical and momentum indicators may expose portfolios to significantly overpriced stocks at their peaks. It is our view that only when both sides of the investment spectrum are combined can investors find undervalued stocks at potentially timely prices for consideration.

Let's examine the chart below, which showcases how the Valuentum process, by definition, may have the greatest profit potential of any common 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). We define the Valuentum strategy as capturing the entire equity pricing cycle, while the value and momentum strategies individually truncate profits, as illustrated in the image below.



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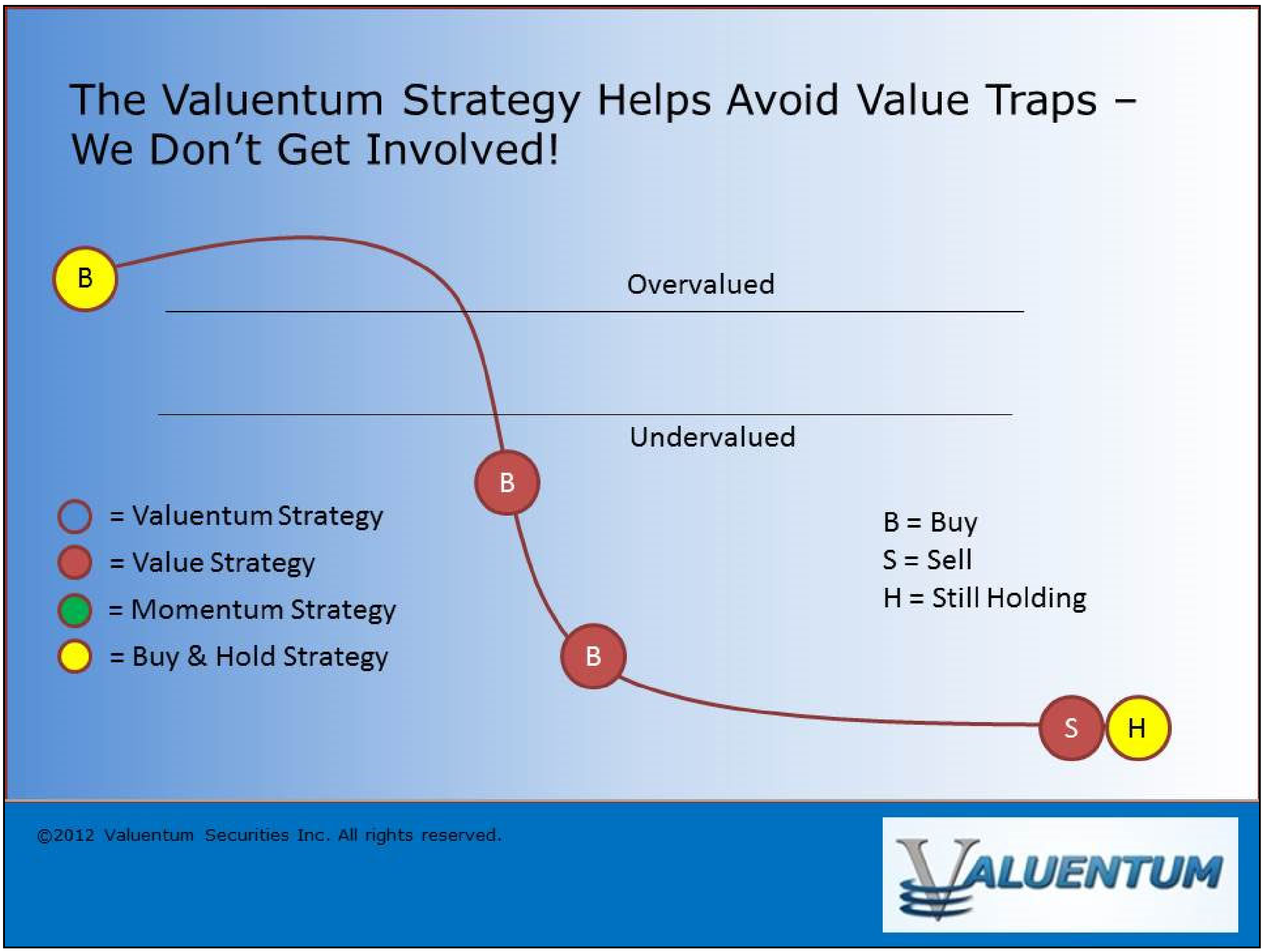
Furthermore, we think Valuentum subscribers are less likely to be involved in so-called value traps because we demand material revenue and earnings growth for firms to earn a 10 on the Valuentum Buying Index. Value traps often occur as a result of secular declines in a firm's products or services, resulting in deteriorating revenue and earnings trends (and often a falling stock price). We also think Valuentum subscribers are less likely to be exposed to these "falling knives" since the process requires firms to not only be undervalued, in our opinion, but also be exhibiting bullish technical and momentum indicators before we would consider adding them to the newsletter 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 attempts to steer clear of these situations. The Valuentum Buying Index is designed to wait for technical improvement in the equity, which often precedes fundamental changes at the company.



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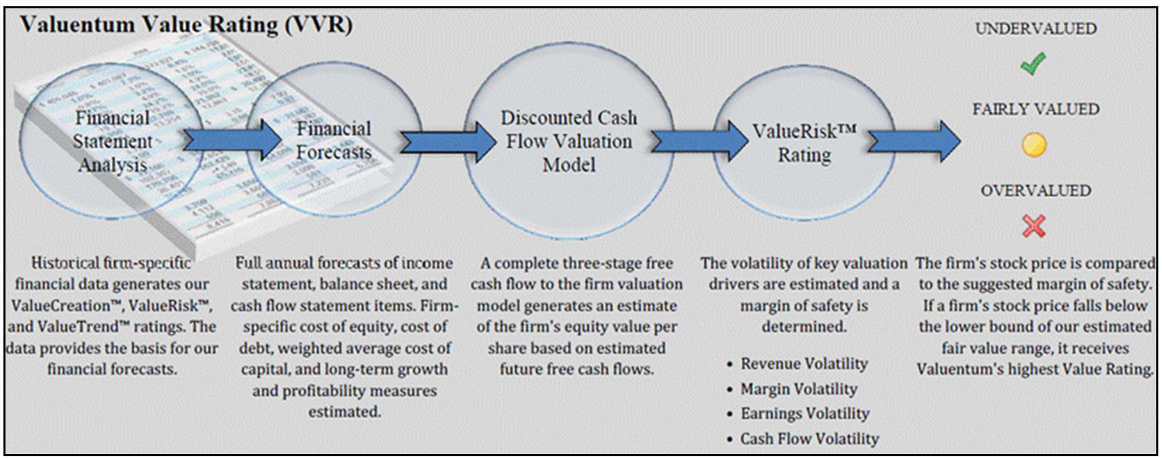
Let's walk through the three investment pillars of our stock-selection methodology.

I. The Valuentum Buying Index Applies A Rigorous Discounted Cash Flow Valuation Process

The Valuentum Buying Index 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.



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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 may provide investors with opportunities to buy attractive stocks at bargain-basement levels, in our view. A forward-looking Economic Castle rating is then derived.

We then assess each company within our 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 (DCF) valuation helps to prevent investors from exposing their portfolios to significantly overpriced stocks at their peaks. The image below reveals how pure momentum investors may expose their portfolios to pricing extremes and dramatic falls (green circles: Buy --> Sell). The Valuentum Buying Index attempts to steer clear from these situations.

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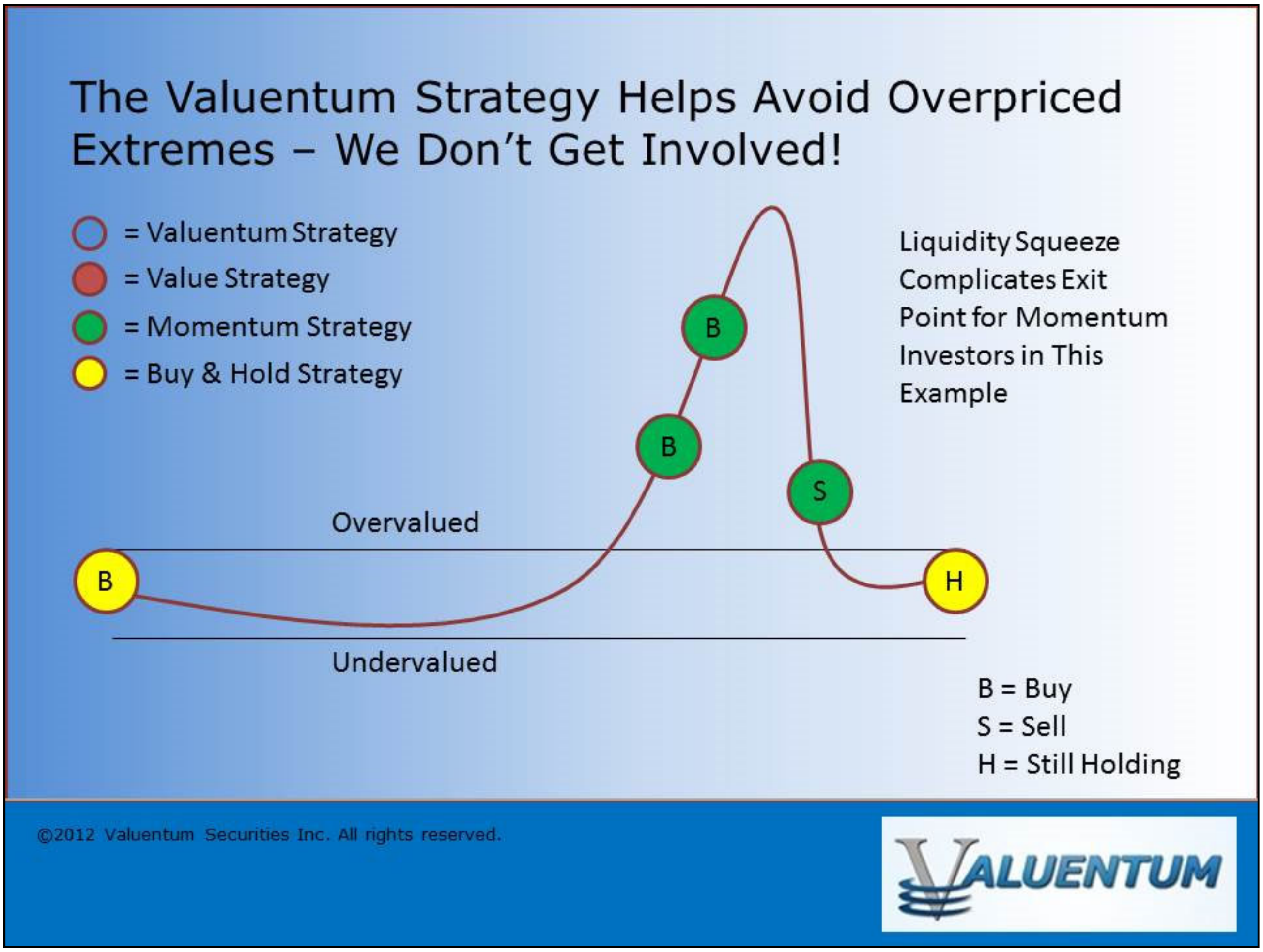

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II. The Valuentum Buying Index Incorporates A Forward-Looking Relative Value Assessment

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. The Valuentum Buying Index Seeks 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 in an attempt to consider entry and exit points on the stock (but only after it meets our stringent

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valuation criteria).

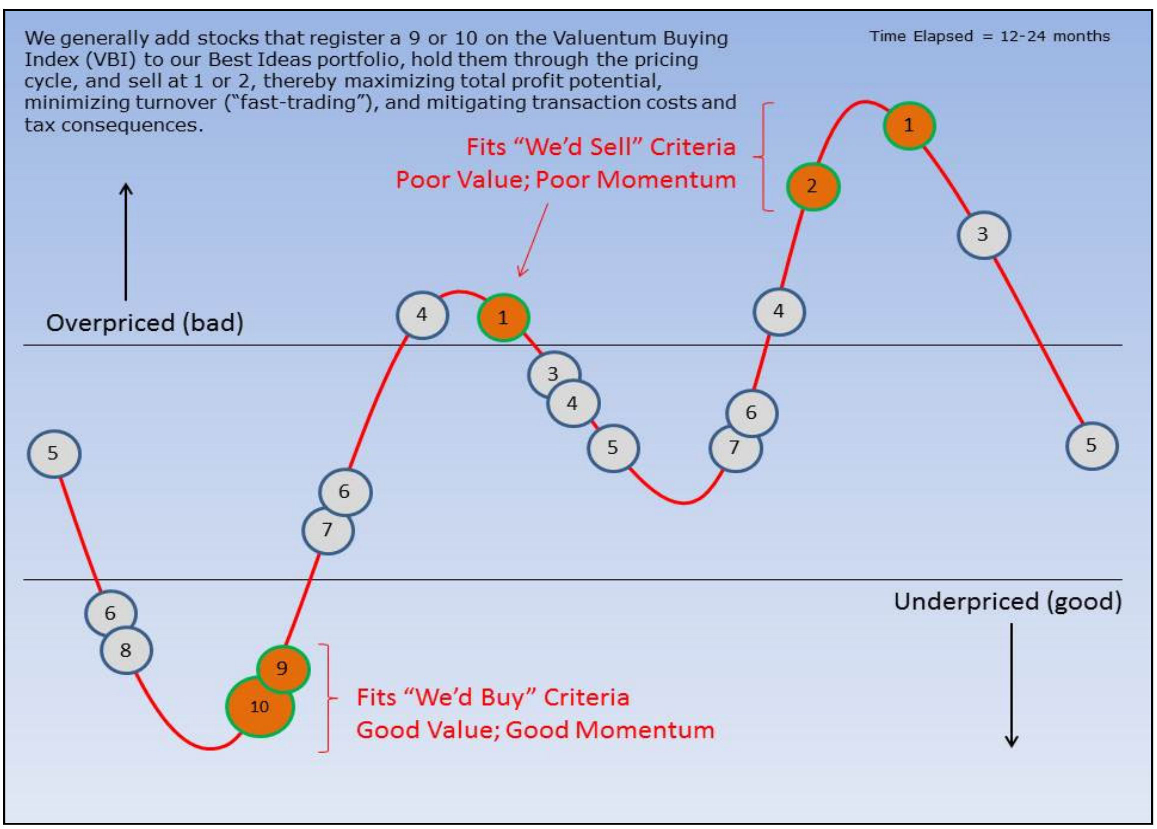
Rigorous valuation analysis and technical analysis are not mutually exclusive, and we believe both can be used together to bolster idea generation. An evaluation of a stock's moving averages, relative strength, upside-downside volume, and money flow index are but a few considerations we look at with respect to a 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 in an attempt to help safeguard against value traps, falling knives, and the opportunity cost of holding an undervalued equity for years before it potentially converges to "fair value." Other research firms may 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, on a theoretically basis, we would expect our best ideas to "work out" over a 12-24 month time horizon (on average) -- the duration of any individual idea can vary considerably, however. We tend to include firms in the Best Ideas Newsletter portfolio when they register a 9 or 10 on our Valuentum Buying Index (VBI) and tend to remove firms from the Best Ideas Newsletter portfolio when they register a 1 or 2 on the Valuentum Buying Index.

In theory, the Valuentum Buying Index attempts to maximize profits on every idea within the Best Ideas Newsletter portfolio, 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), for example, may truncate potential profits, while a momentum strategy (4 --> 1), for example, may ignore profits generated via value assessments. The Valuentum Buying Index seeks to capture the entire profit potential, as shown below.



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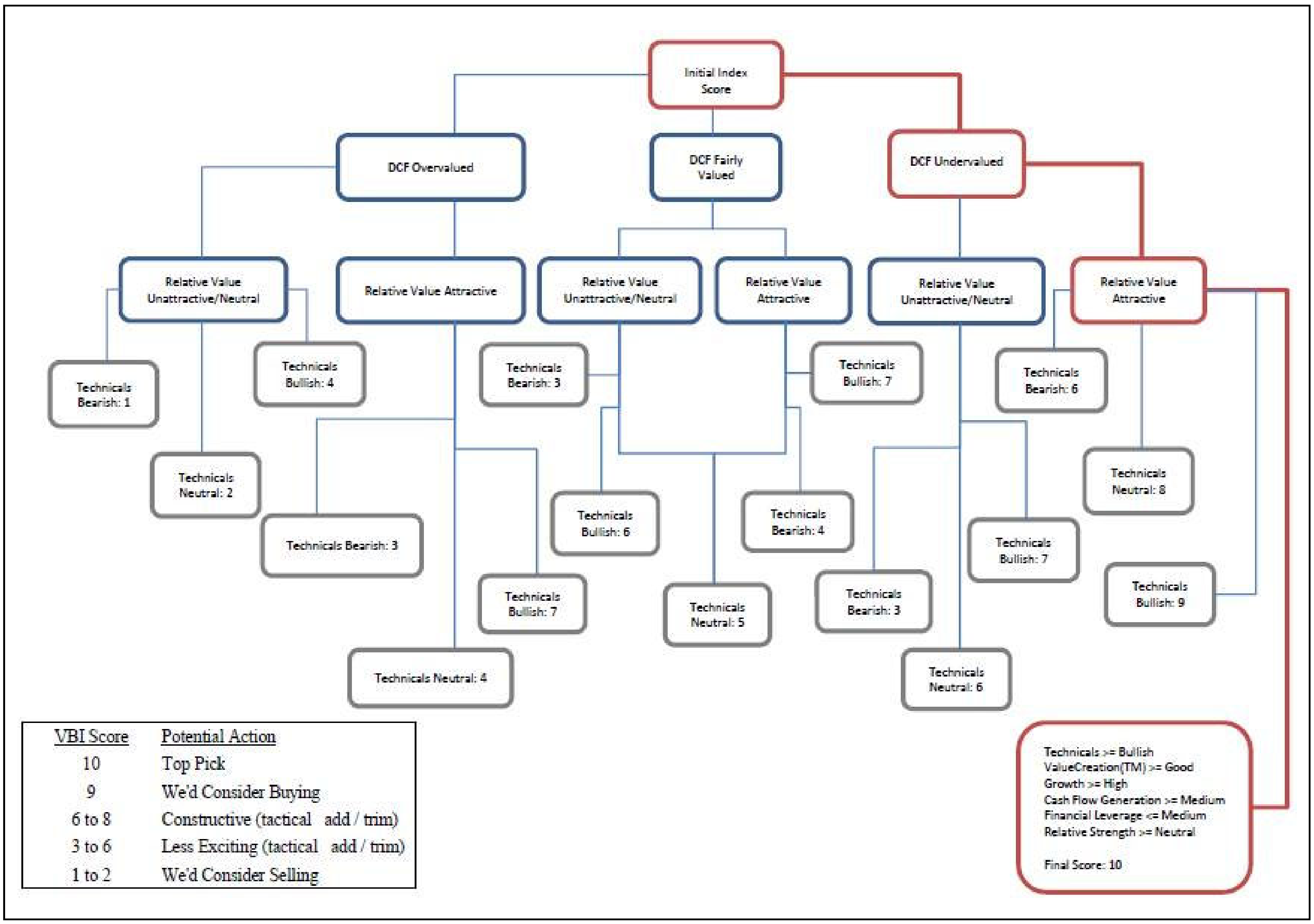
Let's follow the red line on the flow chart below to see how a firm can score a 10, the best mark on the Valuentum Buying Index (a "Top Pick"). Please click here to view an enlarged pdf version.

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



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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?

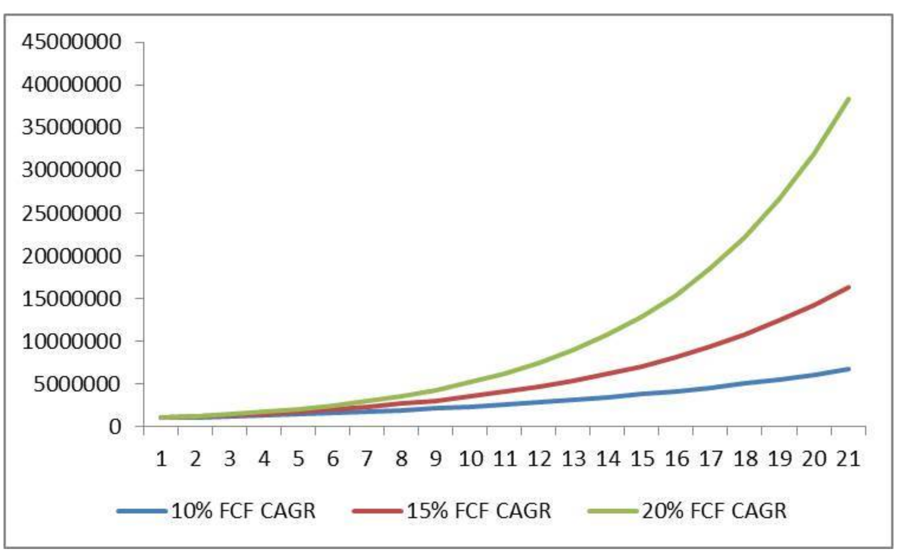
One of the most important concepts of the Valuentum methodology (and valuation in general) is the understanding that the value of a company is a range of probable valuation outcomes, not a single point estimate. Even well-seasoned stock analysts are guilty of saying that a company's shares are worth 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.



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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.

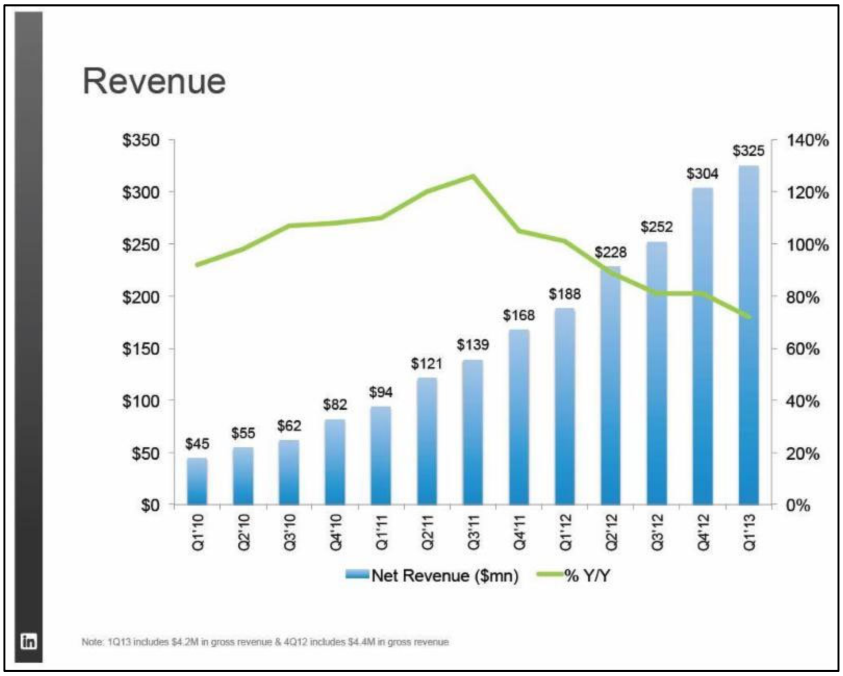

Image Source: LinkedIn

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 1,000+ 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.*

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

By Valuentum Analysts

We often receive questions about how we use the Valuentum Buying Index (VBI) rating system, one of the key metrics we use to source ideas, but we think it is equally important to mention up front 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! Don't forget about the Economic Castle rating and the Nelson Exclusive publication, too.

No matter your strategy or process though (it is not for us to say what is best for you), 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 evaluate as 1, 2, 3, or even buying 9s and 10s and selling 1s and 2s until their VBI changes upon the next update. Generally speaking, we measure the process over longer-term time periods--from the time a company registers a rating to a defined time in the future--not an interim update basis. Please read more our case study, where Valuentum Buying Index ratings, as of September 2013, were recorded and the performance of stocks were measured from that time through September 2014.

The Valuentum Buying Index Has Checks and Balances

With prudence and care, the Valuentum Buying Index process and its components are carried out. Our analyst team spends most of its time thinking about the intrinsic value of companies within the context of a discounted cash-flow model and evaluating the risk profile of a company's revenue model. We have checks and balances, too. First, we use a fair value range in our valuation approach as we embrace the very important concept that value is a range and not a point estimate. A relative value overlay as the second pillar helps to add conviction in the discounted cash-flow process, while a technical and momentum overlay seeks to provide confirmation in all of the valuation work. There's a lot happening behind the scenes even before a VBI rating is published, but it will always be just one factor to consider.

Within any process, of course, we value the human, qualitative overlay, which captures a wealth of experience and common sense. We strive to surface our best ideas for members, and flying blind is never a good strategy, in our opinion. 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 may not know any better. That's why the VBI has checks and balances and focuses on the discounted cash-flow process first and foremost, but the human, qualitative overlay is still extremely important, especially when considering various business models and unique "un-modelable" risks. In our 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, for the sake of transparency, we measure the performance* of the portfolios in the Best Ideas Newsletter and Dividend Growth Newsletter. The portfolios, in part, represent data points measuring the outcome of the work we do on the website, rolled into an assessment: our best ideas for each respective strategy. The ideas in the portfolios in the Best Ideas Newsletter and Dividend Growth Newsletter have been evaluated by our analyst team for consideration in the newsletter portfolios. 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 this is important. In a market environment where more than 90% of large-cap funds have trailed the S&P 500 in the 5-year period ending August 31, 2016, the Best Ideas Newsletter portfolio* has exceeded its benchmark return over a similar time period. What's more, we showcased this performance in full transparency, and we wrote every single day, and some days weren't all that great. When patience

*How We Use…*continued on next page

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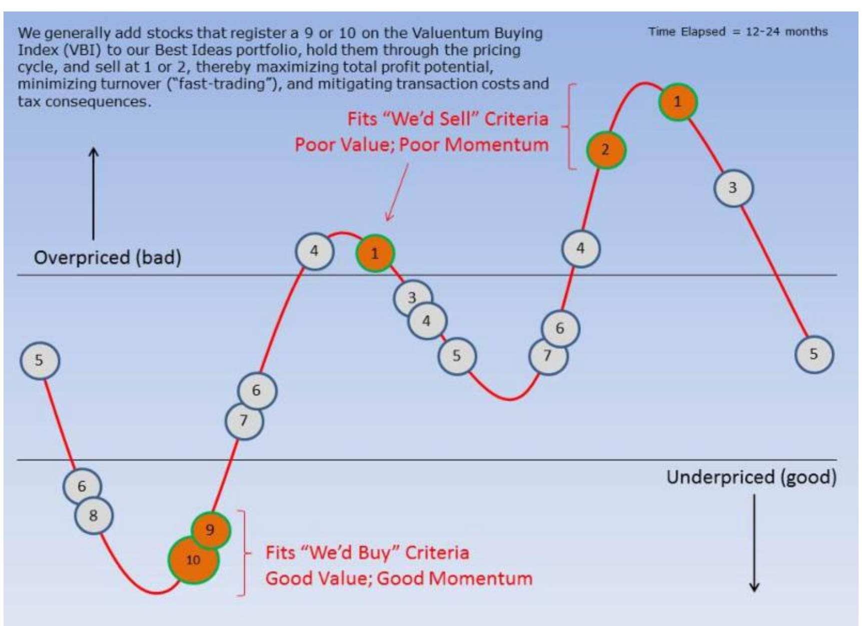
may be the secret to success in investing, a lot could have gone wrong with the temptation to do something each day. Obviously, we're very disciplined, but we also credit the portfolio outperformance to the VBI methodology itself. It is a very helpful tool.

** Actual results may differ from simulated information being presented. The Best Ideas Newsletter portfolio and Dividend Growth Newsletter portfolio are not real money portfolios. Results are hypothetical and do not represent actual trading.*

The Valuentum Buying Index Is One of Many Important Factors to Consider

That said, let's talk about how the VBI helps to inform which ideas we include in the Best Ideas Newsletter portfolio. This is where some clarification is probably important. For one, the word choice is critical, "inform," because the VBI is generally just one factor that goes into whether we add a company to the Best Ideas Newsletter portfolio, even if the VBI is one of the most important factors. Second, the timing element or duration concept is a key consideration. We've noticed via our statistical backtesting that a momentum factor can be much more pronounced (powerful) over longer periods of time. This was one of the interesting findings of our academic white paper study (2012). We try to consider this dynamic with the update cycle of our reports (and the time horizon for 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 think portfolio churn is the way to generate outperformance. Momentum may be high turnover, but Valuentum is low turnover.

Though the time frame varies depending on each idea that we consider for the Best Ideas Newsletter portfolio, we would expect our best ideas to generally work out over a 12-24 month time horizon (on average). Not all ideas will be successful, however. Our "holding period" is targeted to be much, much longer for some ideas in the Dividend Growth Newsletter portfolio, as income and dividend growth are other key factors (in addition to the Valuentum Buying Index and capital appreciation potential). The time horizon or duration concept is where the Valuentum Buying Index rating system becomes more complicated than a simple 1, 2, 3. For example, 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, based on dividend-related considerations).



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*How We Use...*continued on next page

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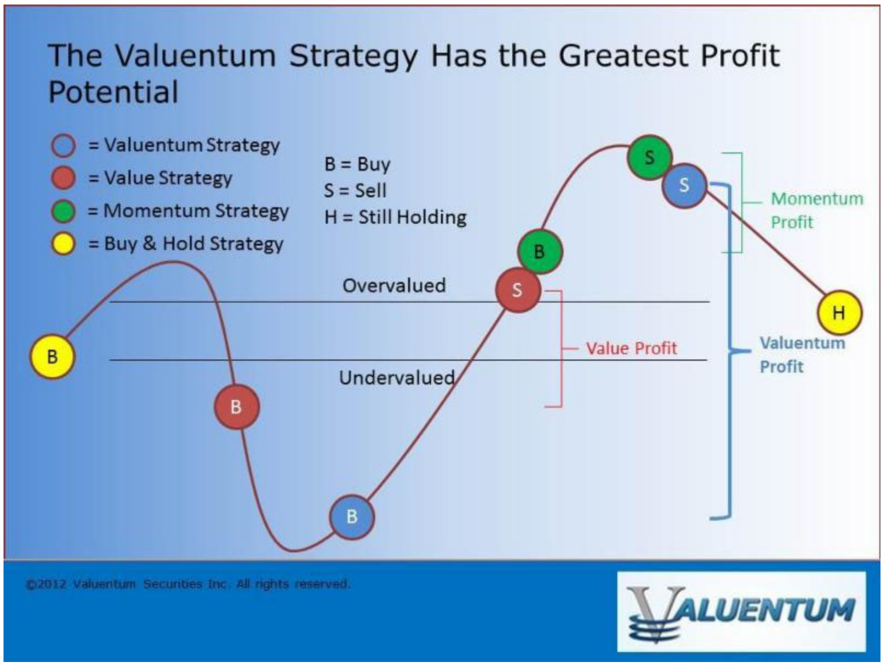
But why don't we churn our ideas by updating daily and trading a lot? Obviously, we don't think that's the secret to investment success. In quite the opposite approach, we strive to maximize profits on every idea that we pursue, with the understanding that momentum does exist and that prices over and 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 "outperformance" of the Best Ideas Newsletter 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).



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Not All Highly-Rated Stocks Are Added to the Newsletter Portfolios

Regarding the Valuentum process, as it is executed in the Best Ideas Newsletter portfolio, we do not "add" all stocks 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. Macro-economic, broader market valuation, and sector weighting considerations are other factors that impact the qualitative portfolio management process.

But why not add every highly-rated stock on the Valuentum Buying Index 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, in his or her opinion -- 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

***How We Use...*continued on next page**

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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. Sometimes, under certain market conditions, we may even have to relax the VBI criteria entirely in order to do what we think is required to achieve newsletter portfolio goals.

Some Examples of the Valuentum Buying Index In Action

Okay, a couple 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 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 (as in the eBay example). Not to be overlooked either, the Valuentum Buying Index rating also informs us when we may consider "removing" a position from the newsletter portfolios. Kinder Morgan (KMI), for example, registered a 1 on the Valuentum Buying Index just prior to its notorious fall and dividend cut. 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.

In all, the Valuentum Buying Index 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. Of course, please always contact your financial advisor to determine if any idea or strategy may be right for you.

** Actual results may differ from simulated information being presented. The Best Ideas Newsletter portfolio and Dividend Growth Newsletter portfolio are not real money portfolios. Results are hypothetical and do not represent actual trading. Valuentum is an investment research publishing company.*

About Our Name

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

-- Warren Buffett, Berkshire Hathaway annual report, 1992

At Valuentum, we take Buffett's thoughts one step further. We think the best opportunities arise from an understanding of a variety of 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. And a combination of the two approaches found on each side of the spectrum (value/momentum) in a name couldn't be more representative of what our analysts do here; hence, we're called Valuentum.

Valuentum Best Ideas Newsletter: Volume 9, Issue 9

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