OUR BEST IDEAS NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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"I know it sounds crazy to say so during a global pandemic and during a recession, but the right multiple and the right earnings to use to value this market is an 18-20x multiple on $196 earnings, putting a fair value range on the S&P 500 today of 3,530-3,920. The S&P 500 is trading at about 3,000 today."

-- Brian Nelson, CFA

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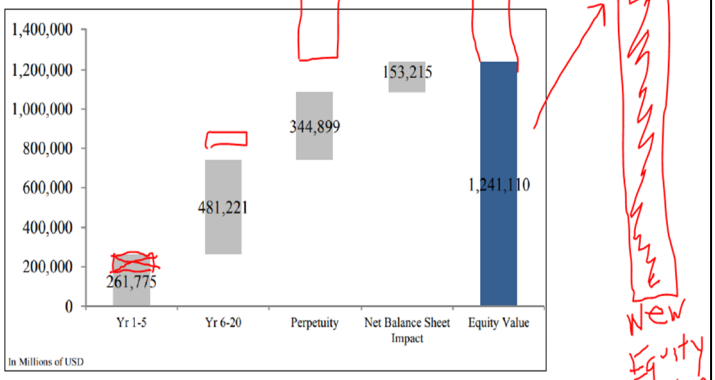
The Best Ideas Newsletter Portfolio (see page 8): AAPL, BRK-B, CSCO, DG, DIS, FB, GOOG, INTC, JNJ, MSFT, PYPL, SDY, XLV, V and SPY Put Option

Recently Removed: *NEW* VNQ, XAR (June 11)

Recent Changes: *NEW* Added SPY Put Option (August 21 expiration, $295 strike) [June 11] --- AAPL, MSFT (June 12)

Scribbles and More Newsletter Portfolio Changes

Figure 6: Sample Distribution of Equity Value Composition



This figure shows the composition of a sample company's equity value. The majority of value is generally ascribed to a period beyond year 5, making an evaluation of mid-cycle revenue and mid-cycle margin assessments generally more important than near-term forecasts within the enterprise cash flow process. Source: Valuentum's 16-page equity report of Apple, September 2018.

***Image Shown**: Why are stock prices increasing while the near-term economy and near-term earnings outlook isn't as bright as before...How unlimited quantitative easing, runaway government spending, increased inflation expectations impact equity values...Why this year's earnings expectations or next year's earnings expectations don't matter much...Why Valuentum thinks equity values are rising today, even as the near-term outlook remains unclear. **Scribbles on page 76 of Value Trap**.*

By Callum Turcan and Brian Nelson, CFA

Please note versions of this article were emailed out to members on June 11 and June 12.

On June 11 and June 12, we made some tweaks to the Best Ideas Newsletter portfolio (page 8). It has been **one of the strongest bull markets we've ever seen off the March 23 bottom**, and while we continue to be optimistic about some of our favorite ideas, we are now re-positioning the newsletter portfolios after taking advantage of the surge.

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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.

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On June 11, we removed the Vanguard Real Estate ETF (VNQ) and the SPDR S&P Aerospace and Defense ETF (XAR) from the Best Ideas Newsletter portfolio. We think, in general, REITs may continue to face pressure as rents become more difficult to collect in a COVID-19 world, and we think the aerospace industry has largely bounced back to fair value, in many individual cases.

Additionally, **we added a 1% put option weighting on the S&P 500 SPDR (SPY) to the Best Ideas Newsletter portfolio (August 21 expiration, $295 strike).** Much like the protection we have in the High Yield Dividend Newsletter portfolio with the SJB, we think this move is prudent to partially "hedge" against downside risks.

Those portfolio tweaks raised some "cash" in the newsletter portfolios, and on June 12, we put that "back to work." **We put the proceeds from the removals on June 11, less the new put option "partial hedge," back into Microsoft (MSFT) and Apple (AAPL), allocating the remaining proceeds equally to both in the Best Ideas Newsletter portfolio to go back to "fully invested."**

Our thoughts on re-adding Apple and Microsoft to the newsletter portfolios are rather simple. Aside from our liking them on a firm-specific basis, if the economy heads south, they've shown an ability to hold up better than most. If we see interest rates lower for longer, their dividend growth potential is enormous, which is a big catalyst for income/yield seekers, and if we do see a strong economy and market, they will participate, and perhaps even lead. One can say we should have never removed them, **but we now know much more about COVID-19 than we did many months ago.**

We've been keeping a running feed/stream of our emails, so new members can evaluate our track record during this crisis and existing members can check in to see if they miss anything. Here is our latest, for example:
http://campaign.r20.constantcontact.com/render?preview=true&m=1110817109903&ca=ef80ac40-f209-41f9-ab15-e2bb4afb5a6b&id=preview

With all the market turbulence during the past few months, we think the feed has worked well as readers can catch up on prior work as they wish. Typically, below each title and before the text of the article, you'll find the date that a piece was written. The most recent article will always be the one in the title of the email. We think this is rather self-explanatory, but if you're scrolling quickly, you may miss the time element to this dynamic.

As the market ebbs and flows, our opinion is going to change. For example, in February, we were expecting a market crash. At the bottom in March, we thought dollar cost averaging made a lot of sense. Through yesterday from the end of April, the newsletter portfolios have been riding the strong bull market wave, something we think will continue. With that said, so where are we today?

For starters, we think we're still in the early innings of a "blow off top" scenario. The sell-off June 11 didn't have much substance to it. Not much was happening technically across the market, and while there may be a second wave of new COVID-19 infections, health professionals know a lot more about the virus than they did in February. **This is certainly not February.** We're well on our way to knowing that at some point in the future, we *will* get past this thing. There is no longer any doubt in my mind, as there might have been in February/March.

The Right Multiple

Many of you use multiples in your work, and that's fine, but I want you to understand the multiple that you are using. Every multiple expands into enterprise valuation, or a discounted cash flow model. So, for example, if you say you want to use 15x or 20x P/E to value the markets, there's a DCF model (and thousands of forward-looking assumptions) that back it up--you know, one of the themes of *Value Trap*. Where investors get into trouble is when they start throwing multiples on the market (and companies) and don't realize it is the DCF that drives the multiple and price.

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There are bears on Wall Street, for example, that are merely throwing a 15x multiple on next year's expected earnings to come up with a ridiculously low S&P 500 price target. This approach makes absolutely no sense. For starters, stock prices are based on expectations long into the future, and **Fed and Treasury policy have all but created an environment where higher multiples should be applied.** In the image on Page 1 (with red scribbles), we show what is happening to DCF models (values and prices) today as it relates to both the impact of COVID-19 and aggressive Fed/Treasury policy stimulus.

As shown by the red scribbles, the near-term composition of the value of companies is declining (COVID-19 is depressing near-term earnings), but this reduction is more than offset by expansion in the intermediate and long-term values, which are driven more by normalized expectations, not the least of which is a lower discount rate (lower interest rates) and higher inflation (pricing power, growth) driven by Fed/Treasury actions. **This means that the net overall value and price of equities is actually rising during this pandemic and recession.**

Prior to COVID-19, for example, a 15-16x multiple on long-run *normalized* earnings (not next year's or the year after that) may have made sense, but today, perhaps an 18-20x multiple on long-run *normalized* earnings may be most appropriate. One should expect the multiple on this year or next year's earnings to then be astronomical. Don't worry about the talking heads on TV talking about lofty multiples on this year's earnings. *Multiples on this year's earnings expectations should be enormous.* With that out of the way, what are normalized earnings and how should we think about them?

The Right Earnings

Let's first throw out historical earnings numbers. Markets are forward-looking. You're not investing for last decade's dividend, are you? Good. That's why markets are forward-looking because you're investing for next quarter or next year's dividend (or dividend growth in the long run). Next, we know using this year's earnings or the year's after that doesn't make much sense. Just because a company has negative earnings doesn't mean it's worthless, for example. Therefore, we know there's a time element to valuation (as well as the balance sheet, etc) that we must embrace. **So if not historical and if not next year's earnings, or the year's after that, what earnings should be put on that 18-20x multiple?**

You guessed it: long-run normalized earnings (not peak, not trough, but normalized). We know the U.S. has managed to prevail through just about everything that has been thrown at it, and we expect COVID-19 to be no different. We already survived a prior pandemic early last century, which was far worse than COVID-19. We also know that pre-COVID-19 2021 earnings numbers (~$196) were within reach *and achievable*, prior to the pandemic.

It's reasonable to assume we're going to get back to those levels eventually, and as history has shown (even from the Great Recession), those pre-COVID-19 numbers might turn out to be low toward the middle of this decade, much like 2018 earnings numbers doubled from those in 2010 (as highlighted in the image at the top of the next page, Page 4). Therefore, on a conservative basis, we think the right normalized earnings number to use for a higher multiple is ~$196.

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***Image Shown**: Consensus earnings estimates for S&P 500 companies, as of February 28, 2020, prior to business shutdowns and the worst of the COVID-19 pandemic.*

The Right Value for the Market

Even though we are talking in terms of price and earnings, using the P/E ratio to explain our valuation of the markets, our thoughts are soaked in DCF interpretation. For example, the DCF explains why a higher multiple is appropriate, and the DCF explains why the near term doesn't matter much, and why normalized numbers should be used in the valuation context. **I know it sounds crazy to say so during a global pandemic and during a recession, but the right multiple and the right earnings to use to value this market is an 18-20x multiple on $196 earnings, putting a fair value range on the S&P 500 today of 3,530-3,920.** The S&P 500 is trading at about 3,000 today.

Investors should expect volatility to be elevated in the coming months as the markets digest more COVID-19 cases and uncertainty related to the political cycle, we remain bullish on big-cap tech (an area that heavily weights ideas in the Best Ideas Newsletter portfolio), and we remain bullish on large cap growth (given that large cap growth has exposure to many of our favorite Valuentum ideas included in the Best Ideas Newsletter portfolio found on page 8). We don't think in terms of these buckets (i.e. big cap tech, large cap growth), as we focus on individual stock selection, but we think this is a good way to characterize our positions at the moment. Our favorite ideas always reside in the newsletter portfolios.

***Disclosure**: Callum Turcan does not own shares in any of the securities mentioned above. Brian Nelson owns shares in SPY and SCHG.*

Disney's Outlook is Improving

By Callum Turcan

Shares of The Walt Disney Company (DIS) are trading near our fair value estimate of $111 per share as of this writing on June 14, after recovering sharply from their March 2020 lows. Disney's stock price came under intense pressure from the ongoing coronavirus ('COVID-19') pandemic, though the firm's outlook has improved materially as various economies around the world have started opening back up.

On May 27, Disney provided an update on the reopening process for its US theme parks in California and Florida after its Shanghai Disney Resort and Disney Springs at Walt Disney World Resort reopened successfully. Please note Disney owns a 43% interest in the Shanghai Disney Resort and Shanghai Shendi Group owns the remaining interest (according to Disney's fiscal 2019 Annual Report). Additionally, Disney owns a 70% interest in the management company that operates the resort and Shanghai Shendi Group owns the remaining interest.

By July 11, Disney aims to reopen two of the Walt Disney World Resort's theme parks (Magic Kingdom Park and Disney's Animal Kingdom). A few days later, Disney aims to reopen the EPCOT and Disney's Hollywood Studios theme parks at the Walt Disney World Resort on July 15. This plan is contingent on approval from Orange County, Florida, which Disney reportedly received in late-May. Please note that as part of the reopening process, which needs to be done in the safest manner possible, Disney's theme parks and resorts are making masks mandatory and the operations at these facilities have changed to encourage and enforce social distancing rules. Though customers will not need to wear a mask while swimming or dining.

Several of Disney's other facilities at the Walt Disney World Resort are set to open up soon, including Disney's Fort Wilderness Resort & Campground which is set for a June 22 reopening. By June 15, Disney Vacation Club resorts in Vero Beach, Florida, and Hilton Head, South Carolina, are set to reopen. Various shopping venues associated with Disney's resorts and theme parks are also in the process of reopening or have already recommenced operations. In California, Disney is positioning itself to reopen Disneyland in mid-July (possibly by July 17). These plans are all contingent on government approval (particularly state and local governments). Disney is also working towards opening its Hong Kong Disneyland Resort, which reportedly may reopen soon. As an aside, please note Disney owns a 47% interest in Hong Kong Disneyland Resort and the Government of the Hong Kong Special Administrative Region owns the remaining interest.

In fiscal 2019 (period ended September 28, 2019), Disney's 'Parks, Experiences and Products' segment generated $26.2 billion in sales (~38% of Disney's GAAP revenues) and $6.8 billion in segment operating income (~45% of 'total segment operating income'). Theme parks, resorts, and the related offerings are a huge part of Disney's business and bottom-line. **Reopening these facilities, in a safe and reasonable manner, should do a lot to improve Disney's near- and medium-term outlook.** Reportedly, when Shanghai Disneyland Resort reopened customers came back in a meaningful way.

On May 5, Disney announced it was forgoing its semi-annual dividend for the first half of fiscal 2020 due to the pandemic to save roughly $1.6 billion in cash (assuming a common dividend payout of $0.88 per share). Given the severity of the situation caused by the pandemic, it was a prudent move, and we like Disney as a holding in the Best Ideas Newsletter portfolio more so for its capital appreciation potential than its yield. **Once things improve, and that appears to be the case, Disney will likely resume its semi-annual dividend payouts.**

Disney's streaming strategy (Hulu, Disney+, ESPN+) is going well and its total paid subscriber base has grown materially. As an aside, Disney owns a 67% interest in Hulu. A combination of the reopening of Disney's theme parks and resorts combined with its growing video streaming services business should help put Disney's financials back on the right track. **If/when a vaccine or cure for COVID-19 is discovered and becomes available, Disney's outlook would improvement materially overnight.**

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

Dollar General Posts a Tremendous Fiscal First Quarter Earnings Report

Image Source: *Dollar General Corporation – Fiscal 2019 Annual Report and Fiscal 2020 Proxy Statement*

By Callum Turcan

Dollar General Corporation (DG) is one of our favorite retail plays given its focus on smaller cities and towns (with populations of 20,000 or less) in the US as that gives it an immense edge over e-commerce giants such as Amazon Inc (AMZN) due to the logistical hurdles involved with expanding into these regions. Shares of DG have run up above the top end of our fair value range as of this writing.

However, given its strong technical and fundamental performance of late, we are keeping Dollar General as an idea in our Best Ideas Newsletter portfolio as we like to let our winners run. It isn't until a company's technicals turn against it that we consider removing shares from our newsletter portfolios. Shares of DG yield ~0.8% as of this writing, which offers incremental income upside to Dollar General's capital appreciation upside.

In March 2020, Dollar General opened its first store in Wyoming which represented the 45th state the company had a retail presence in. In April 2020, Dollar General opened its first store in Washington state, growing its retail presence to 46 US states. Beyond same-store sales growth, Dollar General sees room for upside by expanding its physical store count.

Quarterly Overview

On May 28, Dollar General posted a stellar earnings report for the first quarter of fiscal 2020 (period ended May 1, 2020). **Same-store sales rocketed higher by 21.7% year-over-year and GAAP net sales surged higher by 27.6% year-over-year, performance that looks even stronger when considering Dollar General's GAAP gross margins rose by ~50 basis points year-over-year.** This outperformance was led in part by the surge in consumer spending at retailers brought on by "panic buying" due to the ongoing coronavirus ('COVID-19') pandemic, **but there is more to it than that.**

*Dollar General...*continued on next page

Dollar General...from previous page

Dollar General has invested heavily in bulking up its digital capabilities and adding more consumer staples offerings to its stores (including both prepackaged and fresh food options). We strongly appreciate the various initiatives management is pursuing to enhance Dollar General's competitive edge and to augment the company's long-term free cash flow growth trajectory.

Additionally, Dollar General reported strong demand across a whole slate of offerings as "same-store sales increased in each of the consumables, seasonal, home products and apparel categories, with the largest percentage increase in the home products category," which we appreciate. Dollar General's sales growth trajectory moderated slightly in April 2020 but remained strong, which we'll cover in just a moment.

Economies of scale, managed operating expense growth and gross margin expansion led to Dollar General's GAAP operating income rising by over 69% year-over-year which entailed the firm's GAAP operating margin increasing by over 250 basis points year-over-year last fiscal quarter. SG&A expenses as a percent of total revenues declined by over 200 basis points year-over-year in the fiscal first quarter, highlighting Dollar General's ability to keep costs tame even during harrowing times such as these. Here's some key commentary from management during the retailer's latest quarterly conference call (emphasis added):

> *"Turning now to our first quarter performance. The quarter was highlighted by extraordinary growth in both top and bottom-lines. These results reflect significant changes in shopping patterns which began in March as consumers reacted to the COVID-19 pandemic.*
>
> ***For the month of February, same-store sales increased 5.5%*** *driven by broad based performance across many fronts, which we believe speaks to the continued strength and sustained momentum of the underlying business.*
>
> ***Beginning in the March, we experienced a significant surge in demand and sales as consumers began to stock up and category mix shifted even more than usual to our consumable category. For the month in total, comp sales increased 34.5%.***
>
> ***April sales moderated in comparison to March, but remained elevated*** *as consumers continue to replenish household essentials at a rate greater than normal. During April, we also experienced significant growth in our non-consumable businesses and our three non-consumable categories delivered a combined comp sales increase in excess of our consumable business.* ***For the month in total, same-store sales increased 21.5%.****" --- Todd Vasos, CEO of Dollar General*

Due in part to very favorable working capital movements, Dollar General's free cash flows clocked in north of $1.5 billion last fiscal quarter. That easily covered $0.1 billion in common dividend obligations and a bit less than $0.1 billion in share repurchases during this period. Dollar General exited the fiscal first quarter with $2.7 billion in cash and cash equivalents on hand versus a negligible amount of short-term debt and $4.0 billion in long-term debt. We view Dollar General's net debt load as very manageable given the firm's high quality cash flow profile and very sizable free cash flows of late.

Concluding Thoughts

We continue to like Dollar General as an idea in our Best Ideas Newsletter portfolio and it appears the company's growth trajectory is improving materially. The level of same-store sales growth seen in March 2020 is unlikely to be sustainable; however, Dollar General's various initiatives (improvements to its digital ecosystem, greater in-store consumer staples offerings, expanding into new US states) seem to be paying off, and we remain impressed with its operational and financial performance of late.

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

Valuentum's Best Ideas Portfolio

By Valuentum Analysts

Recently Removed: ***NEW*** **VNQ, XAR (June 11, 2020)**

Recent Changes: ***NEW*** **Added SPY Put Option (August 21 expiration, $295 strike) [June 11] --- AAPL, MSFT (June 12)**

Valuentum's BEST IDEAS -- as of June 15, 2020

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	0.79	181.55	8%-13%
Facebook	FB	0.00%	$284.00	Attractive	5	0.82	232.50	8%-13%
Alphabet - Class C	GOOG	0.00%	$1436.00	Attractive	6	0.99	1419.85	8%-13%
Visa	V	0.62%	$178.00	Very Attractive	6	1.08	191.76	8%-13%
PayPal	PYPL	0.00%	$140.00	Attractive	6	1.13	157.55	6.5%-8%
SPDR S&P Dividend ETF	SDY	3.06%	NA	NA	UR	NA	92.30	6.5%-8%
Health Care ETF	XLV	2.18%	NA	NA	UR	NA	97.82	6.5%-8%
Cisco	CSCO	3.20%	$51.00	Very Attractive	6	0.89	45.35	5%-6.75%
Intel	INTC	2.22%	$51.00	Attractive	3	1.18	60.10	5%-6.75%
Johnson & Johnson	JNJ	2.84%	$148.00	Attractive	7	0.95	141.25	5%-6.75%
Apple ***NEW***	AAPL	0.97%	$344.00	Attractive	6	1.00	342.99	3.8%-5.4%
Microsoft ***NEW***	MSFT	1.09%	$195.00	Attractive	6	0.97	188.94	3.8%-5.4%
Dollar General	DG	0.78%	$143.00	Attractive	6	1.31	187.86	3.5%-5%
Disney	DIS	0.00%	$111.00	Attractive	4	1.05	117.08	3.5%-5%
SPY put options (Aug expiration, $295 strike) ***NEW***								1.0%
Cash consideration	-	-	-	-	-	-	-	0.0%

UR = Under Review
This portfolio is not a real money portfolio. Data as of June 15, 2020, retrieved from YF, Valuentum.

The cash weighting in the Best Ideas Newsletter portfolio is 0% at the midpoint. 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.

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

Facebook Augments Its Impressive Growth Trajectory

***Image Shown**: Shares of Facebook Inc have outperformed the S&P 500 index year-to-date, as of this writing on May 21, by a wide margin.*

By Callum Turcan

Facebook Inc (FB) is a top-weighted holding in the Best Ideas Newsletter portfolio and shares have surged upwards of late, sparked in part by its strong first-quarter 2020 performance, relatively speaking, given the ongoing coronavirus ('COVID-19') pandemic. As of this writing on June 14, shares of FB are up ~9% year-to-date while the S&P 500 (SPY) is down ~6% during the same period (this is before taking dividend considerations into account; however, that doesn't change this picture by much). We continue to like Facebook as a top-weighted holding in the Best Ideas Newsletter portfolio and please note **that the top end of our recently revised fair value estimate range sits at $355 per share (our fair value estimate sits at $284 per share of FB).** Given the company's strong fundamental and technical performance of late, **there's room for shares of FB to march significantly higher as of this writing.**

For a long time, Facebook has wanted to diversify part of its business away from digital advertising, and towards the e-commerce and financial tech (namely payment processing and payment solutions) space. Digital advertising is still a very lucrative business but having more diversified revenue streams by expanding into areas adjacent to its core business is a good move by Facebook, in our view.

In the past we have highlighted how Facebook was teaming up with a local partner in India (a major telecommunications and digital platform conglomerate, Jio Platforms) to better enable consumers to connect with small grocery stores by integrating JioMart (owned by Jio Platforms) with Facebook-owned WhatsApp. We also highlighted in the past Facebook's desire to launch its own "stable coin" digital currency, Libra, which would be backed by a basket of real world currencies from major developed nations. On the Facebook-owned Instagram app, users can purchase products featured in posts and advertisements, and when that service was launched, we mentioned to our members that this new offering is entirely incremental to our fair value estimate and fair value estimate range concerning Facebook.

Launching Shops

Very recently, Facebook's CEO Mark Zuckerberg rolled out a new concept called 'Shops' via a Facebook Live session. This e-commerce strategy is built around businesses having their own Facebook Shop or Instagram Shop, with products and promotions displayed prominently on those webpages similar to what Amazon Inc (AMZN) offers small- and medium-sized businesses through Amazon Storefront and to larger entities through a different service.

Facebook Augments...continued on next page

*Facebook Augments…*from previous page

Businesses can design these webpages with tools provided by Facebook for free to make the user experience more engaging. **Additionally, Facebook isn't competing with its potential small business partners as Amazon often is, which may make Shops more enticing to those seeking a digital partner.**

Facebook Shop will launch first, followed by the launch of Instagram Shop later on (management is targeting for the service to launch in the summer of this year). These Shops will be promoted through ads and "stories" (defined as user generated compilations of photos and videos, specifically on Facebook and Instagram) across Facebook's slate of social media sites. Facebook is integrating these offerings so a business can have potential customers click on a link in the business' live video feed (for example) and end up at their Facebook Shop. For Instagram Shop, potential customers can browse products at Instagram Explore or click on a link in a photo and end up at the relevant business' Instagram Shop (for example).

Part of the appeal of these offerings is that businesses (particularly small businesses) will get to leverage Facebook's existing catalog and customer engagement infrastructure. The social media giant is also aiming to support integrated promotional programs. Facebook will take a small cut per purchase conducted through its various e-commerce marketplace offerings if the consumer uses Facebook's checkout option and payment processing infrastructure. Furthermore, please note that **part of the Shops strategy involves encouraging businesses to spend more on their digital advertising budgets across Facebook's slate of websites and apps.**

Bigger picture, Facebook wants to create an ecosystem that goes beyond allowing its user base to communicate with friends and family, and towards one that allows users to conduct a whole range of activities online across Facebook-owned properties.

While these are very early days, we are intrigued by Facebook's push into the world of e-commerce. **Longer term, we expect Facebook to leverage Shops to push further into the realm of payment processing and payment solutions.** Facebook is already present in these arenas as money can be sent through WhatsApp or Facebook Messenger on a peer-to-peer basis, and the firm built its payment processing infrastructure up from the ground floor as it relates to handling payments concerning games and ads purchased across Facebook's slate of businesses. Additionally, Facebook Payments can be used to handle purchases at the firm's Facebook Marketplace offering and at other websites. Expanding on that, by pushing deeper into the world of e-commerce, Facebook aims to drive greater usage of its payment options over time by creating an ecosystem that users engage with more regularly (at least in theory).

Facebook is encroaching on Shopify Inc's (SHOP) territory, though users of these types of third-party platforms will be able to manage Facebook Shops and Instagram Shops through Shopify directly. The ongoing pandemic has increased demand for e-commerce purchase options and that trend is expected to continue even after the crisis has passed. Facebook is also encroaching on PayPal Holding Inc's (PYPL) territory (Venmo, owned by PayPal, is a very popular peer-to-peer money transfer app), another favorite of ours that's included with a near top-weighted holding in our Best Ideas Newsletter portfolio. However, we see ample room for both firms (and many others) to thrive in the financial tech space.

Concluding Thoughts

While the digital advertising market will take a hit in the short-term, we expect that the digital advertising industry will bounce back relatively quickly once the global economy begins to restart (and we are seeing signs of such an economic rebound beginning to emerge in number countries around the globe). We continue to be impressed with Facebook's long-term growth strategy and are excited to see how its push into the e-commerce and financial tech space plays out, which for the most part is entirely incremental to our fair value estimate and fair value estimate range concerning shares of FB.

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

Data from Visa Indicates the Economic Outlook is Improving

***Image Shown**: Visa Inc reports that US processed transactions volumes across its payment processing network improved materially on a year-over-year basis in May, relatively speaking, versus the downturn seen in the second half of March and the first half of April. **Image Source**: Visa Inc - 8-K SEC Filing*

By Callum Turcan

One of our favorite secular growth industry tailwinds is happening in the payment processing, payment solutions, and financial technology space. **The world is shifting toward a "cashless" society, and that has accelerated due to the ongoing coronavirus ('COVID-19') pandemic**, in part due to the rise of e-commerce and in part due to the preference of many consumers to use contactless payment options when in physical stores.

Visa Inc (V) has been a top-weighted holding in the Best Ideas Newsletter portfolio for some time, and shares of V are up ~6% year-to-date while the S&P 500 (SPY) is down ~1% year-to-date as of this writing on June 14. The top end of our fair value estimate range for Visa sits at $214 per share **indicating there is plenty of room for shares of V to climb higher**; please note **we like to let our winners run.** Additionally, shares of V yield a modest ~0.6% as of this writing, offering incremental upside to its capital appreciation potential.

Recent Update

Visa published an 8-K filing on June 1 that provided investors with a better idea of how its operations, and consumer spending habits at-large, were progressing through the pandemic. **Many countries and numerous US states have begun lifting stay-at-home orders** and are well on their way to restarting "normal" economic activity, though this process will take some time before those economics return to pre-pandemic levels of economic activity. Some countries, particularly developing nations, and nations heavily reliant on tourism, will likely take years to return to pre-pandemic levels of economic activity.

In its recent SEC filing, **Visa noted total payment volumes declined by 5% in the US on a year-over-year basis in May on its payment processing network, which was a major improvement versus April when its total payment volumes were down by 18% year-over-year.**

*Data from Visa...*continued on next page

*Data from Visa…*from previous page

More surprisingly, **Visa noted its US debit payment volumes rebounded from a 5% year-over-year decline in April to 12% year-over-year growth in May across its network**, while its US credit volumes rebounded from a 30% year-over-year decline in April to a 21% year-over-year decline in May. It is likely the decline in credit payment volumes across Visa's network is largely due to US households continuing to hold back on vacations and traveling in general, with Visa noting that its US travel-related payment processing volumes dropped by more than 70% year-over-year in May.

On a global basis, total processed transactions declined by 12% year-over-year in May across Visa's payment processing network, a big improvement from a 24% year-over-year decline in April. Visa noted that in Chile, Denmark, and New Zealand, process transactions on its network experienced "positive year-over-year constant dollar growth in May" though the firm also noted that "India and Singapore are slowly reopening" reinforcing macroeconomic data that the pandemic has had an uneven impact on economic activity across different regions and nations (though when the pandemic first started spreading is an important factor as it relates to the timing of what became the inevitable economic downturn in almost every nation across the globe). Visa also mentioned that the trajectory of the rebound in total payment volumes in "most of Europe, as well as Australia, Canada and Japan" was "comparable" to the trajectory seen in the US. Cross-border transactions remain very subdued across Visa's network however, though volumes improved somewhat as you can see in the upcoming graphic down below.

The table below shows the increase / (decrease) in certain key metrics against the comparable 2019 periods for April, May, and quarter-to-date (April 1 - May 31, 2020):

Year-over-Year Increase / (Decrease)	April	May	Quarter-to-Date
U.S. Payments Volume	(18%)	(5%)	(11%)
Credit	(30%)	(21%)	(25%)
Debit	(5%)	12%	4%
Processed Transactions	(24%)	(12%)	(18%)
Cross-Border Volume Excluding Intra-Europe Transactions*	(51%)	(45%)	(48%)
Cross-Border Volume Including Intra-Europe Transactions*	(43%)	(35%)	(39%)

*In constant dollars

***Image Shown**: Total payment processing volumes are recovering in the US and elsewhere, though cross-border volumes remain heavily subdued as households are shunning travel and vacations. **Image Source**: Visa – 8-K SEC Filing*

n the US, Visa reported that its year-over-year payment processing volumes grew nicely in May in the 'food & drugstores' category likely due to the pandemic induced shift in US household budgets that has seen greater consumer staples purchases as consumer discretionary spending is curtailed. Additionally, the 'home improvement' and 'retail services' categories saw nice year-over-year payment processing growth in May across Visa's network. In the recent past, we covered how Lowe's Companies Inc (LOW) and Home Depot Inc (HD) posted very strong same-store sales growth in the wake of COVID-19 as households (particularly US households) have turned to do-it-yourself ('DIY') projects to pass the time and catch up on maintenance work for their home. For the retail services category, that improvement is likely due to the reopening of the US economy in various US states combined with rising consumer staples purchases at locations not covered in the food & drugstores category.

Pivoting to categories that experienced a moderate level of year-over-year payment volume growth across Visa's network in the US, that included the 'automotive,' 'retail goods,' and 'telecom & utilities' categories. For telecom & utilities, generally speaking it appears most US households have continued paying the bills, assisted by the Coronavirus Aid, Relief, and Economic Security Act ('CARES Act'). The growth in retail goods payment volume on Visa's network is also a promising sign. Additionally, the need to maintain and repair automobiles does not go away because there is a pandemic. As an aside, please note a considerable amount of consumers use credit cards to fund the down payment on automobiles in the US (though the bulk of the funds used to purchase most new and used car purchases in the US are provided by auto loans).

*Data from Visa…*continued on next page

*Data from Visa...*from previous page

Many companies such as General Motors Company (GM) have pivoted to offering home delivery services in states that allow such a thing. Carvana Co (CVNA) allows consumers to purchase used cars online and offers home delivery services. Tesla Inc (TSLA) has long offered home delivery services. While using a credit card to place a down payment on a new automobile may seem unconventional to some, many dealers and automakers have pivoted to very generous terms to prop up their sales.

Finally, looking at the spaces hit hardest by the pandemic, Visa notes that US payment processing volumes across its network in the 'entertainment,' 'fuel,' and especially 'travel' categories all fell by over 40% year-over-year in May. The working-from-home trend has negatively impacted demand for gasoline, even as various US states have started reopening, as has the decline in travel demand. Many entertainment offerings still are not permitted due to quarantine efforts in numerous US states, such as movie theaters, live music events, and live sporting events. Visa also notes the 'quick-service restaurant' ('QSR') and 'restaurant' categories both saw between a 20%-40% year-over-year drop in payment processing volumes in the US across its network in May. Restaurants that have opened back up often have had to reduce in-store capacity by moving tables farther apart, reducing their revenue generation and (as it relates to Visa) total transaction volume potential.

The table below shows the May year-over-year performance in certain U.S. payments volume categories:

Growing 20%+	Growing 0-20%	Declining 0-20%	Declining 20-40%	Declining 40%+
Food & Drugstores Home Improvement Retail Services	Automotive Retail Goods Telecom & Utilities	Business Supplies Department Stores Education & Gov't Healthcare	Restaurant & QSR	Entertainment Fuel Travel*

*Travel declined more than 70% in May year-over-year

***Image Shown**: Visa provides an overview of what industries are performing well and what industries are feeling the pressure from the (both positive and negative) dynamic impacts of COVID-19 as it relates to consumer spending habits, based off the payment processing volumes seen across its network. **Image Source**: Visa – 8-K SEC Filing*

International travel remains heavily subdued, as mentioned previously and as highlighted in the upcoming graphic down below.

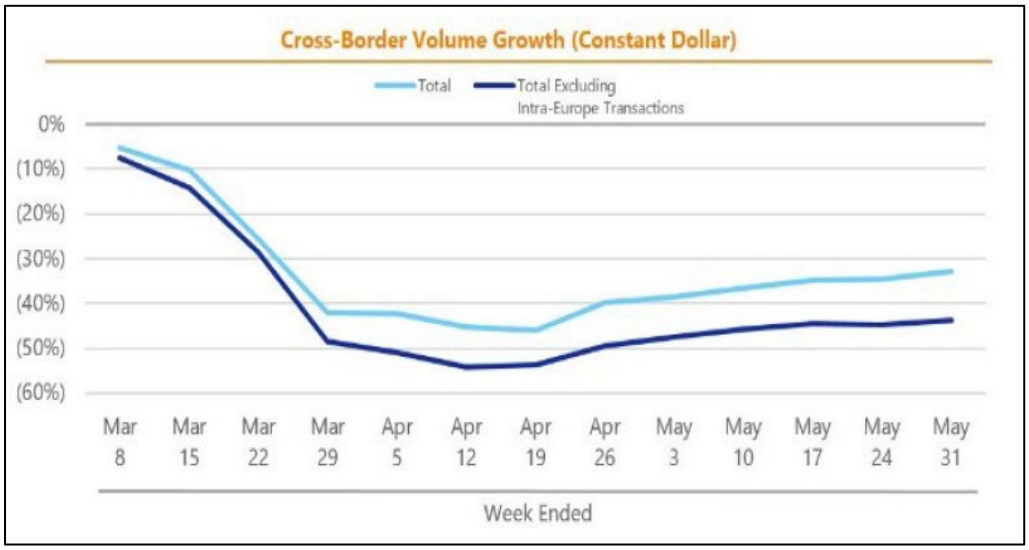

***Image Shown**: The sharp contraction in Visa's cross-border volume growth across its global payment processing and solutions network indicates global demand for travel and vacation-related services remains heavily subdued, though things have improved somewhat since April. **Image Source**: Visa – 8-K SEC Filing*

*Data from Visa...*continued on next page

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In the upcoming graphic down below, Visa provides a trend line of how its US payment processing volumes have improved (relatively speaking) from March 2020 lows over the past couple of months (especially in May).

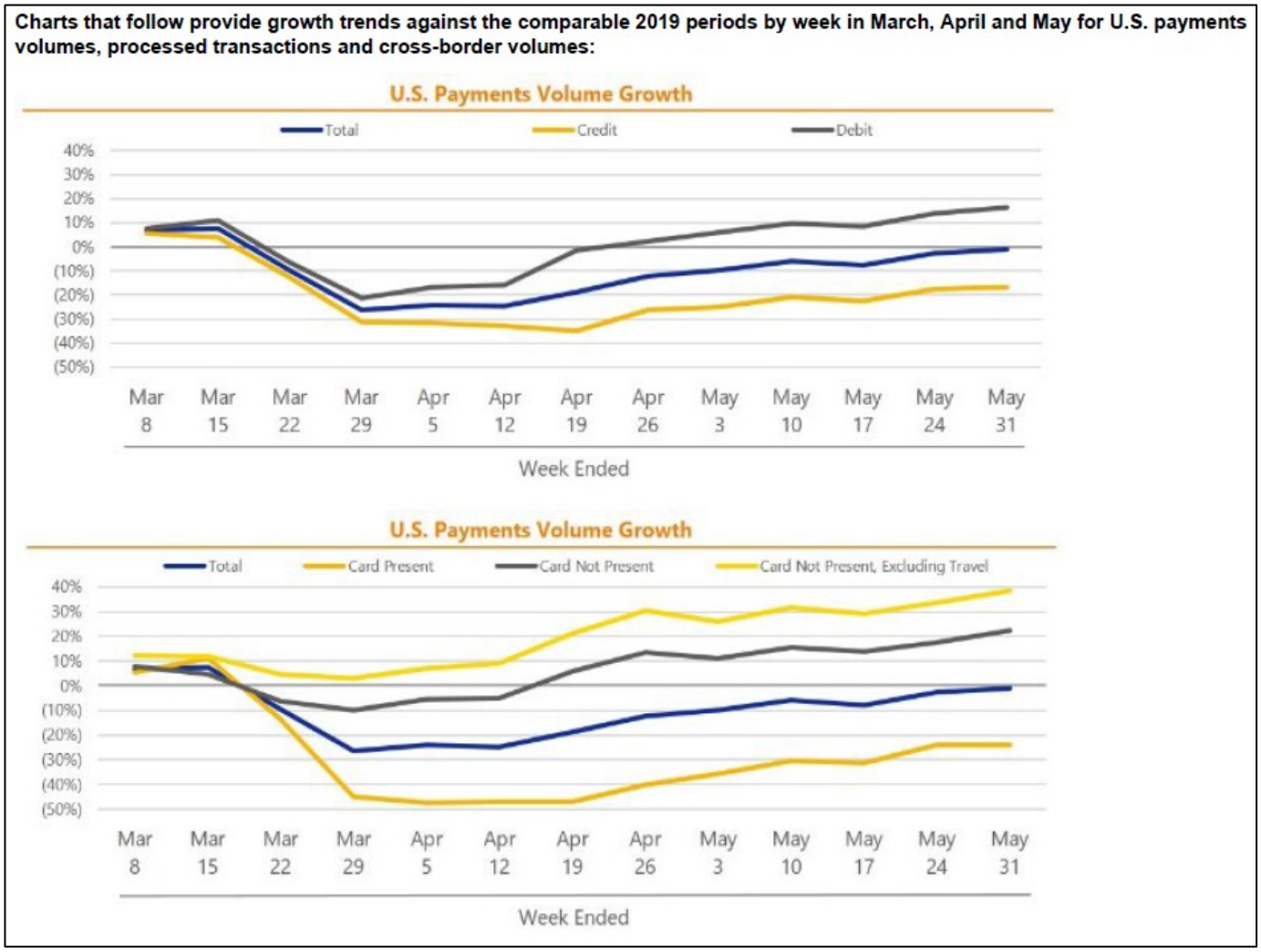

Image Shown: *Data seen across Visa's payment processing network indicates US economic activity is rebounding since contracting sharply in March and April which was the result of containment efforts to stop the spread of COVID-19.* ***Image Source:*** *Visa – 8-K SEC Filing*

Concluding Thoughts

While it will take time for things to return to normal and longer still for economic activity in many nations to return to pre-pandemic levels, we continue to be very excited about the numerous vaccines and cures in the works for COVID-19. Should a cure or even better a vaccine materialize, that could help return economic activities back to pre-pandemic levels at a significantly faster rate, enhancing Visa's near- and medium-term outlook. Beyond that dynamic, we continue to like Visa due to its low net debt load (at the end of March 2020), high quality cash flow profile, very promising long-term growth trajectory, and ability to capitalize on powerful secular growth tailwinds.

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

Cisco Systems Makes a (Potentially) Transformative Acquisition

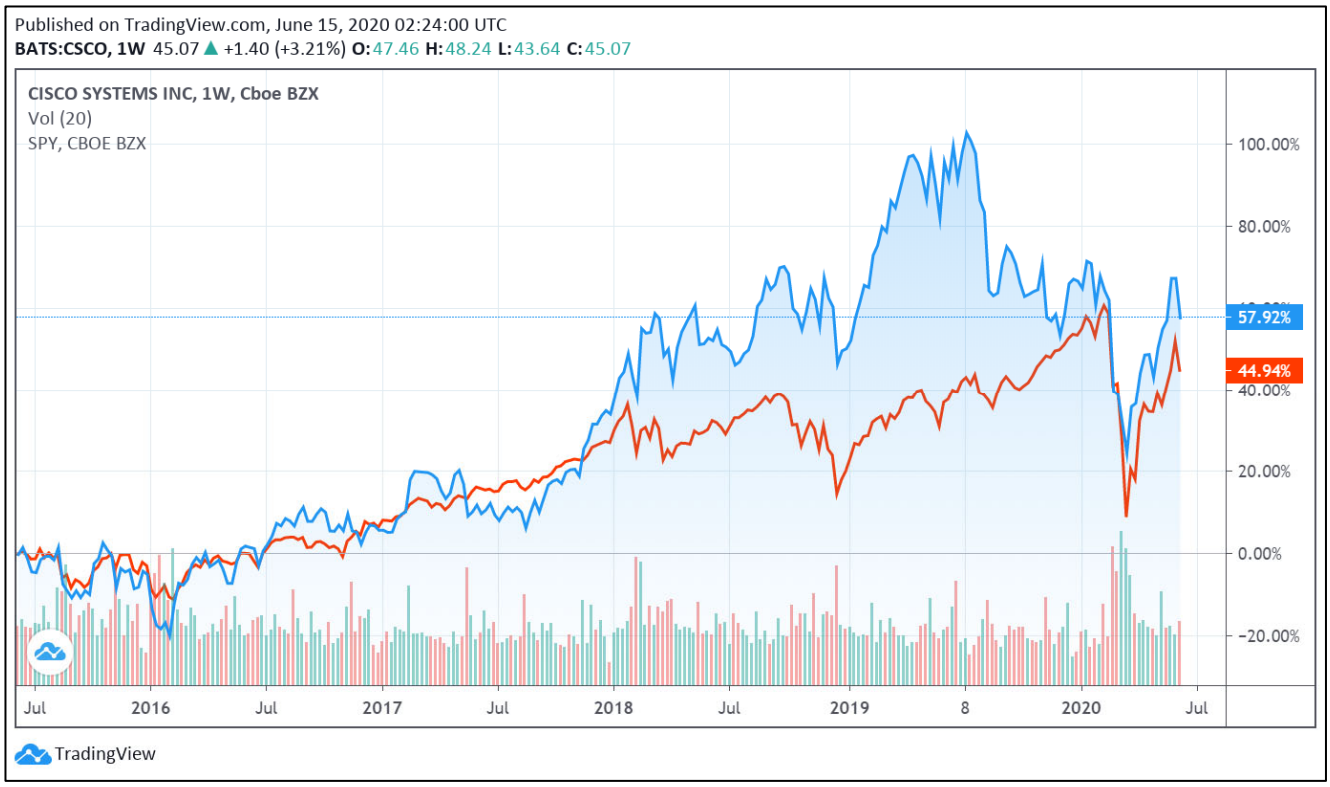

Image Shown: *Over the past five years, shares of Cisco Systems have significantly outperformed the S&P 500 (SPY), before taking dividend considerations into account. When including dividend considerations, Cisco's outperformance would likely grow even further given shares of CSCO carry a juicy yield.*

By Callum Turcan

We include shares of the networking infrastructure giant Cisco Systems (CSCO) as a holding in both the Best Ideas Newsletter and Dividend Growth Newsletter portfolios. Its high quality cash flow profile, pristine balance sheet, and growing subscription-based revenue streams make Cisco quite appealing. As of this writing, shares of CSCO yield ~3.2% and our Dividend Cushion ratio sits at 2.6, earning the firm a "GOOD" Dividend Safety rating. Should that Dividend Cushion ratio climb a tad higher, Cisco would be in a position to earn an "EXCELLENT" Dividend Safety rating. Our fair value estimate of $51 per share indicates Cisco has room to move higher from current levels (~$45 per share as of this writing), supported by its technical strength of late. We want to draw attention **to a recent acquisition that could have major implications for Cisco's medium- and long-term growth trajectory.**

Expanding Performance Monitoring Capabilities

On May 28, Cisco put out a press release noting it intended to acquire privately-held ThousandEyes Inc, though the financial terms weren't disclosed (potentially for competitive reasons). ThousandEyes is a performance monitoring provider and network intelligence company headquartered in San Francisco, California.

In the press release, Cisco noted that ThousandEyes' "Internet and Cloud intelligence platform delivers deep visibility and insights into the digital delivery of applications and services over the Internet." Cisco intends on integrating ThousandEyes with its "core Enterprise Networking and Cloud, and AppDynamics portfolios" and ThousandEyes "will join Cisco's newly-formed Networking Services business unit."

*Cisco Systems Makes...*continued on next page

*Cisco Systems Makes…*from previous page

Cisco wants to better allow its customers to locate and fix problems in real time across their networks, specifically cloud and enterprise networks, and all the way down to the end user. Better digital delivery and maintenance systems for applications and services would improve the performance of its customers' operations, and in turn that should (in theory) drive up demand for Cisco's products and services (including its networking and routing hardware, along with the related software offerings). ThousandEyes is best known as a company that can measures the performance of internet connections anywhere in the world and over the past several years has expanded into providing insights into those digital connections.

Please note that Cisco, as things stand today, is somewhat limited in what it can monitor. While the performance of internal operations can be closely monitored on Cisco's networking infrastructure offerings, the performance outside of that realm cannot. ThousandEyes on the other hand would allow Cisco, and its customers, to monitor the performance of the digital delivery of services and applications from the enterprise all the way down to the end user in a far more comprehensive way than what Cisco's offerings can handle currently.

An Illustrative Example

A recent article on *eWeek* provided a solid illustrative example of how Cisco can integrate ThousandEye's performance monitoring services with its networking and router hardware. The ongoing coronavirus ('COVID-19') pandemic is forcing many employees to work remotely, generally from home (instead of a satellite office or other centralized location). Instead of having enterprise-level internet connections from one internet service provider in a centralized location (meaning there is a level of standardization here), remote employees working at home have their own internet connections with varying degrees of quality (different internet service providers, different internet packages, different regions).

Take customer service operations, for example (as the *eWeek* article did). When a customer service representative is working at a central corporate location, the quality of the experience (specifically, the quality of the phone call if WiFi calling is enabled, the quality of the video conference, or the quality of any sort of internet-related support) will vary greatly from employee to employee. What ThousandEyes can do is locate regions with congested internet connections and route that traffic towards other areas (meaning that instead of having the customer reach Employee A whose internet connection is slower, the customer reaches Employee B whose internet connection is functioning properly).

Though the COVID-19 pandemic will eventually pass, the shift in employee preferences towards working remotely (whether from home or satellite offices) will likely be permanent (at least for some employees). Beyond customer services operations, the digital delivery of enterprise/productivity-oriented applications to the households and/or satellite offices of those remote employees will be very important to manage. That is where the beauty of Cisco's acquisition comes in as there are many ways for the firm to capitalize on this acquisition (this deal will help differentiate its networking and routing hardware and software offerings from its competitors), and why we see this deal as favorably augmenting Cisco's growth trajectory.

We see the ThousandEyes deal as being quite transformative to Cisco's hardware and software offerings. As the digital world gets increasingly complex, smarter solutions are needed to say ahead of the curve. Noticing performance issues in real time puts Cisco, and its clients, ahead of that curve and allows for its clients to mitigate issues before they become very real problems. Beyond noticing problems in the quality of internet connections, ThousandEyes can monitor the performance of the application or service being delivered to the end user as we mentioned previously. That allows the firm to notice if the application or service is not functioning properly and adjust accordingly. For a remote working situation, that means Cisco's client could notice if the productivity service being digitally delivered to an employee (or employees) is having problems before a serious amount of time and cash are wasted (potentially saving the client a lot of money).

*Cisco Systems Makes…*continued on next page

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Brief Deal Overview

Cisco expects the deal will close by the end of the first quarter of its fiscal 2021, keeping in mind its third quarter of fiscal 2020 ended on April 25, 2020. *Bloomberg* reports that Cisco is paying around $1.0 billion to acquire ThousandEyes, and furthermore, that ThousandEyes' last known valuation was $670 million (as of last year) according to data from Morningstar Pitchbook's service. As we have noted in the past, Cisco carries a pristine balance sheet and exited the fiscal third quarter with a net cash position of ~$12.5 billion. **The networking giant can easily afford to add ThousandEyes to its portfolio while still maintaining its financial war chest.**

Concluding Thoughts

We continue to like shares of Cisco as a holding in the Best Ideas Newsletter portfolio and its outlook is supported by its pristine balance sheet and high quality cash flow profile. Once the ThousandEyes deal closes and the integration process begins, we will have more to say on this topic and will provide our members with any relevant updates going forward.

Before then, please take a look at our updated enterprise cash flow models and 'Valuation Analysis' in the upcoming image down below. We forecast modest long-term free cash flow growth at Cisco Systems, though in the event the company outperforms these assumptions in the future (potentially in part due to the ThousandEyes acquisition), shares of CSCO could carry a fair value estimate of up to $61 per share (the top end of our fair value estimate range).

Valuation Analysis

Valuation Assumptions

In Millions of USD (except for per share items)	5-year Projections	
Revenue CAGR %	1.0%	
Avg. EBIT Margin %	36.2%	
Avg. Cash Tax Rate %	19.0%	
Earnings Before Interest CAGR %	6.4%	
Earnings Per Share CAGR %	175.5%	
Free Cash Flow to the Firm CAGR %	11.7%	
Earnings before interest = Net operating profits less adjusted taxes	Long-term Projections	
Phase II --> III FCFF CAGR %	2.1% (II)	3% (III)
Cost of Equity %	9.5%	
After-tax Cost of Debt %	4.9%	
Discount Rate (WACC) %	9.1%	
Synthetic credit spread = 1.727%	Results	
Phase I Present Value	62,810	
Phase II Present Value	98,837	
Phase III Present Value	68,495	
Total Firm Value	230,142	
Net Balance Sheet Impact	20,979	
Total Equity Value	251,121	
Diluted Shares Outstanding	4,881.0	
Fair Value per Share	$51.00	

Valuation Breakdown

In the chart below, we show the build up to our estimate of total enterprise value for Cisco and the break down to the firm's total equity value, which we estimate to be about 251.12USD 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 $51 per share fair value estimate.

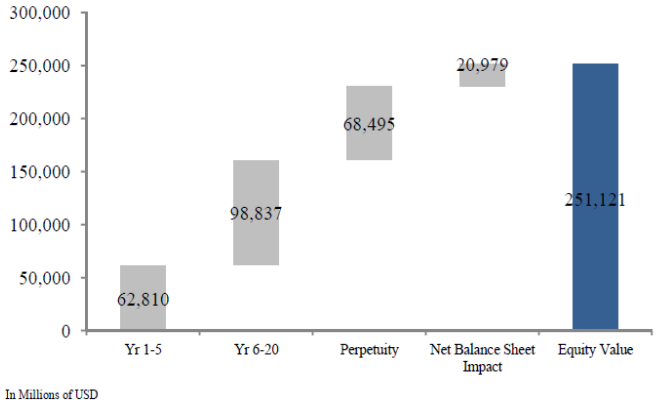


Image Shown: *Cisco Systems' intrinsic value is enhanced by its net cash balance and decent growth outlook.*

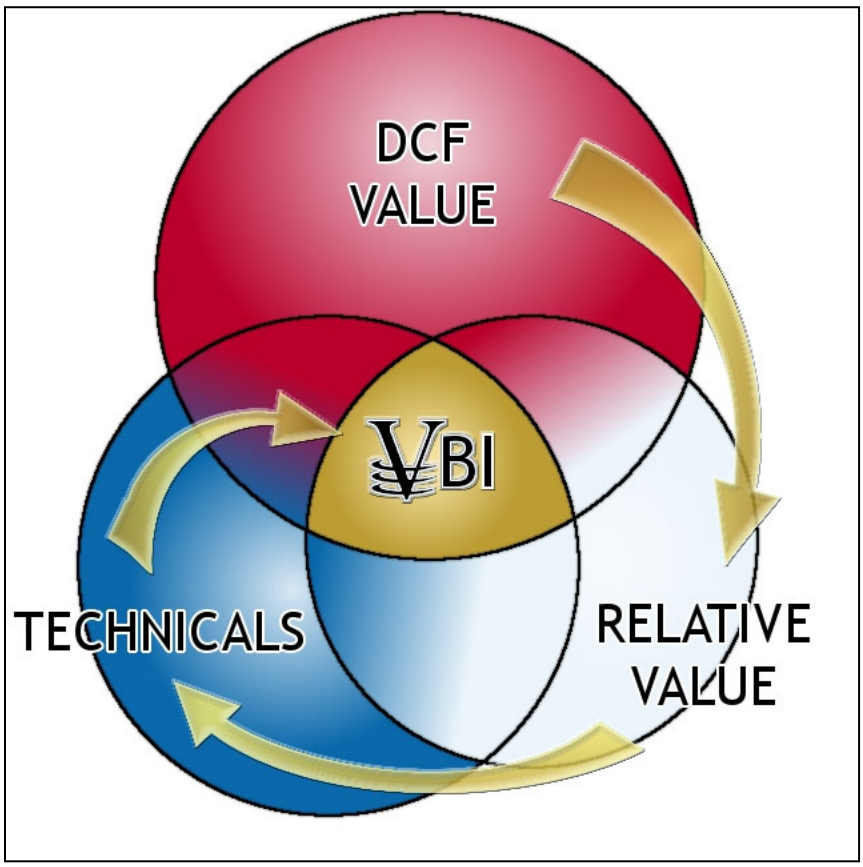
Disclosure: *Callum Turcan does not own shares in any of the securities mentioned above.*

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.



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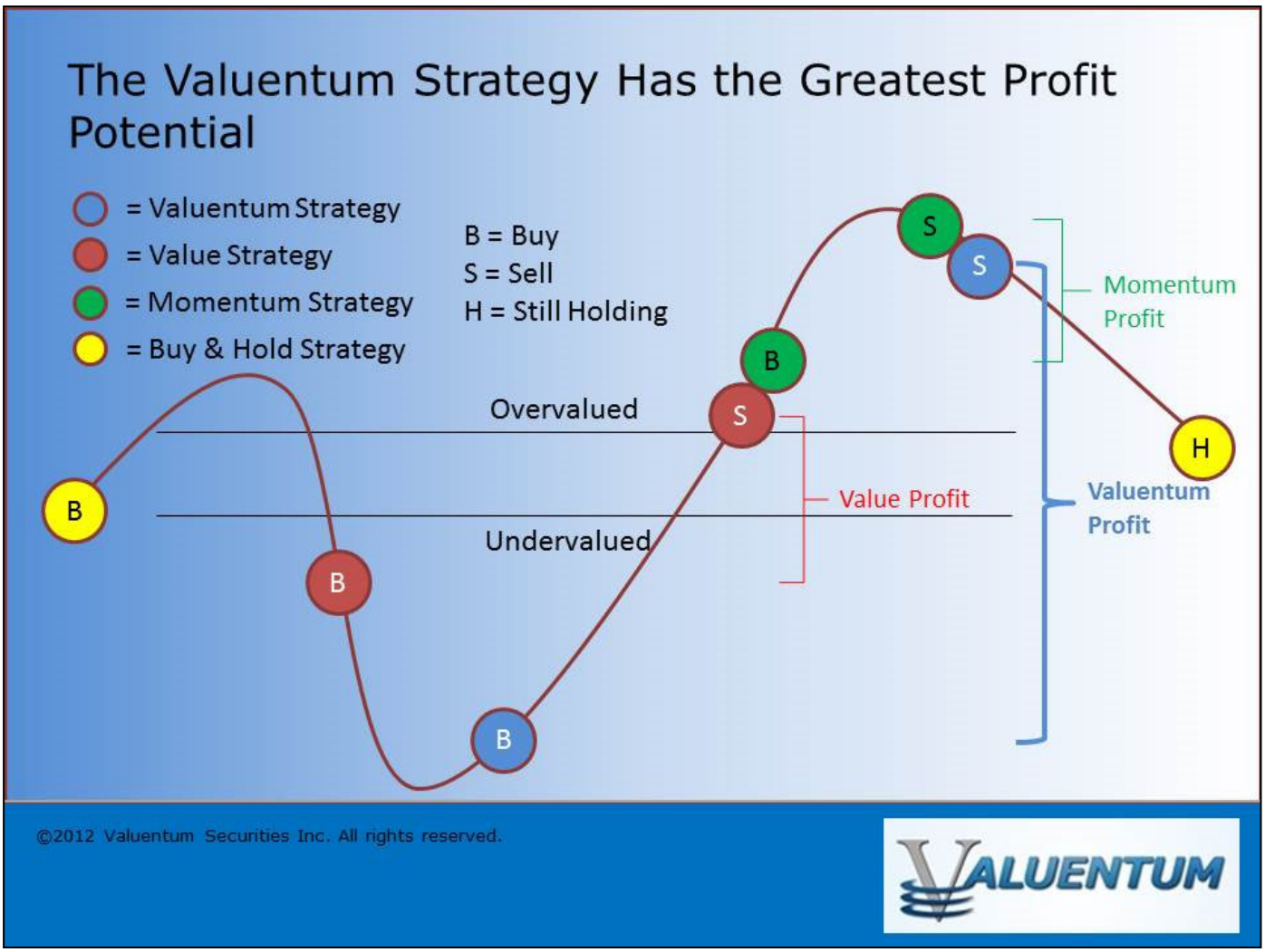
The center of the Venn diagram above, the Valuentum Buying Index (VBI) combines rigorous financial and valuation analysis with an evaluation of a firm's technicals and momentum indicators to derive a rating between 1 and 10 for each company (10=best). Because the process factors in a technical and momentum 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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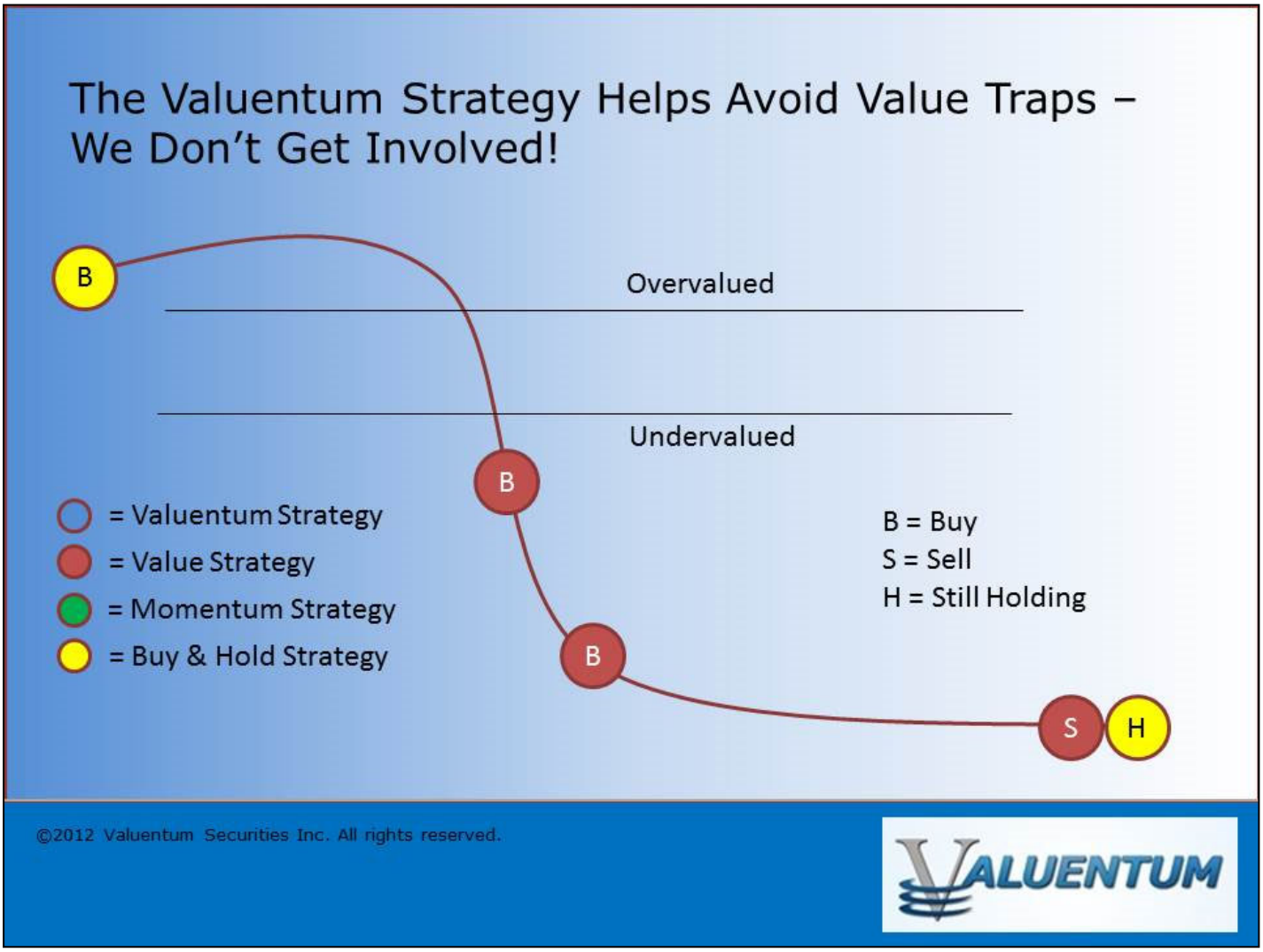
Furthermore, we think Valuentum subscribers are less likely to be involved in so-called value traps because we demand material revenue and earnings growth for firms to earn a 10 on the Valuentum Buying Index. Value traps often occur as a result of secular declines in a firm's products or services, resulting 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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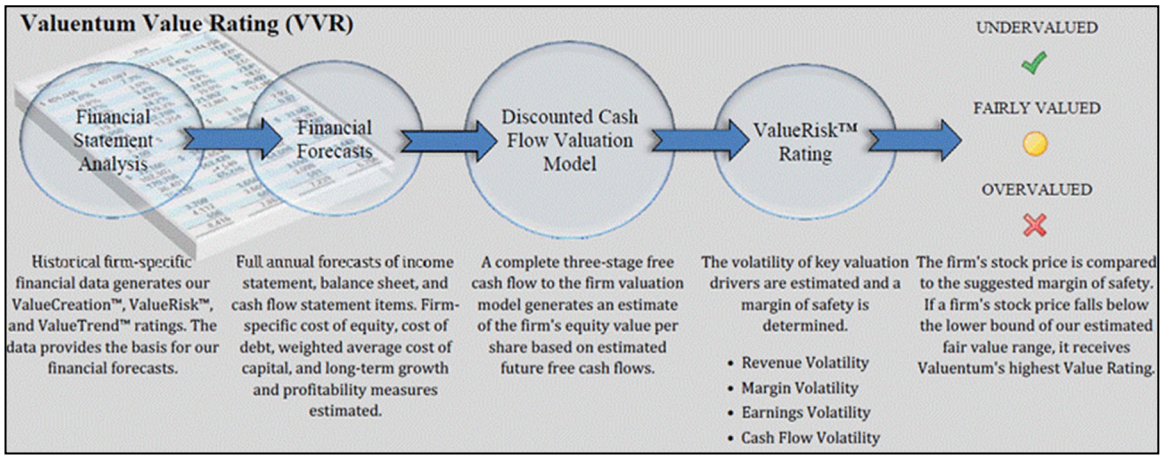
Let's walk through the three investment pillars of our stock-selection methodology.

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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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

Our Methodology – The Valuentum Buying Index continued on next page

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valuation criteria).

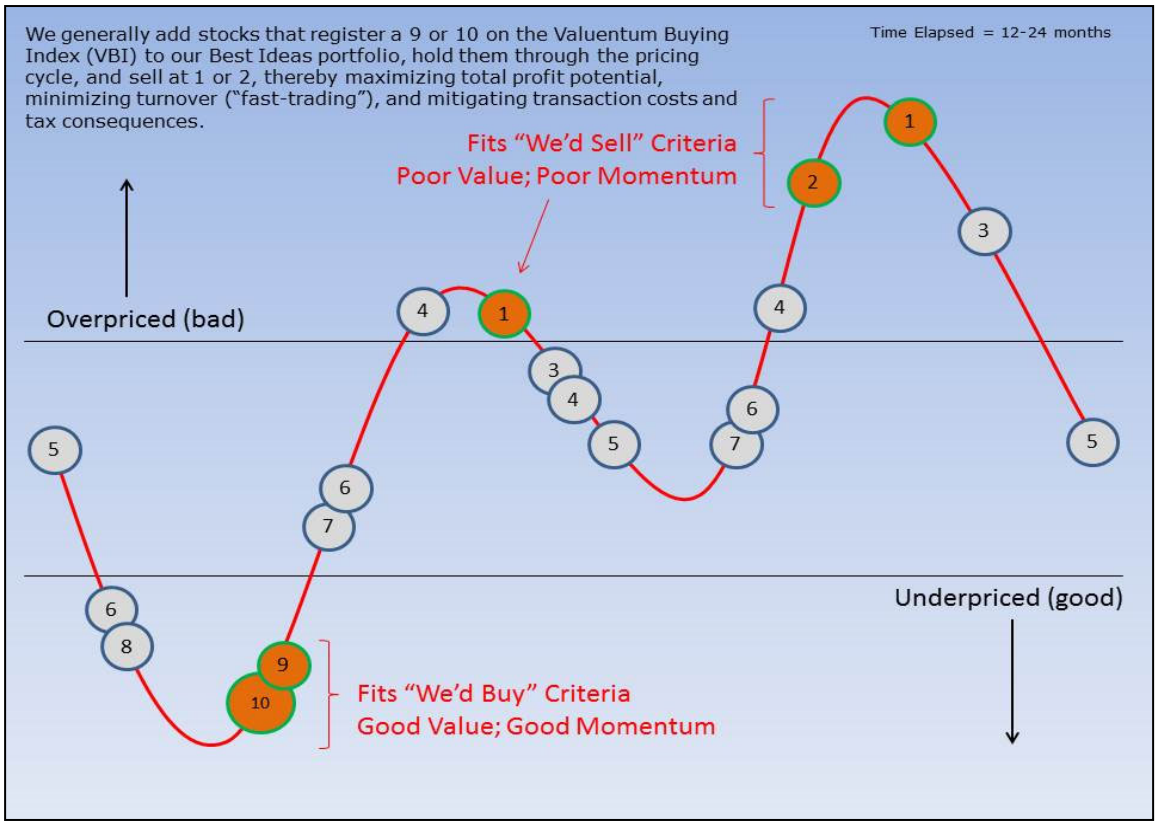
Rigorous valuation analysis and technical analysis are not mutually exclusive, and we believe both can be used together to bolster idea generation. An evaluation of a stock's moving averages, relative strength, upside-downside volume, and money flow index are but a few considerations we look at with 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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Our Methodology – The Valuentum Buying Index continued on next page

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

Let's follow the red line on the flow chart below to see how a firm can score a 10, the best mark on 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.

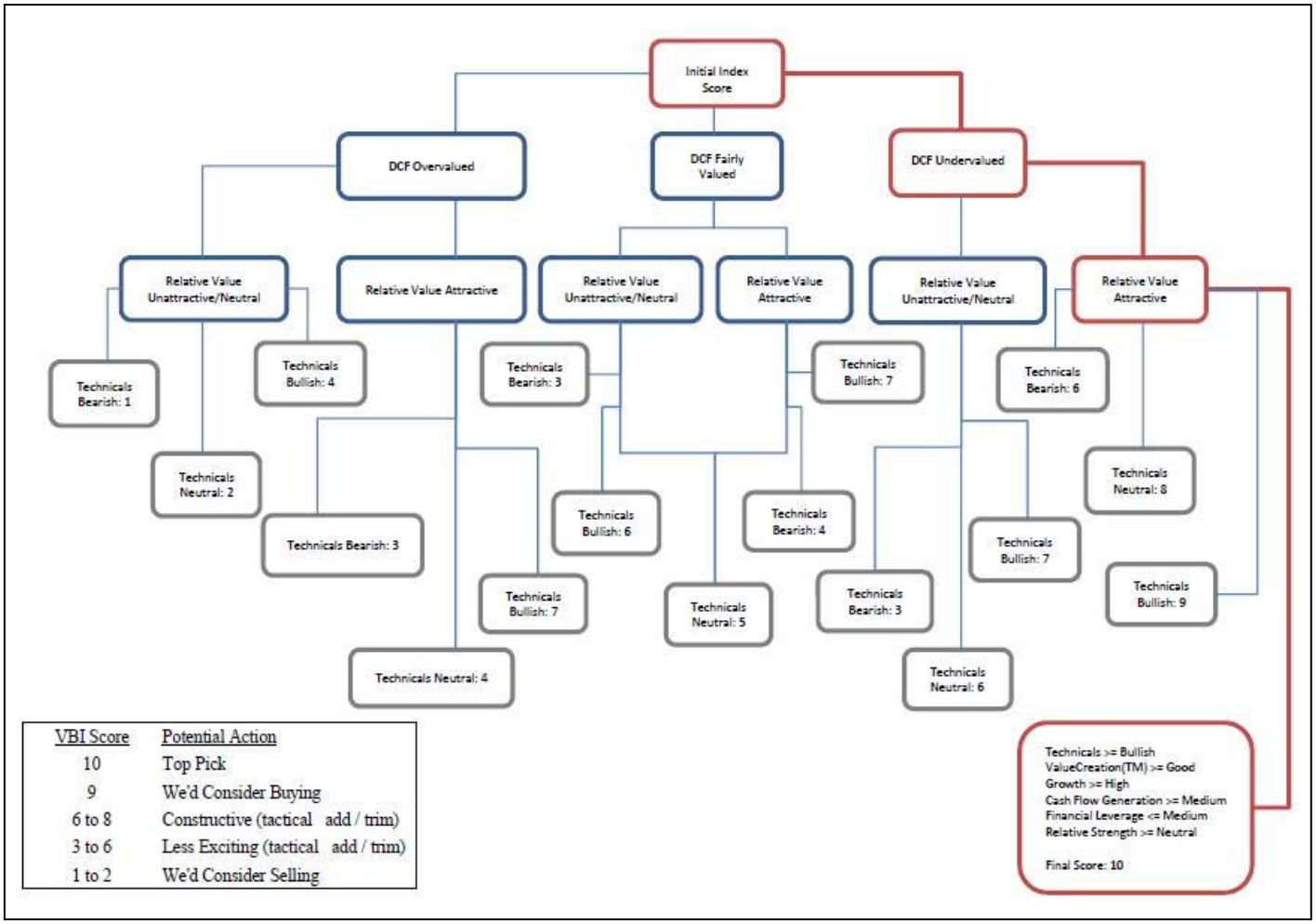


Illustration for educational purposes only.

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?

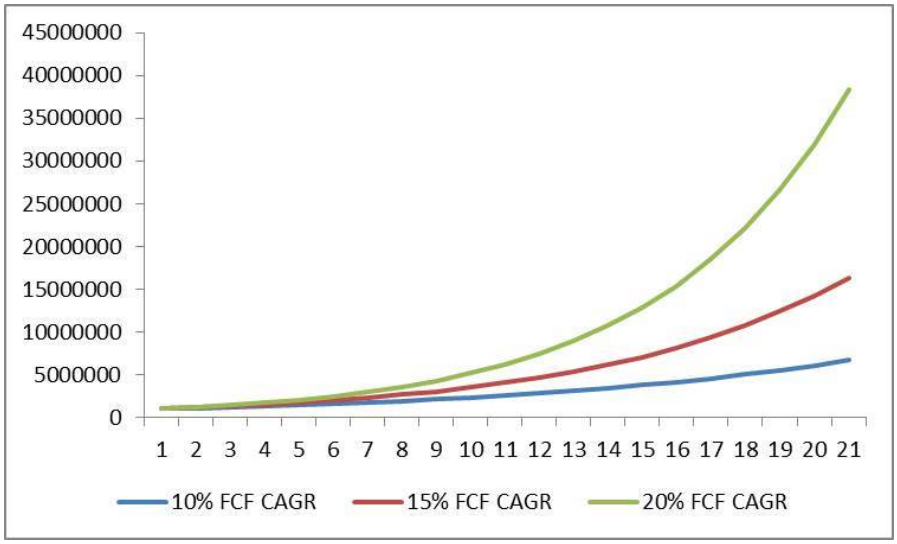
One of the most important concepts of the Valuentum methodology (and valuation in general) is the understanding that the value of a company is a range of probable valuation outcomes, not a single point estimate. Even well-seasoned stock analysts are guilty of saying that a company's shares are worth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

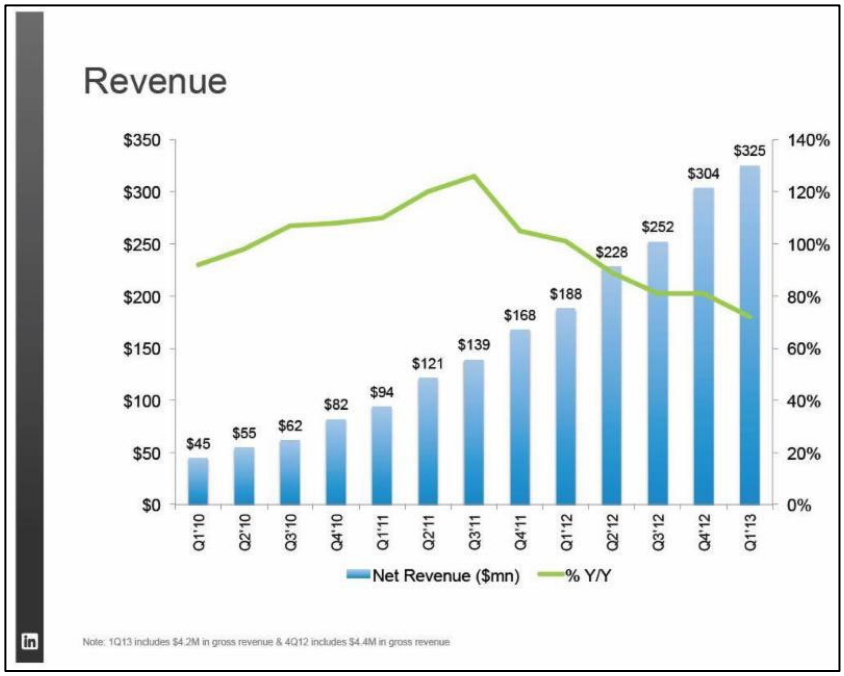

Image Source: LinkedIn

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

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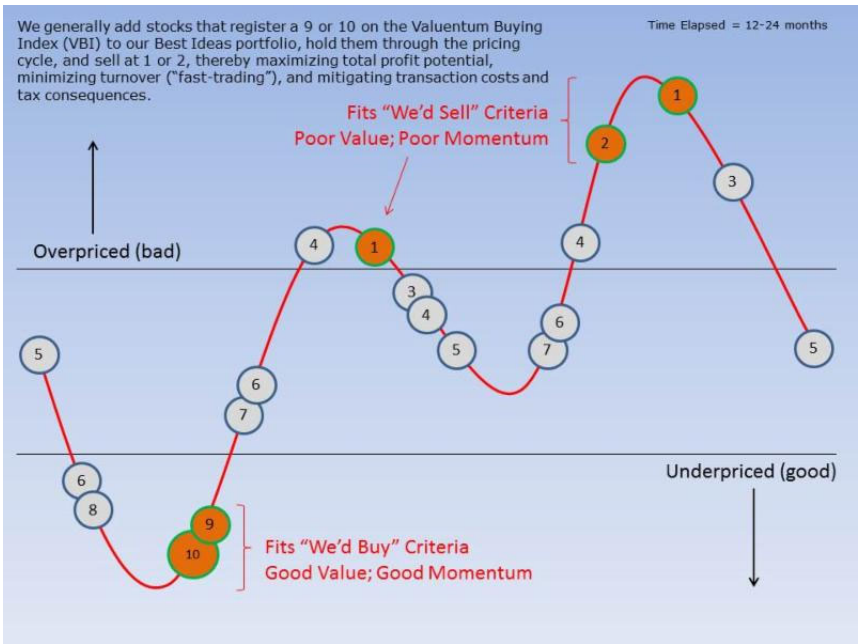
may be the secret to success in investing, a lot could have gone wrong with the temptation to do something each day. Obviously, we're very disciplined, but we also credit the portfolio outperformance to the VBI methodology itself. It is a very helpful tool.

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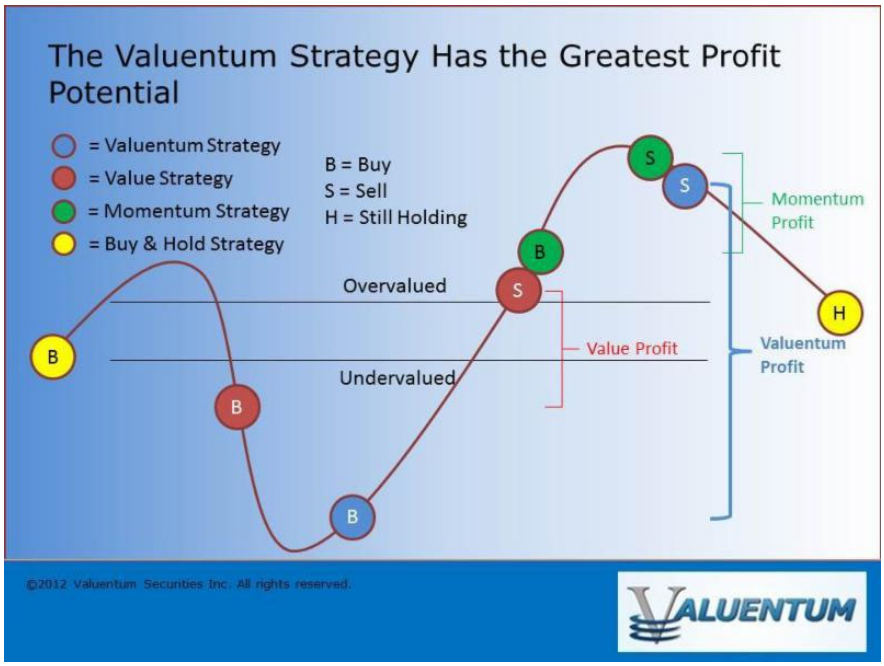
But why don't we churn our ideas by updating daily and trading a lot? Obviously, we don't think that's the secret to investment success. In quite the opposite approach, we strive to maximize profits on every idea that we pursue, with the understanding that momentum does exist and that prices over and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

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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.

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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 10, Issue 6

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

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Valuentum's company-specific forecasts used in its discounted cash flow model are rules-based. These rules reflect the experience and opinions of Valuentum's analyst team. Historical data used in our valuation model is provided by Xignite and from other publicly available sources including annual and quarterly regulatory filings. Stock price and volume data is provided by Xignite. No warranty is made regarding the accuracy of any data or any opinions. Valuentum's valuation model is based on sound academic principles, and other forecasts in the model such as inflation and the equity risk premium are based on long-term averages. The Valuentum proprietary automated text-generation system creates text that will vary by company and may often change for the same company upon subsequent updates.

Valuentum uses its own proprietary stock investment style and industry classification systems. Peer companies are selected based on the opinions of the Valuentum analyst team. Research reports and data are updated periodically, though Valuentum assumes no obligation to update its reports, opinions, or data following publication in any form or format. Performance assessment of Valuentum metrics, including the Valuentum Buying Index, is ongoing, and we intend to update investors periodically, though Valuentum assumes no obligation to do so. Not all information is available on all companies. There may be a lag before reports and data are updated for stock splits and stock dividends.

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