

2014

## Crummer SunTrust Portfolio Recommendations: Crummer Investment Management [2014]

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Elena Anemogiannis, Tatiana Castillo, Saken Smailov, Juan Iznaga, Christopher Simmonds, Garrett Flick, Thomas Trevisani, Charles Ward, and Ang Li

2014

# Crummer SunTrust Portfolio Recommendations

Crummer Investment Management



Dear Members of the Committee,

We would like to thank you for your service to the Crummer SunTrust Portfolio. Without your participation, Crummer students would not benefit from the unique insight you bring to managing an active portfolio.

We have benefitted from some outstanding guest speakers who have been generous with their time and expertise: Rick Ahl, AHL Capital Management; Chris Enger, Aviance Capital Management; Kevin Mayo, CNL; Professor William Seyfreid, Crummer; John Race, DRZ; Derek Grimm, Merrill Lynch; Bhawna Talwar, RVR Consulting Group; Jay Menozzi, Semper Capital Management Phillip Rich, Seaside Bank; Sabina Lien, SunTrust; and John Moskos and Cameron Dawson, US Trust.

This portfolio was endowed by SunTrust to provide scholarships for future Crummer students and to give current students a practical, hands-on learning opportunity. This year we are pleased to be able to provide \$30,000 in scholarships. We also agree that we have all learned a great deal from the experience and responsibility of managing real money.

This portfolio trades only once a year, in late April, presenting some unusual portfolio management challenges. Our first challenge is to establish a portfolio position that takes advantage of economic opportunities while avoiding unnecessary risk and conforming to the Crummer SunTrust Investment Policy Statement (IPS). We are also tasked, by the IPS, to operate at two levels simultaneously— tactical for the near-term and strategic for the long run.

Our tactical approach began with a top-down sector analysis. We established an economic forecast based on research and consultation with economists, including Professor Bill SeyFried of the Crummer School. That forecast then drove our allocation among the ten S&P sectors: Consumer Discretionary, Consumer Staples, Energy, Financial, Health Care, Industrials, Information Technology, Materials, Telecommunications, and Utilities. This year we have forecast a continued slow economic recovery and tilted the allocation towards market sectors that do well in a recovering economy.

Our long-run strategy is embodied in the asset class allocation. The IPS sets asset class ranges to moderate risk and to keep the portfolio from being whipsawed by transitory market cycles. We are in the middle of the large cap value and growth ranges, towards the low side on small cap growth and the high side of small cap value and international. More detail about our ranges and allocation starts on page 12. A major part of our asset allocation decision is the percentage to allocate to bonds. This year we are at the low end of the range. These allocations are modestly risk on, consistent with our view that the stock market has upside potential and bond prices are near a cyclical peak.

We look forward to sharing the results of our analysis with you in person.

## Crummer Investment Management Team

|                                        |                      |
|----------------------------------------|----------------------|
| Consumer Discretionary Sector Analyst: | Elena Anemogiannis   |
| Consumer Staples Sector Analyst:       | Tatiana Castillo     |
| Energy Sector Analyst:                 | Saken Smailov        |
| Financial Sector Analyst:              | Juan Iznaga          |
| Fixed Income Analyst:                  | Christopher Simmonds |
| Healthcare Sector Analyst:             | Garrett Flick        |
| Industrial Sector Analyst:             | Thomas Trevisani     |
| Technology Sector Analyst:             | Charles Ward         |
| Materials Sector Analyst:              | Tatiana Castillo     |
| Telecommunications Sector Analyst:     | Ang Li               |
| Utilities Sector Analyst:              | Ang Li               |



From left to right: Dr. J. Clay Singleton, Garrett Flick, Ang Li, Elena Anemogiannis, Christopher Simmonds, Saken Smailov, Tatiana Castillo, Juan Iznaga, Charles Ward, and Thomas Trevisani.

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## Executive Summary

The Crummer SunTrust portfolio's Investment Policy Statement requires us to base our tactical sector allocations on the market's near-term prospects. We accept the challenge of predicting what will happen next year because we respect the need to base our recommendations on a coherent outlook. Recognizing that the markets often lead the economy, we looked for help from economists, portfolio managers, financial analysts, and financial advisors, seeking their advice on the economy's direction over the next twelve months. Some see the glass as half-empty—others as half-full. Here are some of the things we heard:

### Half Empty

The Fed is a giant unknown. The Fed has announced it will taper its \$85 billion monthly government and agency bond purchases to zero by October this year. Never before has the Fed tried to engineer such a soft landing. William Dudley, president of the New York Fed, told our class last December that the Fed wanted to encourage investors into more risky assets and it deserves some credit for boosting the stock market. As these bond purchases decline, however, the stock market is in uncharted territory and probably headed down as interest rates rise. Even more troubling is the Fed's balance sheet, now bulging with \$3.6 trillion in assets (12/31/2013) and set to grow more this year. If the Fed disposes of these assets in the near term, it will reinforce the downward pressure on the market.

Brazil, Russia, India and China have been a bright spot for the last fifteen years but are now expected to grow at half their pre-crisis rate, taking the wind out of the global economy's sails. We can already see effects on commodity prices and U.S. companies doing business in emerging markets. As these countries slow, the U.S. economy will feel the effects.

Employment remains a problem. Although many journalists focus on the headline unemployment rate, which has improved, the real problem is labor force participation. Before the Great Recession, the rate stood solidly above 65 percent. In early 2014, that rate was stuck around 63 percent. As the unemployment rate improves when the participation rate falls, headline improvement in unemployment must be taken with a grain of salt. Until the participation rate increases and discouraged workers rejoin the workforce, economic growth will be sluggish.

We rely on economic predictions to forecast the market but we cannot help but be market watchers, too. The coming year will not be as good for the markets as 2013. Each April for the last three years, this class has predicted a rising stock market, only to be disappointed in all but last year. Even then, no one we know predicted the market would rise 20 percent from April through December. While the stock market continues its rise so far this year, momentum can only carry us so far and we may be headed for another disappointment.

Would it be relevant to touch on high levels of youth unemployment and student debt? As major factors in young people delaying major asset purchases (auto, home), these could play a role in a bear market for 2014.

## Half Full

A rising stock market has knock-on positive effects on consumption. First, although the consumer confidence survey did decline 2 percent from January to February, due to falling expectations about the future, the current conditions component rose. Consumer spending continues to increase despite an unusual winter while inflation remains subdued. Consumer debt-to-income ratios have trended down, primarily due to mortgage deleveraging. This trend stabilized a bit in the fourth quarter of 2013, confirming an uptick in consumer confidence. Finally, the Employee Benefits Research Institute reports that consumers with employment-based retirement plans are more confident about their retirement, probably reflecting a higher stock market. Increasing confidence in retirement prospects, less debt, and a positive near-term outlook probably mean more consumer spending to drive the economy.

Today's low interest rates continue to moderate companies' capital costs. As companies expand and consumption increases, the economy will grow and push the markets along with it. While the recession was marked by a serious credit crunch, bank lending was up 3.2 percent in the fourth quarter. This trend reflects borrowers' better credit quality and banks' increased willingness to take modest risks. While long rates are likely to rise somewhat as the Fed's tapers, increased business borrowing will help the economy grow.

Residential housing was a big part of the Great Recession. Even though, according to the S&P/Case-Shiller Home Price Index, existing homes are more expensive, the housing affordability index hit a ten-year high in the fourth quarter and is 71 percent better than it was in 2007. While we have to wait for the snow to melt for housing starts to give us a good reading, new housing permits in February were running 7.7 percent higher than a year earlier. Housing creates jobs should boost the economy.

During the Great Recession, companies were risk-averse and economic growth slowed. The index of business conditions that blends employment with industrial sales and production is stable at pre-recession levels. When businesses can plan with confidence, investments in inventory and productive capacity follow.

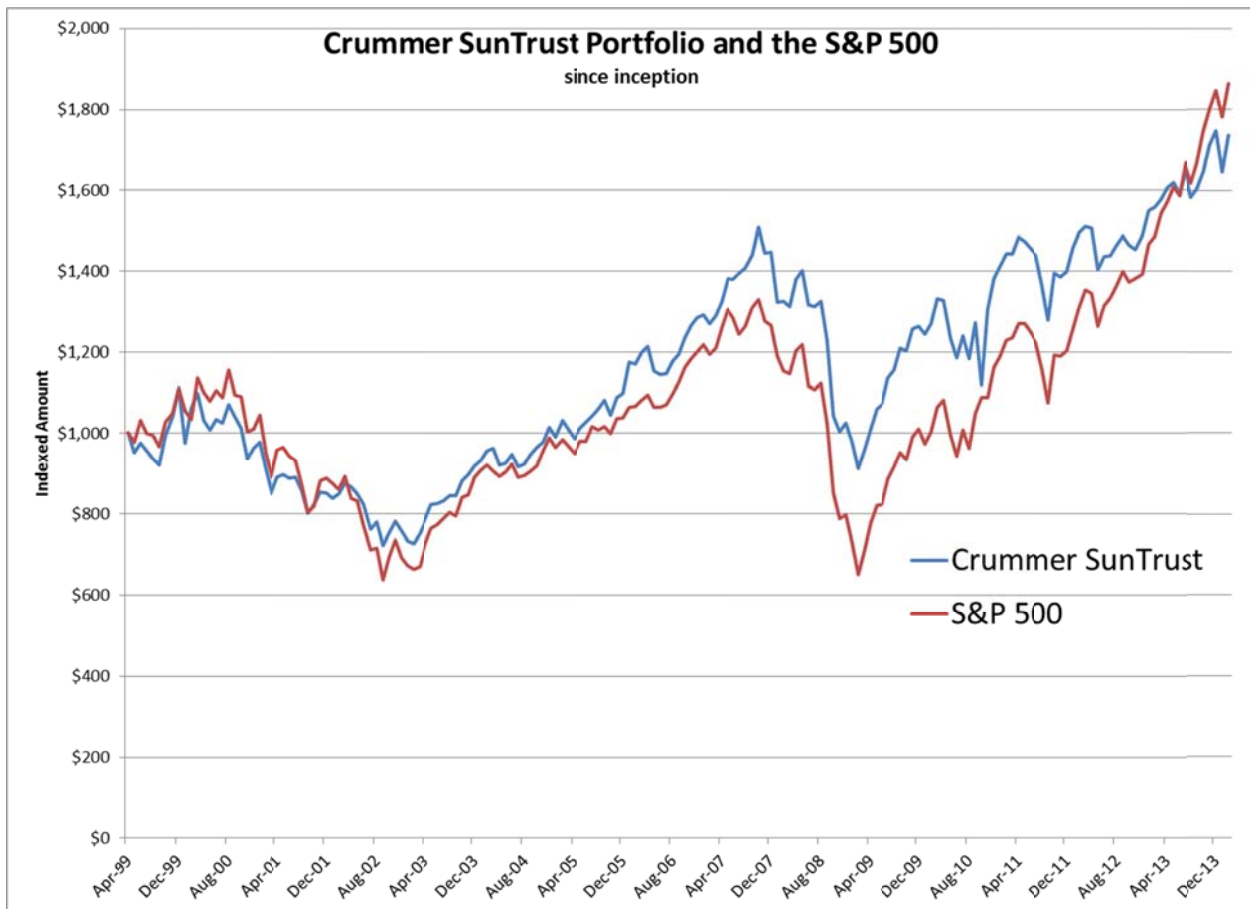
While we look to the economy to predict the market, we also watch the flow of investment funds. Stock prices rise when investors are buying. The ICI reports that in February \$21 billion flowed into bond and stock mutual funds with \$19 billion going to equity funds and \$2 billion to bond funds. Last summer these flows turned in favor of stock funds following a five-year stretch where more money went to bond funds. When money moves into stocks, the market rises.

Having gotten all the advice we could stand, we made our decision: on balance, we believe the market will move modestly higher in the short-term. As we believe the economy is still recovering, we recommend over weighting the portfolio in cyclical sectors and underweighting countercyclical sectors. Like all soothsayers, we can only hope our glass is half-full.

## Performance of the Crummer SunTrust Portfolio

### Since Inception

The Crummer SunTrust portfolio invested the first \$100,000 SunTrust contribution in April 1999. Subsequent contributions brought the total invested to \$500,000. Since inception, the portfolio has generated over \$152,000 in scholarships. As the chart shows, portfolio performance lagged the S&P 500 index until early 2002. Between then and late 2013, the portfolio outpaced the index by a considerable margin.



## 2013 – 2014 Plan Year Performance Highlights

At the end of February 2014, the index was 7 percent ahead of the portfolio. While the portfolio gained a respectable 17 percent in 2013, the S&P 500 was up 32 percent. Absolute performance without adjusting for risk is incomplete. The portfolio's since-inception annual return is 11.7 percent (with a standard deviation of 14.5 percent) versus the S&P 500 index's return of 12.6 percent (with a standard deviation of 15.5 percent) over the same period. This risk-return comparison is all the more noteworthy because the portfolio has held varying amount of bonds over time.

## Buy Recommendations

Analyzing the individual buy trades executed last April, the thirty-eight buy recommendations resulted in a net gain of \$28,592. The best purchase was Green Mountain Coffee Roasters, which gained \$9,638. The biggest loser was Tower group International, Ltd., down \$21,086.

## Sell Recommendations

The sell recommendations were somewhat timely. The twenty-five positions they sold would have gained \$6,817 for the portfolio as winners barely outpaced losers in this group. On the plus side of avoiding losses, the portfolio sold its position in Calumet Specialty Products Partners, LP, sidestepping a loss of \$5,006. On the other hand, the portfolio missed a gain of \$5,110 by selling United Technologies Corporation.

## Hold Recommendations

Each portfolio position is analyzed to make a buy, sell, or hold recommendation. The twenty hold recommendations showed a substantial gain of \$26,624 for the plan year. Tesco PLC and Abercrombie & Fitch were among the biggest losers while Wellpoint and U.S. Bancorp were among the biggest gainers.

## Bonds and Cash

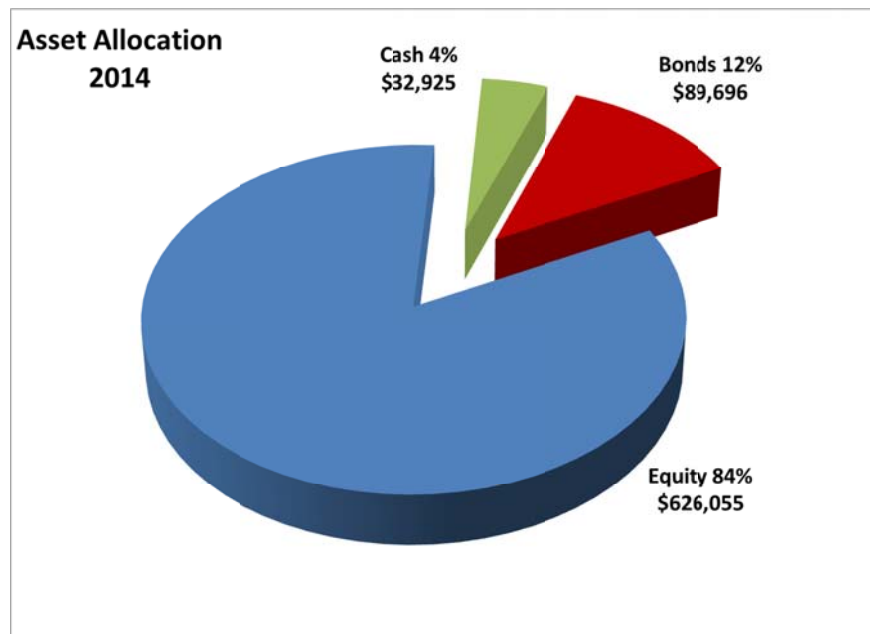
The portfolio began the plan year (April 2013) with 4 percent allocated cash (to fund scholarships), 84 percent to equity, and 12 percent to bonds (PIMCO 1-5 year TIPS and Templeton Global Bond Total Return Fund). The bond investment lost 3.9 percent over the plan year. As of April 1, 2014, the portfolio held less than 1 percent in cash but the proposed trades will generate \$30,000 to contribute to scholarships.

## Portfolio Design

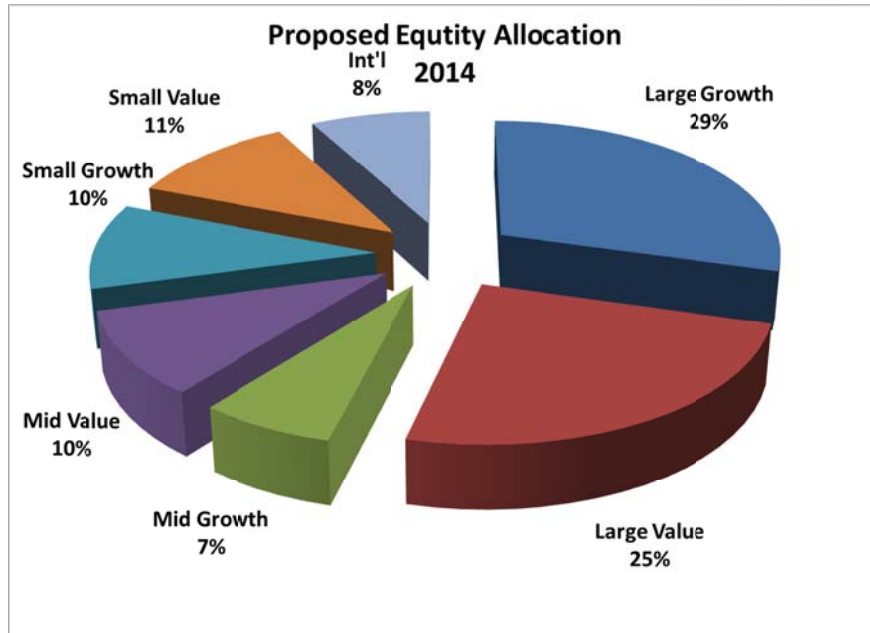
The Crummer SunTrust portfolio's investment policy guidelines provide a wide range of alternatives for tactical and strategic allocation decisions (refer to page 105 for a copy of the IPS). Strategically, we allocated among asset classes to reflect our economic outlook for a return to more normal markets in the long-term. To choose the most desirable allocation, the management team looked at the past performance and volatility of each asset class. The asset class benchmarks and their target range are provided by the IPS as constraints to make the asset class allocation suitable for the portfolio's long-term strategy. After designing the portfolio, we conducted a mean-variance optimization to compare our recommendation to an optimal portfolio (the portfolio with the smallest risk for a desired level of expected return). Our portfolio, while not mathematically optimal, is reasonably mean-variance efficient (refer to Page 109 for more discussion of mean-variance optimization).

On a tactical level, we predict a continued slow economic recovery in the near-term and have overweighted the S&P's ten sectors that have traditionally done well as the economy comes out of a recession. Consistent with our cautious optimism, the portfolio's tilt is modest.

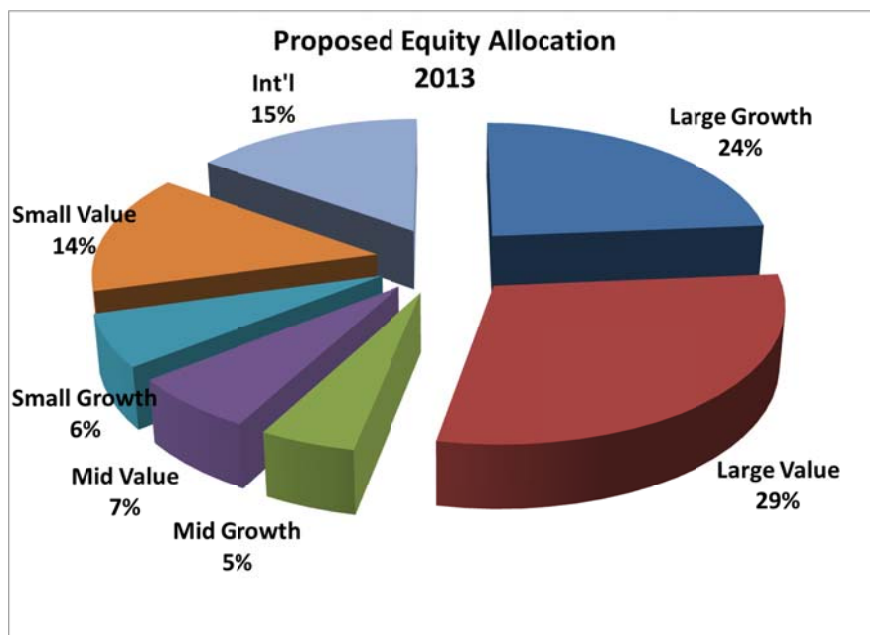
The charts included in this section show the proposed strategic allocation compared to last year's portfolio. Our overall allocation recommendation for 2014 is 84 percent equity, 12 percent bonds and 4 percent cash:



The proposed equity asset allocation is slightly tilted towards growth with 53 percent in growth and 47 percent in value. The 8 percent international exposure is exclusively through ADRs. The size breakdown is 55 percent large, 25 percent mid, and 21 percent small. For stocks that are classified as core, we allocate their market value equally to value and growth. A large growth tilt is consistent with our long-term view of a gradual return to a normal economy.



The proposed equity allocation differs from 2013 with more growth and less allocated to small stocks.

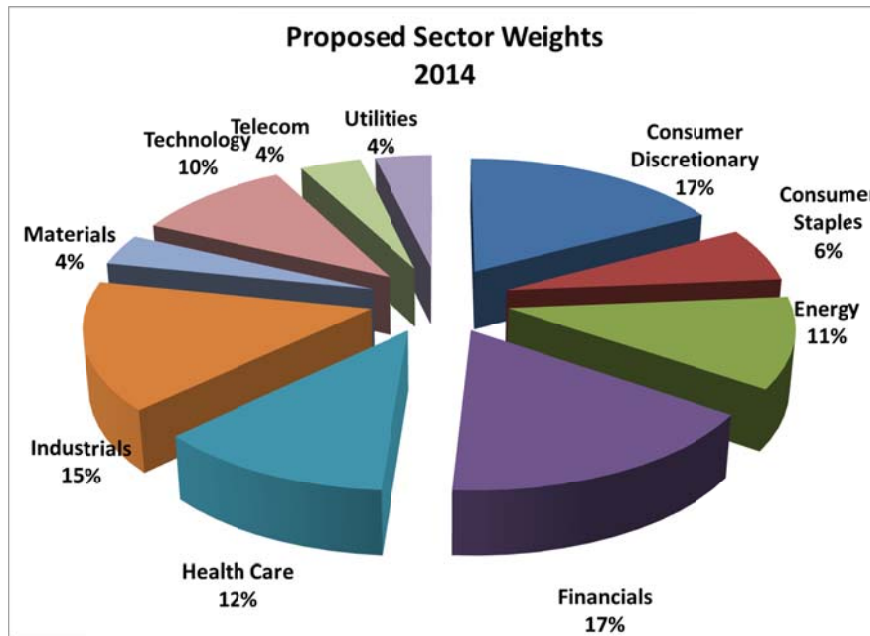


# Crummer Investment Management

This table repeats the proposed asset class allocation and shows the ranges from the IPS. The portfolio is at the high end of the IPS ranges in large and small cap value and towards the lower end of the ranges for mid and small cap growth. Large cap growth and mid cap value are near the middle of their ranges. We believe our proposal reflects with our optimistic market forecast and is consistent the specifications of the IPS.

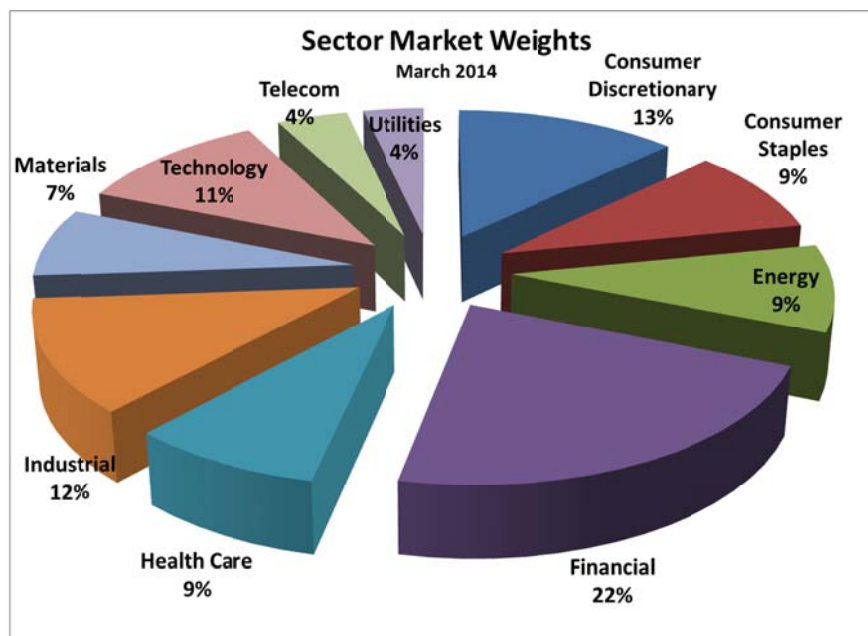
| Asset Class          | Proposed Market Weight | IPS Target Range |
|----------------------|------------------------|------------------|
| Large Cap - Growth   | 29%                    | 10-30%           |
| Large Cap – Value    | 25%                    | 10-30%           |
| Mid Cap – Growth     | 7%                     | 5-10%            |
| Mid Cap – Value      | 10%                    | 5-10%            |
| Small Cap - Growth   | 10%                    | 5-15%            |
| Small Cap – Value    | 11%                    | 5-15%            |
| International Equity | 8%                     | 5-15%            |
| Fixed Income         | 12%                    | 12-18%           |
| Cash                 | 4%                     | As needed        |

Our tactical sector allocation is slightly over weighted in pro-cyclical sectors like consumer discretionary and industrials as shown below:



For contrast, the market weights as of the end of March 2013 were:





The table shows how the sector allocations compare to market weights as of the end of March 2013.

| Sector                        | Proposed | Market | Tilt |
|-------------------------------|----------|--------|------|
| <b>Consumer Discretionary</b> | 17%      | 13%    | 4%   |
| <b>Consumer Staples</b>       | 6%       | 9%     | -3%  |
| <b>Energy</b>                 | 11%      | 9%     | 2%   |
| <b>Financials</b>             | 17%      | 22%    | -5%  |
| <b>Health Care</b>            | 12%      | 9%     | 3%   |
| <b>Industrial</b>             | 12%      | 12%    | 3%   |
| <b>Materials</b>              | 4%       | 7%     | -3%  |
| <b>Technology</b>             | 10%      | 11%    | -1%  |
| <b>Telecom</b>                | 4%       | 4%     | 0%   |
| <b>Utilities</b>              | 4%       | 4%     | 0%   |

Our proposed portfolio is slightly over-weighted cyclical sectors, consistent with our view of a recovering economy, increasing stock market and declining or flat bond market. The one major exception is the financial sector, which is typically cyclical, but where the proposed portfolio is underweighted, despite shifting \$50,000 from other sectors this year. We believe financials have already recovered and may well lag behind the overall market. This equity portfolio is well positioned to take advantage of our forecasts without being overly dependent on a robust recovery.

## Sector Analysis

## Consumer Discretionary

### Outperforming the S&P in 2013

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The consumer discretionary sector consists of businesses that sell nonessential goods and services and is heavily influenced by economic performance. Consumers tend to cut discretionary spending in economic downturns. Companies in this sector include retailers, media companies, consumer services companies, apparel companies, and automobile and component companies. In 2013, the consumer discretionary index rose 30.74 percent, outperforming the S&P 500, which only rose 20.99 percent. This index has 84 constituents with a mean total market cap of over \$25.7 billion.

Consumer confidence is the primary growth driver in this sector. The sector performed well last year because of consumer expectations that the economy is moving from a recovery phase into an expansionary phase. In addition to an economic environment that favored consumers, the job market began to look healthier and the housing market improved.

### Sector Outlook

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#### Consumer Confidence

Consumer confidence will not only remain stable in 2014, but has the potential to grow. Consumers see a more stable job market with a falling unemployment rate. The unemployment rate at the beginning of this year was 6.6 percent as compared to 7.9 percent at the beginning of last year and the outlook is positive. While a portion of the unemployment rate decrease is due to a decrease in labor force participation, the average consumer is not aware of this. The Conference Board Consumer Confidence Index rose between February and March from 78.3 to 82.3 and the Expectations Index increased to 83.5 from 76.5. In addition, consumers are deleveraging and the Debt-to-Income ratio has been experiencing a downward trend. This stabilized in the fourth quarter of 2013, showing that consumers are regaining confidence to take on more credit and increase spending.

#### Demographic Trends

Baby boomers are the largest demographic in the United States. According to the U.S. Census Bureau, the population 65+ numbered 41.4 million in 2011 and is expected to grow to 55 million by 2020. While the Employee Benefits Research Institute states that consumers with employment-based retirement plans are more confident now than they have been in recent years, many live on a fixed income and we do not expect a significant growth in disposable income for this demographic in the near future. The 18-24 cohort is the fastest growing population under 45 and accounts for approximately \$200 billion in spending power, a number that is expected to double by 2020. Millennial customers are discerning buyers – according to a 2013 Columbia Business School survey, over 50 percent of millennials use smartphones to research products as they are shopping. To cater to these needs, companies need to focus on e-commerce and social media as a touch point vital to matching changing consumer tastes and creating demand.

#### Income Disparity

Despite these positive spending trends, there is growing disparity between “haves” and “have-nots”. This disparity is due to several factors including government austerity measures, like the cut in funding of food stamp programs, and the rise in healthcare costs. These factors will cause significant headwind for lower-income consumers. Student loan debt is another factor hindering disposable income, as students are required to pay interest on their loans. The IMF made a statement in March warning “wide income inequality can slow economic growth.” Companies that cater to more affluent clientele are expected to do better in the near future.

## Abercrombie & Fitch Co. ANF

| Recommendation | Valuation | Last Price | As of      | Style      | Dividend Yield |
|----------------|-----------|------------|------------|------------|----------------|
| Hold           | \$37.97   | \$38.78    | 03/28/2014 | Small Core | 2.60%          |



### Introduction

Abercrombie & Fitch operates as an American retailer of casual wear for young men, women, and children, selling through the Abercrombie & Fitch, abercrombie kids, Hollister and Gilly Hicks brands. The company operates over 1,000 stores worldwide and an e-commerce site, generating total revenues of \$4.5 billion in 2012.

### Fundamental Analysis

Abercrombie reported \$217 Million in comprehensive income in 2012. Fiscal results for 2012 included an 8 percent increase in net sales and a 78 percent increase in diluted earnings per share. The company also benefited from improvements in gross margin driven by a reduction of average unit costs without compromising product quality. In addition, the company has begun closing unprofitable domestic stores, which should yield improved performance in 2014.

Abercrombie has recently addressed shareholder concerns over corporate governance. The company added three members to its board and separated the roles of CEO and Board Chairman. Former CFO Jonathan E Ramsden was promoted to COO and will be developing new strategies to elevate the company's brand image and regain customer confidence.

The company's most recent annual report says it will improve earnings through "leveraging the international appeal of our brands to build a highly profitable, sustainable, global business." In 2013, the company is opening flagship A&F locations in Seoul and Shanghai and approximately 20 international Hollister stores including introduction to Australian, Middle Eastern and Japanese markets. Hollister is Abercrombie's most cost-conscious brand. The international expansion of this brand helps Abercrombie compete against other value-priced retailers like Aeropostale and American Eagle. We expect that as the overall consumer discretionary market improves, Abercrombie will benefit in excess of the market, in a large part through the international presence of its Hollister brand.

### Financial Statement Analysis

Abercrombie & Fitch has seen revenue growth of 8.5 percent in the last year while it has grown its EBT margin from 4.48 percent in 2012 to 8.13 percent in 2013. At 5.25 percent, net margins are the highest they have been since 2009 and at 12.88 percent, return on equity is the highest it's been since the recession. The fact that management is growing the company without sacrificing margins makes Abercrombie willing and able to meet its current financial obligations and fund its intended expansions – providing profitable growth for the next few years.

### Conclusion & Recommendation

Across all its product lines, Abercrombie's major short-term growth driver is consumer disposable income. Consumer disposable income is projected to increase 17 percent by 2015 and close to 50 percent by 2020. In the longer term, we expect Abercrombie's branding and cost reduction strategies to help it outperform its peers in this competitive industry, leading to continued growth.

Considering these growth forecasts, our model estimates the company is currently undervalued by roughly 0.5 percent. We recommend our position be held for at least another year.

## The Walt Disney Company DIS

| Recommendation | Valuation | Last Price | As of      | Style        | Dividend Yield |
|----------------|-----------|------------|------------|--------------|----------------|
| Sell           | \$51.68   | \$78.99    | 03/28/2014 | Large Growth | 1.09%          |

### Technical Analysis

|                          |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

The Walt Disney Co. is a media conglomerate with operations in theme parks, television, filmed entertainment, and merchandise licensing. The Theme Parks and Resorts segment (31 percent of revenues) includes the Disney World and Disneyland parks and the Disney Cruise line. The Media Networks segment (45 percent) includes the ABC broadcast network, 10 TV stations and cable networks ESPN. Studio Entertainment (13 percent) includes film, television and home video under the Walt Disney, Touchstone and Miramax brands and Consumer Products (8 percent) includes merchandise licensing, children's book publishing, video game development and retail stores. In 2012, Disney acquired Lucasfilm, best known for the StarWars franchise.

### Fundamental Analysis

Disney generated over \$45 billion in revenues in 2013. Net income and diluted earnings per share both increased by 8 percent to \$454 million and \$3.38 respectively. EPS growth is attributed to improved performance across all segments (excluding Studio Entertain-

ment), and lower net interest expenses due to lower effective interest rates.

We have a neutral outlook on the movies and entertainment sub-industries amid a weak consumer-spending environment and with increasing competition from digital platforms and illegal downloads. Further industry consolidation may fuel the competitive environment. As the industry's largest player, Disney does not have much room for growth.

CEO Bob Iger plans to remain at the helm through 2016. He has shown willingness to embrace new technologies, yet maintains the company's focus on high-quality content. The company's history of strategic acquisitions has resulted in a strong portfolio of animated films and character franchises. In addition, Disney benefits from the creative talent acquired in these partnerships.

### Financial Statement Analysis

Walt Disney Co. has seen revenue growth of 6.5 percent and net income growth has been steadily increasing since the recession. Gross margins in 2013 remain at the previous year's value of 21 percent and operating margins fell by roughly 1 percent. Earnings per share are at an all-time high of 3.38.

### Conclusion & Recommendation

Disney's main growth drivers are nonfarm employment, real consumer disposable income and retail sales. Non-farm employment and retail sales are predicted to grow at small but stable rates of roughly 1.5 percent and real consumer disposable income should see growth rates of roughly 6 percent for the next two years, tapering off to about 2 percent growth in the long-term.

Even with these modest growth forecasts, our discounted cash flow model estimates the company is currently undervalued by at least 50 percent. We recommend selling the stock.

## Foot Locker, Inc. FL

| Recommendation | Valuation | Last Price | As of      | Style    | Dividend Yield |
|----------------|-----------|------------|------------|----------|----------------|
| Sell           | \$22.19   | \$46.13    | 03/28/2014 | Mid Core | 1.70%          |

### Technical Analysis

|                          |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

Foot Locker, Inc. is a global retailer of athletic footwear and apparel operating in two segments: athletic stores and direct-to-customers. The company operates 3,473 stores under various brand, including Foot Locker, Lady Foot Locker, Kids Foot Locker, and Champs Sports in 23 countries. In 2013, the company acquired Runners Point Group. Foot Locker made \$6.5 billion in revenues last year.

### Fundamental Analysis

Foot Locker reported \$429 Million in earnings in 2013. The company has been experiencing sales growth since 2009. The Runners Point Group acquisitions contributed \$164 million to the 2013 sales results.

The company's net income margin has been steadily increasing since 2011 to 6.6 percent. Sales and comparable-store sales have both been increasing due to enhanced store formats across various banners and improved performance of the company's websites. The gross margin rate has fallen since last year due to increases in the cost of merchandise.

Management has seen considerable turnover since the recession. Six members of the twelve member executive

team have only held their positions since 2011 or later. There is uncertainty about the new management's ability to drive growth in the future. In addition, four insiders have sold shares during the last month.

The Apparel Retail sub-industry has experienced slow growth since 2012 due partially to the shift in U.S. consumer spending to durables from nondurables. There is increasing competition from international retailers expanding to the U.S. and off-price retailers are better positioned to gain market share given their attractive value pricing, frequent in-flow of new merchandise and ability to move quickly in and out of product categories based on consumer demand.

### Financial Statement Analysis

In 2013, Foot Locker, Inc. reported a net income of \$429 million or \$2.85 per share. Total sales increased 5.2 percent, a considerable slowdown in growth, to \$6,505 million compared to \$6,182 million last year.

The company's return on assets grew less than one percent last year and its return on invested capital fell to 14.1 percent in 2013 from 14.2 percent in 2012. Growth in comparable-store sales also slowed considerably from 9.4 percent in 2012 to 4.2 percent in 2013. The company's dividend yield has fallen consistently since the recession, by over 65 percent since 2009.

### Conclusion & Recommendation

Foot Locker operates in a very competitive environment with pressure from international, off-price, and e-commerce retailers. The company's relatively new management's strategy has yet to significantly improve the company's performance.

The company's primary growth driver is employment. Because we do not forecast large employment gains in the near future, we expect Foot Locker's short-term growth to be less than projected GDP growth. For this reason, our model give the company's stock an intrinsic value of only \$22.19, more than 100 percent below the stock's current trading price.

## Gap Inc. GPS

| Recommendation | Valuation | Last Price | As of      | Style      | Dividend Yield |
|----------------|-----------|------------|------------|------------|----------------|
| Sell           | \$12.40   | \$40.98    | 03/28/2014 | Large Core | 1.17%          |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Neutral  |
| Money Flow         | Positive |
| Relative Strength  | Neutral  |



### Introduction

Gap, Inc. is a specialty retailer that sells casual apparel, accessories, and personal care products for men, women, and children under the brands Gap, Banana Republic, Old Navy, Athleta, Peperline and Intermix. It operates 3,539 stores in North America, Europe and Asia and franchises an addition 375.

### Fundamental Analysis

The apparel retail industry is highly competitive. Gap is experiencing increasing pressure from domestic mass merchants such as Target and Kohl's, vertically integrated global firms like Inditex, and e-commerce retailers like Amazon. Growth in sales clothing and accessories stores decreased to 3.8 percent in 2013 from 5.5 percent in 2012 and is not expected to increase to more than four percent next year. Gap's easily replicable merchandising strategy leaves it at risk in an industry with low barriers to entry.

Success in the retail industry is incumbent upon driving, or at the very least keeping up with, consumer demand. Gap is at a disadvantage due to a lack of vertical integration. Competitors, like H&M, have faster turnaround capabilities.

In March, three Gap executives sold shares. No insiders have purchased shares in the last year. CFO Sabrina Simmons has reduced her ownership by 35.3 percent, the greatest reduction of three insiders. The CFO's decision to reduce her position eludes to her halfhearted confidence in the company's upcoming performance.

### Financial Statement Analysis

Gap, Inc. has seen a reduction in revenue growth to 3.18 percent in 2013 from 7.57 percent in 2012. The company's gross margins have fallen along with its financial leverage. The company is offering a \$1 billion share repurchase program for the third year in a row and shares outstanding have been decreasing steadily since 2005, a method often used by companies to boost EPS.

In addition, days sales outstanding has grown over 75 percent since 2011 and days in inventory grew five percent last year, meaning the company is having difficulty turning inventory and collecting on sales.

### Conclusion & Recommendation

Across all its product lines, Gap's major short-term growth driver is employment. Because we do not predict substantial growth in employment in the short-term, and due to environmental factors including intense competition and low barriers to entry, we found the stock's market value to be 200 percent over our intrinsic value. Therefore, we recommend liquidating our holdings.



## GameStop, Corp. GME

| Recommendation | Valuation | Last Price | As of      | Style     | Dividend Yield |
|----------------|-----------|------------|------------|-----------|----------------|
| Buy            | \$68.83   | \$41.69    | 03/28/2014 | Mid Value | 2.81%          |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Neutral  |
| Money Flow         | Positive |
| Relative Strength  | Neutral  |



### Introduction

GameStop is a retailer of video game products and PC entertainment software. The company sells new and used video game and PC entertainment hardware, software, and accessories, as well as publishes Game Informer magazine, which has 7.9 million subscribers, and operates video gaming website *kongregate*. The company operates 6,488 stores in North America, Europe and Australia. In 2013, GameStop acquired Spring Mobile, an AT&T wireless products and services retailer.

### Fundamental Analysis

GameStop commands an 80 percent share of the used video game market, which differentiates the company from the majority of its competitors that primarily sell new content. Historically, used games have generated roughly 50 percent of the company's gross profits, primarily due to them commanding almost double the gross profits of new games.

The PowerUp Reward program has proven as a powerful diversification tool as it leverages its large customer base and creates an ecosystem of trade-in credits to promote nontraditional digital categories. Due to the program, digital sales have grown from nearly nothing to over \$630 million in five years.

While the company experienced negative operating margins last year, as the new console installment base grows (for Xbox One and PS4, released in 2013), the company expects operating margins to grow back to the 2011 value of seven percent. Margins on console sales are low, but a one-time expense. During 2014, as these consoles are diffused throughout the consumer base, sales of new and used games are expected to increase.

### Financial Statement Analysis

Despite a poor sales performance year, GameStop has witnessed steady growth in gross margins to 29.84 percent from 25.57 percent since the recession, due to a steady decrease in COGS to 70.16 percent from 74.22 percent. Despite the company's poor financial performance at the end of 2012, trailing twelve month EBT and operating margin ratios are healthy at 6.99 percent and 7.04 percent respectively.

Gamestop's Free Cash Flow has grown by 25 percent since 2011 to \$493 million and its operating cash flow has grown 6.5 percent since 2011 to \$632 million. The company has been issuing dividends since 2012 and plans to continue to do so in the future.

### Conclusion & Recommendation

Despite the poor performance last year, management did a good job of managing expenses and focusing on expansion of the digital divisions. The strong position of the company's reward program and the tepid response for the new generation of gaming consoles should maintain or increase consumer demand for used games resulting in at least one more year of financial health.

As the company does not have a sufficient dividend paying history, we used the discounted cash flows model to arrive at the stock's intrinsic value. We recommend purchasing more stock as it is undervalued by 38 percent.



## Graham Holdings GHC

| Recommendation | Valuation | Last Price | As of      | Style    | Dividend Yield |
|----------------|-----------|------------|------------|----------|----------------|
| Sell           | \$ 486.77 | \$ 705.59  | 03/28/2014 | Mid Core | 0.35%          |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Neutral  |
| Money Flow         | Positive |
| Relative Strength  | Neutral  |

### Introduction



Graham Holdings is a diversified holding company that operates in four business segments: education, broadcast television, cable television, and a collection of smaller businesses classified as “other.” The diversified portfolio allows for leveling of earnings and cash contribution over time. The most important operating segments in terms of earnings and free cash flow generation are cable (45 percent of EBITDA and 34 percent of FCF) and broadcast (33 percent and 51 percent) television. The company sold the majority of its newspaper operation, including The Washington Post, in 2013.

### Fundamental Analysis

In October of 2013, Graham Holdings sold its namesake, The Washington Post, to Jeff Bezos for \$250 million. The newspaper had been unprofitable for several years and required a disproportionate amount of management’s attention as compared to its revenue stream.

The company’s education division is the largest operating segment of the company, accounting for 62.4 percent of the company’s consolidated revenues in 2013. Kaplan Higher Education accounted for 50 percent of

total Kaplan revenues in 2013. Kaplan’s revenues have fallen more than 40 percent since 2010 and the market outlook is not especially good. The for-profit education sector is not doing well as total enrollments shrank 12 percent in 2013. In addition, higher cohort default rates could result in Kaplan losing access to important Title IV funds at some campuses.

The company’s cable division accounted for 23.1 percent of revenue in 2013 and witnessed a three percent increase in revenue since 2012. This revenue increase was due to recent rate increases for a substantial portion of subscribers, growth in commercial sales and a reduction in promotional discounts. The television broadcasting division accounted for 10.7 percent of revenue in 2013 and witnessed a six percent increase in revenue since 2012. Despite this positive growth, both divisions operate in relatively mature market categories. No substantial organic growth is expected in either category in the near future.

### Financial Statement Analysis

Graham Holding’s earnings per share jumped drastically in 2013 from \$6.09 to \$25.78. The company’s free cash flow fell almost 60 percent from \$259 million in 2012 to \$104 million in 2013. Kaplan Higher Education’s sales decrease caused segment EBITA margins to shrink to a low five percent from more than 20 percent in 2010.

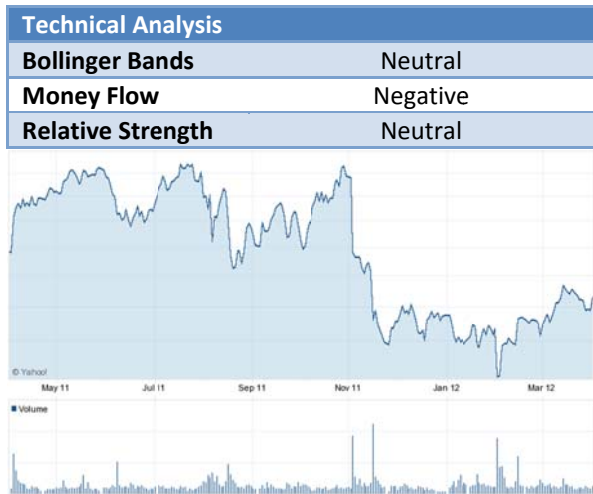
### Conclusion & Recommendation

Graham Holding’s strongest growth driver is real consumer disposable income, which is expected to grow 17 percent by 2015 and over 50 percent by 2020.

However, due to the dismal education market outlook and mature nature of the cable and television broadcast markets, we predict a very modest growth for the company. We determined the company to be overvalued by 50 percent. Therefore, we recommend our holdings be liquidated.

## McDonald's Corporation MCD

|                               |                             |                              |                            |                            |                                |
|-------------------------------|-----------------------------|------------------------------|----------------------------|----------------------------|--------------------------------|
| <b>Recommendation</b><br>Sell | <b>Valuation</b><br>\$71.76 | <b>Last Price</b><br>\$97.24 | <b>As of</b><br>03/28/2014 | <b>Style</b><br>Large Core | <b>Dividend Yield</b><br>3.23% |
|-------------------------------|-----------------------------|------------------------------|----------------------------|----------------------------|--------------------------------|



### Introduction

McDonald's Corp. is the world's largest restaurant company, operating 34,480 restaurants in over 120 countries. McDonald's restaurants sell a variety of products including food items, soft drinks, coffee, and other beverages.

### Fundamental Analysis

The quick-service restaurant industry is fiercely competitive with history of price wars and virtually no switching costs. In such a price sensitive environment, volatility in input costs can result in the company losing its competitive position.

The USDA predicts food prices to rise in 2014. The 2012 drought has resulted in a supply of cattle that is lower than average and beef, veal and poultry prices are expected to rise three to four percent. The company must raise its U.S. worker wages to stay in compliance with the minimum wage hike put into effect January 1, 2014. With increasing costs, the company will either experience a reduction in operating margins or have to raise consumer prices, sacrificing its competitive position.

Global trends toward health foods also have an adverse effect on McDonald's. Reduction in soft drink demands resulted in the company focusing on McCafe operations.

The company's over diversified menu has given rise operational inefficiencies within restaurants, lowering the company's standard quality of service. While these operational inefficiencies are being addressed by new management, it is unlikely we will see bottom line values increase in the short-run.

Compared to industry competitors such as YUM Brands Inc., Chipotle Mexican Grill, and The Wendy's Co., McDonald's is lagging behind in terms of earnings per share, return on equity, return on investment, and stock returns.

### Financial Statement Analysis

McDonald's revenue has increased less than two percent in 2013 from 2012 and only two percent from 2011 to 2012. McDonald's gross profit margin is exceeding the industry, yet its net profit margin is showing a declining quarterly trend. Gross Margins have been decreasing since 2010 and Operating and EBT Margins have decreased since 2011.

Earnings per share have grown \$5.55, due in part to \$1.8 billion in share repurchases. The company has been buying back stock year over year, resulting in earnings boosts of about 1.75 percent per year.

### Conclusion & Recommendation

McDonald's major growth drivers are real consumer disposable income and unemployment. Consumer disposable income is projected to increase 17 percent by 2015 and close to 50 percent by 2020. Unemployment is expected to drop 12 percent by 2015 and seven percent by 2020.

Taking into account these growth factors, our model gives McDonald's an intrinsic value of \$71.76, meaning the stock is overvalued by 36 percent. This is an ideal time to sell this stock.

## Nordstrom, Inc. JWN

|                              |                              |                               |                            |                           |                                |
|------------------------------|------------------------------|-------------------------------|----------------------------|---------------------------|--------------------------------|
| <b>Recommendation</b><br>Buy | <b>Valuation</b><br>\$ 74.23 | <b>Last Price</b><br>\$ 61.83 | <b>As of</b><br>03/28/2014 | <b>Style</b><br>Mid Value | <b>Dividend Yield</b><br>1.94% |
|------------------------------|------------------------------|-------------------------------|----------------------------|---------------------------|--------------------------------|

| Technical Analysis       |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

Nordstrom is a leading retailer of national and exclusive branded apparel, shoes, accessories and cosmetics. The company provides a private label credit card, two Nordstrom VISA credit cards, and a debit card for customer purchasers through its wholly owned federal savings bank, Nordstrom fsb. Cardholders receive loyalty program points that can be redeemed for products and services. Currently, Nordstrom operates 117 full-line stores, an online store, and 121 off-price Rack stores.

### Fundamental Analysis

Nordstrom has a shared inventory platform that allows it to manage and turn its inventory better than its industry competitors. The full-line and internet stores' inventories are completely integrated, allowing for consistent merchandise assortment, improvements in regular-price selling, inventory turns of over 5 times per year (as compared to an industry average of 3x), improvements in regular-price selling, and no over reliance on promotions. The company has industry leading sales of \$400 per square foot and focuses on higher margin items like apparel, footwear and fashion accessories instead of lower margin hard goods like other department stores.

The company's growth strategy includes expansion into Canada, as well as new channels like their Rack stores

and HauteLook.com. Nordstrom plans to invest \$35 million into Canadian stores and expects a \$1 billion revenue opportunity. The company plans to add an additional 90 Rack stores by 2016. Rack net sales increased 12 percent last year, driven by 22 new store openings, and same store sales increased 2.7 percent. In addition, Rack stores can now receive HauteLook merchandise returns, adding convenience for customers and further integrating customer experience across channels.

High-end customers, like those serviced by Nordstrom, are less sensitive to prices and make purchases based on fashion and shopping experience. Growth in high-end consumer spending has been strong and affluent customers tend to continue spending even through economic downturns.

### Financial Statement Analysis

Nordstrom achieved several milestones in 2013 including a record high in sales (of \$12.54 billion), earnings per diluted share (of \$3.71), and cash flow from operations of (\$1.32 billion).

The company's return on assets and return on equity both grew in 2013, by 3.6 percent to 8.87 percent and 10.6 percent to 37.99 percent, respectively.

### Conclusion & Recommendation

Nordstrom's industry leading inventory platform, integrated customer experience, and high-end clientele give the company a positive outlook in terms of future growth. With an upward trend in consumer confidence, and disposable income increases among higher-income earners, Nordstrom is positioned to witness steady growth in the long term.

Our model determined that Nordstrom's intrinsic value is \$74.23, or 20 percent above the current market price. Therefore, we recommend purchasing shares of this company.

## PepsiCo Inc. PEP

|                              |                               |                               |                            |                            |                                |
|------------------------------|-------------------------------|-------------------------------|----------------------------|----------------------------|--------------------------------|
| <b>Recommendation</b><br>Buy | <b>Valuation</b><br>\$ 113.53 | <b>Last Price</b><br>\$ 82.95 | <b>As of</b><br>03/28/2014 | <b>Style</b><br>Large Core | <b>Dividend Yield</b><br>2.74% |
|------------------------------|-------------------------------|-------------------------------|----------------------------|----------------------------|--------------------------------|

| Technical Analysis       |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

PepsiCo manufactures, markets, and sells a variety of salty, convenient, sweet and grain-based snacks, carbonated and non-carbonated beverages, and foods throughout the Americas, Europe, Asia, the Middle East and Africa. PepsiCo products include Fritos, Lay's, Doritos, Tostitos, Cheetos, Quaker Chewy granola bars, Cap'n Crunch, Rice-A-Roni, Mountain Dew, Gatorade, Aquafina and Tropicana, among others.

### Fundamental Analysis

PepsiCo's Frito-Lay division is the world's largest snack food company. It controls almost 40 percent of the world's snack market. While soft drink demand is decreasing throughout North America and Europe, snack consumption volume increased three percent in the Americas and two percent in Europe last year. PepsiCo has done a good job of addressing changing customer demand by expanding its portfolio of products to include health conscious ingredients like fruit, vegetables and whole grains, as well as offerings "that provide a functional benefit, such as addressing the performance needs of athletes."

In their most recent annual report, PepsiCo states that it will continue to invest in developing and emerging markets. Over the last five years, revenue from emerging

markets has tripled. In January of this year, the company announced plans to invest \$5 billion in Mexico over the next five years. Mexico has the world's largest per capita consumption of soft drinks and bottled water. In addition, Sabritas, PepsiCo's Mexican subsidiary, has an 80 percent market share in the country.

PepsiCo has been pursuing cost-cutting initiatives. The company is increasing investment in manufacturing automation to reduce per unit costs. It is closing underperforming manufacturing facilities and reengineering distribution networks in developed markets. In conjunction with the company's bottler acquisition that finished in 2010, this program should save the company \$1 billion per year.

### Financial Statement Analysis

PepsiCo's revenue growth has recovered after a negative growth year in 2012. The company witnessed a five percent growth in operating margins to 14.6 percent of revenues in 2013.

PepsiCo's free cash flow has grown almost 50 percent to \$6,893 million since 2009 and its operating cash flow has grown over 40 percent to \$9,688 million in the same timeframe.

### Conclusion & Recommendation

PepsiCo is well positioned in the domestic and global market to witness steady long-term growth. Domestic cost cutting programs should drive up margins in the short-run and infrastructure investments in key emerging markets should sustain growth in the longer-run.

Even with these modest growth forecasts, our discounted cash flow model estimates the company is currently undervalued by at least 20 percent. We recommend our position be increased.

## PetSmart Inc. PETM

| Recommendation | Valuation | Last Price | As of      | Style    | Dividend Yield |
|----------------|-----------|------------|------------|----------|----------------|
| Buy            | \$113.53  | \$68.49    | 03/28/2014 | Mid Core | 1.03%          |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Neutral  |
| Money Flow         | Negative |
| Relative Strength  | Neutral  |



### Introduction

PetSmart is a specialty provider of products and services for pets. The company offers value-added pet services including grooming, pet training, boarding, day camp, products including pet foods, treats, litter, and other merchandise. In addition, the company sells live pets. The company operates 1,278 in North America, including Canada and Puerto Rico. Of those stores, 816 offer full-service veterinary hospitals.

### Fundamental Analysis

According to the American Pet Products Association, 62 percent of U.S. households own pets. Spending on pets has nearly doubled in the past decade, and is relatively resilient to recessions as consumers see this category as more of a staple and do not sacrifice their pets in times of economic downturn. In a comparison of five-year cumulative total return, PetSmart outperformed both the S&P 500 and S&P Specialty Stores.

PetSmart Inc. is proactive in providing innovation and variety in its products according to market preferences. It identifies trends and incorporates that image in its products. This can be seen in its partnership with Disney, Lyric Culture, and Toys 'R' Us in launching clothing and toys with respective characters and images. In its

industry, competition does not match the product and service variety, or the quality of customer service.

PetSmart opened 55 new stores in 2013 and plans to open an additional 45 to 50 new stores this year. Comparable store sales increased 2.7 percent during 2013, compared to a 6.3 percent increase in 2012.

### Financial Statement Analysis

PetSmart's diluted earnings per share increased 13.2 percent to \$4.02 on a net income of \$419.5 million in 2013 as compared to diluted earnings per share of \$3.55 on a net income of \$389.5 million in 2012. Net sales increased 2.3 percent to \$6.9 billion, partially due to an unfavorable impact from foreign currency fluctuations of \$15.3 million.

Over the last five years, net income has grown at an average rate of 12.7 percent. The company has a respectable return on capital rate of 25.72 percent and earnings yield of almost nine percent. Operating margins increased four percent last year to 10.02 percent of sales and have been growing steadily since the recession. In addition, return on equity and return assets have been growing steadily since 2010 to 37.84 percent and 16.59 percent, respectively.

### Conclusion & Recommendation

Across all its product lines, PetSmart's major short-term growth driver is rising consumer confidence. Consumer confidence is projected to increase between up to two percent each of the next five years. In the longer term, we expect PetSmart's diverse product and service portfolio and excellent customer service to allow it to outperform its peers, leading to continued growth.

Even with these modest growth forecasts, our discounted cash flow model estimates the company is currently undervalued by at least 30 percent. For this reason, we recommend our position be increased.



## Scripps Networks Interactive SNI

| Recommendation | Valuation | Last Price | As of      | Style      | Dividend Yield |
|----------------|-----------|------------|------------|------------|----------------|
| Sell           | \$67.80   | \$75.73    | 03/28/2014 | Mid Growth | 0.85%          |

### Technical Analysis

|                          |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

Scripps Networks Interactive, Inc. develops lifestyle-oriented content for television and Internet markets in the U.S. and internationally. The company operates national television networks including Food Network, HGTV, Travel Channel, and DIY Network, and websites associated with their television networks.

### Fundamental Analysis

Scripps' revenue grew 9.69 percent from \$2.307 billion in 2012 to \$2.531 billion in 2013. This growth is attributed to solid growth in advertising sales and affiliate fee revenue. Advertising revenues grew 8.6 percent, however this was primarily due to higher pricing in sold advertising units. Affiliate fee revenues increase 9 percent in 2013, primarily due to contractual rate increases.

Scripps' Lifestyle Media segment accounted for 97 percent of consolidated revenues in 2013.

The company has, as of yet, been unable to grow outside of the U.S. to the extent that its peer group is. International business made \$68.6 million in revenues in 2013, only three percent of consolidated revenues. This is up from \$49.4 million or two percent of consolidated revenues in 2012.

### Financial Statement Analysis

Scripps' operating margin fell four percent to 37.9 percent in 2013 from 39.6 percent in 2012. Net income fell 25.8 percent to \$505 million in 2013 from \$681 million in 2012, due in part to a five percent increase of costs of goods sold.

The company's return on assets and return on equity fell 30 percent to 11.78 percent and 34 percent to 25.77 percent, respectively. The company has a price to earnings ratio of 22.5 and a price to book ratio of 5.3, significantly higher than the industry averages of 5.3 and 1.8, respectively.

### Conclusion & Recommendation

Through a discounted cash flow method, forecasting the next five years of growth from nine percent fading down to 2.5 percent over the long term, the company is overvalued in the market.

Due to the company's lackluster performance in 2013, its meager international performance, and the downward trend of its year-end dividend yield, we recommend selling our holdings.

## Consumer Staples

### Slow and Steady

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Consumer Staples is a defensive sector, which performs best during recessions but lags during recoveries. Consequently, during the current recovery we do not expect Staples to outperform.

In 2013, S&P 500 increased by 32.4 percent. Despite the amazing surge by the market as a whole, the Consumer Staples index only increased by 6.84 percent. The Consumer Discretionary index increased by 22.4 percent. Companies that specialize in staples, although not having the gains the rest of the market had, still had bright spots.

### Little help from developing markets

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Although the developing countries have been a bright spot for the global economy during the recession, it seems that capital investments are not flowing as much to these developing nations. This past year, there was an increase in the volatility of developing economies and the safer investment was in the recovering domestic economy. A stronger dollar has aided corporations with strong international exposures during the period in volatility. The slowdown in China has also slowed results of many company's ambitious expansions.

Many Consumer Staples companies embarked on cost-savings campaigns during the Great Recession. Some of the larger companies that had announced ambitious plans were Coca-Cola Enterprises, Altria Group and Kimberly-Clark. Even the best of those plans were not able to spark dramatic increase in profits, cash flows, or stock prices.

### A few bright spots

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Despite the countercyclical nature of the Consumer Staples sector, some companies show promise. Keurig Green Mountain, formerly Green Mountain Coffee Roasters, benefitted from the initial success of the trendy Keurig coffee brewing machines. After Coca-Cola purchased a 10 percent stake in Keurig, the company's stock shot up approximately 25 percent in one day. The company appears to be positioned for solid growth in the future.

Despite some promising examples, the Consumer Staples sector faces many challenges as the economic environment in the U.S. improves ever so slowly. The Eurozone, despite improving conditions, remains unstable and China's growth is slowing. We have positioned Consumer Staples at 6 percent of the equity, slightly under its market weight of 9 percent.

## Keurig Green Mountain, Inc. GMCR

|                       |                  |                   |              |              |                       |
|-----------------------|------------------|-------------------|--------------|--------------|-----------------------|
| <b>Recommendation</b> | <b>Valuation</b> | <b>Last Price</b> | <b>As of</b> | <b>Style</b> | <b>Dividend Yield</b> |
| Hold                  | \$124.71         | \$108.15          | 03/28/2014   | Large Growth | 0.49%                 |



### Introduction

Keurig Green Mountain, Inc., formerly Green Mountain Coffee Roasters, Inc., is a specialty coffee and coffee-maker business in the United States and Canada. The company sells Keurig Single Cup Brewers, Arabica bean coffees, traditional whole bean, ground coffee and specialty beverages such as ciders, hot and iced teas, hot cocoa, iced fruit brews, and other dairy-based beverages. For the fiscal year ended September 28, 2013, GMCR generated \$4.36 billion in revenues and \$483.2 million net income.

### Fundamental Analysis

Keurig Green Mountain has consistently displayed superior performance concerning sustainability and managing their financials. The company has an excellent strategy. It supports millions of coffee farmers through its fair-trade activities. The company had strategic partnerships with several other peer companies like Unilever, Starbucks and Kroger in expanding their existing product lines and infusing sustainability. As of February 2014, Keurig and Coca-Cola entered into a strategic partner-

ship in anticipation of its new cold drink maker, which is projected to be released either late 2014 or early 2015. International expansion will be possible into the European market through this strategic partnership. GMCR’s K-Cups, Keurig and Vue are bestselling specialty coffee related products.

The immense growth in revenues in the past two years is nearly unheard of in the consumer staples sector. Maintaining such levels of growth is unsustainable but high levels of growth will persist in the near future.

### Financial Statement Analysis

The company displayed unsustainable revenue and earnings growth in the past five years. Total net sales increased by 46 and 44 percent in 2012 and 2013, respectively, while the operating margin reached 17.6 percent. The company’s first quarter 2014 results also present a significant increase in operating margin in comparison to the first quarter of 2013. The company has a favorable debt to equity position and can use excess leverage to finance further expansion. In 2013, the company started a dividend program of \$0.25 per quarter, \$1.00 per year. The current rate of financial performance coupled with the new dividend program indicates that the stock will rise in the near future.

### Conclusion & Recommendation

The discounted cash flows model with extremely conservative growth rates gives an intrinsic value, which is higher than the current stock price. We recommend holding GMCR due to its strong financial performance, strategic partnerships, sustainability impact, and effective leadership team.



## Tesco PLC (ADR) TSCDY

| Recommendation | Valuation | Last Price | As of      | Style         | Dividend Yield |
|----------------|-----------|------------|------------|---------------|----------------|
| Sell           | \$9.46    | \$14.88    | 03/28/2014 | International | 3.88%          |



### Introduction

Tesco PLC is engaged in retailing and associated activities in Europe and Asia. The company also provides retail banking and insurance services through its subsidiary, Tesco Bank. Tesco, for the most part, is recognized as an international grocery chain. In 2014, the company had revenues of £64.8 billion but only had net income of £124 million.

### Fundamental Analysis

Tesco divested all of its U.S. operations in 2013. Despite the stocks rise following the announcement of the divestiture, the stock dropped in value after the sale. After Tesco’s announcement to sell off land near its stores in Poland, the stock took another dip and has not recovered since.

The company is continuing to expand its international presence in Asia and Europe. The Chairman of the Board, Sir Richard Broadbent, stated in the Annual Report that the “strategic choices are defined... by the strength of the Tesco Brand, the internet, and the potential to leverage our skill and scale internationally.” Tesco has been moving more towards an online ordering format. Much of the investor apprehension is due to this shift in strategy.

### Financial Statement Analysis

Tesco’s revenues only grew 0.44 percent in 2013 and its operating margin decreased from 5.9 percent in 2012 to 3.4 percent in 2013. Coupled with the lack of a formal dividend reinvestment plan, the decrease in operating margins does not paint a good picture to investors.

Other ratios, such as return on assets and return on equity, have decreased from 2012’s figures, which lead to the sell recommendation.

Despite the ability to generate cash returns for the portfolio, Tesco’s poor performance, which does not have many positive indicators, makes this investment a sell. Our valuation model suggests that the stock is within the fair value range.

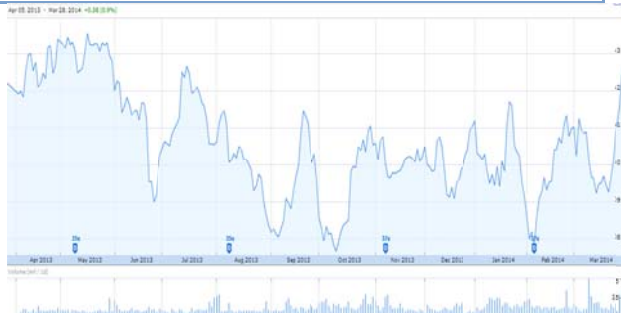
### Conclusion & Recommendation

Our sell recommendation for TSCDY is based on the poor performance in 2013 coupled with a lack of positive indicators for 2014 performance.

# Unilever PLC International (ADR) UL

| Recommendation | Valuation | Last Price | As of     | Style         | Dividend Yield |
|----------------|-----------|------------|-----------|---------------|----------------|
| Hold           | \$47.95   | \$42.62    | 3/28/2014 | International | 3.42%          |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Positive |
| Relative Strength  | Neutral  |



## Introduction

Unilever PLC, based out of is a supplier of fast moving consumer goods. The company’s four product areas are Personal Care, Foods, Refreshment, and Home Care. Unilever products are sold in over 190 countries. In 2014, Unilever generated €49.8 billion in revenues and €4.8 billion in net income.

## Fundamental Analysis

Despite Unilever not hitting projected earnings targets, the gross margins for the company outperformed its projections. Unilever operates in international markets and economic recession both in the U.S. and EU countries pose lot of challenges for the company’s business operations. The projections missed mostly due to volatile exchange rates. Although Unilever is based in Eu-

rope, sales in Europe continue to lag where growth did not offset the lower pricing structure.

Despite projections last year, the U.S. economy improved at a much quicker pace than previously expected which helped Unilevers profits. Unilever has a wide moat due to the breadth of its product offerings worldwide. Despite this, Unilever will remain consistent with its revenues and margins in 2014 and we do not anticipate any growth in future cash dividends.

## Financial Statement Analysis

Unilevers operating margin increased from 13 percent in 2012 to 14.3 percent in 2013. Although revenues decreased by \$1.5 billion, the Company was able to decrease its costs over that period by \$2.5 billion. Due to its operations worldwide, a certain degree of exposure risk and translation risk are unavoidable so valuing the company accurately becomes harder to do. Our dividend discount model suggests that the stock remains slightly undervalued in the market.

## Conclusion & Recommendation

We recommend selling UL because of stiff competition in emerging markets, slowing down of economies and no expected rise in consumer spending. We believe that the company is valued fairly in the market.

## Energy

### 2013 Performance

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As of March 21, 2014, the energy sector has performed unfavorably by decreasing 9.8 percent, compared to the market average of 32.8 percent and the total portfolio return of 9.3 percent (excluding cash and bonds). This poor performance was mainly driven by Transocean LTD (RIG), PetroChina Company Ltd (PTR) and PBF Energy Inc (PBF) at losses of 18.7 percent, 16.5 percent and 13.5 percent, respectively. The loss was offset by Exxon Mobil Corp (XOM) at 7.5 percent and StealthGas Inc. (GASS) at 9.4 percent.

Collectively, these five stocks (one of which is an ADR) have underperformed the S&P500 Energy Index. The total value declined from \$41,600 to \$37,500 and, as a result, amounted to 5.5 percent of the portfolio's total equity. In turn, the portfolio has been rebalanced, and additional funds of \$30,000 were allotted to the energy sector to achieve the 10.25 percent target allocation.

### Opportunities for 2014

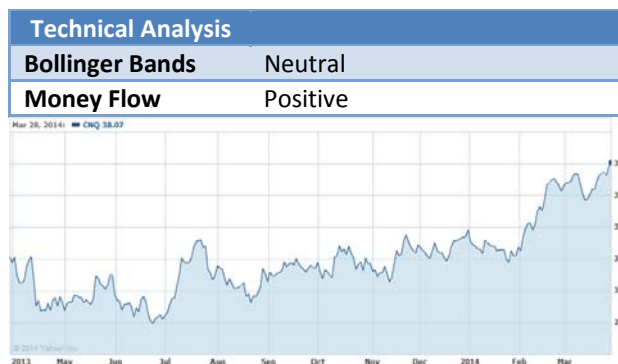
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Tremendous investment in midstream infrastructure in U.S. (mainly Permian, Eagle Ford, Bakken, Marcellus, Haynesville and Niobrara shale plays) and Canada (Athabasca oil sands) has enabled the "renaissance" of North American oil and gas production. With the shale gas and tight oil boom powered by fracking technology, midstream firms have had their pick of organic growth opportunities in recent years. However, this level of organic expansion has somewhat slowed down, which has already prompted consolidation activity within several key areas where investment spending remains strong. These include Natural Gas Liquids (NGL) processing, refining and transportation and Liquefied Natural Gas (LNG) and tight oil production and pipeline projects.

Oil and natural gas production is projected to increase over the next five years, as the U.S. becomes an even more important player in the global energy market. According to U.S. Energy Information Administration, the United States will become the leading oil producer and exporter in the world by 2015. Natural gas energy will also experience steady growth, as more and more electric utilities turn to natural gas for generator fuel. Gas exports have already picked up, which helped alleviate the supply glut domestically. As such, prices shot up 35.7 percent in 2013 and are expected to continue to increase in 2014 due to investments in export terminals and shipping infrastructure. Global demand for energy will increase as economic growth picks up, particularly in emerging economies.

## Canadian Natural Resources Ltd CNQ

| Recommendation | Valuation | Last Price | As of      | Style        | Dividend Yield |
|----------------|-----------|------------|------------|--------------|----------------|
| Buy            | \$47.77   | \$38.07    | 03/28/2014 | Large Growth | 1.60%          |



### Introduction

Canadian Natural Resources is a Canadian based senior independent energy company engaged in the acquisition, exploration, development, production, marketing and sale of crude oil, NGL's and natural gas. It is one of Canada's largest exploration and production companies with oil and gas production in western Canada, the UK sector of the North Sea and offshore West Africa. The company's Horizon Oil Sands Mining and Upgrading segment, which takes advantage of the Horizon Pipeline, produces synthetic crude oil through bitumen mining and upgrading operations.

### Fundamental Analysis

Canadian Natural Resources has a lot going for it. Initially a rough start, the Horizon project has proven to be a success with about 250,000 barrels of light crude oil produced per day. It recently completed construction and startup of its Kirby South Phase 1 project, which added 40,000 barrels of oil per day. As additional phases of the pipeline come online, CNQ will be able to bring down operating costs and spread the fixed costs. It forecasts to add 40,000 to 60,000 barrels a day in oil production every two to three years.

CNQ generates significant cash from its current operations and it has sizable reserves. The company has huge oil sands potential with 14 billion barrels in Grand Rapids, 45 billion in McMurray, 10 billion in Clearwater and

9 billion in Wabiskaw, which are all part of the Athabasca region. The company's infrastructure and size gives it significant competitive advantage in this area and the large inventory of drilling prospects leads to greater flexibility, enabling it to react verky quickly to changes in commodity prices or capital allocation.

CNQ has created immediate value to shareholders by purchasing Devon Energy Corp.'s conventional oil and natural gas fields in Canada for \$3.13 billion in cash. Such purchase will increase output by about 86,000 barrels of oil equivalent a day.

CNQ's strategic plan is to achieve production growth from crude oil and NGL's through a defined growth strategy incorporating low-risk development projects.

### Financial Statement Analysis

Since 2010, CNQ has tripled its dividend payout, and the shares will yield a forecasted 2.04 percent. Cash flow from operations came in at \$7.5 billion for 2013, nearly \$7 per common share. CNQ's current balance sheet is relatively in good health, its long-term debt to equity ratio of 37.20 compares favorably to 68.20 industry average.

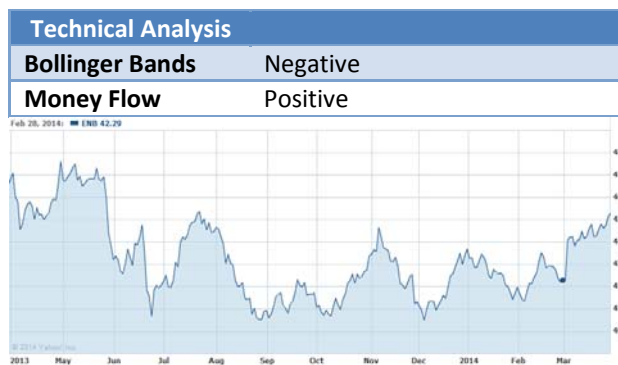
### Conclusion & Recommendation

If the Keystone XL pipeline is approved, it will be a huge benefit to CNQ, as it will significantly improve margins and earnings. In case that the pipeline is not approved, CNQ is still a very promising company all in itself. The company's financial discipline, strong balance sheet and capacity to generate cash flows via a diverse portfolio of assets provide for strong growth.

We believe that CNQ is greatly undervalued and should be purchased at this moment to capitalize on its short-term growth due to increasing liquid and natural gas production, as we believe it will yield great returns and dividend growth in the long-term.

## Enbridge, Inc. ENB

| Recommendation | Valuation | Last Price | As of      | Style        | Dividend Yield |
|----------------|-----------|------------|------------|--------------|----------------|
| Buy            | \$54.95   | \$45.29    | 03/28/2014 | Large Growth | 2.68%          |



### Introduction

Enbridge transports and distributes crude oil and liquids all across North America. It is also involved in natural gas and NGL midstream and downstream businesses. Enbridge owns and operates a natural gas distribution company in Canada serving 2 million customers in Ontario, Quebec, New Brunswick and New York State.

### Fundamental Analysis

Enbridge operates the largest network of liquids export pipelines in Canada with more than 2.5 million barrels per day of export capacity, which ties into its North American system and provides shippers with access to refining markets in Ontario, Quebec, and the U.S. Mid-Continent and Gulf Coast. By 2017 to 2018, the company plans to increase its capacity to 2.8 million as replacement projects and downstream bottlenecks are put into service. Enbridge reported that it has \$36B of enterprise wide commercially secured projects expected to come into service between 2013 and 2017 to meet growing demand for new energy infrastructure.

Enbridge is a dominant operator of feeder pipelines in Canada's Athabasca oil sands and its growing position in the surging Bakken shale play. The liquids pipelines can move light, heavy and synthetic crude oil from Canadian tar sands all the way into the Chicago hub.

Most recently, the company's subsidiary, Tidal Energy Marketing Inc., won a license for 12 months to export Canadian oil via U.S. Gulf Coast. This license will allow it to ship crude to its refiners in Canada and the UK. Reuters reported Enbridge expects to export up to 40,000 tons of heavy oil to its refiners in southern Europe.

Also, the National Energy Board has approved Enbridge's Line 9 pipeline reversal under conditions that Enbridge must undertake activities regarding pipeline integrity, emergency response and continued consultation. The pipeline running between Ontario and Montreal will increase the current capacity of 240,000 barrels of crude oil per day by 60,000 barrels to service its refineries in Ontario and Quebec.

### Financial Statement Analysis

Enbridge has more than doubled its revenue from 2009 when it reported 2013 sales of CAD \$32.9 billion. Enbridge has been increasing its dividend each year since 2009 and is expected to do so in the coming years.

### Conclusion & Recommendation

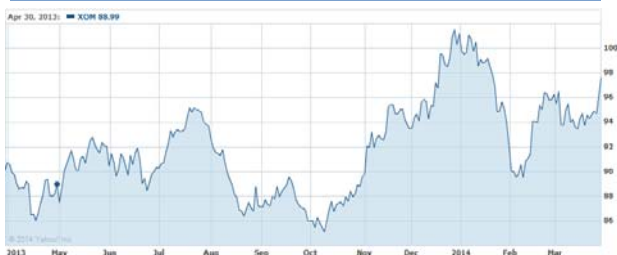
The most significant shift is taking place in Enbridge's liquids rich business unit, which should benefit from the growing volumes associated with the oil sands and Bakken plays. These plays will require gathering systems in order to move the liquids out of the regions, and Enbridge is well positioned to construct and operate these unregulated pipelines.

Enbridge is also in a position to benefit largely from the approval of the Keystone XL pipeline. As the stage is set for strong growth in 2015 to 2017, we recommend purchasing ENB and holding it for a longer-term position.

## Exxon Mobil Corp. XOM

| Recommendation | Valuation | Last Price | As of      | Style       | Dividend Yield |
|----------------|-----------|------------|------------|-------------|----------------|
| Sell           | \$105.47  | \$97.70    | 03/28/2014 | Large Value | 2.57%          |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Negative |
| Money Flow         | Negative |



### Introduction

Exxon Mobil has become the largest globally integrated public energy company in the world. It specializes in high-value petroleum and petrochemical products, which it sells to more than 120 countries. The company's revenue is well diversified internationally as it has operations in 47 countries and a network of 32 refineries across the globe – 45 percent capacity in North America, 30 percent in Europe and the remainder in Asia Pacific and Middle East. Exxon Mobil's main competitive advantages are high-impact technologies, operational efficiency and global integration.

### Fundamental Analysis

As nations become more protective of their natural resources, Exxon Mobil will find it increasingly difficult to increase production and book reserves. To gain access and remain competitive, the company must not only demonstrate its value, but also might have to agree to terms that are not as advantageous as in the past.

Recently, Exxon Mobil reported that it has 28 major projects coming on line between 2013 and 2017, including an expansion of Kearl oil sands project in Alberta, Canada and a LNG export project in Papua, New Guinea. However, only a handful of these projects relating to tight oil and shale gas will start in 2014. The company's relative lack or trailing of liquids production may be the

major reason its shares lagged behind those of its competitors like ConocoPhillips (COP) and Chevron (CVX).

Nonetheless, Exxon Mobil forecasts incremental capacity of 300,000 barrels of oil equivalents per day in 2014 in addition to its average daily production of 2.2 million barrels, an increase of about 13 percent, which we accounted for in our valuation.

### Financial Statement Analysis

Exxon Mobil's annual revenue continued to drop since 2011 and came in at \$438 billion last year, which is a decrease of about 9.1 percent from 2012. Operating and net income decreased by 26.7 percent and 27.4 percent respectively. The company failed to maintain last year's net profit margin of 9.3 percent, which is now at 7.4 percent.

Despite heavy capital expenditures, XOM's free cash flow amounted to a hefty \$28.5 billion. The company still plans to continue to repurchase shares and will most likely increase its dividend payout next quarter from the current \$0.63 cents in spite of the recent decrease in free cash flow.

### Conclusion & Recommendation

With a majority of the world's remaining resources in government hands, opportunities for Exxon Mobil to expand its large production base is becoming more and more limited. Moreover, the political unrest between Ukraine and Russia poses a huge threat to Exxon Mobil.

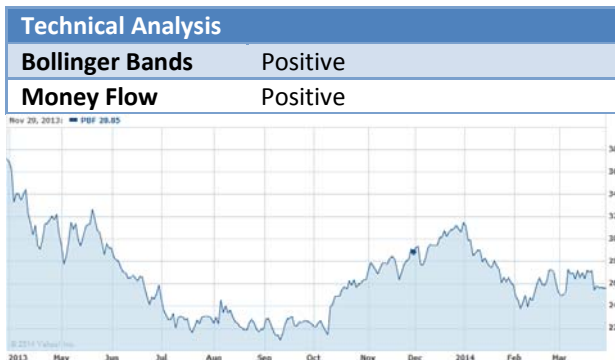
Even though the company might be well positioned to benefit from growing crude oil production in the U.S. and Canada, its revenue could potentially suffer from a decrease in oil prices and its capital-intensive projects might become no longer economical.

Our recommendation is to sell the shares.



## PBF Energy Inc. PBF

| Recommendation | Valuation | Last Price | As of      | Style       | Dividend Yield |
|----------------|-----------|------------|------------|-------------|----------------|
| Hold           | \$39.83   | \$25.64    | 03/38/2014 | Small Value | 4.56%          |



### Introduction

PBF Energy is the fifth largest U.S. independent refiner and supplier of petroleum products including gasoline, ultra-low-sulfur diesel, heating oil, jet fuel, lubricants, petrochemicals and asphalt. The company sells its products in U.S. and Canada and is able to ship products to other countries. It operates three refineries. Their Toledo, Ohio refinery has 60 percent of capacity dedicated to refining WTI crude from the Bakken region and U.S. Gulf Coast. The remaining 40 percent sources Syncrude from Canada. Crude is delivered through a network of pipelines in the Midwest. This facility has been the driving force behind performance, taking advantage of the glut of oil production in the mid-west. The remaining refineries are located in Delaware City, DE and Paulsboro, NJ.

### Fundamental Analysis

Recent rail infrastructure investment on East Coast not only provides the entire system access to WTI, which translates into increased margin due to higher spreads, but also allows to take in nearly six times more crude oil from Canada and North Dakota's Bakken formation. When the project was announced last year, the company was able to bring in 20,000 barrels of Bakken and Canadian crude by rail. The completion of the rail terminal brings that amount to 110,000 barrels a day. As a result, PBF Energy is now able to deliver significant quantities of cost-advantaged North American crude oils

directly to Delaware City at very competitive pricing. This brings up total throughput capacity of the Delaware refinery to 190,000 barrels per day. Paulsboro and Toledo have 180,000 and 170,000 barrels per day of throughput capacity respectively. Both Delaware and Paulsboro refineries have an export capability through Delaware River. Crude is delivered to Toledo through three primary pipelines: Enbridge from the north, Capline, and Mid-Valley from the south.

As for the recent railroad accidents, railroads that haul volatile crude shipments have reached an agreement with U.S. transportation officials to adopt wide-ranging, voluntary safety measure.

### Financial Statement Analysis

In 2013, PBF Energy's profit margin has decreased significantly due to increased cost of sales and other operating and unusual costs. The company has a relatively significant level of debt. It does have enough current assets to cover the liabilities, but most of it is tied up in the inventory.

PBF just recently announced a quarterly dividend of \$0.30 cents and a secondary public offering of 15,000,000 shares valued at \$25.50, which brought our valuation down to \$39.83 from last year's valuation of \$50.

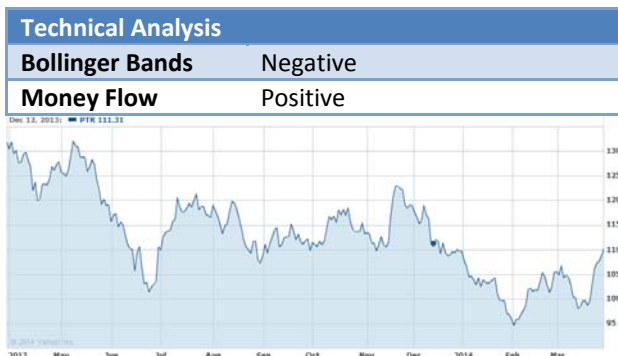
### Conclusion & Recommendation

Last year was a building year for PBF Energy as it continued to progress its strategy of increasing access to cost-advantaged NA crudes, while maintaining its flexibility to take advantage of price dislocations in the waterborne crude market. In 2014, the company is already reaping the benefits and producing earnings well in excess of its capital investments. It will continue to invest in rail facilities and it has committed to increasing safety of rail operations across the entire logistics chain.

We recommend holding the stock until it is fully valued.

## PetroChina Co Ltd (ADR) PTR

| Recommendation | Valuation | Last Price | As of      | Style         | Dividend Yield |
|----------------|-----------|------------|------------|---------------|----------------|
| Sell           | \$89.95   | \$110.21   | 03/28/2014 | International | 3.82%          |



### Introduction

PetroChina is the largest integrated oil and gas company in China. PTR was intended to reform China's oil and gas industry and give it the ability to compete internationally. The company is one of the major producers and distributors of petroleum and petrochemical products in the world. PetroChina engages in a wide range of activities related to oil and natural gas including exploration and production, transportation and storage, refining and marketing.

### Fundamental Analysis

Despite the positive developments in its downstream business, there is little momentum in the firm's exploration and production business, which contributed over 80 percent to the company's earnings in 2013. PetroChina's aging oil fields continue to face structural issues, includ-

ing limited volume growth and rising operating and finding and development costs.

More importantly, recent allegations against the company and of its certain officers do not make this company any more attractive. A class action lawsuit was filed against PetroChina and its senior management who allegedly made false or misleading statements, as well as failed to disclose adverse facts about the company's business, operations and financial performance.

### Financial Statement Analysis

Decreased oil prices and increased lifting costs drove the operating profit down by 5.9 percent in 2013. However, PetroChina was able to achieve 3.9 percent and 7.2 percent revenue and net income gains respectively, as better refining margins and improving natural gas business helped to offset the negatives from its oil business.

### Conclusion & Recommendation

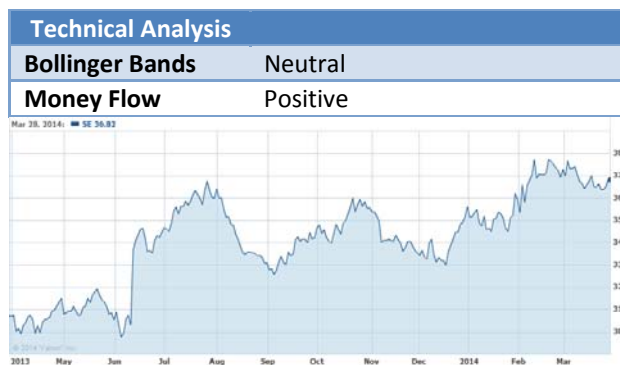
There is a high uncertainty in PetroChina's plans and the overall Chinese economy. With its operations being primarily domestic, the company is always at risk for new regulations or taxes imposed by the Chinese government. In addition, recent corruption accusations involving the former head of PetroChina and its parent, CNPC, could trigger a political backlash against the firm.

We recommend cutting our losses and selling the stock.



## Spectra Energy Corp SE

| Recommendation | Valuation | Last Price | As of      | Style       | Dividend Yield |
|----------------|-----------|------------|------------|-------------|----------------|
| Buy            | \$47.07   | \$36.82    | 03/28/2014 | Large Value | 3.30%          |



### Introduction

Spectra Energy Corp is one of the largest natural gas midstream companies in North America. The company operates in three areas of the natural gas industry – transmission and storage, gathering and processing, and distribution. It operates in four segments – U.S. Transmission, Distribution, Western Canada Transmission and Processing and Field Services.

Last year, SE acquired the interest of Express-Platte Pipeline System through its subsidiary Spectra Energy Partners LP. The company's long-haul interstate pipelines run from the Gulf Coast to Midwest, Northeast, and Florida markets and from northeastern British Columbia to Vancouver.

### Fundamental Analysis

As Morningstar put it, Spectra Energy is a pure play on natural gas demand. Its operations stretch across all links in the natural gas value chain, with the exception of riskier exploration and production.

SE's U.S. Transmission segment, long-haul pipelines and storage facilities move about 12 percent of all natural gas consumed in North America. Its Canadian distribution subsidiary, Union Gas, supplies natural gas to 1.3 million customers in Ontario. Moreover, Spectra has a 50 percent stake in DCP Midstream, a joint venture with Phillips 66, which has positions in six NGL producing regions.

These integrated valued added activities coupled with such a strong infrastructure will continue to provide diversification and generate cash flows in short and long terms.

Spectra Energy's exemplary management that looks out for the interest of shareholders is also worth the mention. Former CFO and board member Greg Ebel stepped up to the company, who is the only executive employed by Spectra. Independent director Bill Esrey took on the role of the chairman, who previously served as CEO for Sprint for 18 years. The new management team's incentive plans stress long-term returns. Indeed, the company has generated 21 percent of total return (including dividends) over the last 5 years and has generated returns well in excess of its cost of capital.

### Financial Statement Analysis

Spectra's 2013 revenue has come in at \$5.5 billion, an increase of 8.7 percent from 2012. Its net profit margin has increased to 18.8 percent and it was able to generate positive net cash flows, all the while paying down its debt, spending heavily on capital expenditures and increasing dividend payout.

### Conclusion & Recommendation

Growth opportunities for Spectra Energy remain convincing due to its large, diverse and well-positioned asset base. Pipelines and fee-based processing opportunities in the U.S. and Canada offer low-risk bolt-on growth opportunities that are backed by firm contracts. DCP, the largest NGL player in the midstream industry, is building new infrastructure to support surging NGL production in the Eagle Ford, Permian and Mid-Continent shale gas plays.

Together, Spectra Energy and DCP are currently executing \$7 billion in approved projects that will enter service between now and 2016, which supports our valuation and reinforces our belief in short-term appreciation.

## Stealth Gas. GASS

| Recommendation | Valuation | Last Price | As of      | Style       | Dividend Yield |
|----------------|-----------|------------|------------|-------------|----------------|
| Buy            | \$14.44   | \$11.51    | 03/28/2014 | Small Value | -              |



### Introduction

Headquartered in Athens, Greece, StealthGas owns a fleet of 38 liquefied petroleum gas (LPG) carriers providing international seaborne transportation services to LPG producers and users, as well as product carriers chartered to oil producers and refiners. In the LPG sector, the company carries various petroleum gas products in liquefied form including propane, butane, butadiene, isopropane, propylene and vinyl chloride monomer, which are byproducts of natural gas and oil. Several carriers are also capable of carrying refined petroleum products, such as gasoline, diesel, fuel oil and jet fuel. The company's 2010-built Aframax tanker can also carry crude oil.

### Fundamental Analysis

In February 2014, StealthGas acquired two new building LPG vessels as part of its fleet expansion program, which brought the total number of LPG carriers to be delivered from March 2014 to August 2017. This will increase the fleet size to 55.

The company operates in a niche market that had not fallen victim to the oversupply problems that other shipping sectors are experiencing and was able to continue to hire out ships and generate substantial cash flow. It recently disclosed a utilization ratio of 94.9 percent.

StealthGas acknowledges the fact that half of its fleet is over 20 years old and that it might come across a potential overcapacity situation in the future. During the recent earnings call, the CEO, Harry Vafias, said the com-

pany plans to continue to update its fleet while divesting the older vessels at best price possible. In addition, the new vessels that are being acquired are more fuel efficient eco vessels, which signals an improved margin.

### Financial Statement Analysis

Last year was relatively a good year for StealthGas with net income amounting to \$29 million compared to \$9 million in 2011. Its EPS increased from \$0.41 to \$1.41.

The company recently announced the results for FY2013. Revenues came in favorable at \$121.5 million, which is an increase of 1.9 percent from last year's revenue, due to higher number of vessels (39). Although, it could not sustain its previous net profit margin of 24.3 percent and its net income dropped to \$21.2 million. Its EPS went down to \$0.75 accordingly. StealthGas has not paid dividends since 2009, but that does not necessarily mean that company will not decide to share its earnings with investors in the future.

### Conclusion & Recommendation

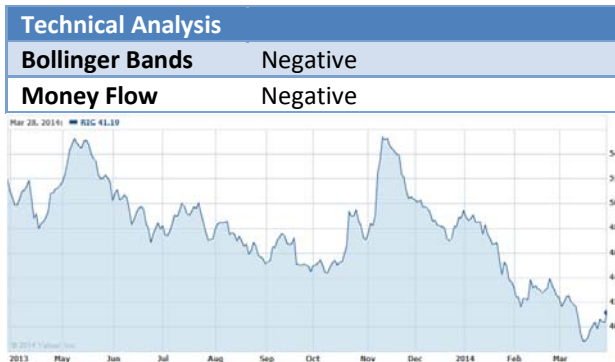
The U.S. is shipping more LPG than ever as a byproduct of the record natural gas output. U.S. LPG annual shipments will reach 12 million metric tons by 2015, more than doubling 2012 levels. The price differential between U.S. propane, the Far East and Europe keeps enquiry for exports rather high. There are no pressurized ships available in the U.S. currently.

As the worldwide leader in LPG shipping vessels with 25 percent market share, GASS is in prime position to take advantage of this trend, which creates favorable pricing environment for the company. StealthGas has a significant growth potential due to its operations in this niche market of LPG carriers.

We recommend increasing our position in GASS to capitalize on the forecasted growth.

## Transocean Ltd RIG

| Recommendation | Valuation | Last Price | As of      | Style       | Dividend Yield |
|----------------|-----------|------------|------------|-------------|----------------|
| Sell           | \$15.19   | \$41.19    | 03/28/2014 | Large Value | 5.42%          |



### Introduction

Transocean is the largest international offshore drilling rig contractor in the world. The company operates in two segments: contract drilling services, which involves contracting its mobile offshore drilling fleet, equipment and work crews on a day rate basis, and drilling management services, which provides oil and gas drilling management services on either a day rate or fixed-price basis. RIG's market is global, given that rigs can be mobilized from region to region, but the major deep-water basins are in West Africa, Brazil and the Gulf of Mexico.

### Fundamental Analysis

Offshore drilling has been one of the worst performing sectors during the first three months of this year, significantly underperforming the market. The biggest concern is the excess capacity currently plaguing the market. As the environment becomes more competitive, multiple companies start to chase after one contract. These companies are forced to cut the day rates for their deep-water and ultra-deep-water drilling units.

Transocean's rig lifespans average 20 years. The company is slowly replacing its legacy rigs with modern ones. Currently, RIG owns twice the number of deep-water rigs as its closest peer, which would have provided a

competitive edge to the company in an upturn market. However, in the current outlook, Transocean is exposed to a buildup of rigs without contracts, and more importantly, to a depressing of day rates for the non-contracted vessels in the event of substantial fall in oil and natural gas prices.

Moreover, in April 2010, one of RIG's deep-water units experienced an explosion, burned and sank in the U.S. Gulf of Mexico while working for its customer, BP, on its Macondo well. In December of that year, the Department of Justice filed a lawsuit against the company and other unaffiliated defendants, alleging violations of the Oil Pollution Act of 1990 and the Clean Water Act. In January 2013, Transocean settled on certain civil charges and potential criminal charges for \$1.4 billion in fines and penalties. However, there are still some outstanding civil charges, which further put a black cloud over the company.

### Financial Statement Analysis

Transocean wrote off its losses in 2011 and was able to substantially increase its revenue and net income in 2013. However, Transocean has a significant debt level with long-term debt amounting to \$10.7 billion. Its debt-to-equity ratio is 94.9 percent, which is extremely high compared to the industry average of 25.09 percent, and its ROE is mere 8.4 percent, which is a very poor return compared to its peers.

### Conclusion & Recommendation

Offshore drilling rig contractors like Transocean are too much of a risk at this time, especially when analysts are forecasting a two-year slowdown in the drilling market.

We recommend selling the stock.

## Financials

### Financial Sector well-positioned for positive economic outlook

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Economic growth in the U.S. continues to improve, as shown in the improvement of the housing market, lower unemployment rate, and a rising interest rates. While the economic recovery remains slow, gradually better employment numbers and a steady housing market rebound have produced a higher consumer confidence.

The real gross domestic product (GDP) growth in the fourth quarter of 2013 was 2.6 percent, which reflected positive contributions from personal consumption, exports, and state and local government spending. As the financial sector tends to do well in economic recoveries we are encouraged by the opportunities we see in the banking and insurance sectors.

### Banks

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We have a positive forecast for the financial sector on the premise that the U.S. economy will continue to grow. Banks will benefit from a stronger housing market, a positive improvement on employment, and rising interest rates. Banks loans continue to grow, and their credit quality improvements will lead to lower loan loss provisions. Furthermore, U.S. banks are well capitalized as most banks passed the annual stress tests, which will lead to returns of excess capital to its shareholders.

### Insurance Companies

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Our forecast for the property and casualty insurance industry is favorable as excess capital has decrease due to insurance companies experiencing very large catastrophe losses around the world and the U.S. in the last several years. As excess capacity decreases, insurance rates rise. As the U.S. economy continues to improve, insurance companies will continue to grow premium revenues through rate increases and exposure growth. We also expect that insurance companies' investment income will continue to grow with a rising interest rate environment.

## American International Group, Inc. AIG

| Recommendation | Valuation | Last Price | As of      | Style        | Dividend Yield |
|----------------|-----------|------------|------------|--------------|----------------|
| Buy            | \$62.00   | \$49.88    | 03/28/2014 | Large-Growth | 1.01%          |

### Technical Analysis

|                        |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Positive |
| <b>Money Flow</b>      | Positive |



### Introduction

American International Group Inc. AIG provides insurance, financial and investment products and services to businesses and individuals in more than 130 countries. Its subsidiaries serve commercial, institutional and individual customers through a property-casualty, life insurance and retirement services network.

### Fundamental Analysis

AIG has paid the entire loan amount back to the U.S. government after the rescue plan from the federal government in 2008. AIG is again 100 percent owned by its common shareholders. New management has focused on its core business and divested non-core assets. AIG's operations consist of property-casualty, life, and Financial services, which contains capital markets and mortgage insurance. AIG's new focus is on building the operations organically instead of through acquisitions in unrelated business.

### Financial Statement Analysis

AIG's 2013 EPS \$4.56 beat the consensus expectations of \$4.38 and the \$3.93 EPS in 2013. Net income increased to \$9.09 billion in 2013 from \$3.44 billion in 2013 based on lower catastrophe losses, claims and other expenses. However, total revenue decreased 3.3 percent year over year to \$68.68 billion, primarily due to lower premiums, net investment income and aircraft leasing revenue. Conversely, AIG improved its core insurance operations, overall combined ratio improved by 21 percent, boosted book value per share, ROE improved to 7.5 percent, and total claims and expenses declined by 12.9 percent in 2013. AIG successful streamlining of operations to control costs, non-core business divestitures, reduction of financial leverage has produced good results.

### Conclusion & Recommendation

We believe AIG's shares are a BUY as we expect the company to continue to increase revenue and operating earnings by leveraging its leading insurer position given its diversified and unique franchise in both domestic and international markets. It is among the top sellers of workers compensation, professional liability and property coverage globally. AIG has successfully divested its non-core assets increasing liquidity and credit profile, enabling the company to focus on its core insurance businesses. AIG has also aimed to reduce exposure to businesses with inadequate pricing and increasing loss trends through simplified reinsurance and capital arrangements. The company is also focusing on reducing operating expenses, which will increase operation margins. The company announced a \$1 billion share repurchase and increased dividend by 25 percent in 2014. Using our DCF model, we believe that AIG's shares are undervalued which support our BUY recommendation.

## BlackRock, Inc. BLK

| Recommendation | Valuation | Last Price | As of      | Style        | Dividend Yield |
|----------------|-----------|------------|------------|--------------|----------------|
| Buy            | \$375.00  | \$310.89   | 03/28/2014 | Large-Growth | 2.62%          |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Neutral  |
| Money Flow         | Positive |



### Introduction

BlackRock (BLK) is the largest asset manager in the world, with over \$4.0 trillion in assets under management. Its acquisitions of iShares and Merrill Lynch Investment Management changed its profile from a fixed income into a multi-product manager. BLK's business is truly global with 45 percent of its revenues coming from outside the United States. BLK has franchises in institutional fixed income, ETFs, alternatives, and cash.

### Fundamental Analysis

BLK is the largest asset manager in the world, and it has a very strong franchise in many areas. BLK has a top position in passive investments, diversity, and strong fund performance, which will help it continue to attract assets over the next few years. BLK business is global with 45 percent of its clients coming from outside the United States. We expect BLK to grow its revenues due

to its asset mix in fixed income, asset management including ETFs, alternatives, and multi-strategy.

### Financial Statement Analysis

BLK's AUM grew 14 percent, to \$4.3 trillion in 2013. Revenues increased 9 percent year over year through performance fees, asset appreciation including primarily equity appreciation. BLK has been generating inflows with its very popular fixed-income and ETF operations. We expect BLK's equities assets and passive investment will increase by 12 percent in 2014. BLK has implemented good cost control practices focusing on reducing operating cost, which we expect will boost operating margins to 39 percent in 2014.

### Conclusion & Recommendation

We believe BLK's shares are a BUY as the company has a competitive advantage around the size and scale of its operations, the strength of its brands, and the diversity of its AUM by asset class, and distribution channels. BLK consistently repurchased shares in 2013 and we expect to continue its shares buy-back program in 2014. Furthermore, BLK announced a 15 percent increase in dividend in 2014. Using our DDM model, we believe that BLK's shares are undervalued and its earnings power will allow it to continue returning profits to shareholders moving forward.

## JPMorgan Chase & Co. JPM

| Recommendation | Valuation | Last Price | As of      | Style       | Dividend Yield |
|----------------|-----------|------------|------------|-------------|----------------|
| Hold           | \$75.00   | \$60.04    | 03/28/2014 | Large-Value | 2.88%          |

### Technical Analysis

|                        |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Positive |
| <b>Money Flow</b>      | Positive |



### Introduction

JP Morgan Chase is an integrated financial institution offering investment banking, commercial lending, and private wealth management services. JPM has expanded its retail locations over the past two years and is well positioned to prosper in an economic recovery. JPM's profitability is dependent on consumer and commercial borrowing activity, investment banking, and overall health of the financial markets.

### Fundamental Analysis

JPM has chosen to place an emphasis on the retail and small business lending markets. We believe that this provides a great differentiation versus the other integrated financial institutions. With borrowing in the current interest rate market remaining cheap, JPM is positioned to gain business as the markets turn and consumers continue to increase borrowing and investing. The key source of JPMorgan's earnings stability is its business diversification. There is a wide range of organic growth opportunities available for the company, such as the retail branch network, investment banking and Credit Cards.

### Financial Statement Analysis

JPM had two years of flat revenues in 2013 and 2012 after having declined revenues in 2011 and 2010. The consensus estimate is that JPM's revenue growth will improve by 2 to 4 percent in 2014 driven by growth of net interest income, loans growth, and net interest margin. JPM in 2013 was able to increase consumer deposits by 10 percent, commercial loans by 7 percent and deposits by 3 percent, and finished the year with a record \$1.6 trillion in assets under management. Furthermore, as the economy improves the short-term interest rates may rise in 2014. Therefore, both loan and deposit balances could grow in this improving economy.

### Conclusion & Recommendation

We believe JPM's shares are a HOLD as the company has a wide range of organic growth opportunities available to them. With some help from higher interest rates, this performance could result in a growing top line. We also think its legal costs peaked in 2013 and earnings could improve significantly once these legal costs are behind them. The company is also reducing costs by bringing down operating expenses. Furthermore, We expect JPM to increase its dividend and share buyback program.



## Meadowbrook Insurance Group MIG

| Recommendation | Valuation | Last Price | As of      | Style       | Dividend Yield |
|----------------|-----------|------------|------------|-------------|----------------|
| Sell           | \$5.00    | \$5.50     | 03/28/2014 | Small Value | 1.42%          |

### Technical Analysis

|                        |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Negative |
| <b>Money Flow</b>      | Neutral  |



### Introduction

Meadowbrook Insurance Group is primarily a specialty commercial insurance underwriter and insurance administration company. The company also markets and underwrites specialty property and casualty insurance products and programs through a broad network of independent retail agents, wholesalers, and program administrators and general agents. The retail agencies also generate commission revenues and are located in Michigan, California, Massachusetts, and Florida.

### Fundamental Analysis

MIG experienced large losses in 2012 that led to the need for significant reserve strengthening. These developments created a lot of negative press and reserve adequacy concerns amongst investors. Subsequently, A.M. Best Company announced that they were placing the company's credit rating under review with "negative implications". The insurer has not been able to turn around results in 2013.

### Financial Statement Analysis

Meadowbrook delivered negative earnings results in three of the last four quarters in 2013. The company's earnings results in the third quarter of 2013 showed a decline of revenues by 16.9 percent per previous year

with continued negative results including higher debt and reduced investment returns.

### Conclusion & Recommendation

Meadowbrook has had negative financial results since 2012. The insurer lacks current growth catalyst due in part to declining cash flows and increased debt. Furthermore, the insurer is also facing operating challenges after discontinuing some of its operations that reduced premiums. Our recommendation is to sell Meadowbrook Insurance Group.



## MFA Financial, Inc. MFA

| Recommendation | Valuation | Last Price | As of      | Style     | Dividend Yield |
|----------------|-----------|------------|------------|-----------|----------------|
| Sell           | \$7.00    | \$7.66     | 03/28/2014 | Mid-Value | 10.20%         |

### Technical Analysis

|                        |         |
|------------------------|---------|
| <b>Bollinger Bands</b> | Neutral |
| <b>Money Flow</b>      | Neutral |



### Introduction

MFA Financial is a REIT that invests via the secondary markets in adjustable rate mortgage-backed securities (MBS). The company splits its portfolio between both agency guaranteed MBS (55 percent) and non-agency MBS (43 percent). MFA utilizes short-term borrowing agreements through repurchase agreements to leverage its acquisition of MBS to about 3x book.

### Fundamental Analysis

MFA Financial, Inc. is engaged in the business of investing, on a leveraged basis, in residential Agency guaranteed mortgage-backed securities (MBS) and Non-Agency MBS. Its business objective is to generate net income for distribution to its stockholders resulting from the difference between the interest and other income it earn on its investments and the interest expense it pays on the borrowings, which it uses to finance its leveraged investments and its operating costs.

MFA has a natural hedge against interest rates with its exposure to non-agency and agency MBS. As interest rates fall, agency MBS will tend to lag but provide downside protection, as they tend to outperform in a macro-economic downturn. The non-agency book is could outperform with significant improvement in the housing markets.

### Financial Statement Analysis

MFA Reported missed earnings in the last 2 quarter of 2013. MFA's reported EPS of \$0.18 missing the consensus estimate of \$0.22 EPS consensus due to incremental interest expense associated with \$1.4 billion of additional, swap notional. MFA stands to lose 4 percent of book value in the event of a 100 basis point increase in rates due to leverage. MFA's non-agency MBS portfolio carries credits risk; the agency portfolio carries prepayment and extension risk if the company experience higher than expected rates of defaults or losses on the mortgages collateralizing the non-agency MBS. These exposures increases as Non Agency book is concentrated in California 45 percent and 8 percent in Florida.

### Conclusion & Recommendation

We believe MFA faces significant headwinds in the short and long term. Agency MBS and ALT a non-agency MBS risk losses in the face of higher rates and spreads. Due to MFA's current business prospects, we recommend selling MFA's shares.

## Morgan Stanley MS

| Recommendation | Valuation | Last Price | As of      | Style       | Dividend Yield |
|----------------|-----------|------------|------------|-------------|----------------|
| Hold           | \$38.00   | \$30.91    | 03/28/2014 | Large Value | 0.70%          |

| Technical Analysis     |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Positive |
| <b>Money Flow</b>      | Positive |



### Introduction

Morgan Stanley is a global investment bank that has a well-rounded breadth of business lines. Other than investment banking, MS offers wealth and asset management, as well as trading and execution services.

### Fundamental Analysis

Morgan Stanley acquired the remaining 35 percent stake in Smith Barney and now it has one of the largest brokerage retail platforms. Due to the new created synergies, Morgan Stanley is poised to take advantage of its cost cutting initiatives in order to expand margins and increase profitability. Morgan Stanley has been selling its non-core operations over the last few years in order to concentrate more on its profitable units.

### Financial Statement Analysis

Morgan Stanley's revenues for the fourth quarter 2013 were \$8.2 billion, up 9 percent year over year. Net interest income was \$282 million in the same quarter, up 63 percent from the year-ago quarter driven by a 37 percent decrease in interest expenses. MS ROE in 2013 was 6.4 percent above average compared to its industry while decreasing costs across all its divisions.

### Conclusion & Recommendation

We believe MS shares are a HOLD as the company has a competitive advantage based on the growth of its wealth management division. Moreover, Morgan Stanley continues to reduce costs by restructuring its operations and focus on its profitable units to increase its earnings. The company will continue its share buyback programs in 2014.

## The Travelers Companies Inc. TRV

| Recommendation | Valuation | Last Price | As of      | Style       | Dividend Yield |
|----------------|-----------|------------|------------|-------------|----------------|
| Buy            | \$105.00  | \$83.99    | 03/28/2014 | Large-Value | 2.34%          |

| Technical Analysis     |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Positive |
| <b>Money Flow</b>      | Neutral  |



### Introduction

Travelers (TRV) was formed with the merger of Travelers and Saint Paul insurance companies in 2004. TRV is a Dow component and is a leading provider of commercial property-liability, homeowners and auto insurance. TRV has big presence in the independent agency and broker commercial and personal lines insurance markets.

### Fundamental Analysis

TRV is as among the best managed insurance carrier in the United States. Since the merger, TRV has produced very stable and better than expected financial results. With one of the cleanest balance sheet in the property and casualty industry, TRV has aggressively managed its capital, and has consistently ROEs above its peer group. TRV's is a top risk management and its underwriting practices have enabled the company to produce underwriting results that are superior to many competitors.

### Financial Statement Analysis

TRV produced record earnings in 2013 when it returned \$3.6 billion in capital. Total revenue increased 5 percent from the previous year due to an improvement in the combined ratio to 87 percent from 105 percent the prior year. The catastrophe losses were significantly lower in 2013 and the company had higher than estimated favorable reserve development. TRV's was ROE 15.5 percent in 2013 compared to 11 percent in 2012. TRV experienced high retention rate, pricing gains, and positive renewal rate increases. Furthermore, the company has introduced a reductions cost program that is expected to produce company savings through 2015.

### Conclusion & Recommendation

We believe TRV's shares are a BUY as the company has a competitive advantage around its strong market position, the size and scale of its operations. In 2014, we expect TRV to continue to leverage its economies of scale and increase revenues across all lines of business by increasing rate premiums and retaining its quality business. Through its financial results over the years, TRV has demonstrated to be a very good underwriting company with an above-average quality balance sheet.

TRV is focusing on reducing operating expenses and acquisition costs in order to keep improving underwriting margins. TRV has consistently repurchased shares in 2013 and the company announced another \$5 billion share repurchase program to continue its shares buy-back program in 2014.

Furthermore, TRV over the last 5 years has increased its dividend 10 percent CAGR and we expect this practice to continue. Using our DDM model, we believe that TRV's shares are undervalued and its earnings power will allow it to continue returning profits to shareholders.

## Tower Group International, LTD. TWGP

| Recommendation | Valuation | Last Price | As of      | Style       | Dividend Yield |
|----------------|-----------|------------|------------|-------------|----------------|
| Sell           | \$2.00    | \$2.65     | 03/28/2014 | Small Value | -              |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Negative |
| Money Flow         | Negative |



### Introduction

Tower Group Inc. is a global personal and casualty insurer and service provider. The company serves the small to mid-sized business, specialty commercial, personal insurance, and assumed reinsurance markets. TWGP focuses primarily on casualty lines including workers’ compensation and commercial multi-peril. Tower distributes its products and services through its network of retail brokers, wholesalers, and agents.

### Fundamental Analysis

Tower Group suffered very serious reserve shortfall in 2013 in their main business of workers’ compensation, commercial liability and commercial auto business lines. Due to the negative results, the Tower Group opted to merge itself with ACP Re Ltd, as a strategic move to save the company.

### Financial Statement Analysis

Tower Group went into trouble in 2013 after it faced a significant reserve shortfall. The company miscalculated the reserve requirement for its workers’ compensation, commercial liability and commercial auto policies. After Tower group decided to merge with ACP Re in order to save the company, A.M. Best has put this merger under review with negative implications due to the concern regarding integration risk on the part of ACP Re. The rating agency is also unsure about the adequacy of loss reserves related to the business acquired from Tower Group International, which has itself suffered serious adverse reserve development in the past.

### Conclusion & Recommendation

Due to the negative trend on Tower Group fundamental business and the concern regarding the integration risk with the ACP Re LTD, our recommendation is to Sell Tower Group International.

## U.S. Bancorp USB

| Recommendation | Valuation | Last Price | As of      | Style       | Dividend Yield |
|----------------|-----------|------------|------------|-------------|----------------|
| Hold           | \$53.00   | \$42.30    | 03/28/2014 | Large Value | 2.27%          |

| Technical Analysis     |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Neutral  |
| <b>Money Flow</b>      | Positive |



### Introduction

U.S. Bancorp is a commercial bank that offers commercial lending, mortgages, and retail banking to consumers and small businesses. USB has seen increased credit quality from clients in recent years, and has been able to grow its loans, mortgages, and deposits during a time when its competitors have struggled to do so.

### Fundamental Analysis

USB has had an outstanding operating performance of over the past few years and during financial crisis of 2008-09. USB has an ability to increase excess returns on capital due to its credit underwriting, fee generation, strategically acquisitions, and management. As with any bank, strong loan underwriting is essential. Even during financial crisis of 2008-2009, USB did not have losses from credit charge offs as many other financial institutions.

### Financial Statement Analysis

USB is one of the most profitable large banks in the U.S., with a return on equity of 16.0 percent and a return on assets of 1.67 percent for the first 3 quarter in 2013.

USB reduced Net charge-offs, provision for credit losses and nonperforming assets as the U.S. economy improves slowly. USB deposits increased by 5.0 percent, and commercial loans also increased by 3.6 percent. With the help of higher interest rates, and an improved economy both loan and deposit balances could grow significantly in 2014.

### Conclusion & Recommendation

We believe USB's shares are a HOLD as the company continued to improve and grow its favorable mix of businesses and excess returns on capital. We expect USB to continue to reduce its cost, increase their dividend, and increase its share buyback program in 2014.

## Health Care

2013 was an excellent year on the stock market for most industries, especially Health Care. Whenever a sector gains over 50 percent in a single year, however, the prudent analyst must be especially cautious in selecting stocks to both buy and hold as many trends are driving stocks above their fair values. The overall market's strong performance and the historically significant amount of share repurchases by many stocks in this sector are both driving share prices up, making many stocks appear overvalued. For this reason, we have reduced the allocation to this sector of the portfolio in order to realize the substantial gains made by these assets in 2013 from approximately 16 to 7 percent.

Five stocks in the portfolio, Agilent, Covidien, United Health, WellPoint, and St. Jude's have realized their underlying value, and thus warrant a sell recommendation. Three stocks in the portfolio, Abbott, Express Scripts, and Exelixis are undervalued in the market as per our analysis. Accordingly, we recommend a hold position for these three stocks. Finally, we recommend that the portfolio increase its holdings of PDL BioPharma due to its significant upside potential and strong value.

### An Update on Health Care Reform

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The confirmation by the Supreme Court of the constitutionality of the Affordable Care Act (henceforth referred to as the ACA) gives analysts a green light to factor its changes firmly into future assumptions. Furthermore, the Obama administration's recent announcement that they have hit their enrollment target of 7 million individuals leads us to believe that the law will continue to shape the health care marketplace of this decade. The primary beneficiaries of these reforms will be care providers and managed-care organizations, particularly those with established market share and wide economic moats. Furthermore, pharmacy benefit managers (such as Express Scripts) may see the greatest benefit from the law, as their business is highly volume-dependent and any increase in those with coverage is sure to positively impact their revenues. Pharmaceutical manufacturers of generic drugs will also likely see healthy increases in revenues, while brand-name producers may find a headwind in lowered Medicare reimbursement. Finally, medical device firms may find this new environment more challenging than previously, with lowered reimbursement and a new excise tax on devices acting as substantial hurdles to their current growth trajectories.

### Demographics

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With the Baby Boomer generation reaching typical retirement age at a staggering 8-10,000/day, the health care industry must simultaneously grow operations while increasing efficiencies to meet the demands of a new regulatory environment. Given that the majority of an individual's health care costs occur in the post-retirement stage of life, this demographic trend in particular should continue to provide healthy, secular growth in U.S. revenues for the rest of this decade and the better part of the next one.

While this trend is also present in Europe and other developed economies, ongoing uncertainty in both macroeconomic growth and government finances continues to present a headwind for growth in the Eurozone. Furthermore, the large potential market in Russia (which is also facing a similar demographic transition) is likely to be increasingly inaccessible, especially to U.S.-based multinationals as international politics heighten tensions between the two nations.

### Conclusion

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With much of the uncertainty surrounding the ACA implementation largely resolved, we predict that several sub-industries within the health care sector will benefit from this. In particular, we believe that the pharmacy benefit management sector, represented by Express Scripts in our portfolio, will continue to make gains throughout 2014. While managed care organizations such as United Health will likely benefit as well, the outsize gains made by them and others last year presents a significant obstacle to assigning a buy or hold recommendation, as they are already overvalued by consensus estimates. This is indicative of many of the stocks in our portfolio, such as St. Jude's Medical and WellPoint, which have decent growth prospects in 2014 from a company perspective but who also have shot up so fast in stock price that correction is almost inevitable. Therefore, we recommend that the portfolio realize the majority of these gains and overall reduce the size of the sector in order to better accommodate for the market conditions in 2014.

# Abbott Laboratories ABT

| Recommendation | Valuation | Last Price | As of      | Style      | Dividend Yield |
|----------------|-----------|------------|------------|------------|----------------|
| Hold           | \$80.00   | \$38.47    | 03/28/2014 | Large Core | 4.62%          |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Neutral  |
| Money Flow         | Positive |
| Relative Strength  | Neutral  |



### Introduction

Abbott Laboratories is a diverse medical products corporation who primarily sells branded generic drugs, diagnostic devices, infant formula, and internal medical devices to retailers, wholesalers, hospitals, health care facilities, laboratories, physicians’ offices, and government agencies. The company employs 69,000 people and posted FY2013 revenues of \$21.8 billion.

### Fundamental Analysis

Following the spin-off of AbbVie, the research-based pharmaceutical division of Abbott that once constituted its core business, Abbott has embarked on a mission to cut costs and improve efficiencies as it repositions itself as an international multi-product and multi-market firm. By shifting their geographical exposure to only 30 percent U.S. through their divestiture, Abbott has traded short-run stock market gains for a diversified approach that appears poised to generate healthy returns in the long run as Europe recovers and emerging markets regain momentum.

The market reaction to the spin-off has been generally positive, with the stock increasing 10 percent upon the finalization of the split. However, the stock price lagged both the S&P and the industry as a whole throughout 2013, possibly reflecting uncertainties surrounding its future performance without its pharmaceutical business.

### Financial Statement Analysis

While it may be too early to draw firm conclusions about Abbott’s performance without their pharmaceutical division, their FY2013 financials are a mixed bag.

The spin-off of AbbVie has left Abbott with just over half of their previous revenues and did relatively little to lower operational costs. Common-size analysis reveals that COGS has increased from 38 to 46 percent of revenues with operating incomes down from approximately 20 percent of revenues to just above 12 percent.

On a positive note, the divestiture of AbbVie has substantially reduced Abbott’s non-current liabilities, specifically through a significant reduction in pension obligations and long-term debt.

### Conclusion & Recommendation

With Abbott only one year out from a significant change in operations, it is difficult to draw any firm conclusions regarding their likely future performance based only on a single year of data. Overall, Abbott appears to be well positioned for worldwide growth over the next decade through their diverse product and market mix, something that also insulates them from the risk of any single market failing to deliver

Considering these factors alongside a valuation well in excess of their current market price, we recommend that the portfolio maintain its holdings of Abbott Laboratories.



## Agilent Technologies, Inc. A

| Recommendation | Valuation | Last Price | As of      | Style      | Dividend Yield |
|----------------|-----------|------------|------------|------------|----------------|
| Sell           | \$23.00   | \$56.36    | 03/28/2014 | Large Core | 1.01%          |

| Technical Analysis       |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

Agilent Technologies was spun off from Hewlett-Packard in 1999 and is today a leader in the medical diagnostics business. Agilent offers “the broadest range of innovative measurement solutions in the industry,” with operations in Chemical Analysis, Life Sciences, Diagnostics and Genomics, and Electronic Measurement sectors. The company employs 20,600 people and posted FY2013 revenues of \$6.8 billion.

### Fundamental Analysis

Agilent announced in September 2013 that their electronic measurement business would be spun off in late 2014 as a new publicly traded company, Keysight Technologies, Inc. With revenues of \$2.9 billion in FY2013, the electronic measurement business represents roughly 43 percent of their sales, this decision significantly impacts Agilent’s direction as the company will focus on their chemical analysis, life sciences, and diagnostics sectors.

The market reaction to the announcement was overwhelmingly positive, with the stock rising by 6 percent that week and by 16 percent since then. This is likely

due to Agilent’s assurance that they will maintain or increase their current dividend yield while continuing their share repurchase program to maintain the current level of shares outstanding.

While the market’s reaction to the divestiture has been largely positive, the near-term implications are not as certain. Poor performance from the electronic measurement division in FY2013 caused them to lower the EPS target for FY2014 from \$3.03-\$3.33 to \$2.96-\$3.16. While Agilent will retain its more profitable segments after the spin-off, this could negatively affect the stock’s performance in the short term, especially after a more than robust year in 2013 with a nearly 36 percent increase in share price.

### Financial Statement Analysis

Despite their strong performance on the stock market, Agilent’s FY2013 results were the opposite of what you would expect for a stock up 36 percent over the year. Revenues, margins, and net income all fell for the first time since the financial crisis, causing EPS to shrink by over one third to \$2.10. Furthermore, common-size analysis reveals that COGS as a percent of revenues is at a 4-year high while research and development spending is just above historic lows.

### Conclusion & Recommendation

Ultimately, the spin-off of Agilent’s electronic measurement business should prove to be a profitable move for the company. However, poor performance leading up to the divestiture will likely degrade investor confidence and keep share price growth in 2014 to a minimum.

While Agilent may recover momentum once positive signs start emerging after the divestiture, it is unlikely that the 36 percent appreciation since we purchased the stock will be maintained in the short run. We recommend our position be liquidated to realize these gains as the stock is currently trading at 245 percent of our valuation.



## Covidien PLC COV

| Recommendation | Valuation | Last Price | As of      | Style      | Dividend Yield |
|----------------|-----------|------------|------------|------------|----------------|
| Sell           | \$60.00   | \$72.80    | 03/28/2014 | Large Core | 1.48%          |

### Technical Analysis

|                          |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

Covidien PLC is an Irish-based medical devices and supplies company that operates worldwide. Covidien's Medical Devices division designs, manufactures, and sells endomechanical surgical equipment while their Medical Supplies designs, manufactures, and sells nursing and operating room supplies to primary care providers. The company employs 38,500 people and posted FY2013 revenues of \$10.2 billion.

### Fundamental Analysis

Having recently divested their pharmaceutical division, now known as Mallinckrodt, Covidien is now in the process of streamlining operations and focusing on becoming a pure medical device firm. In the years leading up to the separation, Covidien had been heavily investing in their research and development, doubling their budget in four years as they sought to gain market share and drive top-line growth. Now that Mallinckrodt has been divested, the focus seems to be shifting away from top-line growth and towards delivering greater profits and higher dividends. In fact, Covidien returned 130 percent of their 2013 free cash flow to shareholders through dividends and share repurchases. When combined with their heavy focus on high-margin medical devices for their research and development spending over their

medical supplies segment, the signal is clear that Covidien intends on maintaining and widening their economic moat.

A challenge that Covidien faces in the near term is their reliance on a still-uncertain U.S. market for half of their revenue, as the ACA implementation is likely to increase their costs through a more stringent regulatory environment. This could have the effect of reversing gains in operational efficiency from their consolidation strategy currently in progress. Furthermore, Johnson & Johnson's entry into their soft tissue market represents a significant threat to growth in a sector that comprises approximately 10 percent of their overall revenues.

### Financial Statement Analysis

Covidien's financial statements reflect the company's new focus on efficiency and bottom-line growth. Since divesting Mallinckrodt, cost of revenue has fallen from 42.5 percent to 40 percent of revenues. Furthermore, net income is at its highest proportion of revenues in five years. On the other hand, overall operating expenses are also at their highest proportion of revenues in the same five-year period, primarily driven by increases in restructuring and selling, general, and administrative expenses.

Looking at the balance sheet, one clear standout is the rapid increase in treasury stock over the last three years, doubling from 2012 to 2013. While this effectively provides shareholders with a supplement to dividends, it also implies that the company may be either out of profitable research and development endeavors or struggling to meet EPS targets.

### Conclusion & Recommendation

While Covidien appears to be repositioning itself to grow with the changing healthcare environment, the future remains highly uncertain. With seven insiders selling a significant amount of shares in December and a valuation 20 percent short of the share price, it seems prudent for the portfolio to sell its holdings of Covidien PLC.

## Express Scripts ESRX

| Recommendation | Valuation | Last Price | As of      | Style        | Dividend Yield |
|----------------|-----------|------------|------------|--------------|----------------|
| Hold           | \$85.00   | \$75.60    | 03/28/2014 | Large Growth | -              |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Neutral  |
| Relative Strength  | Positive |
| Relative Strength  | Neutral  |



### Introduction

Express Scripts Holding Company is a U.S.-based corporation that provides pharmacy benefit management and other business services to customers in the U.S. and Canada. The company employs 30,000 people and posted FY2013 revenues of \$98.2 billion.

### Fundamental Analysis

From a competitive standpoint, Express Scripts is in a mixed position. On one hand, their rapid growth has enabled them to become one of the most powerful players in the within the marketplace, filling 1.3 billion claims in 2013. On the other hand, the competitive landscape is full of a diverse array of challengers, with other independent Pharmacy Benefit Management (PBM) companies, Managed Care Organizations (MCO) such as Aetna or Cigna, and retail outlets such as CVS

and Wal-Mart. While Express Scripts faces some serious competition in a market with relatively low barriers to entry, their market share alone gives them an advantage that is very difficult to replicate quickly.

The passing and confirmation of the Affordable Care Act has significant potential impact on Express Scripts. By closing the coverage gap with respect to Medicare part D and prohibiting insurers from placing a cap on prescription drug benefits, it is likely that the ACA will have a net positive impact on Express Scripts in the near future.

### Financial Statement Analysis

Express Script’s financial statements reveal a company that is undergoing massive growth. Revenues increased 400 percent since 2009, with bottom-line growth of over 230 percent during the same period. While Express Scripts’ margins are razor-thin, with net incomes of less than 2 percent of revenues. While such a trend is to be expected of a company in a strong market-share growth phase, Express Scripts will have to increase efficiency in the future if they want to generate enough free cash flow to satisfy investors.

### Conclusion & Recommendation

Despite the very strong performance of their stock in 2013, Express Scripts appears to be positioned to grow further with the changing healthcare landscape. Their rapid growth happened at just the right time to enable them to benefit most from changes in the regulatory environment, and it is this size that should prove most useful in maintaining a competitive advantage as the industry consolidates further. With a valuation clear of the current share price, we recommend that the portfolio maintain its holdings of Express Scripts.

## Exelixis, Inc. EXEL

| Recommendation | Valuation | Last Price | As of      | Style      | Dividend Yield |
|----------------|-----------|------------|------------|------------|----------------|
| Buy            | \$7.00    | \$3.57     | 03/28/2014 | Small Core | -              |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Neutral  |
| Money Flow         | Positive |
| Relative Strength  | Neutral  |



### Introduction

Exelixis, Inc. is a California-based biopharmaceuticals company engaged in the development of small-molecule therapies for certain types of cancers. The company employs 227 people and posted FY2013 revenues of \$31 million.

### Fundamental Analysis

Exelixis' primary hurdle is the significant uncertainty that surrounds its pharmaceutical pipeline as only one drug, Cometriq, has been approved by the FDA. To make matters worse, a recent announcement that phase III trials will not be stopped early has caused their stock to fall by nearly 50 percent, likely because similar drugs

from competitors such as Johnson & Johnson and Bayer were stopped early.

Despite this uncertainty, there is reason to be bullish about Exelixis. Cometriq has shown significant promise in treating cancers outside of its initial designation of thyroid cancer. Furthermore, partnerships with GlaxoSmithKline and Roche demonstrate that the company is viewed with promise by some of the major players in the pharmaceutical industry.

### Financial Statement Analysis

Exelixis' financial statements are difficult to analyze given its small size and highly irregular revenue streams. In their 10-k, the company writes that they have derived all of their revenues from collaborative research and development agreements with other pharmaceutical companies. This has resulted in very inconsistent revenues with FY2013's results down 30 percent from 2012 and over 80 percent from 2011.

### Conclusion & Recommendation

Despite their highly uncertain direction, Exelixis has significant upside potential should Cometriq pan out into a multi-use cancer drug. Furthermore, the recent sell-off of their stock has left it trading at half or less of both consensus estimates and our valuation. For this reason, we recommend the portfolio increase its holdings of Exelixis, Inc.

## Mallinckrodt PLC MNK

| Recommendation | Valuation | Last Price | As of      | Style        | Dividend Yield |
|----------------|-----------|------------|------------|--------------|----------------|
| Sell           | \$42.00   | \$62.52    | 03/28/2014 | Large Growth | -              |

### Technical Analysis

|                          |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

Mallinckrodt is the result of the spin-off of Covidien's pharmaceutical division effective in July of 2013. Mallinckrodt develops, manufactures, markets, and distributes branded and generic pharmaceuticals to hospitals and pharmacies. The company employs 5,500 people and posted FY2013 revenues of \$2.2 billion.

### Fundamental Analysis

Mallinckrodt is one of the largest producers of opioid painkillers on the market. This market, however, faces long-term pressures from the public conception that they are overprescribed and dangerous and the significant regulations already in place. Furthermore,

Mallinckrodt's flagship branded opioid, Exalgo, faces generic pressure beginning in July 2014. With little resources for marketing it effectively, Mallinckrodt faces an uphill battle in building their own brand. Finally, their pharmaceutical pipeline features few compounds with unique applications, significantly increasing Mallinckrodt's potential risk from an investor standpoint.

### Financial Statement Analysis

Mallinckrodt shows relatively stable revenues over its three-year reported operational period, but common-size analysis reveals that their operational costs as a proportion of revenues has risen from 33 to nearly 40 percent. The impact of this is clearly seen on net income, which has fallen from 7.8 to a mere 2.6 percent of revenues. Simply put, Mallinckrodt shows clear signs of decreasing operational efficiency.

### Conclusion & Recommendation

With a limited period of operations over which to analyze, assessing Mallinckrodt's financial and operational health is difficult. What information is available shows troubling signs of a company with a shaky competitive position, rapidly shrinking margins, and few certain prospects for growth in the future.

Mallinckrodt's valuation of \$42, combined with its 50 percent gain on the market in 2013 signal us to recommend that the portfolio sell its holdings of Mallinckrodt PLC

## PDL BioPharma, Inc. PDLI

| Recommendation | Valuation | Last Price | As of      | Style      | Dividend Yield |
|----------------|-----------|------------|------------|------------|----------------|
| Buy            | \$17.00   | \$8.23     | 03/28/2014 | Small Core | 8.12%          |

| Technical Analysis       |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

PDL BioPharma, Inc. is a Nevada-based biopharmaceutical company that manages patents and royalty assets as well as develops cancer and immunological disease treatments. The company employs 10 people and posted FY2013 revenues of \$443 million.

### Fundamental Analysis

PDL is relatively unique among biotech firms for several reasons. Firstly, its dividend yield of 7.25 percent is remarkably high for its industry. Secondly, it is trading at only 5 times price to earnings while the industry as a whole is trading at a stratospheric 108 times earnings. These seemingly anomalous results are likely caused by

their significant holdings of patents and other royalty assets which enable PDL to earn significant and nearly cost-free revenues which can be painlessly distributed to shareholders.

Another positive sign from PDL is their recent victory in a suit with Genetech that enables them to earn higher royalties on and recognize revenue for one of their most lucrative patents until 2016, softening the blow from the patent's expiration in late 2014.

### Financial Statement Analysis

PDL is in excellent financial health, demonstrating year-over-year revenue growth for five years and stable margins. Furthermore, they have recently completed a financing deal, which has enabled them to reduce their long-term debt from \$180 million to only \$48 million. While a glance at their balance sheets might tell the reader that they have traded long-term debt for short-term debt, this has resulted from financing deals with several biotech firms that enable them to collect substantial royalties for several years.

### Conclusion & Recommendation

From the standpoint of a long-term value investor, PDL is an excellent bargain right now at just above \$8 per share. The uncertainty surrounding the stock in late 2013 has cleared, leaving a company with healthy revenue streams, strong dividends, and very low operating costs. With a valuation of \$17, we recommend that the portfolio increase its holdings of PDL BioPharma.

## St. Jude Medical, Inc. STJ

| Recommendation | Valuation | Last Price | As of      | Style      | Dividend Yield |
|----------------|-----------|------------|------------|------------|----------------|
| Sell           | \$62.00   | \$66.22    | 03/28/2014 | Small Core | 2.24%          |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Neutral  |
| Money Flow         | Positive |
| Relative Strength  | Neutral  |



### Introduction

St. Jude’s Medical, Inc. is a Minnesota-based medical device company that produces a wide range of endo- and exomechanical devices primarily for cardiac pathologies. These devices are also integrated into remote monitoring systems for physicians. The company employs 16,000 people and posted FY2013 revenues of \$5.5 billion.

### Fundamental Analysis

St. Jude’s Medical, Inc. faces some significant challenges moving into 2014. A strong early leader in the development of implantable defibrillators, St. Jude’s is now in a distant-second place position to Medtronic with Boston Scientific hot on their heels. Furthermore, the implementation of the ACA presents several potential headwinds for St. Jude’s. The medical device excise tax is sure to raise costs across the board. Furthermore, the push to lower Medicare reimbursements will likely have a negative impact on revenue growth in the short run.

Despite these challenges, the fundamentals of St. Jude’s business are very strong. Their competitive position overall relies on an excellent portfolio of intellectual property that has placed it in the top 10 medical device firms as ranked by the Patent Board. Furthermore, the oligopolistic structure of their market puts St. Jude’s in a strong position to acquire any startups that present an opportunity to strengthen their product portfolio.

### Financial Statement Analysis

Examining St. Jude’s income statement, we see a few troubling signs. Revenue growth has stagnated since peaking in 2011. Furthermore, operational efficiency has steadily declined with cost of sales at a five-year high and net income as a percentage of revenue at a five-year low.

Their balance sheet also shows some red flags. For instance, growth in liabilities has strongly outpaced growth in property, plant and equipment, with intangible asset growth failing to reconcile the difference.

On a positive note, the company’s cash balances have been improving over the last five years. This has led to healthy dividend growth and significant share repurchases a welcome sign for investors.

### Conclusion & Recommendation

Overall, St. Jude’s medical is a strong company experiencing a slight slowdown in their business coming out of 2013. While this would typically be a good time to buy the stock, the market has sent it flying up well over 50 percent since being acquired by the portfolio. Keeping this in mind, a valuation slightly short of the current share price means that we must recommend that the portfolio realize its gains and sell their holdings of St. Jude’s Medical.



## UnitedHealth Group, Inc. UNH

| Recommendation | Valuation | Last Price | As of      | Style      | Dividend Yield |
|----------------|-----------|------------|------------|------------|----------------|
| Sell           | \$80.00   | \$81.62    | 03/28/2014 | Large Core | 1.50%          |

### Technical Analysis

|                          |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

UnitedHealth Group, Inc. is a Minnesota-based diversified health company that offers a wide range of health plans to individuals, small- to large-sized businesses, and the public sector. The company employs 156,000 people and posted FY2013 revenues of \$122.5 billion.

### Fundamental Analysis

United Health is one of the largest Managed Care Organizations (MCO) in the marketplace, a significant factor in today's health care environment, which appears to be rewarding the economies of scale brought about through consolidation. This large reach allows it to participate in many of the newly established health care exchanges nationwide, providing an excellent opportunity for growing its revenue base. Furthermore, these

economies of scale also translate into better pricing strategies, a necessary factor in the coming years as pressures to cut costs mount for MCO's.

However, not all factors relating to the ACA implementation are a net positive for United Health. Their status as the largest player in Medicare Advantage and Medicaid programs puts them in the position of having the most to lose as pressures to reign in reimbursements continues.

### Financial Statement Analysis

An analysis of their income statement shows healthy revenue growth and relatively stable margins. However, common-size analysis reveals that selling, general, and administrative expenses have been on the rise as a proportion of revenues, highlighting the need for expansion into higher-margin lines of business or an increased focus on cost cutting.

A major standout on their financial statements is the significant ramping up of share repurchases in the last few years. While it is impossible to discern the exact impact on their share price this has had, we can assume that these repurchases cannot continue to increase indefinitely and as such, their impact on the stock price will begin to trail off.

### Conclusion & Recommendation

While United Health shows healthy revenues and real growth prospects as the ACA solidifies in the health care landscape, their outsize gains in the market of 2013 as well as their realization of their valuation gives us ample reason to recommend that the portfolio sell its holdings of United Health.

## WellPoint Inc. WLP

| Recommendation | Valuation | Last Price | As of      | Style      | Dividend Yield |
|----------------|-----------|------------|------------|------------|----------------|
| Sell           | \$100.00  | \$97.62    | 03/28/2014 | Large Core | 1.81%          |

### Technical Analysis

|                          |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

WellPoint Inc. is an Indiana-based managed care organization that offers a wide range of health plans to individuals, small- to large-sized businesses, and the public sector. The company employs 48,200 people and posted FY2013 revenues of \$71 billion.

### Fundamental Analysis

Similar to United Health, WellPoint is also a large-scale managed care organization with significant geographic reach. With a customer base of 35 million as well as operations under the Blue Cross/Blue Shield brand name in 14 states, WellPoint has the advantage of significant name recognition. These factors strongly contribute to the kind of economic moat necessary to be a successful MCO in a post-ACA healthcare market.

A major factor that must be considered in determining an investment decision for WellPoint is its history of underperformance. A new CEO has been brought on, as of late 2013, which, combined with the release of 2013 financials, appears to have increased confidence in the stock as it has gained 10 percent in the last month alone.

### Financial Statement Analysis

An analysis of their income statement shows the clear impact of new management. This past year, revenues were up nearly 20 percent from 2012, and while top-line growth has outpaced profits, a strategy of aggressively expanding market share at the cost of profits is likely to serve them well in the coming years as cost pressures on MCO's mount and only the largest will be able to deliver economic profits.

### Conclusion & Recommendation

WellPoint's underperformance in recent years has been offset by its significant share repurchases that have undoubtedly buoyed the stock price. With that trend on the decline and new management in place, the pressure is on for WellPoint to finally live up to its potential and provide value that is more substantial.

WellPoint's realization of their underlying value through substantial gains on the market in 2013 signals us to recommend that the portfolio sell its holdings of WellPoint.



## Industrials

### Overview

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The industrial sector encompasses a wide range of industrial firms that supply the machinery, equipment, parts, and services that other companies use to operate in their businesses.

Following the 2007–09 economic recession, manufacturing-specific indicators began to show year-over-year improvements in late 2009, as did revenue and earnings figures for industrial companies. In 2010, industrial machinery companies built on this momentum as the economic recovery gained steam, leading to improved sales and earnings for the group. Acceleration in the pace of growth continued into early 2011. However, as concerns about world economic growth and rising commodity prices increased, the pace of growth began to slow.

Economic concerns have heightened through mid-2012, with a number of European economies in recession and growth slowing in both the U.S. and emerging markets. We believe the implementation of across-the-board cuts that came with sequestration in March 2013 had a negative impact on the economic recovery as U.S. companies delayed orders and revenues slowed among large industrial companies. However, we note that even in the face of all these obstacles, industrial machinery companies have continued to grow.

### Fundamental Outlook

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Demand for industrial machinery is forecast to pick up as downstream industries regain profit and increase production. However, we view the recent slowing in global economic growth, along with recessionary conditions in Europe, as significant headwinds for companies in the industry. In our view, positive factors include continued economic growth in the U.S. and in the emerging markets, especially in Asia and Latin America. We expect manufacturing and machinery usage to expand this year in the U.S., and we believe that over the longer term, developing regions should drive industrial machinery growth.

### Conclusion and Recommendation

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The fundamentals outlook for Industrials sector is somewhat positive. We also note that historically industrials sector has performed well in early days of economic recovery. Overall, we see the economic situations conducive to industrials sector. We believe this sector will outperform the overall market.

## Altra Industrial Motion Corp. AIMC

| Recommendation | Valuation | Last Price | As of      | Style      | Dividend Yield |
|----------------|-----------|------------|------------|------------|----------------|
| Sell           | \$34.23   | \$34.52    | 03/28/2014 | Small Core | 1.93%          |

| Technical Analysis     |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Neutral  |
| <b>Money Flow</b>      | Negative |



### Introduction

Altra Holdings, Inc., through its subsidiary, Altra Industrial Motion, Inc., designs, produces, and markets a range of mechanical power transmission and motion control products worldwide. The company's product offerings include industrial clutches and brakes for elevators, forklifts, lawn mowers, oil well draw works, ethanol mixers, packaging machinery, turbines, steel strip mills, and pumps. It also offers engineered bearing assemblies for cargo rollers, power transmission components, and engineered belted drives. The company sells its products under multiple brands through its sales force, industrial distributors, and independent sales representatives. It serves aerospace, energy, food processing, general industrial, material handling, mining, petrochemical, transportation, and turf and garden markets.

Altra Holdings, Inc. is headquartered in Braintree, Massachusetts.

### Fundamental Analysis

Our fundamental outlook for the industrial machinery sub-sector is very positive. However, this positive trend was not the case for Altra as sales declined by (1.37 percent) from 2012 to 2013. This decline in revenue is attributed to the decrease in orders from mining companies as major customers put a hold on capital expenditures as they pause to see if commodity prices rise in 2014.

### Financial Statement Analysis

We expect Altra's revenue will continue to decline or remain relatively flat throughout 2014. With little ground to gain in a saturated and highly competitive industry substantial growth in volume is not foreseen.

The company's dividend yield grew by 1 percent.

### Conclusion & Recommendation

Using a discounted cash flow model, we believe that Altra is no longer undervalued and we recommend selling our position in this company. Our intrinsic value of Altra stock is \$32.23. This price is moderately lower than the stock's current price and we have a prime opportunity to cash out on our investments. We also do not find the potential cash flow to shareholders to be sufficient to warrant holding our position.

## 3M Company MMM

|                               |                              |                               |                            |                            |                                |
|-------------------------------|------------------------------|-------------------------------|----------------------------|----------------------------|--------------------------------|
| <b>Recommendation</b><br>Hold | <b>Valuation</b><br>\$186.69 | <b>Last Price</b><br>\$134.20 | <b>As of</b><br>03/28/2014 | <b>Style</b><br>Large Core | <b>Dividend Yield</b><br>2.52% |
|-------------------------------|------------------------------|-------------------------------|----------------------------|----------------------------|--------------------------------|

| Technical Analysis     |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Neutral  |
| <b>Money Flow</b>      | Positive |



### Introduction

3M Co. is a global manufacturer operating a broadly diversified business. The company classifies its business into six reportable segments -- Industrial and Transportation, Health Care, Display and Graphics, Consumer and Office, Electro and Communications, and Safety, Security and Protection. The company's products involving some form of coating, sealant, adhesive, film, or chemical additive that increases the product's overall functionality and usability for consumers.

The company is formerly known as Minnesota Mining and Manufacturing Company, was founded in 1902 and is based in St. Paul, MN.

### Fundamental Analysis

We see economic conditions in the U.S. as moderately growing and see emerging markets as potential catalysts for the 3M's revenue in 2014. The company is well poised to benefit from early to mid-stages of economic recovery, which tends to generate heightened industrial output and hence demand for 3M's products.

The company's performance in 2013 was strong with none of its divisions losing money. We are even more optimistic about 3M's performance in 2014 in light of continuing economic recovery. 3M invests heavily in research and development and maintains 40 separate technology platforms that insulate it from geographic or economic issues.

We also anticipate significant acquisitions and stock repurchase by 3M in 2014. Risks to our recommendation include a slowing down of the global economy, particularly in emerging markets such as Asia and Latin America, as well as acquisition risks.

Considering dividends, the Crummer SunTrust portfolio's return on investment in 3M Company in 2013 was 51 percent.

### Financial Statement Analysis

We note that the company's operating margins were over 21 percent in five of six business segments on 3M, with some sectors posting substantially higher margins. These margin levels represent strong profitability in this industry. We project sales to grow throughout 2014 due to volume increases and productivity enhancements.

### Conclusion & Recommendation

Favorable economic conditions will allow 3M Company to benefit from its already strong position in many of the markets it serves. Moreover, the management has demonstrated ability to convert cash flow to strong earnings and dividends.

We estimate the intrinsic value of 3M stock at \$186.69, which is over 20 percent above its current market price of \$134.60. This, combined with strong dividends and lower risk make 3M Company an attractive investment choice and we recommend holding this stock.

## FedEx Corporation FDX

| Recommendation | Valuation | Last Price | As of      | Style        | Dividend Yield |
|----------------|-----------|------------|------------|--------------|----------------|
| Buy            | \$165.22  | \$132.01   | 03/28/2014 | Large Growth | 0.45%          |

### Technical Analysis

|                        |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Neutral  |
| <b>Money Flow</b>      | Positive |



### Introduction

FedEx Corporation provides transportation, e-commerce, and business services in the United States and internationally. It operates in four segments: FedEx Express, FedEx Ground, FedEx Freight, and FedEx Services. In addition, FedEx offers supply chain solutions, which include critical inventory logistics, transportation management, and temperature-controlled transportation services. The FedEx Corporation was founded in 1971 and is headquartered in Memphis, Tennessee.

### Fundamental Analysis

FedEx is known for its speedy overnight delivery of parcels. It has been able to build on its core strength by increasing the variety of services it offers customers. FedEx has also shown that it is capable of keeping pace with demand by adding additional capacity to handle higher volumes of shipments.

The company possesses a distinctly wide moat, as it would be difficult for a competitor to duplicate its vast international shipping network. This unique advantage is

evidenced by the departure of competitor DHL from the U.S. domestic parcel delivery market in 2009. Despite the expected rise in fuel prices, we foresee FedEx to continue to exploit its competitive advantage.

Risks for FedEx are its exposure to international/global trade downturns as well as political interference with its business.

Capital expenditures are also a threat as FedEx operates in an industry that is known for being highly capital intensive with the replacement and the maintenance of aircraft. Despite being in a capital-intensive environment, we believe that FedEx will be able to offset this high cost segment of its business by focusing on higher margin ground operations.

### Financial Statement Analysis

Company net margins have remained consistent over the last four years at around 4 percent, which is relatively in line with the industry average. Although the dividend yield for FedEx is below the industry average, after taking into account share repurchases expected in 2014, we foresee substantial cash flow to shareholders.

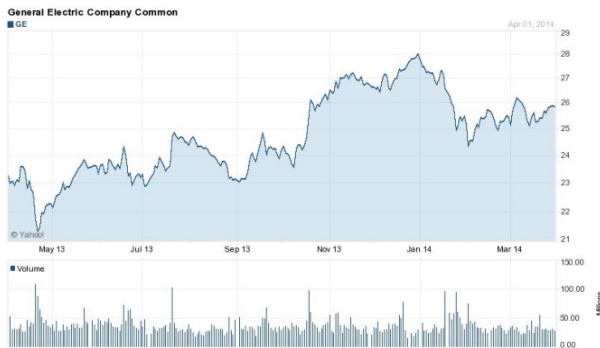
### Conclusion & Recommendation

Given FedEx's distinct competitive advantage, wide moat, ability to shift capacity to higher margin operations, and substantial cash flow to shareholders in the form of repurchases we believe FedEx is a strong buy for 2014. Further reinforcing our recommendation, our intrinsic valuation of FedEx is \$165.22, 20 percent above the current price of \$132.01.

# General Electric GE

| Recommendation | Valuation | Last Price | As of      | Style       | Dividend Yield |
|----------------|-----------|------------|------------|-------------|----------------|
| Sell           | \$18.75   | \$25.88    | 03/28/2014 | Large Value | 3.15%          |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Neutral  |
| Money Flow         | Positive |



## Introduction

General Electric Company operates as an infrastructure and financial services company worldwide. It was founded in 1892 and is headquartered in Fairfield, Connecticut.

The company does business through eight segments: Power and Water, Oil and Gas, Energy Management, Aviation, Healthcare, Transportation, Home and Business Solutions and GE Capital. The company’s product offering across all segments include turbines, surface and subsea drilling and production systems, nuclear reactors, electrical distribution and control products, lighting and power panels, hardware, software, jet engines, turboprop and turbo shaft engines, medical imaging and information technologies, freight and passenger locomotives, underground mining equipment, commercial and home loans, credit cards, etc.

## Fundamental Analysis

In 2013, GE saw a decline in revenue by 1 percent which can be attributed to the decline revenue from GE Capital. It is worth noting that GE revenues have remained largely flat since their decline in 2008. Although GE is an industry leader in manufactured industrial goods we believe that it is becoming easier for firms to compete with GE as programs like Six Sigma and lean manufacturing are becoming more available to GE competitor’s which could reduce its low cost advantage. In addition, GE’s earnings are likely to become more cyclical following their departure from NBC Universal.

## Financial Statement Analysis

We expect GE’s revenue will continue to decline or remain relatively flat throughout 2014. With little ground to gain in a saturated and highly competitive industry substantial growth in volume in not foreseen.

## Conclusion & Recommendation

GE has historically paid a 3.48 percent dividend to its investors. Yet despite this dividend, we have valued GE at \$18.75 using a discounted cash flow model. Given that GE will likely not repurchase any shares in 2014, as it spins off its private label credit card operations, our intrinsic valuation does not support holding our position.

Our recommendation is to sell our holdings in General Electric.

# Honeywell International, Inc. HON

| Recommendation | Valuation | Last Price | As of      | Style        | Dividend Yield |
|----------------|-----------|------------|------------|--------------|----------------|
| Buy            | \$110.15  | \$90.89    | 03/28/2014 | Large Growth | 1.93%          |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Neutral  |
| Money Flow         | Positive |



## Introduction

Honeywell International Inc. operates as a diversified technology and manufacturing company worldwide. It operates in four major segments that include Aerospace, Automation and Controls, Performance Materials and Technologies, and Transportation Systems.

Honeywell International Inc. was founded in 1920 and is headquartered in Morris Township, New Jersey.

## Fundamental Analysis

Honeywell International Inc. is a strongly diversified industrial company that has spread its resources across a variety of promising businesses. Instead of competing directly with industry giants like GE and United Technologies, Honeywell has carved out a niche for itself in the regional jet aircraft arena. A recent win in the Aviation Segment is the supplying of major mechanical systems for the Airbus A350.

In addition, Honeywell has continued investing in its Automation and Control segment and has seen significant growth as a result. Its Performance materials and Technology segment has recently introduced a process that helps refiners make gasoline out of thicker crude

oil. Demand in these areas will help Honeywell maintain a healthy rate of growth.

The greatest feat however for HON in the last decade has been the restructuring of internal operations to improve productivity by the Honeywell Operating System. Since the implementation began, operating margins have widened as efficiencies strengthened and less profitable business units sold off. What is left is a more potent and profitable organization.

Risks for Honeywell include the inherent cyclical nature of the industrial industry. There is also the risk of a downturn in the global economy.

## Financial Statement Analysis

Company net margins have consistently improved over the last four years with 2013 seeing an increase from 7.8 percent in 2012 to 10.05 percent. The forecasted trend through 2017 is that margins will reach 14.5 percent as Honeywell completes the implementation of the Honeywell Operating System.

Cash flow to shareholder has been around 1.93 percent and share repurchases are expected to continue into 2014 as Honeywell authorized a \$5 billion share buy-back program after successfully completing a \$3 billion buy-back program that began in 2011.

## Conclusion & Recommendation

Given Honeywell's broad international diversification and distinct competitive advantage within select industrial segments, we recommend that the portfolio invest in this company. Our intrinsic valuation of Honeywell is \$110.15, which is 20 percent above the current price of \$90.89.

## Metso Oyi MXCYY (ADR)

|                               |                             |                              |                            |                               |                                |
|-------------------------------|-----------------------------|------------------------------|----------------------------|-------------------------------|--------------------------------|
| <b>Recommendation</b><br>Sell | <b>Valuation</b><br>\$32.25 | <b>Last Price</b><br>\$32.07 | <b>As of</b><br>03/28/2014 | <b>Style</b><br>International | <b>Dividend Yield</b><br>2.95% |
|-------------------------------|-----------------------------|------------------------------|----------------------------|-------------------------------|--------------------------------|

| Technical Analysis     |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Neutral  |
| <b>Money Flow</b>      | Negative |



### Introduction

Metso Oyj is a supplier of technology and services to process industries, including mining, construction, pulp and paper, power, and oil and gas. Company’s product and services portfolio includes products across three segments. The Mining and Construction segment offers technology, processes, machinery, and services for mining and minerals processing industry including products for crushing, feeding, grinding, separation, slurry pumping and pyro processing. The Automation segment supplies industry process flow control solutions and services such as quality controls, automated laboratory testing, consistency transmitters and ESD valve products. The Pulp, Paper and Power segment supplies processes, machinery and services for the pulp, paper, and power industries including products for wood handling, chemical pulping, etc. The company also engages in automotive business.

Metso Oyj is headquartered in Helsinki, Finland.

### Fundamental Analysis

Uncertainty in the mining industry during 2013 negatively affected Metso’s orders from customers. Metso has recently spun off their paper-machines unit after succumbing to pressure from Carl Icahn. A wise cost cutting maneuver, however the results will not be recognized until demand for industrial mining equipment returns in 2015.

### Financial Statement Analysis

Growth in net income over the last three years has been a disappointing 4.7 percent with an industry average of 24.3 percent. Metso Oyi, including dividends, returned a modest 6 percent to the Crummer SunTrust portfolio in 2013.

### Conclusion & Recommendation

Our 12-month estimate of Metso does not exceed \$32.25. Despite a strong dividend yield of 2.95 percent, Metso does not meet our investment policy standard with an intrinsic value 20 percent below the current market price.

Our recommendation is to sell our holdings in Metso Oyi.



# Paychex, Inc. PAYX

|                               |                             |                              |                            |                          |                                |
|-------------------------------|-----------------------------|------------------------------|----------------------------|--------------------------|--------------------------------|
| <b>Recommendation</b><br>Hold | <b>Valuation</b><br>\$51.40 | <b>Last Price</b><br>\$42.56 | <b>As of</b><br>03/28/2014 | <b>Style</b><br>Mid Core | <b>Dividend Yield</b><br>2.53% |
|-------------------------------|-----------------------------|------------------------------|----------------------------|--------------------------|--------------------------------|

| Technical Analysis     |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Neutral  |
| <b>Money Flow</b>      | Negative |



## Introduction

Paychex, Inc. provides comprehensive payroll and integrated human resource and employee benefits outsourcing solutions for small-to-medium-sized businesses in the United States. The Company’s services range from calculating payroll and filing tax payments to administering retirement plans and workers’ compensation.

## Fundamental Analysis

Paychex provides easy to use solutions for companies to outsource their human resources departments. They provide three main categories for business, which include Payroll and Taxes, HR and Employee Benefits. The first category is self-explanatory; HR includes hiring, compliance and management. The third is comprised mainly of savings and insurance plans.

Paychex is a medium-sized company that focuses on small-to-medium-sized businesses, which gives it greater pricing power to take on new clients, increasing gross margins. At the same time, high customer switching costs has allowed the Paychex to raise prices annually at a rate above that of inflation. With the economy slowly recovering, Paychex will see modest growth to its client base due to the inexperience of new business owners in HR management. In addition, Paychex and its main rival, ADP, make up about 40 percent of the payroll outsourcing industry, positioning the company for significant growth opportunities moving forward.

## Financial Statement Analysis

Revenue has increased modestly from 2010 to 2013 at roughly 7 percent. With a small force of employees, Paychex has earned a little over \$2.3 billion in revenues for 2013. The \$2.3 billion in sales translated into a net income of \$569 million, up roughly 3.8 percent from 2012. With an after tax margin around 24.5 percent, Paychex is in good position expand its business in the coming future as the economy continues to recover. We expect sales to continue to grow at around 7 percent. This expected sale growth combined with a high dividend yield justifies maintaining our position in Paychex, Inc.

## Conclusion & Recommendation

Through a simple dividend discount model using a historic growth rate of 5.3 percent, Paychex is undervalued by 20 percent and we recommend holding this position for another year.



## Snap-on Inc. SNA

| Recommendation | Valuation | Last Price | As of      | Style    | Dividend Yield |
|----------------|-----------|------------|------------|----------|----------------|
| Hold           | \$141.04  | \$111.80   | 03/28/2014 | Mid Core | 1.57%          |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Neutral  |
| Money Flow         | Positive |



### Introduction

Snap-on Inc. is a major global manufacturer and marketer of high-quality tool, diagnostic, service and equipment solutions for professional tool and equipment users under various brands and trade names. Products and services include hand and power tools, tool storage, diagnostics software, information and management systems, shop equipment, and other solutions for vehicle dealerships and repair centers, as well as for customers in areas including aviation, aerospace, agriculture, construction, government and military, mining, natural resources and power generation. The company also derives income from financing programs used to facilitate the sale of its products. SNA services these customers primarily through the mobile van channel; company direct sales; distributors; and e-commerce.

Snap-on Incorporated was founded in 1920 and is headquartered in Kenosha, Wisconsin. The company sells its products in 130 countries.

### Fundamental Analysis

We believe that modest global economic growth will lead to higher order rates and sales across SNA's segments.

On a geographic basis, we see the largest sales improvement in emerging markets, which continue to record stronger economic gains than those in developed markets (with sales declines likely to be posted in Europe in the near term). On a segment basis, we expect the biggest gains in the Snap-On Tools segment, where SNA has taken actions to expand its market share in serving the franchised dealer van channel.

Considering dividends, the Crummer SunTrust portfolio's return on investment in SNA in 2013 was impressive 39.89 percent.

Risks SNA faces in 2013 include the possibility of a renewed global recession, failure to introduce successful new products, as well as rising fuel costs for its franchise fleet.

### Financial Statement Analysis

Company net margins were at 11 percent in 2013, which is in line relative to competitors, and trends suggest it will continue to improve. This reflects the ongoing effort by SNA's management to reduce cost and transform into a leaner organization.

SNA's dividend yield is lower than its competition in the industrial sector. However, SNA has been generous by increasing dividends year over year and will likely continue its share repurchase program into 2014.

### Conclusion & Recommendation

SNA's fundamentals are strong and we expect 7 percent growth in revenue, after posting 4 percent gains in revenue in 2013. We anticipate similar improvements in earnings.

Our intrinsic values for SNA of \$141.04 suggests it is significantly undervalued. We also note that most indicators are pointing in the right direction for SNA, and it should repeat its impressive 2013 performance.

We recommend holding our investment in SNA.

# TAL International Group, Inc. TAL

|                               |                             |                              |                            |                             |                                |
|-------------------------------|-----------------------------|------------------------------|----------------------------|-----------------------------|--------------------------------|
| <b>Recommendation</b><br>Sell | <b>Valuation</b><br>\$35.89 | <b>Last Price</b><br>\$41.97 | <b>As of</b><br>03/28/2014 | <b>Style</b><br>Small Value | <b>Dividend Yield</b><br>6.27% |
|-------------------------------|-----------------------------|------------------------------|----------------------------|-----------------------------|--------------------------------|

| Technical Analysis     |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Neutral  |
| <b>Money Flow</b>      | Negative |



## Introduction

TAL International Group, Inc. is a lessor of intermodal containers and chassis. The Company has two segments:

- Equipment Leasing, in which the Company owns, leases and disposes containers and chassis from its lease fleet, as well as manages containers owned by third parties, and
- Equipment Trading, in which the Company purchases containers from shipping line customers, and other sellers of containers, then resells these containers to container traders and users of containers for storage or one-way shipment.

TAL International Group, Inc. was founded in 1963 and is headquartered in Purchase, New York.

## Fundamental Analysis

The fundamental outlook for TAL international group is not very positive. Although accelerated recovery in North American have driven global trade higher, the benefits of this increased trade was only short lived for TAL. As seen in the chart TAL’s stock price peaked in late December 2013. Since then TAL suffered losses due to an inability to renew many leases, rising interest costs, as well as rising depreciation costs.

The forward outlook for the shipping container industry is not promising either. Consolidation in the industry, as companies such as Maersk and CMA begin working together to put empty containers on each other’s ships, has allowed for the more efficient use of assets. As a result, there is less of a demand for shipping container-leasing companies.

## Financial Statement Analysis

Company net margins have declined from 2012 to 2013 by 8 percent. In addition, the company’s debt to equity is on the rise and is currently at 4.1 versus and industry average of 3.2.

## Conclusion & Recommendation

Given out outlook of the shipping container-leasing industry and the decline in margins for TAL, we recommend selling our holdings of this company.

## Information Technology

### Growth in IT budgets will create demand for application software

The growth in business investment in information technology is set to outpace the growth in total business investment. Recovering from its slow pace of growth in 2013, spending on IT is expected to increase in 2014. Software spending by both businesses and governments is expected to be the largest IT expenditure of 2014. Rapid transformation in business technology is forcing businesses that have been postponing capital IT expenditures to increase expenditures going into 2014. Even though some businesses are hesitant to increase capital spending, large cash balances will likely motivate highly competitive businesses to reinvest cash in software applications such as cloud-based software and data security.

### Software as a Service companies are creating a tech bubble

Software as a Service (SaaS) is a form of cloud computing that allows businesses to access software through the internet. SaaS currently has market share of 15 percent and we expect this to triple over the next decade. Since SaaS software can easily be replicated within a moderate timeframe, SaaS companies are currently facing an intensified threat of new entrants. This growing threat will influence more firms to enter the SaaS market as overall market share increases. An increase in competition will drastically lower the stock price of SaaS firms that are currently trading with a high premium. In the past two years, the value of publicly traded SaaS companies has grown by 200 to 400 percent, while the underlying sales efficiency of marketing and sales reinvestments for those businesses has remained stagnant. From 2004 to 2011, the average publicly traded SaaS company held an EV/Revenue multiple of 3 to 5x. Since 2011, that figure has been multiplied by 4 to 7 times. Today, those ratios stand at 12 to 20x EV/Revenue. We expect the SaaS tech bubble to experience significant headwinds in 2014.

### Cyber Security is poised for growth in 2014

Data security is becoming an increasing concern as more businesses migrate to the cloud and large-scale cyber-attacks increase. Since interaction with cloud-based software requires connecting to an external server, confidential business data cannot be internally monitored. This is forcing cloud-based tech companies, such as SaaS companies, to increase their data security in order to mitigate the risk of losing customers over a cyber-attack. The cybercrime network is expanding, strengthening, and increasingly operating like any legitimate, sophisticated business network. Malicious exploits are gaining access to web hosting servers, name servers, and data centers. This suggests that hackers are seeking to exploit high-reputation and resource-rich assets. The increasing threat of cybercrime is forcing businesses to increase data security going into 2014. We expect global cyber security spending to grow at an estimated annual growth rate of 12 percent in 2014.

### A mobile-centric approach with personal clouds

Cloud computing is the ability for both personal and professional users to store data on the internet without the need for owning servers. Cloud computing is expected to gain even more momentum in 2014 as consumers and employees are increasingly accessing their personal clouds through mobile devices. Last year, many dominant cloud-computing companies devoted significant research and development measures to ensure long-term market share in cloud technologies. IT companies that have been establishing a foothold in the cloud computing industry are poised for growth in 2014.

The chart below illustrates how the S&P 500 Information Technology Index (in blue) has outpaced the S&P 500 (in green).



# Apple, Inc. AAPL

|                              |                              |                               |                            |                            |                                |
|------------------------------|------------------------------|-------------------------------|----------------------------|----------------------------|--------------------------------|
| <b>Recommendation</b><br>Buy | <b>Valuation</b><br>\$644.58 | <b>Last Price</b><br>\$536.86 | <b>As of</b><br>03/28/2014 | <b>Style</b><br>Large Core | <b>Dividend Yield</b><br>2.27% |
|------------------------------|------------------------------|-------------------------------|----------------------------|----------------------------|--------------------------------|

| Technical Analysis     |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Neutral  |
| <b>Money Flow</b>      | Positive |



## Introduction

Apple Inc. designs, manufactures, and markets personal computers and mobile communication devices along with a variety of related software, services, peripherals and networking solutions. The Company sells its products worldwide through its online stores, retail stores, direct sales force, third-party wholesalers, and resellers.

## Fundamental Analysis

Apple's strength lies in its ability to integrate hardware and software into mobile devices. Short product life cycles and high premiums have swayed some Apple customers to the Android platform. However, Apple still maintains a loyal customer following. Switching costs associated with Apple's iOS platform are diminishing as Android devices are increasingly being designed to ease the burden of switching platforms.

Within the last 15 months, Apple has acquired 20 relatively small tech companies. Apple spent \$525 million

on acquisitions, nearly double, what it spent in the same period a year ago. These mini acquisitions can point towards what Apple intends to do with its product line. One of Apple's biggest acquisitions last year was a company called PrimeSense. PrimeSense developed sensors that allows the user to control software through body movements. We believe this technology will be applied to an Apple television set.

Apple's flagship product, the iPhone, is likely to be updated in the 3<sup>rd</sup> quarter of this year. There are rumors that the new iPhone will have a larger screen and come in two sizes. Having multiple sizes and a larger screen will help Apple to compete with the diverse line of Android mobile phones.

## Financial Statement Analysis

Apple's stock price has risen since May 2013, showing that there is positive momentum for the company going in 2014. However, the growth of Apple's profit has slowed in the past year. Declining profits were a result of lackluster iPhone 5s follow up sales in the 1<sup>st</sup> quarter of 2014. We project that iPhone 6 sales will help boost Apple's stock price.

## Conclusion & Recommendation

Through a dividend discount model, using price of computers and peripheral equipment as a growth driver, the company is attractively undervalued and we recommend an increase in the position.

## CA, Inc. CA

|                               |                             |                              |                            |                          |                                |
|-------------------------------|-----------------------------|------------------------------|----------------------------|--------------------------|--------------------------------|
| <b>Recommendation</b><br>Sell | <b>Valuation</b><br>\$31.81 | <b>Last Price</b><br>\$30.84 | <b>As of</b><br>03/28/2014 | <b>Style</b><br>Mid Core | <b>Dividend Yield</b><br>3.24% |
|-------------------------------|-----------------------------|------------------------------|----------------------------|--------------------------|--------------------------------|

| Technical Analysis     |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Negative |
| <b>Money Flow</b>      | Negative |



### Introduction

CA, Inc. designs, develops, markets, licenses, and supports standardized computer software products. The Company's products are used with mainframe computers and in client/server environments. CA offers various enterprise systems management, information management, and SaaS business applications solutions to a variety of organizations.

### Fundamental Analysis

At first glance, CA may appear to have room for growth, but legacy products may limit its future options. CA draws its strength from high switching costs associated with replacing entrenched IT operations. In addition, limited substitutes in the marketplace make it difficult for businesses with large-scale IT operations to find suitable competitors. With limited competition and a

lack of new entrants, CA has been able to entrench its market leadership in mainframe services, with profit margins averaging 60 percent. However, the mainframe business will continue to experience sluggish growth moving forward.

Increasing research and development on supporting multiple versions of older legacy product may hurt CA in the long run. Overspending on legacy products will hamper new product innovations. Assuming that most business will increase IT expenditures in 2014, high switching cost may be negated by the competitive advantage of new technologies.

### Financial Statement Analysis

According to Morningstar, mainframe solutions contributed 54 percent to total revenue, Enterprise Solutions 38 percent, and Services 8 percent. Revenue declined \$171 million from fiscal year 2012 to 2013. Cost of revenue only declined \$5 million from fiscal year 2012 to 2013. We project revenue to continue on its downward trajectory going into 2014. CA repurchased \$493 million worth of shares in 2013. At March 31, 2013, the Company remained authorized to purchase approximately \$505 million of its common stock under its current stock repurchase program.

### Conclusion & Recommendation

Using a simple dividend discount model, CA is marginally undervalued. We recommend a sell position because CA has fully realized its potential value.

## Cadence Design Systems, Inc. CDNS

| Recommendation | Valuation | Last Price | As of      | Style      | Dividend Yield |
|----------------|-----------|------------|------------|------------|----------------|
| Buy            | \$18.98   | \$15.40    | 03/28/2014 | Mid Growth | -              |

### Technical Analysis

|                        |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Positive |
| <b>Money Flow</b>      | Positive |



### Introduction

Cadence Design Systems, Inc. provides software technology, design and consulting services technology. The Company licenses its electronic design automation software technology and provides a variety of professional services. Cadence's design realization solutions are used to design and develop complex chips and electronic systems.

### Fundamental Analysis

Cadence Design Systems, Inc. holds its competitive in electronic design automation (EDA) tools that are used in semiconductor manufacturing. The expanding range of uses for microchips in 2014 will drive demand for EDA developers. High barriers to entry in the EDA market allows Cadence to maintain its relatively high economic moat. Because it is extremely capital intensive for new companies to develop the scale and resources to design comparable products, Cadence will be able to maintain its economic moat in 2014.

During 2013, Cadence hired an additional 700 employees worldwide, mostly for research and development functions. Expansion in research and development is vital for Cadence's future performance, given that future growth largely depends on its ability to enhance its current product offerings. However, Cadence is prone to risk with its large research and development expenditures, as chipmakers will scale back during an economic lull. We believe this risk will not be a major problem for Cadence because of consumers demand for new mobile devices that require complex electronic systems. Cadence also pursued external growth through the acquisition of Forte Design Systems in February 2014. Forte Design Systems enabled Cadence to have access to a product called Cynthesizer. Cynthesizer is a highly advance tool used by high-level designers in hardware architecture.

### Financial Statement Analysis

As of December 2013, Cadence had no long-term debt and \$536 in cash and cash equivalents. Cash and cash equivalents declined \$190 million from fiscal year 2012 to 2013 due to hiring new employees and acquiring Forte Design Systems. Cadence was able to grow its revenues from 2012 to 2013 by 10.10 percent, while revenue for the semiconductor industry only grew 5.2 percent.

### Conclusion & Recommendation

Through using a free cash flow analysis Cadence Design Systems is attractively undervalued. We recommend a buy position for Cadence, due to the company's strong competitive advantage and research and development initiatives.



# EMC Corporation EMC

|                               |                             |                              |                            |                            |                                |
|-------------------------------|-----------------------------|------------------------------|----------------------------|----------------------------|--------------------------------|
| <b>Recommendation</b><br>Hold | <b>Valuation</b><br>\$33.06 | <b>Last Price</b><br>\$27.48 | <b>As of</b><br>03/28/2014 | <b>Style</b><br>Large Core | <b>Dividend Yield</b><br>1.44% |
|-------------------------------|-----------------------------|------------------------------|----------------------------|----------------------------|--------------------------------|

| Technical Analysis     |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Neutral  |
| <b>Money Flow</b>      | Positive |



## Introduction

EMC Corporation develops and delivers information infrastructure and virtual infrastructure technologies, solutions and services. The Company manages its business in two broad categories: EMC Information Infrastructure and VMware Virtual Infrastructure. EMC Information Infrastructure provides a foundation for organizations to store, manage, protect, analyze and secure ever-increasing quantities of information. EMC's VMware Virtual Infrastructure business, which is represented by EMC's majority equity stake in VMware, Inc., engaged in virtualization cloud infrastructure solutions utilized by organizations to help them transform the way they build, deliver and consume IT resources.

## Fundamental Analysis

EMC's leading position in the network storage industry and 80 percent ownership of VMware make the firm a major player among cloud infrastructure solutions. However, EMC does faces the possible threat of other

cloud computing companies gaining market share, as cloud computing becomes more mainstream. We believe that EMC's strong sales force will enable EMC to compete aggressively as competition expands. In addition to an aggressive sales force, EMC also maintains its competitive advantage in high switch costs associated with migrating data storage platforms. EMC will be able to leverage its existing assets to capitalize on IT spending in 2014.

## Financial Statement Analysis

Offsetting EMC's otherwise solid balance sheet is \$5.4 billion in long-term debt and \$1.6 billion in short-term debt. EMC used \$770 million of its debt holdings to finance EMC's acquisitions. EMC's net income growth during the past 3 years has outpaced the industry average by 11 percent. Given the cyclicity of hardware revenue and increasing competitive pressures going into 2014, we believe EMC's net income growth will face some headwinds. However, EMC's earnings are still poised to be well ahead of its industry peers in 2014.

In 2013, the company paid out \$415 in dividends, and repurchased \$3.7 billion of EMC and VMware shares. We agree with Morningstar's projection that EMC will increase its dividend over the coming years.

## Conclusion & Recommendation

Using a free cash flow analysis, with a short-term growth rate of 9.6 percent, we believe that EMC is still attractively undervalued. However, we recommend a hold position because EMC's future value may not be fully realized due to the cyclicity of the hardware revenue in 2014.



## International Business Machines IBM

|                               |                              |                               |                            |                             |                                |
|-------------------------------|------------------------------|-------------------------------|----------------------------|-----------------------------|--------------------------------|
| <b>Recommendation</b><br>Sell | <b>Valuation</b><br>\$186.50 | <b>Last Price</b><br>\$190.45 | <b>As of</b><br>03/28/2014 | <b>Style</b><br>Large Value | <b>Dividend Yield</b><br>1.95% |
|-------------------------------|------------------------------|-------------------------------|----------------------------|-----------------------------|--------------------------------|



### Introduction

IBM Corporation provides computer solutions using advanced information technology. The Company’s solutions include technologies, systems, products, services, software, and financing. IBM offers its products through its global sales and distribution organization, as well as through a variety of third party distributors. IBM’s Soft-Layer is a global cloud infrastructure that can power the most demanding cloud application. IBM has over 120 best-in-class software as a service (SaaS) applications and business process as a service (BPaaS) capabilities.

### Fundamental Analysis

IBM is a large established company that focuses on business clients ranging from small companies to large enterprise. Corporations will also begin offloading cash to invest in new capital projects and upgrade aging technology infrastructure. However, investment in software and cloud computing will far outpace investments in hardware, such as hosted mainframes. As businesses begin to invest in software, IBM will experience margin-

al benefits due to the increasing focus on advanced technological solutions.

An increased focus on cloud computing will driver large enterprises to develop their own private clouds, and IBM is well positioned to build and manage such clouds for customers. However, at the same time, IBM’s high-end computer hardware and mainframe business faces growing competition from low-cost cloud-based servers that do not require substantial investments in hardware. Since IBM derives the majority of its revenue from hardware and services, this will ultimately lower revenue and hurt profits for IBM’s mainframe business going forward.

### Financial Statement Analysis

IBM has \$10.4 billion in cash and cash equivalents, and \$33.2 billion in total debt. In addition to a high debt-to-equity ratio, average net income growth from the past three years was approximately one-third of the industry’s average growth. IBM’s board of directors has stated that it expects the firm to generate upwards of \$20 per share in non-GAAP earnings in 2015. The company has announced plans to repurchase \$50 billion of stock and pay out \$20 billion in dividends to shareholders through 2015.

### Conclusion & Recommendation

Using a dividend discount model, and a historical growth rate of 5.2 percent, we believe that IBM is overvalued. We recommend selling this position because IBM will face headwinds with its hardware mainframe segment going into 2014.

## Imperva Inc IMPV

| Recommendation | Valuation | Last Price | As of      | Style        | Dividend Yield |
|----------------|-----------|------------|------------|--------------|----------------|
| Buy            | \$68.00   | \$55.68    | 03/28/2014 | Small Growth | -              |



### Introduction

Imperva, Inc. is engaged in providing data security solutions focused on providing visibility and control over business data across systems within the data center. The Company's SecureSphere data security suite is a solution designed to prioritize and mitigate risks to high-value business data, protect against hackers and malicious insiders and address and streamline regulatory compliance. SecureSphere is an integrated, modular suite, which provides database, file and Web application security and secures all business data across a range of systems in data centers, including traditional on-premise data centers as well as private, public and hybrid cloud computing environments. The Company also offers on-demand, cloud-based security services.

### Fundamental Analysis

Imperva's core competencies are in enterprise security, data center security, and high-value application protection. The company has data security solutions that covers to both the virtual and physical data center. As of

December 31, 2013, Imperva has over 3,000 end user customers in more than 75 countries. Imperva's data security solutions also protect SaaS companies that host applications on the cloud. Imperva's goal to further penetrate its SaaS customer base is in line with our outlook for 2014. Continuing to pursue data security opportunities as more businesses adopt cloud computing will drive growth for Imperva in 2014.

Imperva plans to increase awareness of the importance of data security in 2014. Since the data security market is in its early stages of growth, we believe this is a good marketing strategy for a small cap firm like Imperva. We believe that CIOs will become more risk adverse in 2014, thus increasing demand for Imperva's products that protect high-value data centers.

### Financial Statement Analysis

The company has incurred losses in each fiscal year since its inception. Net losses attributable to stockholders were \$10.3 million in 2011, \$7.4 million in 2012 and \$25.2 million in 2013. Because of these losses, Imperva had an accumulated deficit of \$98.7 million at December 31, 2013. However, Imperva generated revenue of \$137.8 million in 2013, an increase of 32 percent over the \$104.2 million in revenue it generated in 2012. We expect revenue to increase 35 percent in 2014 given our optimistic outlook for the cyber security industry.

### Conclusion & Recommendation

Using a historical growth rate of 30 percent, we believe that Imperva is currently undervalued by 22 percent. We recommend buying this position due to Imperva's strong position in areas that are expected to benefit from an increase in cyber-attacks

## Insight Enterprises, Inc. NSIT

|                               |                             |                              |                            |                             |                            |
|-------------------------------|-----------------------------|------------------------------|----------------------------|-----------------------------|----------------------------|
| <b>Recommendation</b><br>Hold | <b>Valuation</b><br>\$30.17 | <b>Last Price</b><br>\$24.62 | <b>As of</b><br>03/28/2014 | <b>Style</b><br>Small Value | <b>Dividend Yield</b><br>- |
|-------------------------------|-----------------------------|------------------------------|----------------------------|-----------------------------|----------------------------|

| Technical Analysis     |         |
|------------------------|---------|
| <b>Bollinger Bands</b> | Neutral |
| <b>Money Flow</b>      | Neutral |



### Introduction

Insight Enterprises, Inc. offers information technology hardware, software and services to large enterprises, small to medium sized businesses and public sector institutions in North America, Europe, the Middle East, Africa, and Asia-Pacific.

### Fundamental Analysis

The company is currently reorganizing its sales force and has appointed a new regional vice president. Looking abroad, business remains weak in Europe, the Middle East and Africa as the global economy tries to find its footing. European hardware sales saw a jump though, with the acquisition of Frankfurt-based Inmac, a technology hardware firm. Inmac is expected to provide

synergies and expand the company’s reach in the Euro-zone.

So far, efficiency improvements in product lineup and cost control have helped offset downward pressure on Insight’s top-line. Insight also enhance its technology offerings in cloud computing, as the cloud market continues to gain popularity. Insight has been increasingly targeting the mobile IT market with its product offerings and services. Its mobility solutions leverages productivity based hardware and software to meet client requirements.

### Financial Statement Analysis

Insight Enterprises finished 2013 with reduced revenues. Revenue came in at \$5.1 billion, lower than \$5.3 billion for 2012. While Insight had declining revenues for 2013, we expect revenues to make a comeback in 2014. A strengthening mobility IT solutions business segment combined with new software offerings will drive Insight Enterprise’s revenue going into 2014.

### Conclusion & Recommendation

Using a free cash flow analysis we believe that Insight is currently undervalued by 21 percent. We recommend holding this position because Insight will be able to leverage its competitive advantage with its mobility and cloud solutions in 2014.

# Intel Corp INTC

|                               |                             |                              |                            |                             |                                |
|-------------------------------|-----------------------------|------------------------------|----------------------------|-----------------------------|--------------------------------|
| <b>Recommendation</b><br>Sell | <b>Valuation</b><br>\$24.67 | <b>Last Price</b><br>\$25.62 | <b>As of</b><br>03/28/2014 | <b>Style</b><br>Large Value | <b>Dividend Yield</b><br>3.46% |
|-------------------------------|-----------------------------|------------------------------|----------------------------|-----------------------------|--------------------------------|

| Technical Analysis     |          |
|------------------------|----------|
| <b>Bollinger Bands</b> | Negative |
| <b>Money Flow</b>      | Neutral  |



## Introduction

Intel Corporation designs, manufactures, and sells computer components and related products. The company's major products include microprocessors, chipsets, embedded processors and microcontrollers, flash memory products, graphics products, network and communications products, systems management software, conferencing products, and digital imaging products.

## Fundamental Analysis

The semiconductor industry is expected to recover slowly in 2104 despite an expected increase in IT spending. According to IBISWorld, industry revenue is forecast to increase at an annualized rate of 0.1 percent to \$80.8 in the five years to 2019. Industry revenue is expected to decrease by two percent in 2014. International semiconductor manufacturers have been able to gain a substantial competitive advantage over domestic manufac-

turers due to lower production costs. This outsourcing trend has negatively affected Intel's domestic operations. Intel currently has 12 semiconductor fabrication plants, of which only three are located internationally.

Intel has had limited success in gaining traction with its mobile device microchips. Growing consumer demand for mobile devices has forced Intel to create a mobile chip called Atom. Recently, Atom chips have taken a beating from ARM chips, as most mobile device producers prefer the ARM chip due to its superior energy consumption.

## Financial Statement Analysis

Although annual revenue growth was down one percent in 2013, Intel continues to remain in solid financial shape. Average net income growth from the past three years has stayed in line with industry average growth of negative six percent. At the end of 2013, the firm had \$13.4 billion in total debt. Offsetting its total debt liability, Intel currently holds \$11.6 billion in cash and short-term investments. As of December 28, 2013, \$3.2 billion remained available for share repurchases under the existing repurchase authorization limit.

## Conclusion & Recommendation

Using a simple dividend discount model with the price of semiconductors and electronic component as a growth driver, Intel is slightly overvalued. We recommend selling this position because of Intel's lackluster performance in the mobile device market and low revenue projections.

## KEYW Holding Corp KEYW

| Recommendation | Valuation | Last Price | As of      | Style        | Dividend Yield |
|----------------|-----------|------------|------------|--------------|----------------|
| Buy            | \$22.72   | \$18.05    | 03/28/2014 | Small Growth | -              |



### Introduction

The KEYW Holding Corporation (KEYW), incorporated in December 2009, is a holding company. The company provides cyber security and cyber superiority solutions to defense, intelligence and national security agencies. The company’s solutions, services and products support the collection, processing, analysis and use of intelligence data and information in the domain of cyberspace. KEYW’s customers include the National Security Agency (NSA), other intelligence agencies, the Department of Defense and other federal defense and law enforcement agencies

### Fundamental Analysis

During the past four years, KEYW has acquired seven information technology companies, the majority of which helped KEYW retain its current government contracts for intelligence agencies. We believe these acquisitions were a good move for KEYW given that the company receives most of its revenue for the U.S. government. KEYW’s 2013 revenue is derived from over 150 contracts, the ten largest of which accounted for approximately 54 percent of 2013 actual revenue, with no

individual contract accounting for greater than 17 percent of 2013 revenue. The current political climate towards government spending on intelligence gathering, especially covert NSA operations, may threaten the security of KEYW’s government contracts. However, the cyber security market for U.S. government intelligence agencies continues to be lucrative for KEYW.

KEYW will pursue opportunities in cyberspace and cyber security for the U.S. government and enterprises in 2014. We believe that KEYW’s strong competitive advantage in the U.S. government intelligence community will prove valuable in selling cyber security solutions to private enterprises that frequently interact with the U.S. intelligence community.

### Financial Statement Analysis

Revenue increased by \$55 million or 23 percent, in 2013 from 2012, because of the full year impact of the 2012 acquisitions and organic growth. However, we project that revenue will average a 16 percent growth rate for the next two years. According to KEYW’s 10-K, they anticipate that private cyber solutions will drive revenue growth in 2014. Gross margins decreased slightly as a percentage of revenue from 2012 to 2013 due to a larger proportion of subcontract revenue from an acquired geospace company. High software margins will offset lower margins from geospace activities in 2014.

### Conclusion & Recommendation

According to our valuation, KEYW is undervalued by 25 percent. We recommend a buy position because of the strengthening cyber security market and KEYW’S ability to leverage its competitive advantage in the U.S. intelligence community for enterprise cyber security solutions.

## Microsoft Corp. MSFT

| Recommendation | Valuation | Last Price | As of      | Style      | Dividend Yield |
|----------------|-----------|------------|------------|------------|----------------|
| Sell           | \$39.07   | \$40.30    | 03/28/2014 | Large Core | 2.47%          |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Negative |
| Money Flow         | Positive |



### Introduction

Microsoft Corporation is engaged in developing, licensing and supporting a range of software products and services. The Company also designs and sells hardware, and delivers online advertising to the customers. The Company’s products include operating systems for personal computers (PCs), servers, phones, and other intelligent devices; server applications for distributed computing environments; productivity applications; business solution applications; desktop and server management tools; software development tools; video games, and online advertising. It also designs and sells hardware, such as the Xbox One gaming and entertainment console.

### Fundamental Analysis

Satya Nadella was appointed as the new CEO of Microsoft in 2014, succeeding Steve Ballmer. He was previously president of Microsoft’s Cloud and Enterprise group. We are optimistic about Sataya Nadella as we believe that he will be able to negate some of the headwinds Microsoft has been facing from Windows 8 and the Xbox One. Even so, Staya’s new direction for Microsoft does not possess enough momentum to change Microsoft’s downward trajectory of its Windows

OS franchise in 2014. Windows 8 adoption rates have been disappointing despite Microsoft spending a massive amount of cash on its marketing campaign. The Xbox One continues to face intense completion from Sony’s PS4. The PS4 is currently outselling the Xbox One due to the PS4’s superior hardware and number of games.

Even though Microsoft has had major setbacks in its core business, the company has been successful in retaining its competitive advantage in the productivity software market with Microsoft Office. The company has recently released a subscription-based service called Microsoft Office 365. Microsoft Office 365 is a cloud-powered, web-based version of Microsoft’s Office with enterprise-grade applications. One of the most notable advantages Microsoft Office 365 offers is access to Office on Apple devices. The ability to access Microsoft Office 365 on iPhones and iPads should help nudge users to singing up to Microsoft Office 365.

### Financial Statement Analysis

Although Microsoft’s market share is currently under fire, the company still has a semi strong financial position. Microsoft has \$77 billion in cash and cash equivalents and approximately \$12 billion in long-term debt. Disappointing earnings from the past two years has caused Microsoft’s share price to lose value. Net income was \$16.9 billion in 2012, down from \$23.1 billion in 2011. In 2013, earnings increased 28 percent from its abysmal level in 2012. However, Microsoft’s earnings growth of 5.2 percent in 2013 is still far behind the industry’s average of 8.2 percent.

### Conclusion & Recommendation

Using a simple dividend discount model and a modest growth rate of 3.1 percent, Microsoft is overvalued. We recommend a sell position due to Microsoft’s downward trajectory of its core offerings.

## Materials

### Slow and Steady

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The Materials Sector encompasses a wide range of commodity-related manufacturing industries. Included in this sector are companies that manufacture chemicals, construction materials, glass, paper, forest products and related packaging products, and metals, minerals and mining companies, including steel producers. In 2013, the Materials sector had annualized returns 23.1 percent whereas the market as a whole had annualized returns of 32.4 percent.

The volatility in the emerging markets has left the investors of the Materials sector slightly uneasy. There was once again an overabundance of supply with a decrease in demand. Demand is expected to increase as the world economy continues to recover but slower than previously expected due to the emerging market uncertainty. Companies in the Materials sector are moving towards more prudent capital allocation and divestitures of unnecessary and unprofitable lines of business that have led to slightly increased margins.

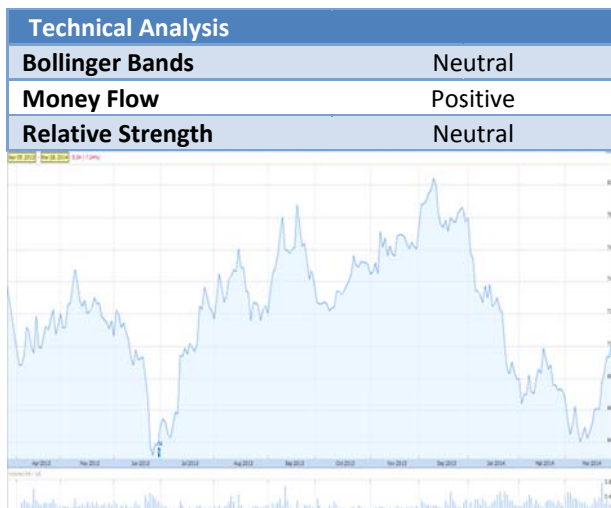
Indicators have led us to believe that the cost of iron ore will decrease in the upcoming year. Companies that sell and export iron ore will most likely see a decrease in revenues of that commodity. Conversely, companies that produce steel will most likely see an increase in margins due to the decrease in costs for iron ore. We predict a rebound in key commodity prices which, coupled with better asset management and reduced cost structures, should drive the industry back to normal profitability.

We are recommending companies with exposure to multiple commodities to take advantage of diversification and our expectation of a broad recovery in the sector. Our picks are international companies that operate mines in a variety of countries and have convincing drivers for multiple product lines.



## POSCO (ADR) PKX

| Recommendation | Valuation | Last Price | As of      | Style         | Dividend Yield |
|----------------|-----------|------------|------------|---------------|----------------|
| Buy            | \$115.20  | \$68.37    | 03/28/2014 | International | 2.40%          |



### Introduction

POSCO is a South Korea-based company engaged in the manufacture of steel products. The Company operates in steel business, engaged in the manufacture of hot rolled steels, electrical galvanized steels, stainless steels; trading business, engaged in the trading of steel products, chemical products, automobile parts, and others; construction business, engaged in the construction of commercial and residential buildings, and other businesses such as the operation of power plants, sale of refractory products.

### Fundamental Analysis

POSCO is one of the largest steel companies in South Korea with plants that are among the most efficient and cost effective in the world. An innovation leader for this industry, POSCO has increased output through leading edge technology and low cost production processes. The Company currently has approximately 50 percent of the South Korean market while increasing its exports.

POSCO's largest export market is China, making China's growth integral to the health of the company and vulnerable to the country's slowdown. POSCO is able to compete with the Chinese steel manufacturers, despite trade tariffs imposed by China, through its low-cost position.

Steel manufacturers have heavy exposure to the prices of iron ore, coal, and nickel. Iron ore, the main component, is predicted to have decreasing commodity prices in 2014 and 2015, which is a boon for POSCO. On top of that, POSCO is aiming to increase its self-sufficiency in iron ore to 50 percent from its current 30 percent. This would further stabilize its cost structure.

### Financial Statement Analysis

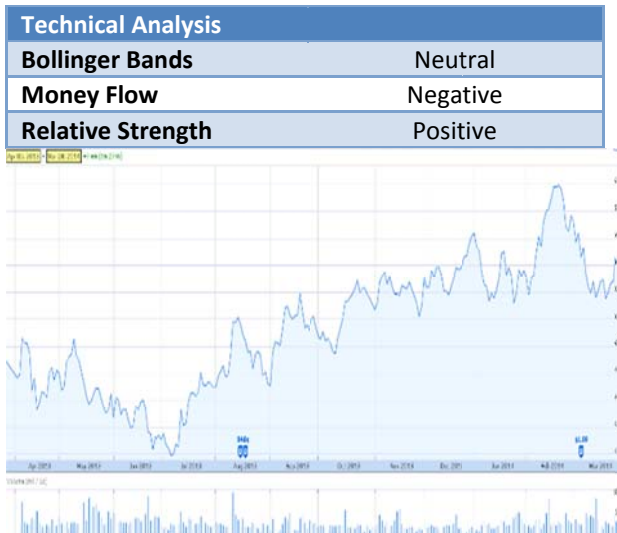
In 2013, the Company was able to keep profits margins around 5 percent despite the slowdown in China. Revenues dropped 2.7 percent but the operating margin only fell by 0.3 percent. This shows that the management of POSCO is able to keep profits flowing through to the investors. The price to book value of 0.6 is grossly below the market average of 0.8. and its revenue growth of 20 percent is much higher than the industry average of 2.1 percent.

### Conclusion & Recommendation

Despite the Company's decreased earnings per share in 2013, all economic indicators point to healthy growth for POSCO in 2014. The projected drop in price for iron ore should serve to lower POSCO's costs and boost the profit margin. With these indications in mind, we have a buy recommendation for this equity.

## Rio Tinto plc (ADR) RIO

| Recommendation | Valuation | Last Price | As of      | Style         | Dividend Yield |
|----------------|-----------|------------|------------|---------------|----------------|
| Sell           | \$67.40   | \$54.72    | 03/28/2014 | International | 3.50%          |



### Introduction

Rio Tinto plc is an international mining company. Rio Tinto's business is finding, mining, and processing mineral resources. Major products are aluminum, copper, diamonds, gold, industrial minerals, iron ore, thermal, and metallurgical coal and uranium. In 2014, the Company generated \$51.2 billion in revenues that equated to \$3.67 billion in net income.

### Fundamental Analysis

Following the loss of \$2.99 billion in 2012, the Company was able to generate underlying earnings of \$10.2 billion in 2013. The loss was attributed to several factors, which included a decrease in cash flows from operations due to declining commodity prices, an increase in capital expenditure aimed at expanding mining capacity, and a \$14.4 billion accounting charge for goodwill impairment. Without the impairment charge, the Company would have generated a healthy net income. Chief executive Sam Walsh is working on decreasing operating and capital costs as a means of improving profitability. One way

to improve profitability for Rio, a company with 85 percent of its EBIT coming from iron ore, would be to increase the diversification of the product lines.

Commodity prices are expected to stabilize and increase this upcoming year. The Company will continue to increase production with the new, lower cost structure, which should drive profits.

Indications show that the influx of capital into emerging markets is slowing, mostly due in part to the volatility of those markets. Developed areas such as the United States and the Eurozone look to be the safer investment. As a whole, though, the global economy will grow at 3.7 percent, which will help increase the demand for Rio's products. The diversity of Rio's products position the company to take advantage of recovery in a variety of sectors and industries. This also provides protection against the volatility that might be experienced by a company that has only one product.

### Financial Statement Analysis

In 2013, Rio Tinto reported earnings of \$10.2 billion, which is a 10 percent increase from 2012. Rio also increased its dividend from \$0.93 per share to \$1.92 per share. Operating margin increased from -5 percent in 2012 to 6.8 percent in 2013. 2014 appears to be another year where expenses will increase but revenues will increase at a larger rate, therefore increasing the profitability of the company.

### Conclusion & Recommendation

Rio bounced back from its poor performance in 2012 with relatively strong numbers. As of now, the company remains undervalued in the market. Our recommendation is, therefore, to hold the stock due to indicators showing that the Company's stock is likely to appreciate and dividends may be greater than the exorbitant amount distributed in 2013.

## Vale SA (ADR) VALE

| Recommendation | Valuation | Last Price | As of      | Style         | Dividend Yield |
|----------------|-----------|------------|------------|---------------|----------------|
| Hold           | \$15.24   | \$13.68    | 03/28/2014 | International | 0.91%          |

| Technical Analysis |          |
|--------------------|----------|
| Bollinger Bands    | Neutral  |
| Money Flow         | Positive |
| Relative Strength  | Neutral  |



### Introduction

Vale SA is a Brazil-based metals and mining company. The Company's services are divided into four segments: bulk material, basic metals, fertilizers, and logistic services. These segments include the mining of iron ore, manganese, and ferroalloys, producing potash, phosphate, and nitrogen, and transporting the materials.

### Fundamental Analysis

Vale's low cost structure, possible through the strategic initiatives taken in 2012, has stabilized the company's revenues in 2013. Over the past decade, Vale has put plenty of capital investment into diverse product lines to move away from solely being a provider of iron ore. Vale is still the world's largest provider of iron ore, though. The three new mines opened in 2012 helped Vale improve the operating margin. Vale is set to open up a new iron ore mine in 2016. The newly opened mines are still building to full capacity and the company will see increasing production for several years at which time new projects like the 2016 iron mine will continue to provide growth.

The other issue that the company faced was a reduction of growth in China. Investors have revised their growth estimates for China downward. China's slowdown continues to affect Vale heavily because China is the world's largest purchaser for iron ore. China's growth, though, will remain around 7 percent, which was the projection for last year as well. The Company can expect increased demand from other developing economies such as India, Brazil, South Korea and Indonesia.

The company is also increasing value by streamline its operation and working on reductions in its cost structure. The new mine opening in 2016 has much lower extraction cost which will improve the company's margins and drive future profitability.

### Financial Statement Analysis

In 2012, the Company was able to maintain profitability after a \$4 billion impairment and \$6 billion to shareholders. The remainder of the \$5 billion of earnings and the \$5 billion of additional debt were invested in Vale's mines and in acquisitions. In 2013, the Company's revenues were able to maintain some consistency with the previous fiscal year's despite the volatility in the commodities market due to the emerging economies instability. Although revenues decreased, the operating margin increased from 11.3 percent in 2012 to 15.9 percent in 2013. This gain is mostly due to the divestiture of unprofitable mines in 2012 and the acquisitions made in 2012.

### Conclusion & Recommendation

After another year with a poor performance, the company is severely undervalued and with the modest improvement in the global economy, that we expect the company should spring back to a higher level of profitability.

## Telecommunications Services

### Sector Overview

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Telecommunication sector has two sub-sectors, wireline and wireless. Most of telecommunication companies have business operations in both wireline and wireless. The major names in telecommunication are multibillion-dollar companies, which have complex network systems cover telephones, cell phones and cellular.

In the past decade, due to deregulation and innovation, wireless capabilities have been rapidly growing. However, the growth rate has slowed recently. In the United States, the penetration rate of wireless services has reached 103 percent in year 2013, which means there are 103 people have a telecommunication service provider in every 100 people. This key industry statistic is quite incredible and means that the telecommunications industry is at greater than full penetration.

Even though the future growth is very limited, our team believes the demand of telecommunication service will remain strong. As the high, rapid growth of mobile application technology and social networks increases, the demand for a quality service provider is going to increase.

### Investment Objective and Strategy

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Our team's investment objective for the telecommunication sector is to seek short-term stable income and long-term asset appreciation. As a small sector in the portfolio, our team has decided to sacrifice the exposure to growth for short-term stable price and high dividend. Due to the growth outlook in this sector being quite limited, in terms of the major names, we have decided to pursue a stable price, high dividend allocation in telecommunications.

One of the concerns is how to allocate the asset in the sector. The period is short-term so we are afraid to take risks, especially in a year like 2014. After the bullish run of 2013, there are many uncertainties in the upcoming year. We have decided to use defensive strategy in the Telecommunications sector. We will increase diversification in our holdings to reduce sector risk.

In the first quarter of 2014, we have seen a big pull back in the emerging market following the emerging market bearish of 2013. In addition, the worries of Ukraine and Russia give investors a warning of the importance of quality holding. As a result of these international events, our team decides to reduce the international exposure in the portfolio. We will keep a very small portion of international stock in telecommunication sector, so we can take advantage of global growth and secure the downside at the same time.

## BCE Inc. (USA) BCE

| Recommendation | Valuation | Last Price | As of      | Style         | Dividend Yield |
|----------------|-----------|------------|------------|---------------|----------------|
| Sell           | \$49.70   | \$42.93    | 03/28/2014 | International | 5.2%           |



### Introduction

Bell Canada Enterprises (BCE) is a communication company, mainly operating domestically. The company has a diversified portfolio of business, with four major business segments are Bell Wireline, Bell Wireless, Bell Media and Bell Aliant. Under these business segments, the company has some famous brands, such as Bell Home Phone, Bell Fibe TV, Bell and Virgin Mobile.

BCE provides communication solutions to residential customers, small businesses and wholesale customers in Canada. The company offers local and long-distance telephone services, direct-to-home satellite television services, video conferencing services and webcasting services. In addition, the company also has business lines for data service and TV programming services.

### Fundamental Analysis

Our team believes BCE earnings will grow the next year because of the development of technology, and the demand for wireless data services. However, the penetration rate is already over 100 percent in United States and Canada. Therefore, the growth will be limited.

The company has been improving the cost control and the operating margin has been increasing over the year.

We believe this trend will continue, and it will help generating net revenue for BCE.

Canada business has a strong correlation with the United States. This will reduce the effect from other international issues. As the United States economy is recovering, we believe BCE will benefit from this recovery as well.

### Financial Statement Analysis

Bell Canada has a slow but steady revenue growth within the recent five years. The company has another source of income from 2009 to 2012, but in 2013, this source ended up losing money for BCE. As a result, BCE net income declined comparing to 2012. However, the major business of BCE is still strong.

### Conclusion & Recommendation

As the largest telecommunication company in Canada, BCE has a wide product range and economic scale. Moreover, the company issues a dividend yield of 5.2 percent. However, our team believes it is not a great idea to hold a single stock for the telecommunication sector. Even though the stock price is lower than our valuation, our recommendation is to sell the stock.

## Frontier Communications Corporation FTR

| Recommendation | Valuation | Last Price | As of      | Style     | Dividend Yield |
|----------------|-----------|------------|------------|-----------|----------------|
| Sell           | \$6.24    | \$5.62     | 03/28/2014 | Mid Value | 7.10%          |

### Technical Analysis

|                          |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

Frontier Communications Corporation (FTR) is a communications company, providing voice, data and video services. The company was founded in 1927 in Connecticut. The company changed to its current name from Citizens Communications Company in July 2008. Frontier offers data and Internet services comprising residential services, commercial services, and computer security services.

Additionally, the company offers a switched access services to originate and terminate their local and long distance voice traffic. It also provides satellite and terrestrial video services to business customers.

As of December 31, 2013, Frontier Communications Corporation had 2,803,500 residential customers, 270,800 business customers, 1,866,700 broadband subscribers, and 385,400 video subscribers.

### Fundamental Analysis

Frontier has a very favorable dividend to most investors who are looking for yield. However, our team believes that Frontier does not have a very strong cash flow or revenue to support this dividend payment. The current market capitalization is \$5.69 billion, and 7.1 percent of

that would be an annual payment of \$404 million dollars.

However, the gross income of Frontier in 2013 was only \$308 million and the operating cash flow was \$342 million. In addition, the company has only \$891 million in cash and cash equivalents. If Frontier does not increase revenue, the company will end up running out of cash in the future.

Due to the high dividend yield, the company would have very little cash to invest back to its own business. In other words, the company has very limited growth, which is generally true in telecommunication industry.

### Financial Statement Analysis

Frontier had a strong growth rate from 2009 to 2011. However, after 2011 the revenue started to decline. The company has been maintaining a stable cost structure over the years. There are no significant cost increases or cost decreases within the five years. Frontier has a low profit margin, which was 2.4 percent in 2013.

### Conclusion & Recommendation

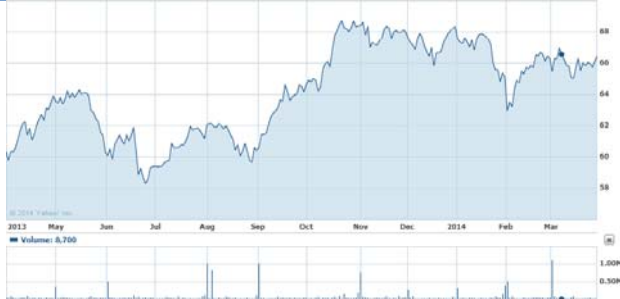
Our team believes Frontier will have problems maintaining its current dividend. To solve the problem, Frontier has either to raise capital or cut its dividend. Neither solution is good for investors. Our recommendation is to sell.



## iShares S&P Global Telecommunications IXP (ETF)

|                               |                        |                              |                            |                   |                                |
|-------------------------------|------------------------|------------------------------|----------------------------|-------------------|--------------------------------|
| <b>Recommendation</b><br>Sell | <b>Valuation</b><br>NA | <b>Last Price</b><br>\$66.46 | <b>As of</b><br>03/28/2014 | <b>Style</b><br>- | <b>Dividend Yield</b><br>3.50% |
|-------------------------------|------------------------|------------------------------|----------------------------|-------------------|--------------------------------|

| Technical Analysis       |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

Exchange Traded Fund is a perfect fit for our demand for diversification and asset safety. The managers added IXP into the portfolio 2 years ago with the same purpose. IXP invests at least 90 percent of its assets in securities of the underlying index and in depositary receipts representing securities of the underlying index. The fund seeks to track the investment results of the S&P Global 1200 Telecommunications Sector Index.

### Fund Description

A description of the fund per iShares Fund Fact Sheet: *The iShares S&P Global Telecommunications Sector Index Fund seeks investment results that correspond generally to the price and yield performance, before fees and expenses, of companies that Standard and Poor's deems part of the telecommunications sector of the economy and important to global markets, as repre-*

*sented by the Standard and Poor's Global Telecommunications Sector Index. The index is a subset of the Standard and Poor's Global 1200 Index.*

### Sector Fundamentals

The team has an outlook of neutral for telecommunication sector, because of the key industry statistics penetration rate has been over 100 percent in 2013. We believe there will be very limited growth in United States.

In the global market, there are definitely places where high growth potential exists. However, since the second half of 2013 and the beginning of 2014, we have seen many uncertainties happened in these markets. Our team wants to take advantage of this growth, but at the same time, we want to minimize our risk.

### Conclusion & Recommendation

As a small proportion of the portfolio, we believe safety and a stable income are more appropriate for us. The team recommends we sacrifice the growth in this sector and, in turn, we will get stable price and dividend payment.

Exchange Traded Funds are a great way to allocate our capital. IXP gives us diversification and we will have allocation across the global markets.

However, as an index fund, IXP has an expensive net expense of 0.48 percent; this net expense reduces the dividend to 3 percent. As a result, our recommendation is to sell IXP.



## Vanguard Telecom Services VOX (ETF)

| Recommendation | Valuation | Last Price | As of      | Style | Dividend Yield |
|----------------|-----------|------------|------------|-------|----------------|
| Buy            | NA        | \$84.46    | 03/28/2014 | -     | 3.82%          |

| Technical Analysis       |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

VOX seeks to track the performance of a benchmark index. The fund employs an indexing investment approach designed to track the performance of the MSCI U.S. Investable Market Index (IMI)/Telecommunication Services 25/50, an index made up of stocks of large, mid-size, and small U.S. companies within the telecommunication services sector, as classified under the Global Industry Classification Standard. The fund has an allocation of U.S. stocks and cash only. The fund has 95 percent invested in Telecommunication Sector and 4 percent in Technology.

### Fund Description

VOX seeks to track the performance of a benchmark index that measures the investment return of stocks in the telecommunication services sector.

VOX is passively managed, using a full-replication strategy when possible and a sampling strategy if regulatory constraints dictate.

VOX includes stocks of companies that provide telephone, data-transmission, cellular or wireless communication services.

### Sector Fundamentals

The team has an outlook of neutral for telecommunication sector, because of the key industry statistics penetration rate has been over 100 percent in 2013. We believe there will be very limited growth in United States.

In the global market, there are definitely places where high growth potential exists. However, since the second half of 2013 and the beginning of 2014, we have seen many uncertainties happened in these markets. Our team wants to take advantage of these growths, but at the same time, we want to control our risk at a low level.

### Conclusion & Recommendation

Same as IXP, VOX gives us diversification. As a small proportion of the SunTrust portfolio, we believe the safety and stability of income is more favorable for us. The team recommends sacrificing growth in this sector in exchange for stable prices and a reliable dividend.

VOX has a net expense of 0.14 percent, which is cheaper than IXP's. In addition, VOX has a higher dividend than IXP. As a result, VOX has a net dividend of 3.68 percent. Both of these two funds are the same tracking index, so the top holdings and asset allocation in the United States market are similar.

Our recommendation is to buy VOX.

## Verizon Communications VZ

| Recommendation | Valuation | Last Price | As of      | Style       | Dividend Yield |
|----------------|-----------|------------|------------|-------------|----------------|
| Sell           | \$54.04   | \$47.42    | 03/28/2014 | Large Value | 4.50%          |

### Technical Analysis

|                          |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

Verizon Communication provides communications, information and entertainment products and services to consumers, businesses, and governmental agencies all around the world. Its wireless segment offers access to various wireless voice and data services comprising Internet access through smart phones and basic phones, and notebook computers and tablets. This segment also provides location-based service, global data services, high-speed Internet service for homes, other connection-related services, and machine-to-machine services that support devices used in healthcare, manufacturing, utilities, distribution, and consumer products markets, as well as sells smart phones and basic phones, tablets, and other Internet access devices.

The company's Wireline segment offers video services over its fiber-optic network, data Services comprising high-speed Internet and FiOS broadband data products, voice services, voice messaging services, wireless services, and local dial tone and broadband services to local, long distance, and other carriers. This segment also provides networking products and solutions, such as private Internet protocol services, and Ethernet access and ring services, and infrastructure and cloud services.

### Fundamental Analysis

Verizon is one of the largest telecommunication companies in the world and it is one of the most recognized brands in United States. In addition, Verizon is expecting to finish the deal with Vodafone. After the acquisition, the new company will have more diversified business lines and stronger earning power.

### Financial Statement Analysis

Verizon has very strong income statement. The company was able to control cost in 2013, such as operating expense decreased to \$44 billion comparing to \$56 billion in 2012. Because of this cost cut, the company net income in 2013 reached a peak of \$11 billion of the recent 5 years. The average net income since 2009 to 2012 was about \$2 billion and in 2013, the company achieved more than 450 percent profit increase.

In December 2013, Verizon has \$54 billion in cash and cash equivalents on the balance sheet, which is a significant difference comparing to other years. The average cash holding from 2009 to 2012 was \$6 billion. Our team believes the increase in cash was to prepare for deal with Vodafone. The company has a big position of debt on balance sheet and the leverage ratio of Verizon is 6.05. However, the company has a strong cash flow and earning power. In addition, Verizon is one of the most well recognized brands in United States.

### Conclusion & Recommendation

Our recommendation is to sell.

## Vodafone Group (ADR) VOD

| Recommendation | Valuation | Last Price | As of      | Style         | Dividend Yield |
|----------------|-----------|------------|------------|---------------|----------------|
| Sell           | \$32.44   | \$36.45    | 03/28/2014 | International | 5.70%          |

### Technical Analysis

|                          |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

Vodafone Group is a worldwide mobile telecommunication service provider, which is based in UK. The company offers mobile services, financial services, and cloud solutions to over 404 million customers worldwide.

Vodafone sells and distributes its products through approximately 15,000 Vodafone branded retail stores. The company operation covers world fastest growing markets such as Africa and India. In 2013, Verizon Communications acquired the company U.S. division.

### Fundamental Analysis

Vodafone has a diversified portfolio of business operation. The growth in developed market such as the U.S.

and European countries are very limited. There is high growth potential in Emerging Markets, such as Africa and Asia-Pacific.

In 2013, Vodafone agreed on its deal with Verizon for 130 billion, which is one of the largest merger deals in the world. Because of this deal, the share price of Vodafone has gone up a 62 percent in 2013.

Vodafone has a healthy capital structure, with 50 percent debt and 50 percent equity. In addition, the company has a very attractive dividend yield of 5.7 percent.

### Financial Statement Analysis

Vodafone Group increased revenue every year since 2009, but in 2013, the revenue declined. In 2012, the company did a great job reducing operating expenses, but in 2013, the advantage did not last. The other source of income had been strong through the years. However, it became significantly weak in 2012. As a result, Vodafone Group's 2013 net income decreased by 94 percent compared to 2012.

### Conclusion & Recommendation

Vodafone has a strong financial structure and a diversified business model. This company also pays a decent dividend of 5.7 percent annually. However, based on our valuation, the share price has been up too much because of the deal with Verizon. Our intrinsic value is \$32.44, which is lower than the current value of \$36.54. We recommend selling the stock.

## Utilities

### The Giant Unknown – The Federal Reserve

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Since the summer of 2013, Federal Reserve has started to reduce the monthly asset purchasing amount, also known as “tapering”. Additionally, in the latest FOMC meeting, the new Fed chairwoman Janet Yellen declared the Fed will probably increase the interest rate in 2015. The increase in interest rate will hurt the bond market seriously, especially core bond with a very long duration. Bonds have been considered a safe asset for years, but since 2013, we have seen a big draw back in the bond market. Based on what William Dudley, the President of the New York Fed, stated, the Fed is intending to make people steer away from safe assets and invest money into risky assets, such as equities. However, there is a huge demand for safe assets in the market. Pension funds are always looking for yield, but the bond market is not very promising and the yield is low. Where would they find yield instead? One of the best places is utilities.

### Utilities Overview

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In general, the Utility sector is a small proportion of the market. Utility companies are normally quite regulated, so the prices of utility stocks are relatively more stable than other sector stocks. Another reason that investors like utilities is that most utility companies are paying a very high dividend. This is a great place for investors seeking safe assets and also want to have a secure yield.

However, there are some downsides of Utility sector. It is great to hold a utility stock and enjoy the high yield, but the high yield also means there is very limited future growth. As a result of strict regulation and high industry entry barrier, quality utility companies have large economic scale and very limited growth.

### Investment Objective and Strategy

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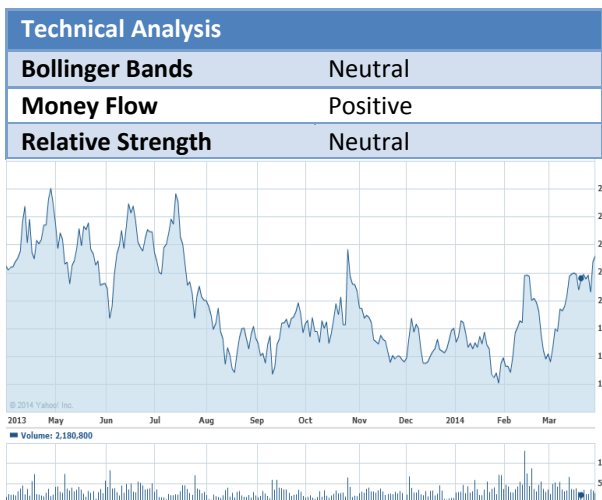
Based on the outlook of 2014 economic growth and stock market forecast, the team sets the objective for the Utilities sector as seeking income through regular payment of dividend.

We will only select stocks that issue dividends. In addition, we invest in utilities in this sector, which are regarded as safe assets. Our goal is not to gain or pursue asset appreciation in the short term, but to look for yield and a moderate total return.

According to the objective and goal, we are highly risk adverse during the selection of investments in this sector. There are growth stocks because of unregulated subsidiaries, but we will not select this type stock into our portfolio. In addition, the team believes diversification is the best way to reduce risk. Since the Utilities sector has small allocation, we will not use any single stock. Lastly, due to the uncertainty of emerging market and slow recovery of European market, we will limit our international exposure in the Utilities sector.

## Calpine Corporation CPN

| Recommendation | Valuation | Last Price | As of      | Style    | Dividend Yield |
|----------------|-----------|------------|------------|----------|----------------|
| Sell           | \$23.00   | \$20.80    | 03/28/2014 | Mid Core | -              |



### Introduction

Calpine is a wholesale power generation company, using natural gas-fired and geothermal power to provide power, steam and capacity to utilities and industrial companies. Calpine operates 94 power plants and its generation capacity is 29,000 megawatts.

### Fundamental Analysis

Calpine Corporation has operations in many regions across the country, such as West, North, Southeast and Texas. However, our team believes various regions do not diversify the business portfolio very much, because Calpine mainly provide nuclear in these markets. The source of energy is dependent and that will increase the operating risk, no matter how many regions the company covered.

The company has a low earning per share, which is \$0.03. As a result, the company has a significant high P/E ratio of 704.83, which means the company is over-valued.

Additionally, as a utility company, the company does not issue any dividend. This provides the company large potential for future growth.

### Financial Statement Analysis

Calpine has been able to increase sales from previous year. However, the company is operating in a very low profit margin, especially in 2013. In 2013, the company profit margin is 0.2 percent, because of the high commodity prices and high operating expenses. In addition, in the recent 3 years, Calpine net income has been fluctuating very often. In 2011 the company posted a net loss of 190 million.

### Conclusion & Recommendation

Calpine was added into the portfolio is because of the potential growth. The team decides to identify utilities based on the objectives of high yield and asset safety. Obviously, Calpine does not fit into these two objectives. The company share price is more than 700 times of the company earnings, which means the stock is very expensive. As a utility company, Calpine does not issue any dividend at all. This is not a favorable feature for investors looking for utility stocks.

In conclusion, the team recommendation is to sell Calpine Corporation.

## Cleco Corporation CNL

| Recommendation | Valuation | Last Price | As of      | Style       | Dividend Yield |
|----------------|-----------|------------|------------|-------------|----------------|
| Sell           | \$43.93   | \$49.78    | 03/28/2014 | Small Value | 2.87%          |



### Introduction

Cleco is public utility holding company with two subsidiaries Cleco Power LLC and Midstream. Cleco Power provides electricity service to retail customers and wholesale customers in Louisiana. Cleco Power has a diversified power generation portfolio, includes three steam electric generating stations, two gas turbines, one combined cycle unit, 81 active transmission substations and 220 active distribution substations. Midstream is an unregulated merchant energy business operating in Louisiana and Texas.

### Fundamental Analysis

Cleco Corporation has a diversified source of providing energy, such as western coal, petroleum coal, lignite, oil and natural gas. This diversified combination will reduce

the risk of single commodity price fluctuation or any tail risk.

Cleco has a P/E ratio of 18.90, which is higher than the industry average 16.7. The dividend yield of Cleco is lower than the industry average 4.7 percent as well. In addition, the return of equity is also lower than the industry average.

### Financial Statement Analysis

Cleco has increased revenue for 10 percent comparing to the previous year. The company was able to maintain the cost of goods sold, so the gross margin stays the same. However, the company has not done a great job in controlling the operating expenses. The company operating expenses increased by 7 percent, which result the operating income increased 9 percent. In addition, the company paid a significantly increased tax rate comparing to year 2012. The total tax rate was 33 percent in 2013, while in 2012 the tax rate was 29 percent. As a result, the company net income was lower than 2012 even though the revenue went up.

### Conclusion & Recommendation

Cleco has diversified energy source providers, but the company is a small cap and it is an expensive stock according to the P/E ratio. In addition, based on our valuation, Cleco market price is more than the intrinsic value. Our team recommends selling Cleco Corporation.

## Energy Company of Parana (ADR) ELP

| Recommendation | Valuation | Last Price | As of      | Style         | Dividend Yield |
|----------------|-----------|------------|------------|---------------|----------------|
| Sell           | \$22.56   | \$13.11    | 03/28/2014 | International | 3.50%          |

| Technical Analysis       |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

Energy Company of Parana provides power generation, transmission, distribution and utility sales services in the State of Paraná, Brazil. The company operates a diversified plants portfolio, including hydroelectric plant, wind-ing plant and transmission system. The company also provides corporate telecommunication services and international long-distance services.

### Fundamental Analysis

Energy Company of Parana had very high gross margin from 2003 to 2007. Since 2008, the company growth margin has declined almost half and has kept the decreasing trend. In 2012, the company has a lower earning.

The company has a health financial structure. The leverage ratio is relatively low. However, the company largest current asset is account receivable, which is a reason why the company has declining net income. On the other hand, the company has problem to receive the payment for their service. In a volatile environment, this can be very risky for business operations.

### Financial Statement Analysis

Energy Company of Parana has a revenue decline in 2012 (2013 data not available). The cost of revenue in 2012 increased 10 percent comparing to 2011. As a result, the company net income decreased almost half in 2012. The company has a potential problem of controlling cost.

### Conclusion & Recommendation

Energy Company of Parana is a company located in Brazil, which is a member of BRIC. However, in 2013 and the beginning of 2014, we have seen very serious happened in these countries, such as high inflation and investors' concerns about government bond default.

In addition, the team is not familiar with how utilities business operates in Brazil. Even though the valuation tells us the stock is undervalued, we do not feel comfortable to buy things we do not know or understand.

Our team believes it is too risky to hold ADR in utilities sector and our recommendation is to sell.



## Vanguard Utilities (ETF) VPU

| Recommendation | Valuation | Last Price | As of      | Style | Dividend Yield |
|----------------|-----------|------------|------------|-------|----------------|
| Buy            | -         | \$89.44    | 03/28/2014 | -     | 3.54%          |

| Technical Analysis       |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

VPU seeks to track the performance of a benchmark index. The fund employs an indexing investment approach designed to track the performance of the MSCI U.S. Investable Market Index (IMI)/Utilities 25/50, an index made up of stocks of large, mid-size, and small U.S. companies within the utilities sector, as classified under the Global Industry Classification Standard. The fund is fully invested in United States, with an allocation of 99 percent in utilities and 1 percent in Energy.

### Fund Description

VPU Seeks to track the performance of a benchmark index that measures the investment return of stocks in the utilities sector.

VPU is passively managed, using a full-replication strategy when possible and a sampling strategy if regulatory constraints dictate.

VPU Includes stocks of companies that distribute electricity, water, or gas, or that operate as independent power producers.

### Sector Fundamentals

Our team believes investors want utilities stocks because they want to diversify their assets that provide income. We have seen a major pull back in the bond market and institutional investors who are looking for yield have to invest into other asset classes.

Utility is a great alternative for bond, and we are expecting a major fund inflow into the equity market. However, at the same time, the Fed is tapering the Quantitative Easing program and the Fed is about to increase the interest rate in 2015. This will hurt the bond market as well as the utility stocks. Because of both factors, our outlook for the utilities sector is neutral.

### Conclusion & Recommendation

As a small proportion of the SunTrust portfolio, we believe the safety and stable income are more important for us. The team decides to sacrifice the growth in this sector and in turn, we will get stable price and dividend payment. VPU gives us diversification and reduces the overall sector risk. In addition, the team decides not to invest in the global market, because of we are unfamiliar with foreign markets and the uncertainties of international affairs.

VPU has a net expense of 0.14 percent, which is cheaper than most utility ETFs. VPU issues a dividend of 3.54 percent. As a result, VPU has a net dividend of 3.40 percent. VPU has a high Sharpe Ratio of 1.24 and within the recent 3 years, VPU has been able to generate positive alpha, which means no matter how the market fluctuates VPU is able to gain positive return.

In conclusion, our recommendation is to buy VPU.

## National Electricity Company of Chile, Inc. (ADR) EOC

| Recommendation | Valuation | Last Price | As of      | Style         | Dividend Yield |
|----------------|-----------|------------|------------|---------------|----------------|
| Sell           | \$100.48  | \$43.10    | 03/28/2014 | International | 1.00%          |

### Technical Analysis

|                          |          |
|--------------------------|----------|
| <b>Bollinger Bands</b>   | Neutral  |
| <b>Money Flow</b>        | Positive |
| <b>Relative Strength</b> | Neutral  |



### Introduction

National Electricity Company of Chile is an electricity company operates in Chile, Argentina, Brazil, Colombia, and Peru. Besides the regulated electricity business, National Electricity Company of Chile also owns an unregulated industrial firm focusing on pulp, and steel sectors.

### Fundamental Analysis

National Electricity Company of Chile has very strong financials. The company profit margin has increased since 2004 at a steady rate. Even though the revenue declined in 2013, the company operating cash inflow increased comparing to previous year.

The company has a return of equity of 13.63 percent in 2013, but within the recent 10 years, the return of equity rate has been volatile. The share price has also been volatile within the years.

### Financial Statement Analysis

Since 2009, the revenue of National Electricity Company of Chile has been declining every year until 2012 (2013 financial statement not available yet). However, the Company has been able to keep operating expenses relatively low. As a result, the company has a declining net income.

### Conclusion & Recommendation

National Electricity Company of Chile has strong financial data, but our team does not very familiar with the company, because it is an international company. Because of the culture difference, nobody on the team is familiar with the culture of Chile or doing business in Chile.

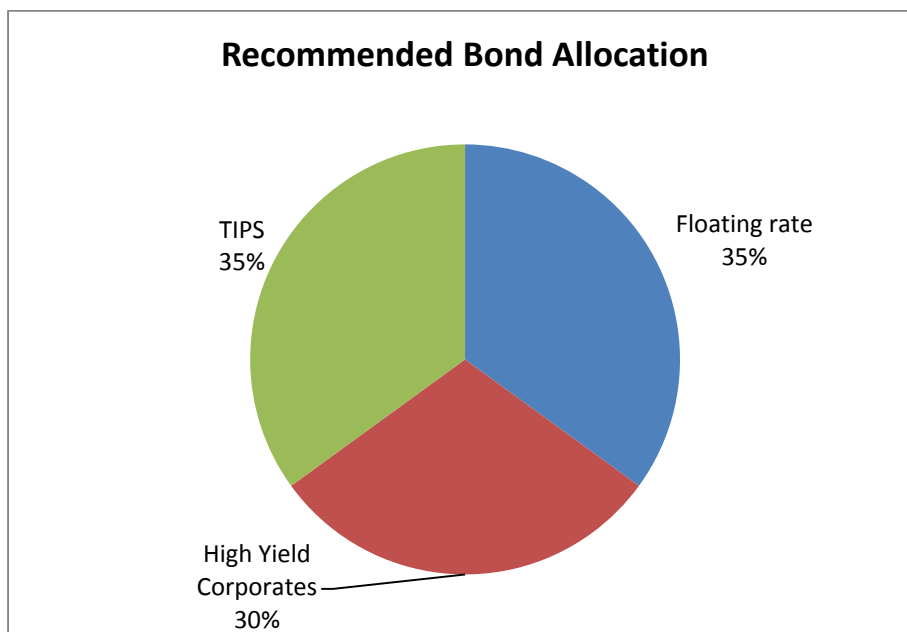
In addition, Chile is an emerging market with little popularity. Due to the concerns with Emerging Market in general, our team decides to avoid using any ADR in this sector and especially from ADR from Emerging Market.

One of our goals is to identify quality value stock in Utilities sector. However, EOC pays very low dividend yield. The original reason to add the stock in our portfolio is to take advantage of high growth. However, our team believes investors putting money in Utilities stocks is not looking for growth but for yield and safety. Therefore, our recommendation is to sell this stock.

## Fixed Income Assets

### 2014-2015 Outlook

March 19, 2014 the Fed announced that it will continue to taper the purchases of bonds from \$34 billion per month to \$30 billion per month starting in April 2014. This tapering is expected to continue until October 2014 when the Fed should be able to stop its bond-purchasing program. Once this program ends, longer-term rates on the yield curve will no longer have downward pressure and will be expected to rise shortly thereafter. According to the Federal Reserve, to reach its goals of maximum employment and a 2 percent inflation target, it will take into account a wide range of information including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. This is in stark contrast to previously utilizing unemployment in isolation as a measure for economic health. Unemployment remains at 6.7 percent and the Fed has stated that they will keep interest rates low well after unemployment is below 6.5 percent. Utilizing this information, we expect Interest rates to increase by **spring 2015** or about six months after the Fed has stopped tapering. Even though we do not expect interest rates to increase within the next year it is important to prepare for the long-term with this portfolio. Our goal with the portfolio is to decrease duration while increasing yield. This has been accomplished with the allocation listed below. More specifically there are three funds that we believe will accomplish this goal: LFRIX, STPZ, and PRHYX.



*This is the allocation for the bond portfolio that we suggest based on our stated goals.*

| Old Allocation | Duration | Weight | WA Duration | TTM  | WA TTM |
|----------------|----------|--------|-------------|------|--------|
| TTRZX          | 1.85     | 70%    | 1.295       | 4.77 | 3.339  |
| STPZ           | 2.53     | 30%    | 0.759       | 0.09 | 0.027  |
| Total          |          |        | 2.054       |      | 3.366  |

*This allocation has a weighted average duration of 2.054 with a weighted average trailing twelve-month yield of 3.366.*

| New Allocation | Duration | Weight | WA Duration | TTM  | WA TTM |
|----------------|----------|--------|-------------|------|--------|
| LFRIX          | 0.25     | 35%    | 0.0875      | 4.6  | 1.61   |
| STPZ           | 2.53     | 35%    | 0.8855      | 0.09 | 0.0315 |
| PRHYX          | 3.51     | 30%    | 1.053       | 5.99 | 1.797  |
| Total          |          |        | 2.026       |      | 3.4385 |

The new allocation has a weighted average duration of 2.026 with a weighted average trailing twelve-month yield of 3.4385. The new allocation has **decreased** the duration by .28 and **increased** the yield by 0.0725 percent.

### Floating Rates—35% Allocation

First, we recommend using the rising interest rate environment to our advantage with a floating rate fund. A floating rate fund is a financial instrument that allows investors to invest in a fixed income product that has coupon payments that vary with a reference rate such as the London Interbank Offered Rate. We recommend this type of product to provide diversification and to prepare for the rise in interest rates in 2015. This fund in particular is the best in its class. It has the highest return attribution, very low duration and a low expense ratio.

### TIPS—35% Allocation

Second, Crummer's tuition is increasing and it is important that we have a fixed income product that hedges the implicit tuition inflation. According to Steve Gauthier, the associate dean, a 2.5 percent increase in tuition rates is expected in 2014 for the Early Advantage MBA program. We need something in the portfolio that protects the buying power of scholarships for future generations of students. While this hedge is not perfect, it does provide some protection against inflation. As the consumer price index increases so, will this product. This also provides us with a quality government bond in case there is a flight to quality in the future. As the summary below shows, inflationary expectations are not dead.

| Source                             | Date Provided (2014) | Inflation 2014 | Inflation 2015 |
|------------------------------------|----------------------|----------------|----------------|
| Survey of Professional Forecasters | February             | 1.60%          | 1.80%          |
| Wells Fargo                        | March                | 1.40%          | 1.90%          |
| Wall Street Journal                | March                | 1.90%          | 2.10%          |
| Federal Reserve                    | March                | 1.5% - 1.6%    | 1.5% - 2.0%    |
| Congressional Budget Office        | February             | 1.50%          | 1.70%          |

Table provides inflation expectations for 2014 and 2015

### High Yield Corporates—30% Allocation

Finally, we recommend purchasing high yield corporate bonds for two reasons: high yield corporate bonds have less interest rate risk and they perform best when the economy is expanding and default risk is low. As noted previously, interest rates are expected to rise. These bonds have higher coupons and higher duration. We also expect the economy to do

well. An expanding economy minimizes both flight to quality risk and default risk in corporate bonds. Because we believe most of the risk with a high yield bond is credit risk, an expanding economy should minimize default.

## Conclusion

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We expect interest rates to rise in the spring of 2015. Our goal with the portfolio is to decrease duration and increase yield. We have accomplished that goal through an allocation of 35 percent floating rate, 35 percent TIPS, and 30 percent high yield bonds.

# Appendix

## Crummer SunTrust Portfolio Investment Policy Statement

(Revised April 6<sup>th</sup> 2008)

### Crummer/SunTrust Portfolio

1.1 History: The SunTrust Banks of Central Florida Foundation contributed all of the Crummer/SunTrust Portfolio's (Portfolio) initial assets, totaling \$500,000 beginning with \$100,000 per year in 1999, and no additional contributions are expected. The Portfolio is part of the Rollins College endowment and is exempt from federal income taxes.

1.2 Purpose: The Portfolio was established to fund periodic scholarships for students at the Crummer Graduate School of Business and to provide Crummer students with practical experience in portfolio management. The Portfolio expects to exist in perpetuity and the only required distribution is the funding of scholarships.

1.3 SunTrust Scholars: SunTrust Scholarships are funded by an annual amount established by the Crummer School that generally follows the endowment distribution policy of Rollins College—4½ percent of the three-year moving average of the Portfolio's market value at calendar year-end.

### Governance

2.1 Students: The students in Crummer's portfolio management class (class) act as security analysts and portfolio managers, making recommendations on portfolio strategy and individual asset selection, subject to the guidelines and limitation set forth in this Investment Policy Statement. This statement assumes the class is only offered in the spring term (January to April).

2.2 Oversight: An Oversight Committee (Committee), consisting of industry practitioners, a member of the Rollins College Board of Trustees, if the Board so chooses, a member selected by the Vice President of Finance at Rollins College and a Crummer faculty member, provides guidance for the Portfolio. The overall philosophy of the Committee is one of oversight and not direct portfolio management. When the class is not in session, however, changes in the portfolio can be made by the Committee but only in light of events with the potential to significantly affect the portfolio's value.

2.3 Prohibited Transactions: No transactions for the portfolio can be undertaken that are contrary to the SunTrust gift agreement, if any, or to applicable Rollins College Trustee policies.

### Long-term and Short-term Investment Approaches

3.1 Long-term Strategy: The Portfolio operates in both long-term and short-term environments. As a perpetual portfolio, its long-term investment strategy is designed for a conservative investor who seeks a real total rate of return that will maintain the purchasing power of the Portfolio after distributions and net of expenses. A long-term portfolio will inevitably encounter many market cycles so the asset allocation is expected to be relatively constant. Table A contains the current long-term real growth and inflation expectations. These expectations are subject to an annual review by the class.

3.2 Short-term Tactics: On an annual basis, the Portfolio will adopt a tactical (short-term) sector tilt relative to the sector market weights of the S&P 500 Index. This investment tactic is designed to take advantage of short-term (one year or less) market movements by establishing the managers' economic outlook and then underweighting sectors that are expected to do poorly and overweighting sectors that are expected to do well. The S&P 500 sectors are shown in Table B. Tactical sector targets may deviate as much as +/- 20% from each sector's S&P 500 market weight.

3.3 Objective: These short-term and long-term approaches are consistent with the intent to maintain the Portfolio's value in down market environments and increase its value in up market environments while funding scholarships—all without diminishing principal.



## Long-Term Perspective and Asset Allocation

4.1 Risk in the Portfolio is managed by allocating among asset classes and investment styles within asset classes as a long-term strategic policy. The Portfolio's asset classes, strategic targets, and designated benchmarks are discussed in Section 10.2 and listed in Table C. Monitoring asset allocation, combined with a sector focus, is designed to keep the Portfolio consistent with both its short and long-term goals.

## Rate of Return

5.1 Target: The Portfolio's target rate of return incorporates the investment goals and spending policy. The target rate of return, investment goals, and expected volatility are interrelated and must be viewed as such. The long-term target rate of return goal that accommodates the Portfolio's expenses and distributions is attached as Table A.

5.2 Horizon: The investment horizon of the Portfolio is perpetual and preservation of the real value of principal is necessary with such a long-term perspective.

5.3 Investment Decisions: Long-term objectives guide asset allocation decisions. Short-term opportunities guide sector weight decisions.

5.4 Growth: The primary source of Portfolio growth is expected to be judicious and timely security selection. While the Portfolio might fund additional scholarships with a more aggressive asset allocation (e.g., all equity)—prudence, and the perpetual life of the Portfolio, suggest a less risky approach that will allow the value of the Portfolio to rise with the US economy. This organic economic growth is expected to be in line with historical experience—in the range of 2 to 2½%.

## Portfolio Transactions

6.1 The class recommends one portfolio composition per year to the Committee. The Committee has the authority to make changes in these recommendations.

6.2 Trades in the Portfolio are made in only one batch each year, typically in mid-April, following the class presentation to the Committee. See Section 2.2 for exceptions.

## Cash Requirements

7.1 Scholarship Funding: Because the date of the scholarship draw varies around the end of the College's fiscal year (May 31), as of May 1 the Portfolio will hold a cash reserve large enough to cover the annual scholarship funding rather than requiring security liquidation.

7.2 Transactions Costs and Fees: Trading costs and fees will be funded in cash and incorporated into the annual transactions to avoid forced security liquidation and will usually be covered by normal sell recommendations.

## Volatility

8.1 The target rate of return will ultimately dictate the level of risk in the Portfolio. If the expected volatility of the Portfolio is deemed inappropriate, the class will recommend a change in the target rate of return to the Committee.

## Income, Appreciation and Taxes

9.1 The Portfolio pays no taxes on investment income and, therefore, the investments are not tax sensitive. Portfolio distributions are not limited to realize income and, therefore, the Portfolio need not generate income to fund its spending policy. The cash requirements can be met by liquidating securities before May 1 (see Section 7) and will usually be covered by normal sell recommendations.

## Sector & Asset Allocation

10.1 Short-term Sector Allocation: To achieve its short-term tactical investment objective the Crummer/SunTrust Portfolio's assets shall be managed by under- and overweighting S&P's ten market sectors. These sectors are listed in Table B. The tactical target deviations are +/- 20% of their S&P 500 market weights. Cash is a separate asset class and governed by the asset allocation policy.

10.2 Long-term Asset Allocation: Asset classes are outlined in Table C. Each asset class will have a minimum of 5% of the portfolio value. In the short-term, security selections are driven by sector weights and, although stable asset class allocations are essential for risk control, they are flexible enough to allow tactical sector allocations in the short run.

10.2.1 Equity Styles: Asset allocation recognizes equity investment styles to help manage the risk of the portfolio. Investment styles within the equity asset class are defined as follows:

10.2.1.1 Value—companies believed to be undervalued with potential for capital appreciation.

10.2.1.2 Growth—companies that are expected to have above average long-term growth in earnings and profitability.

10.2.1.3 Small Cap—companies with total market capitalization less than one billion dollars.

10.2.1.4 Mid Cap—companies with total market capitalization between one and five billion dollars.

10.2.1.5 Large Cap—companies with total market capitalization greater than five billion dollars.

10.2.1.6 International—equity investments in companies domiciled outside the U.S. are limited to American Depository Receipts (ADRs) listed on major U.S. exchanges or to mutual funds or exchange traded funds.

10.2.2 Each of the three size styles is combined with value and growth to produce seven equity styles: large growth, large value, mid growth, mid value, small growth, small value, and international.

10.2.3 While equity styles go in and out of favor over time, the portfolio's strategic risk control relies on a stable asset allocation near the target. Chasing the best performing equity style is inconsistent with maintaining value in the long term.

10.3 Bonds: Bonds function as both an asset class and a sector.

10.3.3 Allocation Range: The portfolio relies on the bond asset class to moderate risk over the long term through diversification. Therefore, the bond allocation range is limited.

10.3.4 Bonds as a Sector: Bonds are similar to a sector with an economic outlook that the managers should have the flexibility to incorporate into the portfolio.

10.3.5 Risk Control: The bond allocation's ability to temper the portfolio's risk is dependent on reasonable controls over the risk of the bond portfolio.

10.3.6 Effective Duration: To establish risk control, the bond portfolio's effective duration is bounded between 3.5 and 5.5 years.

10.3.7 Flexibility and Risk Control: By varying both the bond allocation and the effective duration, the managers have enough flexibility to take a view of the bond sector's prospects without distorting the risk profile of the portfolio.

10.3.8 Strategic and Tactical Balance: The managers must balance short and long run objectives and, therefore, navigate between sector and asset allocations. There is no set formula and the best judgment of the class and the Committee must be used to accommodate both tactical sector weights and strategic asset class allocation.

10.3.9 Diversification Limit: No individual asset in the portfolio may represent more than 5% of the total market value of the portfolio. This rule does not apply to mutual funds or exchange traded funds.

10.3.10 Derivatives: The Crummer/SunTrust Portfolio may contain derivative securities. Typically, the Portfolio will only use derivatives as a hedge in association with the derivatives class. In this case, a separate written proposal must be approved by the instructors involved. The cash required by these hedges will constitute no more than 10% of the Portfolio's market value.

### Rebalancing Procedure

11.1 Should the asset allocation range for a particular asset class or sector be breached by reason of gains, losses, or any other reason, the class will recommend whether to rebalance the assets to the target asset class allocation, taking into account the transaction cost. In addition, the Committee shall have the authority to review the actual allocations at any time to insure conformity with the adopted tactical and strategic allocations. See Section 2.2. The assets will not be automatically rebalanced on any set schedule.

### Custodian

12.1 SunTrust Bank is the custodian for the assets of the Crummer/SunTrust Portfolio.

**Table A**

Target Rates of Return, Components, and Spending Policy

|                                     | Long Term | Short Term             |
|-------------------------------------|-----------|------------------------|
| Administrative and Trading Expenses | ½ - 1%    | ½ - 1%                 |
| Allowance for Inflation             | 2 - 3%    | Consumer Price Index   |
| Distribution from Portfolio         | 3½ - 5½%  | Approximately \$25,000 |
| Portfolio Real Growth               | 2 - 2½%   | > 0%                   |
| Target Total Return                 | 8 - 11½%  | Dependent On Above     |

**Table B**

## Crummer/SunTrust Portfolio Equity Portfolio Sectors

|                        |                                  |
|------------------------|----------------------------------|
| S&P 500 Sector         | Benchmark                        |
| Consumer Discretionary | S&P Consumer Discretionary Index |
| Consumer Staples       | S&P Consumer Staples Index       |
| Energy                 | S&P Energy Index                 |
| Financials             | S&P Financials Index             |
| Healthcare             | S&P Healthcare Index             |
| Industrials            | S&P Industrials Index            |
| Information Technology | S&P Information Technology Index |
| Materials              | S&P Materials Index              |
| Telecom                | S&P Telecom Index                |
| Utilities              | S&P Utilities Index              |

Target Deviation for any sector is +/- 20% of its S&P 500 market weight

**Table C**

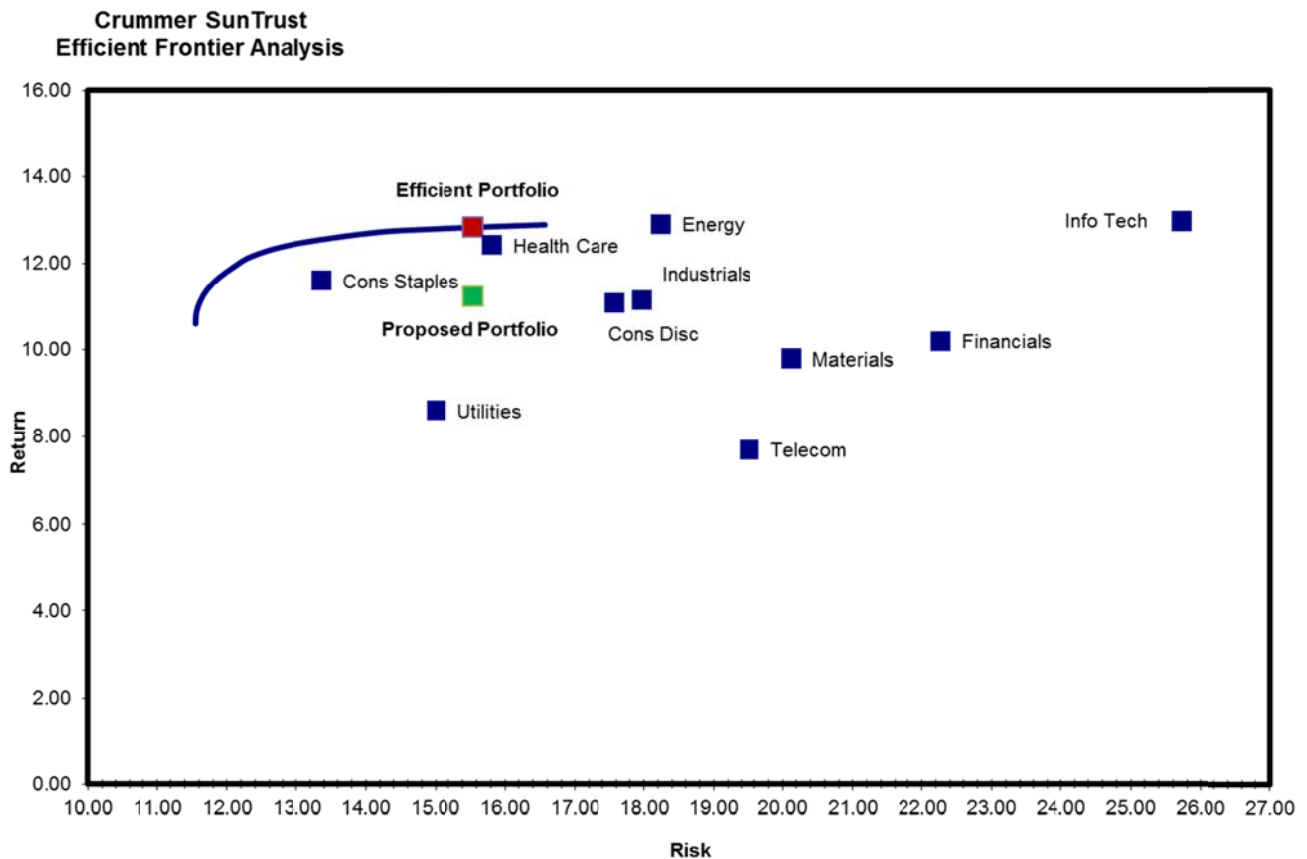
## Crummer/SunTrust Portfolio Asset Allocation Guidelines

| Asset Class          | Target Range |      |      | Benchmark                                  |
|----------------------|--------------|------|------|--------------------------------------------|
|                      | Low          | Mid  | High |                                            |
| Large Cap - Growth   | 10%          | 20%  | 30%  | Russell 1000 Growth                        |
| Large Cap – Value    | 10%          | 20%  | 30%  | Russell 1000 Value                         |
| Mid Cap – Growth     | 5%           | 7.5% | 10%  | Russell MidCap Growth                      |
| Mid Cap – Value      | 5%           | 7.5% | 10%  | Russell MidCap Value                       |
| Small Cap - Growth   | 5%           | 10%  | 15%  | Russell 2000 Growth                        |
| Small Cap – Value    | 5%           | 10%  | 15%  | Russell 2000 Value                         |
| International Equity | 5%           | 10%  | 15%  | MSCI – EAFE                                |
| Fixed Income         | 12%          | 15%  | 18%  | Vanguard Total Bond Market Bond Index Fund |
| Derivatives          | 10%          | Max  |      |                                            |
| Cash                 | as needed    |      |      |                                            |

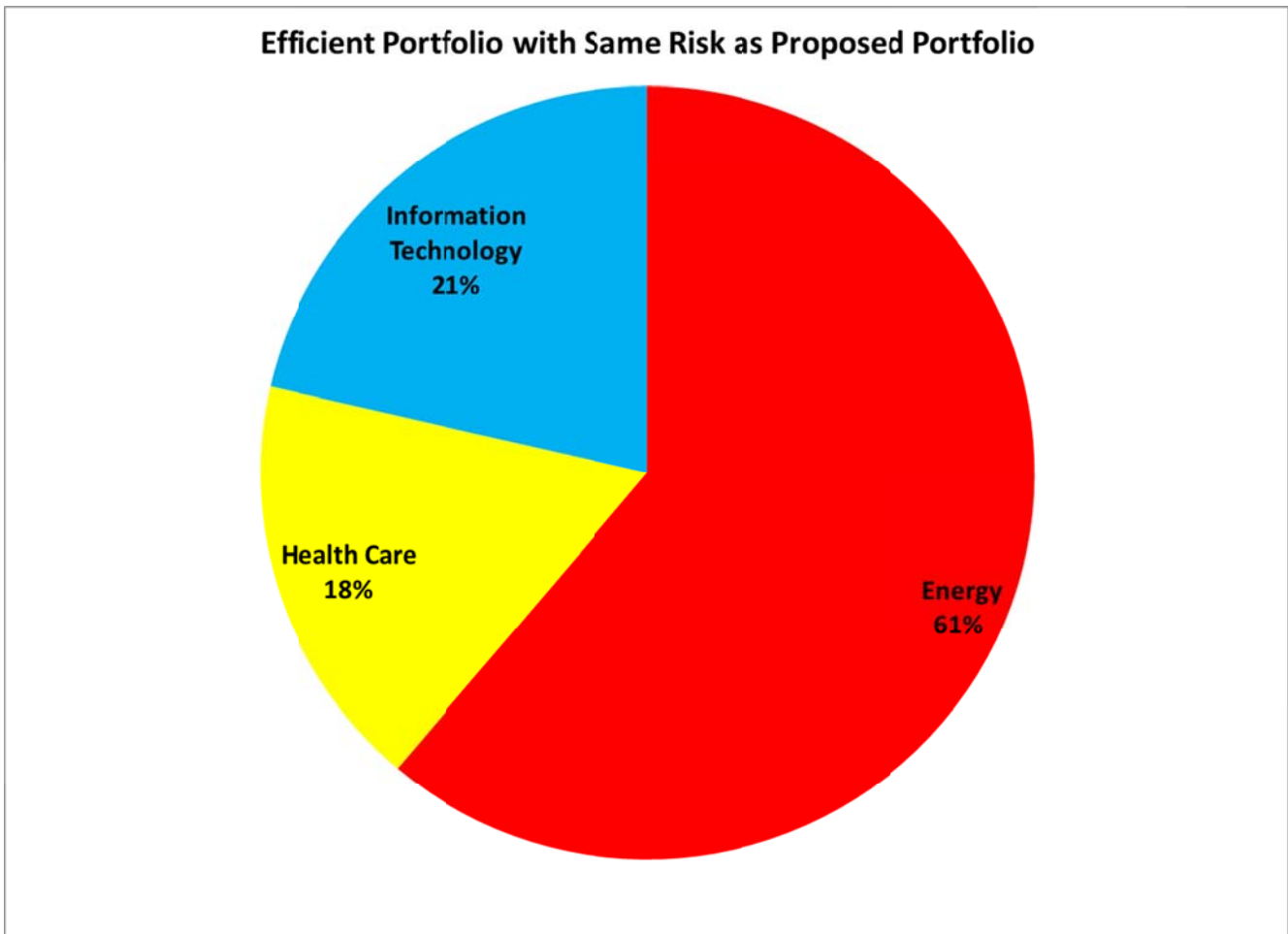
Minimum weight for any asset class is 5%

## Mean-Variance Efficiency Analysis

Mean-variance efficiency analysis is part of modern portfolio theory. Although not a widely used guide to constructing portfolios, this analysis can identify where the proposed portfolio might be improved. To conduct this analysis we assembled historical data for the ten equity sectors and constructed the efficient frontier shown in the chart below. The efficient frontier traces those portfolios of the ten sectors with the lowest amount of risk (standard deviation). The chart also plots the individual sectors and the proposed portfolio.



Of most interest in this analysis are the two portfolios: proposed (in green) and mean-variance optimal (MVO) (in red on the efficient frontier). The proposed portfolio offers an expected return of 11.5% with a standard deviation of 15.5%. The corresponding MVO portfolio has the same risk but a higher expected return, 12.8%. Unfortunately, this increase in return requires a sector allocation that places 61% in the energy sector, 21% in IT and 18% in Health Care (shown in the chart below).



This portfolio, while more efficient, is inconsistent with our short-term economic expectations strategy and undesirable from a diversification perspective. We only use the mean-variance efficient portfolio as a check on our allocations because the MVO portfolio is poorly diversified and would not be acceptable under the IPS. We do observe, however, that the proposed portfolio is nearly as efficient in providing a reasonable return for the risk assumed.

## Technical Analysis Tools

Although fundamental value-based analysis was the primary method for stock recommendations, we also used some technical analysis tools to determine whether the timing of the trade is right. Within the portfolio management group, we hold the belief that fundamental analysis answers the question of, “What securities do we buy and sell?” while technical analysis provides the answer to, “Is this a bad time to buy or sell the securities identified?” The three tools that each analyst used after conducting fundamental research were Bollinger Bands, Money Flow Index and RSI.

### Bollinger Bands

Bollinger Bands were created by John Bollinger in the 1980s to measure the peaks and troughs of the price relative to previous trades. The bands are as follows:

- Middle band – a simple moving average (SMA)
- Upper band – shows a standard deviation above the middle band
- Lower band – shows a standard deviation below the middle band

When the price is at the lower band, it is expected to revert upward toward the middle band. When the price is at the upper band, it is indicating a reversion downward to the middle band. However, the Bollinger Bands can also indicate price breaks to the upside and downside if the price goes outside of either band with strong volume.

### Money Flow Index

The Money Flow Index is an oscillator that uses both price and volume to determine if money is flowing in or out of a security. Money flow is positive when there is buying pressure and negative when there is selling pressure. This number is multiplied with the RSI and gives a range from 0 to 100. This indicator tells whether a stock is overbought (80 or above) or oversold (20 or below).

### RSI

The RSI, developed by J. Welles Wilder, is the Relative Strength Index. The RSI is a momentum oscillator that monitors both the speed and change of price movements. The indicator ranges from 0 to 100 and indicates overbought (above 70) and oversold (below 30) conditions.

### Value at Risk

“Value at risk (VaR) measures the worst expected loss under normal market conditions over a specified time interval at a given confidence level.” - Financial Modeling, Simon Beninga. VaR is another technical tool that helps us evaluate the changes we propose. VaR is widely used in investment banking and as is required for commercial banks under Basel III.

One way to interpret this concept is that VaR answers the question: how much would the Rollins SunTrust Portfolio lose in a major market breakdown with 1% of probability over next year. The idea is not to drive the VaR to zero because riskless portfolios earn the risk-free rate of return. Rather, we want to compare the VaR between alternative portfolios. Our VaR calculations used the historical returns for each sector and assumed no trading during the next year. We calculate VaR for the portfolio with current, market, and proposed sector weights to determine whether we are risking more money by carrying out our proposed allocations.



### Our Findings:

- VaR with our proposed sector weights at 1% confidence level: \$129,539
- VaR with current portfolio sector weights at 1% confidence level: \$120,446

Our VaR analysis suggests our proposed sector allocation exposes the portfolio to more risk than the current sector allocation at the 1% confidence level. These results make sense, as our goal was to position the portfolio to take advantage of a continued market recovery. VaR increases slightly as we move to the proposed sector allocations.