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Crummer/SunTrust Portfolio Recommendations [2011]

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Dear members of the oversight committee,

Although many of us have taken classes at Crummer that offer hypothetical business simulations, this class has been a brand new experience. The uniqueness of this class comes from the fact that we are working with real, not virtual, money, making decisions for a live Crummer/SunTrust Portfolio and we have learned a great deal.

We (the students) all assumed extra responsibility when it came to the final investment recommendations. First, our decisions will affect future scholarships offered at Crummer and the students who depend on them. Second, because the portfolio has performed extremely well, we recognized a greater accountability to continue the portfolio’s legacy. In fact, because the portfolio has done so well recently, the cash requirement for the scholarships has been increased from $20,000 to $25,000 in 2011. We discuss the account’s performance since its inception in 1999 later in this report.

This portfolio is unique. We have only one at bat to get it right because we only trade once a year. Therefore, we must execute our trades in mid April 2011 without regard to market timing. As much as we might be tempted to try to hit a home run for the next 12 months, our decisions must be both short and long term oriented. Our recommendations came from a thorough analysis of the past, present and forecasted market performance. We relied largely on the past performances of various asset classes to develop the portfolio’s asset allocation. Analysis of the current economic conditions supported our asset class allocation recommendation and provided consistency for the sector analysts’ individual security selections. In addition, based on the current market conditions and analysis of the common circumstances affecting market sectors, a tactical sector tilt was adopted relative to the sector market weights of the S&P 500 Index. Both long and short-term strategies adopted by the management team are consistent with the IPS requirements.

We look forward to discussing our analysis with you on April 12, 2011, and hope to receive your approval to implement our portfolio recommendations.
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Executive Summary

The portfolio we inherited was not consistent with the IPS. To satisfy the IPS we rebalanced the portfolio to meet both asset class and sector allocation requirements.

Asset Class Requirements

Modern Portfolio Theory provided a benchmark portfolio we used as a guide for the asset class allocation. Based on the historical performance of the asset classes and the constraints identified in the IPS we generated an efficient frontier to provide a benchmark. We selected an efficient portfolio with the best risk-return characteristics. When we compared this portfolio to the previous year’s asset class allocation, we found that our current portfolio was overweighted in the Large Cap Sector and had barely any presence in the Small Cap asset classes—both inconsistent with the IPS. To better match the IPS and achieve a more efficient risk-return balance, we needed to increase our allocation in these asset classes. The current economic situation provided additional guidance on how best to rebalance the portfolio.

In its second post-recession year, the American economy is growing at higher than anticipated rates. This time around, however, it is not recovering as fast as it did after the previous recessions. Many analysts attribute this steady growth to a healthier business environment, where unlike the technology boom in the 1990s or the housing boom of the 2000s, this economic recovery is not being “sponsored” by bubbles. Many economic indicators signal a positive environment for U.S. corporations to continue their growth. We predict that U.S. GDP would be nearing 4% growth by 2012, with inflation remaining at current low levels; largely because we believe the Fed will continue to keep interest rates near zero. These economic indicators support the efficient frontier portfolio’s investment mostly in equities with a minimum of 12% (as per IPS) in fixed income securities. Additionally, one of characteristics of current economic recovery is corporate “cash hoarding.” U.S. corporations are sitting on approximately $1.6 Trillion and, when they start spending these funds, we believe they will be spending a large portion of them in mergers and acquisitions. The prospect of an M&A wave was another reinforcing factor that led us to continue using the efficient frontier as a reference portfolio and to increase our position in the small asset classes when making allocation decisions for the selected securities. To increase our small cap allocation, we challenged our analysts to look for worthy small cap stocks for the 2011 portfolio.

Sector Requirements

To meet the short-term objective of the portfolio our sector analysts thoroughly researched S&P 500 sectors assigned to them. Based on their analyses, sectors’ past performances in post-recession years, and the specifics of the last recession, we adopted a sector tilt for the recommended portfolio that reflects our optimistic economic perspective. We used both fundamental and technical analyses of the companies to make recommendations on the stock selections for the proposed portfolio. Value-at-Risk analyses were performed when the allocation decisions were finalized; it indicated that proposed allocation would reduce the VaR by $4,450 when compared to the allocation of the current portfolio. Additionally, our analysts performed a sector correlation analysis to demonstrate how well their stock selection will be representing their sector in the proposed portfolio. The average sector correlation is sufficiently high to assure us the recommended stocks adequately represent the sectors. The correlation analysis can be found in the appendix.
Crummer Investment Management

Crummer Investment Management Team

Managing Director: Ina Toderita
Sector Managers: Daniel Parry
Jared Schneider
Consumer Discretionary Sector Analyst: John Flatley
Consumer Staples Sector Analyst: Kevin Ford
Energy Sector Analyst: Neil Asma
Financial Sector Analyst: Nicole Hession
Fixed Income Analysts: Kevin Schnacke
Ronald Wensing
Healthcare Sector Analyst: Jennifer Anderson
Industrial Sector Analyst: Homer Marshman
Technology Sector Analyst: Michael Ackerman
Materials Sector Analyst: Dean Walker
Telecommunications Sector Analyst: Ardit Bitincka
Utilities Sector Analyst: Thomas Biddinger
Performance of the Crummer SunTrust Portfolio

Since Inception

The Crummer SunTrust portfolio invested the first $100,000 SunTrust contribution in April 1999. As the chart shows, the performance lagged the S&P 500 index until early 2002. Since then the portfolio has had a higher return with less volatility than the benchmark. By the end of February 2011, the portfolio’s since-inception return was 12.19% (with a standard deviation of 4.37%) versus the S&P 500 index’s annual return of 10.39% (with a standard deviation of 4.68%) over the same period.
The following chart shows annual returns by plan year, i.e., starting in May when the students’ recommendations are implemented.

As this chart shows, the plan year returns were better than the S&P 500 index returns in six of the eleven years (2001, 2002, 2004, 2005, 2007, and 2008).

2010 – 2011 Plan Year Performance Highlights

The student recommendations for the portfolio for the ten months ended February 2011 resulted in an 8.29% return while the S&P 500 index returned 13.80% for the same period. Their hold recommendations carried the portfolio while their buy recommendations showed a net loss.
Buy Recommendations

Analyzing the individual buy trades executed last April, the twenty-eight buy recommendations resulted in a net loss of $4,801. The five biggest winners and losers in total dollars (price change times shares) are shown in the following chart. For example, the portfolio bought 400 shares of Cisco at $27.32 in April 2010 and it closed on February 28, 2011 at $18.56 for a loss of $3,504. Alternatively, 75 shares of Amazon.com were purchased at $143.77 and closed at $173.29 for a gain of $2,214.

This chart shows security positions that were purchased in April 2010. Red indicates the five largest losses between April 2010 and February 28, 2011—black indicates the five largest gains.
The students’ sell recommendations were not particularly timely. The fifteen positions they sold would have resulted in a $25,988 gain for the portfolio as winners outpaced losers in this group. The chart below illustrates the point with the five biggest winners and losers. For example, the portfolio sold its position in the Vanguard Intermediate Bond Fund at $9.86 in April 2010 and by the end of February 2011, these shares were priced at $13.31, resulting in a lost opportunity worth $12,850. On the other hand, the portfolio avoided a loss of $1,178 by selling St Jude Medical, which went from $41.04 to $35.15.

This chart shows security positions that were sold in April 2010. Red indicates securities that subsequently gained in price through February 28, 2011—security positions that lost value are shown in black.
Hold Recommendations

The students analyze each portfolio position and make either a buy, sell, or hold recommendation. The twenty-three hold recommendations performed well, enabling the portfolio to show an 8.29% gain for the plan year. As the chart shows, IBM and Suncor Energy were among the biggest gainers while Clean Energy Fuels and Colgate-Palmolive were among the biggest losers. In dollar value, however, winners outpaced losers. In fact only five of these twenty-three hold recommendations lost value.

![Chart showing security positions that were continued through the plan year—April 2010 to February 28, 2011. Red indicates securities that lost value over the year while security positions that gained value are shown in black.]

Fixed Income

The portfolio began the plan year with 3.89% allocated cash (to fund scholarships), 91.61% to equity, and 4.50% to fixed income (TIPS). Included in the equity allocation was Annaly Capital Management, a REIT. The Annaly investment started the plan year at $19,848 and closed the year at $20,996 after paying over $3,000 in distributions. The fixed income allocation was all in TIPS through the Vanguard Inflation Protected Securities mutual fund. This investment started the plan year at $30,403 and ended at $31,674.

The gain in these two investments was not material to the portfolio’s performance. At February 28, 2011, the portfolio had 2.50% allocated to cash, 4.46% allocated to fixed income (TIPS), and 93.04% allocated to equities.
**Long-Term Asset Allocation Recommendation**

The Crummer/SunTrust portfolio asset allocation guidelines provide a wide range of alternatives for the class allocation decision. To choose the most desired allocation the management team looked at the past performance and volatility of each class. A mean-variance optimization was utilized to find an optimal portfolio (the portfolio with the smallest risk for a desired level of expected return). We choose appropriate benchmarks and their target range provided by the IPS as constraints to make a decision for the desired class allocation suitable for the portfolio’s long-term strategy.

The following optimal portfolio was selected from the efficient frontier:
When comparing the current portfolio with the efficient portfolio it was evident that our current holdings were overweighted in Large Cap and rather underweighted in the Small Caps. The chart below shows asset class distribution in the portfolio we have inherited in the beginning of the year.

The management team requested portfolio analysts to find new companies for the portfolio in the Small Cap segment. During their research, our financial analysts ran into difficulties finding worthy small cap value companies in the time they were given. To have presence in this asset class it is our recommendation to allocate 5% of the portfolio value in Vanguard Small-Cap Value ETF (VBR). We propose not to use all 15% of the efficient portfolio designated portion for a Small Cap Value ETF to preserve control over portfolio’s holdings. The management team allocated 8% of the portfolio value in small cap growth. A higher percentage allocated into the small growth cap sector is backed by our analysts’ research of each recommended security.

Additionally, we did not look specifically for international companies to satisfy the IPS as many of the companies recommended for the portfolio have a significant international presence. Our research indicated that over 30% of the sales in the recommended companies are from outside the US. The management team
concluded that rather than insist on companies domiciled outside the US, the companies we have recommended satisfy the IPS requirement for international allocation.

The Risk-Return analysis for our recommended portfolio would have generated a 10.93% return with a standard deviation of 15.20 since 1986. The return of the recommended portfolio is slightly lower than returns by both the efficient portfolio and the S&P 500. The standard deviation of the proposed allocation is somewhat higher than the efficient portfolio’s standard deviation, but is notably lower in comparison to the S&P 500. The following chart shows how our recommended portfolio compares to the efficient frontier and to the S&P500:

<table>
<thead>
<tr>
<th></th>
<th>Rate of Return</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Efficient Portfolio</td>
<td>11.03%</td>
<td>14.74%</td>
</tr>
<tr>
<td>Crummer Portfolio</td>
<td>10.93%</td>
<td>15.20%</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>11.05%</td>
<td>17.06%</td>
</tr>
</tbody>
</table>
Additionally, the Sharpe Ratio was used to measure the excess of return per unit of risk for the efficient portfolio, the proposed portfolio, and the S&P 500. As shown on the chart below, at the same level of risk the efficient portfolio would have generated the highest return followed by our proposed portfolio, which would have outperformed the S&P 500.

![Sharpe Ratio Chart]

As per IPS the Crummer portfolio is benchmarked to the S&P 500, based on the risk-return analysis we have concluded that the proposed asset class allocation satisfied this requirement. To further justify our allocation recommendations we looked closely at the current economic environment and the outlook for the U.S. corporations.
**Economic Outlook**

**U.S. Economic Growth (GDP)**
Various forecasters are predicting U.S. economy to experience a gradual growth in 2011 and most predict above-trend growth in 2012. Goldman Sachs foresees the economy growing at 3.5% in 2011 and 4% by early/mid 2012. Managing Director and Senior Economist at JPMorgan Chase, James Glassman, forecasts 2% GDP growth in the first half of 2011, 3.5% growth in the third quarter, and 4% percent growth in the fourth quarter. Recently, Fed upgraded its forecast for 2011 to 3.4-3.9% from its previous range of 3-3.6%. Our forecast is 3.6% GDP growth in 2011, and 4.0% growth for 2012.

**Inflation**
In its economic outlook Goldman Sachs is predicting inflation in the U.S. to remain stable below the Fed’s “mandate-consistent” 2%, largely due to the high unemployment rates and slow growth in the housing market. This outlook is consistent with the J.P. Morgan’s survey of finance professionals, the mean response regarding the core inflation, measured by the consumer price index excluding food and energy, was at 1.8% for the next year. However, their sentiment for the medium term (2-5 years) is 2.9%. Another indicator of low inflation expectations for 2011 is the spread between regular treasury bonds and inflation-protected bonds (TIPS) which is at 2.63% for a 10-year term, as of April 6, 2011. At the same time, a March consumer survey by Thomson Reuters/University of Michigan shows that consumers anticipate 4.6% inflation for 2011 from now and 3.2% for a five-year term. A different outlook on the U.S. inflation by the consumers may lead to the higher wages and prices incorporated into union contracts, which will result in swelling of the actual inflation. We believe the inflation will remain at low levels around 2% for the next year.

**Interest Rates**
There is no indication from the Federal Reserve that they would allow a spike in interest rates in the near future. In fact, as recently as April 2, the most powerful Fed’s decision makers signaled that that they would continue keeping the rates at the lowest possible levels. Although there are some regional Fed presidents who are pushing for the rate increases due to the high unemployment rates, New York Fed President William Dudley says now is not a time to reverse the course.¹ Many analysts agree that the rates will remain at the current low levels all through 2011; Goldman Sachs analysts are forecasting no rate hikes until 2013.² Current interest rate outlook and its effect on the investment decisions are discussed further in the report in the Fixed

Income section. We are forecasting that interest rates will remain at current low levels through 2011 and the beginning of 2012.

**Unemployment**

On April 1, the U.S. Department of Labor and Statistics reported a slight drop in the unemployment claims for March 2011 at 8.8%, which resulted from a 216,000 non-farm job increase.³ This is only the second payroll increase since 2007.⁴ The unemployment forecasts remain pessimistic: the Fed, Wells Fargo, Congressional Budget Office, and The White House’s Office of Management and Budget all forecast the unemployment rate for 2012 to be between 7.6% and 8.2%.⁵ We believe that unemployment will be decreasing slowly in 2011, and will not get below 8% by year-end.

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³ United States Unemployment Rate. Trading Economist. [www.tradingeconomics.com](http://www.tradingeconomics.com)

⁴ Blake, Rich and Fahmy, Dalia. Hoarding, Not Hiring – Corporations Stockpile Mountains of Cash. abcnews.go.com April 1, 2011

⁵ Economic Forecasts. [http://web.rollins.edu/~wseyfried/forecast.htm](http://web.rollins.edu/~wseyfried/forecast.htm)

Corporate Cash Reserves
A rather unique post-recession attribute shared among US corporations is their unusually high cash reserves. The Bureau of Economic Analysis estimates cash reserves of U.S. corporations at approximately $1.6 trillion with S&P 500 companies holding approximately $1.1 trillion. As a percent of their total market capitalization, this is more than double their reserves before the recession years.  

Summary
Our analysis of the current economic situation forecasts a favorable environment for growth for U.S. corporations. As described earlier, our desired asset class allocation distributes only the minimum to cover the fixed income and cash constraint; the rest of the portfolio is allocated to equities. Predicted economic growth means increased production and low interest rates will provide a favorable environment for U.S. corporations to grow earnings. In addition, low inflation will help keep costs low, allowing businesses to hold prices for their goods and services. Even though we believe U.S. consumers are not ready to pay higher prices due to continued high unemployment, low costs mean corporations should not have to squeeze their profits. Additionally, high cash reserves will provide companies with investment opportunities through M&A, which will be welcomed by our portfolio with 13%, allocated in small caps.

Short Term Tactical Sector Allocation

We have weighted the portfolio to favor certain sectors that the management team has deemed as preferable given where we are in the expansionary cycle and with a view towards current economic conditions. We researched the post-recession behaviors of sectors, to determine the proper assignments of the sectors weight in relation to this stage of the recovery. We chose to look at several different periods to aid in our tactical sector allocation. We chose to look at 20 months and 32 months after recessions as well as all non-recessionary periods since 1989—the period covered by the available sector performance data. We chose 20 months because that is the period since the end of the last recession through February 2011. We compared each sector’s performance for the previous two recessions for this period as well. We also looked at 32 months post recession to gain insight into the sectors that might be expected to perform best over the next twelve months. In the typical recovery since 1989, the top returning sectors included Consumer Discretionary, Industrials, Financials and Materials. We believe that the recovery from this recession will not resemble a typical sector based recovery. Because this recession was created by the financial sector, we are anticipating financials will underperform for at least the upcoming twelve-month period. We recommend, therefore, overweighting Consumer Discretionary, Industrials, and Materials that historically perform well in this stage of the expansionary cycle and underweighting the sectors that typically lag concurrently.

We have compiled our proposed sector weights versus the S&P weights in the appendix. In addition, the appendix includes an illustration of our sector analysis showing the returns for the select periods that our tactical sector allocation assumptions were based upon.
Sector Analysis
Consumer Discretionary

Historical Behavior is Volatile

The consumer discretionary sector is a cyclical industry tied closely to consumer spending. The consumer sector encompasses those consumer related industries that tend to be the most sensitive to economic cycles. Its manufacturing segment includes automotive, household durable goods, textiles & apparel and leisure equipment. The services segment includes hotels, restaurants and other leisure facilities, media production and services, and consumer retailing services.

Over 40% of the sector’s assets are tied to retailers, restaurants, about 23% are media-based companies, and about 22% are apparel and consumer goods companies. During the recessionary environment, this sector took a hard hit on total return. The S&P 500 consumer discretionary total return in October 2008 increased to -19.19% (its worst return in over 20 years), rivaling the other top total returns (losses) of -22.48% (Energy) and -22.07% (Materials). This sector typically averages a 1.5% total annual return in a more normalized market. However, we have identified specific opportunities within our analysis that we believe can exceed this return to meet the objective return for the portfolio. We believe that there are still sufficient opportunities to reap gains from the economic recovery as consumers shift away from their skittish view on the market.

Forward Look is Positive

We believe that this overall sector will benefit from even slight increases in macroeconomic factors like employment and consumer confidence, but most of the factors that will warrant growth in this sector are company-specific. The better a firm did to manage itself during the economic downturn the more faith we have that it has developed a forward-looking plan for success that it can execute. In addition, we know that some companies were more susceptible to downturns in the economy. However, those firms that managed to minimize earnings losses are generally better positioned for strong recoveries. We also know that some of these firms managed to stave off losses by cutting expenses while revenues stayed flat—painting a better picture to investors. Other firms grew margins but hoarded cash and are ready to begin to grow organically, inorganically, or both. We view the discretionary sector as poised for a good comeback, but we think that specific firms within the sector are better postured for growth because of their unique operating plans.
We give Amazon a sell rating due to its weakening competitive advantage and shortened pipeline of future opportunities.

Amazon.com, Inc. provides an online marketplace and is a retailer of almost anything from home and garden products to drum sets, dog food, and books. It also allows for Web-based payments and direct shipping to its customers.

Amazon Cannot Sustain Its Margins

Amazon will not be able to sustain the 3.4% average net margin it has attained through the 2007-2009 periods. The company will face margin pressure as it shifts its business model to incorporate slimmer-margin digital products. We believe that Amazon has the leadership to shift its business model under the leadership of current CEO Jeff Bezos. Bezos has a 20% stake in the company. However, we believe that investors are embedding unrealistic growth rates into Amazon’s current value and brand. Even if revenues were to continue to grow at its ten-year average of 35.6%, the company cannot continue to grow its operating margins, which have been flat at 4.4% as it transitions to digitally based products. Further, we believe that the increase in cap-ex spending since 2007 is indicative of the fact that Amazon is struggling to stay competitive. In 2007, Amazon spent $224 Million on cap-ex. From 2008 to 2010, Amazon increased its capital spending from 1.7% to 2.9% of sales. However, Amazon’s operating margin decreased 50bps from 2009 to 2010 and is trending to reach its lowest margins in nearly five years. Ironically, this low point followed the company’s report that the Kindle has become the best-selling product in the company’s history and that in 2010 it shipped a 29% increase in products compared to 2009. What we did not hear was that the Kindle is facing mounting competition from the tablet market to the point where Amazon may have to reduce pricing on the device.

Realistic Growth Rates Bring Realistic Fair Value

Amazon should be fair valued in the range of $94.33-$113.78. This is approximately a 38% discount to its current share price of $165.08. In addition, the shares are trading at all-time highs. We simply cannot justify the current share price from a risk-adjusted return basis, even using unrealistic growth rates. Compared to its peers, Amazon’s net margin is challenged the most by eBay Inc. eBay’s gross margin is 28.8% compared to Amazon’s 22.35%, but its current P/E is 16.7 versus Amazon’s 72.8 P/E. In addition, eBay’s 2010 earnings were approximately $1,800 Million compared to Amazon’s $1,152 Million. We feel that investors are pricing in very unrealistic growth expectations, when Amazon should realistically see net earnings growth between 3%-4% year-over-year for the next five years. The company has spent approximately $1,685 Million in capital expenditures over the past three calendar years.
but has not seen an exponential increase in earnings as a result. We think the company is forced to spend its free cash on cap-ex just to stay minimally competitive. We would have to price sustainable growth rates over the next six years that would increase Amazon’s EPS to nearly $20/share in order to justify its current share price. Its current EPS is 2.54.

**Conclusion & Recommendation**

Amazon does not offer a dividend so there is little reason to wait for the correction in price to happen. We need to sell here given the valuation and reap some healthy gains.
Abercrombie & Fitch Co. ANF

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We give Abercrombie a buy rating due to its potential for income growth through its new pricing model, and its shift to focusing more of its operations abroad.

Abercrombie operates as a specialty retailer of casual apparel for men, women and children, which includes Hollister and Gilly Hicks, less well-known subsidiaries that operate as a lingerie company and retailer of women’s at-home products, respectively.

**A&F’s New Pricing Model Will Drive Earnings**

Abercrombie reported $0 earnings in 2009 after the $79 Million loss it reported on its closure of RUEHL, but it reduced pricing and will soon be back to the margins it realized in 2008. We believe the stock has been over-penalized for its poor earnings in 2009. Abercrombie’s approach prior to its failure to generate sufficient earnings in 2009 was largely due to its premium pricing strategy. Its shares, however, have risen 59% in the last 12 months. In 2010, the company finally reduced its pricing 20%-30% and, in conjunction with an increase in overall consumer spending, reported net earnings of $288 Million, or a net margin of 8.78%. These earnings exceed that of its 2008 earnings of $272 Million and, per our estimates, are expected to trend past its 2007 levels of $476 Million.

We do not think investors are including enough value in this stock. Today’s market value of $54.76 would fall at the top end of our dividend discount model sensitivity analysis. However, since the company rolled out its new pricing model it has managed to maintain its premium brand name. Further, it is diversified in the sense that it targets several demographics through Abercrombie kids, Hollister, and Gilly Hicks that “compete head to head with existing brands like GapKids and Victoria’s Secret (Morningstar, 2011)”.

Abercrombie saw a 13% sales growth at Abercrombie & Fitch stores, a 12% increase at Abercrombie kids and a 17% increase at Hollister. The company reported better-than-expected total and comparable-store sales growth (Argus Research, 2011). In addition, the company’s overall December sales of $596 Million reflected a YOY increase of 26% versus its competitors that saw an average increase of just 15%. Certainly, this is attributable to its aggressive promotional environment, but management expects this to last through 2011. This is especially true because the company has more room than its competitors to cut prices.

Alongside the push to drive earnings is creating shareholder value. The company ended FYE10 with large stockpile of cash that at $680 Million, a significant increase from its $522 Million level at FYE 2009. Although management does not expect to reissue a dividend, it did just repurchase 669,000 shares of stock for $29.2 Million with another $10.7 Million authorized for repurchase.
The effort to create further shareholder value makes this a more attractive buy for us. We also see it as favorable that Abercrombie intends to reinvest cash the excess cash after stock repurchase into cap-ex for expanding by 25 international mall-based stores in FY11.

International Growth Will Take Place of Domestic

Management believes it can improve margins through “productivity initiatives and international growth” (Argus Research, 2011). It may have difficulty restoring the margins to historical levels of 67%, but it did report gross margins of 63.7% in Q3 2009. It has fulfilled plans to open stores in Denmark, the UK, and Japan. It also plans to open 25 international mall-based Hollister stores.

Hollister is Abercrombie’s most cost-conscious brand that has a target demographic of boys and girls between the ages of 13-17. The international expansion of this brand helps balance its competition against other value-priced retailers like Aeropostale and Buckle, Inc... Zacks Research estimates the company’s beta at 1.67. Therefore, we can expect that if the overall S&P improves, then Abercrombie, through its international diversification, will benefit in excess of the market.

Conclusion & Recommendation

Would like to increase position in short term but would not recommend holding beyond 2012 due to uncertainty of competition after price cuts conclude. We should see good growth until then through increase in revenue growth.
We give Autoliv a hold rating due to its potential for growth through its strong balance sheet, its strong solid market share, and the increasing demand for safety dollars per vehicle from emerging markets.

Autoliv is a Swedish-based company that develops, manufactures and supplies automotive safety systems to automotive the industry. It primarily markets its products to the North America, Europe and Asia regions.

**Strong Balance Sheet Foreshadows Organic Growth**

At FYE10, Autoliv reported $588 million cash on hand and debt-to-capital ratio of 21%, which are both indicators of a company postured to grow. The company’s operating margins were decreasing since its 2006 margin of 8.4% and 1.3% as of 2009. However, it reported a margin of 12.1% in 2010 and $869MM in operating income, a YOY uptick of $800MM. It also nearly doubled its FCF from 2009 to 2010 from $353MM to $688MM and ended FY2010 with working capital of $854MM. In 2010, it also experienced its highest operating and gross margins of 12.12% and 22.20%, respectively, in ten years. This was mostly a result of a return on assets of nearly 11% through a cost-cutting strategy, coupled with outperforming industry production in all regions except Japan. Lastly, its coverage ratio of 14x and leverage ratio of 0.1 indicates that it is securely covered and under levered. From this, we conclude that Autoliv is positioned to organically grow, but concessions demanded from car manufacturers will keep these margins pressured. In response to the pressured margins from this, Autoliv now has 62% of its workforce in low-cost countries versus just 29% in 2002 (Morningstar, 2011). While we applaud this proactive behavior to keep margins profitable, this is unsustainable. Therefore, we should expect the company to look to place this excess cash and acquire companies that make production more efficient or help it enter new markets. We think that the company’s balance sheet and management will allow the company to successfully do this.

**Emerging Markets Demand Safety as Wealth Increases**

As per-capita wealth increases in emerging markets, the demand for safer vehicles and dollars of safety equipment invested per vehicle also increases. Morningstar states that the “global average of safety content per vehicle is $260 (Morningstar, 2011)”. However, China’s safety content per vehicle is nearly $200 and India’s is just $70. Because China is perceived to be growing out of its emerging market perception (but still below the average) and India is still well within it, there is potential for increased demand from both markets. This is especially true if these countries want to continue to ship their products to the United States. Autoliv is well diversified to wait on this organic growth from emerging markets because it has 35% of its sales from Europe and 30% from...
North America. Approximately 25% currently is driven by emerging markets. The company’s market share, according to its website, is a commanding 40%, so we see it leveraging its global name and new leadership to encourage further growth. We also think that, despite its focus on growing business in emerging markets, it diversifies itself from foreign exchange risk through its exposure to several different regions.

Conclusion & Recommendation

This is a good long-term buy but will depend on how much money is allocated.
The Walt Disney Company DIS

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We recommend holding Disney due to its better-than average dividend payout and its forward-looking business model that should help it regain focus.

Disney operates a worldwide entertainment company. According to its annual report, Disney’s Media Networks segment includes television production and distribution operations and domestic television, radio and cable network stations, including ESPN and ABC. The company’s Parks and Resorts segment owns and operates the Walt Disney World Resort in Florida that includes theme parks, hotels, dining, a sports complex, conference centers, campgrounds, golf courses and water parks. This segment also owns and operates Disneyland Resort in California, Disney Vacation Club and Disney Cruise Line, and it manages Disneyland Resort Paris and Hong Kong Disneyland Resort. Its Studio Entertainment segment produces and acquires live-action and animated motion pictures, direct-to-video programming, musical recordings, and live stage plays. The company’s Consumer Products segment licenses Disney characters and visual and literary properties to manufacturers, retailers, show promoters, and publishers, and it publishes books and magazines.

Its Disney Interactive Media Group segment creates and delivers Disney-branded entertainment and lifestyle content across interactive media platforms.

Disney at Top End of Valuation, But Good Dividend Payout

The dividend discount model fair values Disney between $32.78 and $39.07 (compared to its current market value of $41.62), but the company just raised its annual dividend by $0.05/share to $0.40/share, or a yield of 1.1%. Further, Disney shares have risen 16% in the last year compared to a 13% increase for the S&P. This dividend increase was following Disney’s sale of Miramax Films for $663MM in cash, which indicates that Disney continues to value its shareholders by passing cash through as dividends. Further, sensitivity analysis shows that a slight increase in its forecasted average earnings growth rate of 10.7% will put the fair value of the stock more in line with today’s market price. Aside from the sale of Miramax, Disney generated revenues of $38,000MM in 2010, an increase of 5.3% from 2009. Despite a -4.5% revenue growth rate from 2008-2009, the company reported gross profits that parallel the levels reported before the recent recession. Disney’s trailing P/E is 17.9 and is below its peer average of 18.8, but it exceeds its media peer average of 12.65 (Argus Research, 2010). Media accounts for roughly half of the earnings of the company. Aside from the sale of Miramax translating into a healthy increase in dividend payout, we see this as a move to make Disney a more focused company in its Consumer Products and Disney Interactive Media Groups.
Refocused Movie Character Pipeline is Key

Disney is under the strong leadership of CEO Robert Iger who is continuously looking to make business changes that keep the company proactive in the technological shift of the media industry. Recent developments include a partnership with Apple to supply Disney/ABC content to the iTunes store. In addition, Disney signed an agreement with Hulu in late 2009 to distribute its content over the internet, announced an agreement with the Chinese government for a new park in Shanghai and acquired Marvel Entertainment (Argus Research, 2010). It also struck a short-term deal with Netflix for select ABC and Disney channel shows. Disney plans to deliver its titles to video-on-demand on the same day it releases the DVD to maximize rentals. It has also stood to refocus its cast of characters to produce quality franchises, including Toy Story 3 and Cars 2. Exploiting some of these branded characters should also help its Parks and Resorts and its cruise line segment bounce back from globally poor consumer confidence and discretionary spending.

Further, ESPN is 75% contributor to earnings from cable network sales, and its media networks in general generate more than half of the company’s operating profit, benefitting from advertising fees and affiliate fees. The potential to compete with ESPN is slim, so we see this and its media networks continuing to be the backbone of the company.

Conclusion & Recommendation

We recommend holding Disney due to its fair valuation, and its focus on increasing dividends.
Hasbro, Inc. HAS

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We give Hasbro a sell rating due to overexposure to foreign exchange risk and a recent earnings slide that cannot be overcome by promising future initiatives.

Hasbro is engaged in the designing, manufacturing and marketing of games and toys. The company provides children and families leisure time and entertainment products and services.

**Earnings Beat by Cutting Costs**

Hasbro’s earnings have consistently beat analyst expectations over the past six quarters, but it has done so via cost-cutting initiatives, not on revenue growth. Its revenues have stayed flat at approximately $4,000MM for four years. In addition, its gross margin has decreased from 2009 to 2010 by 780bps. While we applaud Hasbro’s proactive initiative in cutting costs, it will be nearly impossible to continue to do so since there is no visibility of upcoming efficiencies it can take advantage of. We feel that the stock is already at the top end of its fair value range provided by our dividend discount model sensitivity analysis.

Further, toy manufacturers have been adversely impacted by changes in age demographics because children are maturing at younger ages. Hasbro is faced with a marketplace that is shifting to digital media and “alternative activities, including video games, MP3 players, computers and other electronic devices. While specialty toy retailers have lost market share to mass merchants in recent years, the retail market has also shrunk due to industry-wide consolidation and bankruptcy filings. Competition from private label toys is also increasing (Zacks Research, 2011).”

While Hasbro has a long-term strategy to focus more on shifting its brands to incorporate a digital marketplace, it is in the early stages of implementing this strategy. This concerns us due to the rapid change in consumer behavior and has forced the company to rely on short-term partnerships that cut into Hasbro’s earnings. Its capital spending has stayed relatively consistent for the past four years, which does not boost our confidence that Hasbro is taking the market shifts very seriously.

Hasbro’s customer concentration is focused on Wal-Mart Stores Inc. (25%), Target Corporation (13%) and Toys R Us Inc. (11%). Its top five customers account for 54% of its total 2009 sales (Zacks Research, 2011). Because of this significant consolidation in this industry over the past few years, a large portion of Hasbro’s sales are now going to large chain stores, distributors and wholesalers that have more buyer power. Hasbro also further exposes itself to the changes in financial health of these companies in addition to the substantial sales it generates outside of the United States.
Exposure to Foreign Exchange Risk Difficult to Balance

Net revenues in FYE09 from international customers comprised approximately 42% of its consolidated net revenues. “Additionally, the company has manufacturing operations outside the US, which makes it subject to certain risks associated with international operations, significantly that of fluctuation in foreign exchange rate (Zacks Research, 2011)”. Its 2010 Q4 net revenue of $1,279MM in the quarter was down 7.2% year-over-year. The impact of foreign exchange rate fluctuation had an unfavorable impact of $23.5 million in this year. For FYE10, earnings per share were $2.74 versus $2.48 in 2009 with flat revenues. Foreign exchange had a $17MM negative impact on these revenues.

Geographically, net revenue from the U.S. and Canada region declined 20% year over year to $605MM, while its operating profit plummeted 54% to $71MM (Zacks Research, 2011). The International segment reported net revenue of $618MM, a 12% year-over-year increase. The segment registered an operating profit of $130MM, reflecting a 35% year-over-year rise. This is also indicative of an increase in foreign exposure risk.

Conclusion & Recommendation

We recommend selling Hasbro despite selling for less than our estimate of intrinsic value because it lacks a forward-looking strategy and its overwhelming foreign exchange risk.
McDonald’s Corporation MCD

We recommend buying McDonald's due to its proven management philosophy and its brand awareness that translates into future earnings potential.

McDonald's operates as a worldwide foodservice retailer. It franchises and operates McDonald's restaurants that offer various food items, soft drinks, coffee, and other beverages.

Proactive During Recession and Anticipatory of Consumer Demand

McDonald's market price is at the low end of our dividend discount fair value range of $72.71-$87.03. We see this as indication that the stock is undervalued. McDonald's should see strong earnings growth of 6%-7% in FY2011, which will mildly temper to 5%-6% over the next five years due to rising commodity costs. The company successfully adapted to changes in consumer demand through the recession by changes to its menu. For instance, McDonald’s introduced its iced coffee drinks when premium branded coffee, similar to that sold by Starbucks, became less attractive to the cash-strapped consumer. It also has successfully transformed itself to more of a convenience store in reaction to consumers having less time to spend on eating and more time on jobs absorbing more workload during the recession. On that note, McDonald has also introduced its Snack Wrap to target individuals like those who have been laid off or are seeking inexpensive alternatives to full meals. At one point, McDonald’s was selling more Snack Wraps than it was Big Macs. The company also adapted to the health-conscious demographic by introducing oatmeal and fruit smoothies to its menu. It has also worked to accommodate a more professional and tech-savvy environment in its stores by offering free Wi-Fi. All of this translated into earnings of $24,000MM in 2010, compared to $22,745MM in 2009. It also increased its gross margin 130bps in the same period. We think that this impressive adaptation is convincing enough to support our forecasted future growth and continue to offer an increasing dividend. The dividend has grown approximately 30.5% over the last ten years.

Brand Name Wields Control over QSR Industry

Through its system of 80% franchised restaurants and average unit volume of $2.2MM, the McDonald’s brand name sits far above its competition. McDonald’s operates nearly 14,000 units, which is second to Subway who operates the greatest number of units- 23,000. Its structure of franchising 80% of its units provides the company with “an annuity like stream of rent and royalties, even during challenging economic times, with minimal corresponding capital needs (Morningstar, 2011).” These royalties carry much more weight when considering that they are based off of the strongest average unit volume among its competitors. Further, McDonald’s carries much weight through its brand name in bargaining power and labor expenses that will help it focus on
operating margin improvement in the near term. Under the current leadership of CEO Jim Skinner we see this as a great buy opportunity due to his focus on return on invested capital. According to Morningstar, “from 2007 to 2009, the firm returned $16.6 billion to shareholders through share repurchases and dividends, doubling the $8.3 billion returned to shareholders during the previous three-year period (Morningstar, 2011).”

Conclusion & Recommendation

We recommend buying McDonald’s due to its proactive management plan and its strong unit performances.
We recommend buying Staples due to its dominant market positioning and margin expansion strides. Staples operates as an office products company. The company sells various office supplies and services, business machines and related products, computers and related products, and office furniture. It also provides high-speed, color and self-service copying, other printing services, faxing, and pack and ship services.

**Dominant Market Position Will Be Increased**

Staples’ fair value range is between $20.56-$28.17 based on our dividend discount model valuation; therefore we think it is significantly undervalued. We estimate that Staples can maintain and extend its leading market share positioning through “continuous product line extensions and additional service offerings (Morningstar, 2011).” It aims to expand these margins through a shift to higher-margin products and services while it leverages economies of scale realized from its acquisition of Corporate Express. Morningstar estimates that we can expect returns on invested capital to increase to an average of 14% compared to its current 9.9% versus our 9.26% estimated cost of capital. We estimate overall revenue growth between 4%-6% over the next six years, which will be primarily driven by growth in its international segment. The international segment currently accounts for 22% of its revenue while North America is 40% of its revenue. Staples’ 10-k also states that it will add 30-40 new stores per year that are smaller and dedicated to print and copy services. We also expect Staples to use its superior management to leverage Corporate Express to gain profitability and market share internationally.

**Emergence as High-Quality Retailer Boosts Attractiveness**

As Staples’ increases its efforts to grow its margins, it also quietly but quickly slips into the focus of more investors as it emerges as a stronger quality retailer. Its operating margins of 7.9% in Q3 2010 yielded a 70bp increase YOY. We are confident that management, under the leadership of CEO Ron Sargent, will be able to manage costs and introduce higher-margin products and services. The company, according to its annual report, estimates that its North American Delivery will increase 380bps to 12%. We can also expect to see an increased marketing effort to midsized companies, “winning more contracts with states and the federal government, encourage customers to buy a wider array of products, emphasize Staples-brand products, and encourage clients to shop more efficiently by consolidating small orders (Argus Research, 2010).”

Following the company’s assumption of debt from its Corporate Express acquisition was a significant reduction in that debt. It maintains its investment
grade credit rating of BBB and a good commercial paper rating which will give it better access to short-term financing in most market environments (Argus Research, 2010). It is also emerging as a company that values its shareholders, evident from its $102MM repurchase of stock in Q2 2010 and $156MM in Q3. It also has an authorization of $740MM left.

Conclusion & Recommendation

The company is exposed to rise in gas prices. A $1 increase could affect it by $7MM, but with its shift to consolidate orders we believe management is on top of the situation. By the same token the company could see exponential benefit from a decrease in gas prices. Staples also exposes us to currency fluctuations but we believe the company is solid.
We recommend buying Lowe’s due to its refocus on growth and its active balance sheet management to improve return on investment. Lowe’s Companies, Inc., together with its subsidiaries, operate as a home improvement retailer in the United States and Canada. The company offers a range of products for home decorating, maintenance, repair, remodeling, and property maintenance.

LOW Well Positioned to Recover

The company beat analyst estimates on Q4 2010 earnings and has introduced programs to show its ability to get back on track. Q4 revenues increased 3.1% and same store sales grew 190bps YOY. It also increased margins 150bps which was primarily driven by cost management (Morningstar, 2011). Further, the company was able to repurchase $2,600MM of its shares in 2010 with another $2,400MM under authorization. It “has introduced tools such as a base-price optimization program to capture incremental sales on the local market level, better forecasting tools, and new “weekend” staff and employee training sessions to help improve the consumer shopping experience (Morningstar, 2011).” These are not significant steps to proving it can recover, but they are steps to continue to add to its leverage of scale and efficient supply chain. Its sales have stayed flat at $48,000MM but had the potential to be hit harder from the downturn in the construction industry. However, as construction slowed more consumers shifted to DIY projects which helped keep Lowe’s sales flat as opposed to down. We see this as a good time to buy due to its persistence in keep profits flat even in challenging times. We predict an average of 5% sales growth in the next six years, which can translate into gross margins expansion of approximately 200bps. Its focus to more private label products should further help this margin improvement. Morningstar predicts that on a nine year horizon we can predict an average return on investment of 16% versus its 8.8% cost of capital.

Lastly, the firm is currently operating with a cash cushion of 2.5 times and is covering interest at 12 times earnings. The firm shows that it can support an increase in debt if it wanted to grow using debt. It also has the ability to place cash to help finance its opening of 30 new stores over the course of 2011.

Conclusion & Recommendation

Recommend buying Lowe’s, due to its proactive recovery plan and management through the economic downturn.
We recommend buying Snap-on Inc. due to its refocus on efficient operations and its strong product diversification. Snap-on Inc. manufactures and sells tools, equipment, diagnostics, repair information and systems solutions primarily for independent vehicle repair centers, but also for new vehicle dealerships, as well as industrial, government, agriculture, aviation and natural resources customers. Snap-on’s franchisees operate about 3,200 vans in the U.S., providing weekly contact with vehicle service technicians and shop owners.

**Sustainable, Efficient Operations Translates into Strong Margin Growth**

Our fair value range of $63.18-$74.53 is indicative that SNA is undervalued and will outperform expectations through strong margin growth resulting from management’s global refocus. Management, under the new leadership of Nicholas Pinchuk, has taken a lean-manufacturing approach and is reducing dealer turnover. Pinchuk’s quest is to command greater market share, grow SNA’s service-focused distribution, increase brand power and address the once poor expansion execution through a new vehicle monitoring process. Pinchuk’s compensation is currently tied to increased sales, so this gives us continued confidence that Pinchuk will act to seek long- and short-run growth opportunities. SNA’s plan to improve and better manage operational efficiencies will be the key in staving off any threats posed by the U.S. automotive industry.

SNA’s reduced cost structures under this strategy led to an operating margin of 13.5% in 2010 and revenue growth of 8.2% We estimate that the company will sustain 6%-7% long-run revenue growth and margins of 12%-13%.

The management team has worked to improve working capital requirements and lower its costs to improve organizational effectiveness. SNA also has implemented planned growth developments including expansion of manufacturing capacity to lower-cost regions in China and Eastern Europe. The team’s goal is to transform global manufacturing and supply chain into a market-demand-based, lower-cost replenishment system. It also closed a portion of its plants in 2010 to rationalize production as part of this plan. Through the closure of these plants and eyeing other methods of improving efficiency, its order-fill rates are improving and profitability is increasing across its operating segments. Further, its even-spread revenue contributions across its different business units help diversify its revenue resources and put SNA on a longer-term growth path.
Strong Product Diversification Creates Wide Economic Moat for SNA

Snap-on’s management and growth of revenue across all of its business units is the key driver to the protection of both its recent and long-term growth.

SNA’s Repair and Information Systems currently commands 50% market share and is its diagnostics, business management systems and electronic catalogue ordering. This business unit accounted for 28.9% of SNA’s 2010 revenues and individually increased $30MM, or 14.9%, from its previous year’s revenue.

SNA’s Snap-on Tools Group is its business operations segment that serves the worldwide franchise van channel. This business unit accounted for 33% of SNA’s 2010 revenues. The Snap-on Tools Group 2010 revenues increased $31.2MM in Q4 2010, which was a 12.8% increase from the prior year period.

It’s Commercial and Industrial Group provides tools and equipment products and equipment services through direct, distributor and non-franchise distribution channels. Its mission is to provide face-to-face details explaining the best method for repairing a problem, which is popular to independent repair shops. The segment’s revenues accounted for 35% of SNA’s total revenues, and increased $35.6MM, or 15.5% from the period one year prior.

Lastly, its Financial Services Group is its newest segment addition that includes wholly owned finance subsidiaries. It reported positive net operating earnings of $9.4MM, a 43.7% margin, in Q4 2010. This earnings report is an increase when compared to the $3.8MM loss it reported in the same period of the prior year.

SNA is now targeting further international expansion in the Chinese market and is looking to diversify its services further to incorporate aerospace and power generation. It recently took a 60% stake in Chinese company Zhejiang Wanda Tools Co., Ltd. for $14.7MM cash. This acquisition expands SNA’s hot-forged hand tool manufacturing presence in the emerging market and low-cost region. Further, it is designing plans to expand its storage manufacturing capacity in this region. These new segments will lead to stronger margins due to an emphasis on high-performance, higher-margin quality tools.

Snap-on has made these strides while maintaining short- and long-term debt ratios that are in-line with its peer group. It also has a current ratio of 1.8 and pays a 2.22% dividend yield or $1.28 annually. Its dividend has increased from $2.32 in 2009 and is projected to increase to $4.68 by 2012. Its free cash flow has averaged 13% of sales over the past five years, and the company had $572MM in cash at EOY2010.

Conclusion & Recommendation

We recommend buying Snap-on due to its strong forward-looking margins and its undervaluation.
Health Care Sector


While Abbott Laboratories and Johnson & Johnson are labeled as pharmaceutical companies, they also operate in other industries and thus are starting to be labeled as health care diversified companies. In addition to pharmaceuticals, Abbott Laboratories operates in diagnostic, nutritional, and vascular products. Johnson & Johnson operates in medical devices, consumer products, and diagnostic products, in addition to pharmaceuticals. Therefore, even though the portfolio may appear to be heavily weighted in drug manufacturers, it is actually more diversified than it initially appears. Furthermore, Teva Pharmaceuticals is aligning itself to offer biosimilars in the future, thereby covering the biotech industry. Accordingly, the companies in the Crummer portfolio actually represents: branded pharmaceuticals, generic pharmaceuticals, biotechnology, medical equipment and devices, vascular products, diagnostics, nutritional, consumer products, and research.

Health Care Reform

On March 23, 2010, President Obama signed the Patient Protection and Affordable Care Act (PPACA). Although there is a potential for Republican-dominated state legislatures to revolt and not implement the reform, they will more likely delay implementation rather than prevent it. Therefore, we are operating under the assumption that the changes to the health care industry imposed by PPACA will in fact occur. This act requires individuals and their families to purchase insurance if they are not covered by an employer. PPACA prevents insurers from refusing to provide coverage, limiting coverage, and dropping coverage. The rules and regulations of the health care reform will be phased over a multiyear period; 2011 will be the first year for changes.

In 2012 there will be a drug manufacturer fee, which will affect Abbott Laboratories, Merck & Co. Inc, Johnson & Johnson, and Teva Pharmaceuticals. Johnson & Johnson estimated in its 2010 10k that the fee will cost the company around $200 million the first year and almost $400 million the second year. Although this may appear to be a large number, companies like Johnson & Johnson, Abbott, Merck, and Teva are operating with financial statements in the billions. Health care reform will cost drug-manufacturing companies about $100 billion over the next decade, but will also bring about $76 billion in new profit opportunities, resulting in a wash (Morningstar). Healthcare reform is a win-win for generic pharmaceutical companies like Teva, as nearly all health insurance plans will favor low-cost products. However, with more generic pharmaceuticals in circulation price pressures will emerge that may deter future profits. However, overall health care reform will more likely change the way drug-manufacturing companies operate rather than severely affecting their profit.
margins. Therefore, Abbott, Johnson & Johnson, Merck, and Teva are relatively safe from any negative implications caused by PPACA.

The health care reform is projected to increase the number of medical procedures performed as it is inferred that there is a strong correlation between insured patients and the number of medical procedures. Therefore, even though medical equipment companies like Stryker will experience a 2.3% health care reform tax in 2013, the increase in medical procedures will in turn create profit opportunities. Much like in the drug manufacturing industry, the medical device and equipment industry will be relatively safe from health care reform impacts because the negative and positive aspects will wash each other out.

**Patent Expirations**

A significant amount of major branded blockbuster drugs, which total 17% of worldwide sales, will lose patent protection in the United States and Europe over the next few years. As a result, the generic drug sector and companies such as Teva, are expected to enjoy above average growth over the next several years and to expand at double-digit rates.

In response to the dreaded patent cliff, the health care sector experienced heightened M&A activity as major branded companies sought to expand their businesses globally, and broaden their product portfolios in order to insulate themselves from the decline in revenue caused by patent expirations. Abbott, Merck, Johnson & Johnson and Teva all engaged in such M&A activity in recent years. Through such mergers and acquisitions the companies expanded their drug pipelines and strengthened other business segments. Fortunately, none of the portfolio’s companies will experience any major patent loses in 2011. In 2012, Merck is the only company in the portfolio that is set to lose a major patent. However, even though Merck will lose the patent for its blockbuster Singulair in 2012, revenue is not expected to be affected until 2014. Therefore, over the next few years the portfolio is safe from the risk exposure associated with major patent expirations. Nevertheless, it is important to note that the companies are currently engaging in M&A activities and increased R&D spending that will deter future potential risk.

**Strategic Focus Shifting**

According to Morningstar, there is a trend in Big Pharma where companies are moving away from a developed world model, towards niche drugs and emerging markets. This move will yield stronger pricing power and a longer cost basis for the industry (Morozov, 2010). This shift is evident, and correlates with the strategic mergers that are currently seen throughout the health care sector, and can be specifically seen through Abbott’s acquisition of India’s largest generic pharmaceutical company, Piramal. Niche drugs provide firms with drugs that are more resistant to competition, pricing pressure, and patent exposure. Expanding into global markets not only offers significant growth opportunities, but it also opens the door for product diversification which is easier to do in a market with large and assumed steady future growth.
Consolidation of the industry is a result of these mergers and acquisitions as big companies are buying up minor players and competitors. This consolidation indicates that in the future of health care sector companies is extreme diversification and international geographic and revenue growth. Companies like Abbott Laboratories and Johnson & Johnson are the future of the health care sector because they have diversified business segments, have a strong international presence, and are expanding through acquisitions. Companies that specialize in only one industry within the health care sector, like Covance, will most likely not survive in the future.

**Overview Conclusion**

The dreaded branded patent cliff will continue to occur over the next several years and brand pharmaceutical companies will see sale and revenue decreases which, along with economic uncertainty and frozen credit, will bring an industry-wide drug development slowdown. In response, pharmaceutical companies are now investing in strategic acquisitions to expand their product portfolios and to broaden their drug pipelines, as well as emphasizing internal drug research. All in all, the changes in the health care sector suggest that our portfolio should remain invested in companies like Abbott and Johnson & Johnson which operate under diversified business segments, as well as companies like Teva and Stryker that will benefit from rapid growth opportunities over the next 12 months. In addition, the portfolio should maintain a position in Merck which is well positioned for potential future growth and is protected from immediate danger. Companies like Covance, therefore, which depend on the pharmaceutical and biotechnology industries for work, will face great hardships. Consequently, we decided to drop Covance from the portfolio.
Abbott Laboratories ABT

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- Acquisition of Piramal’s pharmaceutical business in India drives international growth, especially in emerging markets
- Limited patent losses until 2013

Abbott Laboratories (Abbott) develops, manufactures, and sells a broad and diversified line of health care products. Its products include pharmaceuticals, diagnostics, nutritional, and vascular. The largest business segment is pharmaceuticals and its leading products are HUMIRA, for rheumatoid arthritis, Kaletra, for HIV, and Niaspan, Simcor, and TriCor, cholesterol management agents. In 2010, 55% of its net sales were outside the United States.

HUMIRA Continues to Show Strong Growth

HUMIRA accounts for 18% of Abbott’s revenue and is experiencing robust growth, particularly in overseas markets. Currently HUMIRA has growth rates in the low teens and will not lose its patent until 2016. However, sales from the patent expiration are not set to affect the company until 2017. This means the company, its revenues, and its growth rates will benefit from this strong blockbuster drug for at least five more years.

Acquisition of Primal Healthcare Limited

Primal Healthcare Limited’s Healthcare Solutions business is the leader in the Indian branded generics market. The acquisition gives Abbott market leadership in India and will further accelerate the company’s growth in emerging markets. In addition, the acquisition strategy of Primal Healthcare Limited allows Abbott to expand its product portfolio to include generic drugs. This strategic move will protect the company from future revenue losses associated with the expiration of branded pharmaceuticals. The acquisition of Primal aligns Abbott for future growth through international expansions that will increase its pipeline, enlarge its distribution channels, and expand its global presence.

Relatively Safe from Patent Expirations until 2013

Only fenofibrate products are expected to expire in 2011. This will not have a major affect on the profitability of the company. Abbott will not have any significant patent or license expirations in the next three years, thus making it an attractive company in the industry. Furthermore, the company’s acquisition of Solvay’s pharmaceutical units in February 2010 increased its drug pipeline and lined it with potential blockbuster drugs that can offset any patent loses.
Top-tier Diagnostic and Nutritional Segments

The diagnostic and nutritional segments generate over 25% of total sales for Abbott. This helps insulate the company from revenue losses associated with patent expirations in the pharmaceutical industry. Through sales of coronary stents Abbott operates in the medical device manufacturer industry. In addition, Abbott recently expanded its vascular line which is poised for rapid growth.

Abbott is labeled as a pharmaceutical company, but in reality it is a health care diversified company that operates in several sectors. This diversification protects the company from any negative industry trends, and fosters growth from any positive industry trends.

Conclusion & Recommendation

Due to limited patent losses, steady growth of HUMIRA, diversified business segments, and the acquisition of Primal, Abbott is positioned for solid long-term growth. Currently the company is increasing research and development spending in order to develop new medications. This emphasizes the company’s commitment to increasing and strengthening its drug pipeline, which is presently small compared to its major competitors.

Abbott reports that in 2011 it will focus on building its global presence, expanding its presence in emerging markets, and diversifying its source of growth with acquisitions. This company is a buy due to its impressive acquisition strategy, diversified business segments, and limited patent expirations.
Covance Inc. CVD

Covance Inc. is a drug development service company providing a wide range of early-stage and late-stage product development services to the pharmaceutical, biotechnology, and medical device industries. The company’s value lies in its ability to provide data as rapidly as possible in order to reduce development time and aid its clients in introducing its products into the market place faster, thus maximizing the company’s period of market exclusivity. Covance operates in more than 30 countries and its main competitors are in-house drug development departments of pharmaceutical companies, universities, teaching hospitals, and contract research organizations.

Demand for Covance Service is Low

Covance revenue is reliant on the research, development and marketing expenditures of the pharmaceutical, biotechnology, and medical device industries. Companies outsource this work to Covance in an effort to decrease the amount of time products are in development and to make the development process more efficient.

The decrease in spending on health care, the looming health care reform, economic pressures, and frozen credit has decreased the money companies spend on the development of new drugs. Some argue that with an increase in government regulation and the doomed patent cliff companies will be in need of the services offered by Covance. Conversely, companies appear to be broadening the depth of their pipelines through strategic acquisitions rather than through outsourced development. In addition, the trend of the health care industry is consolidation which will in turn continue to create health care sector one-stop-shop power houses that will have internal departments that are strong enough to create for themselves the value added by Covance. Due to this, the expected demand for Covance services will be lowered over the next few years.

Poor Fundamental Financials

The company has a weak growth indicators and any increase to the bottom line will have to come from cost cutting. Profitability indicators are very poor and show signs of company deterioration due to its weak return on equity (ROE) over the last few quarters.

Even though the company has an impressive 100% equity capital structure, which can help jump start future growth through acquisitions in order to
diversify its product and service offerings, the company is not taking advantage of this. Instead, the company is acquiring firms, like Sanofi-aventis, that simply increase its tangible assets and do not diversify the company’s offerings.

**Conclusion & Recommendation**

Covance has not offered a dividend in five years and in its 2010 10K stated that it does not intend to pay a dividend any time soon. Covance has a negative beta which means the company’s performance is the opposite of the market.

Through technical analysis it is apparent that the stock is considered overvalued with an RSI of 69. In addition, through a Price/Money flow chart it is apparent that when the company stock price dropped, the market had faith in the stock and poured money into it. When this occurred, the stock price increased. In my opinion, this was a self-fulfilling prophecy which articulates the belief that Covance is overvalued.

Due to its reliance on the pharmaceutical and biotechnology industries, its current poor fundamental financials, and an overvalued stock price, Covance is a sell.
Johnson & Johnson JNJ

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- Stands alone as leader across the major health care industries
- Diverse operating segments
- Steady growth expected to continue

This indicates the power of the current product pipeline. Currently, there are 10 potential pharmaceutical blockbusters in late-stage development or are recently approved. This strong pipeline will help ease the revenue loss associated with product recalls from 2010 and the weak health care spending due to the economic downturn.

**Crucell Acquisition**

The Crucell acquisition gives Johnson & Johnson a vaccine platform and a strong new drug pipeline that will contribute to future growth in 2011. The Crucell acquisition reflects the company's strategic framework that is set to achieve sustainable growth for the company.

**Steady Growth**

Despite recalls of certain over the counter medicines in 2010, the suspension of manufacturing at the McNeil facility in Pennsylvania, and price pressures in Europe, the pharmaceutical segment has able to achieve a 5.9% growth and the medical devices and diagnostics segment achieved a 1.3% growth. Overall, the demand for Johnson & Johnson products and services remain strong. In addition, in 2010, the company increased its dividends for the 48th consecutive year.

**Diverse Operating Segments**

Johnson & Johnson has diverse operating segments in medical devices and diagnostics, and consumer products which insulate the company from the branded patent cliff that threatens the pharmaceutical business segment. Although the highest performing business segment is pharmaceuticals with 41% of sales, 59% of sales are

Johnson & Johnson is a diversified health care company that develops, manufacturers, and markets products in pharmaceuticals, medical devices and diagnostics, and consumer health care products. Pharmaceuticals account for 41% of sales, Medical Devices and Diagnostics are close behind accounting for 35% of sales, and Consumer Products account for 24% of sales. Johnson & Johnson operates as a holding company with more than 250 operating companies in 60 countries worldwide.

**Strong Pipeline of Products**

Johnson & Johnson invests 11.1% of sales in research and development which reflects management’s commitment to ongoing development of new and differentiated products in order to sustain long-term growth. New products that were introduced in the past five years accounted for 25% of sales in 2010.
from the other segments. This further supports the argument that Johnson & Johnson should be considered more as a diversified health care company than a pharmaceutical company.

**Conclusion & Recommendation**

Johnson & Johnson stands alone as a leader across the major health care industries and is the largest diversified healthcare company in terms of revenue base. A strong presence in diverse areas of health care products, with a diverse revenue base, a robust research pipeline, in addition to strong sales and marketing abilities, has created a strong financial position for the company and this is why it is a buy. Johnson & Johnson defines the health care sector and is a solid stock that should anchor the portfolio.
Merck & Co. Inc. (Merck) is a global health company that delivers innovative health solutions through medicines, vaccines, biologic therapies, and consumer and animal products. Its principle businesses are pharmaceuticals and animal health products, and it has a leading vaccine and consumer products business segment. In 2010, 44% of its sales were outside the United States and are a result of the merger with Schering-Plough Corporation.

Merger with Schering-Plough Corporation

In November 2009, Old Merck and Schering-Plough came together to form Merck & Co. Inc. The merger was treated as an acquisition for accounting purposes. Through this merger, the research and development pipeline increased in depth and breadth. The combined company has a broader portfolio of medicines, and has an expanded international presence; especially in high growth emerging markets. Even though the merger was finalized in late 2009, the combined company is expected to see a strong increase in EPS until 2012.

Strong Financials

The company has strong profitability indicators with return on assets (ROA) and return on equity (ROE) well above the industry averages. Additionally, for the last three years the company had positive operating cash flow. The company is operating conservatively with 75.33% total equity which gives it plenty of room to raise capital for future growth opportunities.

No Significant Expirations in 2011

Merck’s key billion-dollar blockbusters are not set to come off patent until 2012 when Singulair loses its patent. This blockbuster drug has a 12% year-over-year sales growth that is driven by volume growth. In addition to Singulair, Merck has several other billion-dollar blockbusters such as Zetia for cholesterol, Remicade for inflammatory disease, and Isentress for HIV. Together these drugs, and about three others, compose 50% of Merck’s 2010 sales. However, none of these said blockbusters are set to expire in 2011. Even though Singular’s patent expires in 2012, the company does not expect to see a substantial lose in sales until 2014.

Liability Issues are Settling

Merck & Co. Inc. faces product liability issues and settlement programs related to the removal of Vioxx from the market in 2004. The company set aside has made it through the worst and thus the near future is expected to improve.
Conclusion & Recommendation

Currently its stock price is very attractive, selling in the mid $30’s and technical analysis is neutral indicating the stock is safe for investment. Due to its strong financials, future growth possibilities, and attractive stock price Merck is a buy.
Stryker Corporation SYK

**Recommendation**
Buy

**Valuation**
$71.76

**Market Price**
$60.06

**As of**
4/8/11

**Sector**
Health Care

**Industry**
Medical Devices

- The demand for surgical procedures is expected to increase with health care reform and active aging demographics
- Strong ROE and ROA

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**Orthopedic Demand Can Only Go Up**

Orthopedic sales represent 60% of the company’s revenue. Economic pressures resulted in unemployment and uninsured numbers which in turn decreased the demand for orthopedic implants. In addition, COBRA benefits for the unemployed ended which may have contributed to a decline in orthopedic procedures over the last few years. However, these surgeries cannot be put off forever and the demand for orthopedic implants can only go up as the industry recovers. Furthermore, the demographic trends in developed countries like the United States should drive solid volume growth for the industry as the population ages.

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**Hospital Capital Expenditures Increasing**

The company is experiencing strong sales of hospital equipment and surgical tools. This is because hospitals are spending more on capital equipment and tools. This may be a sign that hospitals are preparing for a rise in procedural volume. More likely, this increase in hospital spending is due to improvements in hospital financial strength and budgets. UnitedHealth expects medical utilization to increase over the next year which may lead to an increase in procedural volume. Either way, the service care providers are making more capital equipment purchases which will increase business opportunities for Stryker. An increase is already seen with MedSurg Equipment sales growing 16.1% in 2010.

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**Increased R&D**

The company is increasing its R&D spending which shows its increased focus on new product development for anticipated future product launches.

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Stryker Corporation is a medical technology company that provides innovative orthopedic implants and state of the art medical and surgical equipment. The company sells products through subsidiaries and company owned branches in 100 countries. In 2010, 65% of its revenue was from the United States. Stryker markets its products directly to doctors, hospitals, and facilities.

**Strong Fundamental Financials**

The company has a high return on assets (ROA) of 13.41 compared to the industry average of .21. This high ROA reflects the management’s ability to produce profits from the company’s assets. Stryker also has a high return on equity (ROE) of 19.76% which represents an impressive potential for growth in future earnings.
and continued investments in new technologies. The key to this industry is technological advances and Stryker’s commitment to R&D verifies its ability to maintain future growth through product innovation.

Conclusion & Recommendation

Stryker Corporation is set for future growth as the health care sector experiences an increase in medical procedures and financial strength. Although technical analysis is neutral, it does indicate that the stock price movement is reliable in trends. Due to future growth potentials, increased R&D spending, and current strong financials makes Stryker a buy.
**Teva Pharmaceutical Industries TEVA**

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- Largest global generics company with double the next competitors revenue
- Generics pharmaceutical industry is expected to continue to grow 10% over the next few years
- Steady and healthy company growth over the short and long term due to current strong financial situation

Teva Pharmaceutical Industries (Teva) engages in the development, production, and sale of generic and branded pharmaceuticals, biogenerics (also known as biosimilars), and active pharmaceutical ingredients worldwide. The company is headquartered in Israel with global operations in North America, Europe, Latin America, Asia, and Israel. 85% of its sales are in North America and Western Europe. Teva is the leading generic drug company in the world with a leading value and volume position in the United States, and a leading value position in Europe.

The generic drug sector is expected to enjoy above average growth over the next several years and to expand at double-digit rates. This is because an extraordinary number of major branded blockbuster drugs, which make up 17% of worldwide sales, are set to lose patent protection in the United States and Europe. Teva is projected to gain the largest rewards in the United States due to this branded patent cliff.

In a few years, Teva will be set for revenue growth in the biosimilar market. Biosimilars are generic versions of biopharmaceutical products that are the next big thing for pharmaceuticals.

### Manufacturing Generics and Branded Pharmaceuticals

Although Teva is the leading generic drug company in the world, 30% of sales are generated from innovative branded drugs. Its leading innovative product is Copaxone which is used in the treatment of multiple sclerosis. Copaxone accounted for 18% of Teva’s sales in 2010 and will not see generic competition until 2014. A large portion of success stems from the brand pharmaceutical segment, and as the company moves forward it will continue to gain value from both the generic and branded segments.

It is important to remember that although the generics pharmaceutical industry is expected to grow 10% over the next 5 years, through this growth is the emergence of generic price pressures. Therefore, Teva diversified its business segments in order to protect its future revenues from changes in the industry. This diversification in both generic and branded pharmaceuticals aligns the company for future steady growth.
Current Financial Situation is Strong

Teva has a high growth rate and margin expansion, which sets it to gain in market share without forgoing its strong financial performance. The company had a 62% increase in dividends from 2009 to 2010, and has an expected 5 year dividend growth rate of 26.44% (Bloomberg, 2011). Compared to other companies in the industry, Teva has a high ROA of 8.29, which indicates the management’s ability to produce profits from the company’s assets, and a high ROE of 13.97%, which reflects the company’s ability to grow future earnings. The strong ROE and ROA ratios emphasize the ability of Teva’s management to effectively manage company resources and generate profits.

Operating in 60 Countries

Teva is headquartered in Israel with operations in over 60 countries. The United States pharmaceutical industry is expected to grow 3.5% over the next five years, but the global pharmaceutical industry is expected to grow 5.8% over the next five years. Specifically, European markets are expected to grow 4.3% and Asia-Pacific markets will grow 8.1%. There is a rising trend toward globalization of the generics industry. By already operating in 60 countries, Teva is remaining ahead of the competition with a broad geographic revenue base. Teva’s international presence contributes to the company’s strong revenue, which is twice as big as its closest competitor.

In August of 2010, Teva acquired ratiopharm-Merckle Group, Germany’s second largest generic pharmaceutical producer and the sixth largest generic drug company worldwide.

Conclusion & Recommendation

Over the next several years, Teva will further establish its dominant position in the pharmaceutical industry through international expansion, generic drug growth, and innovative branded drug pipeline expansion. Teva is a buy due to its international operations, market position, strong potential future growth, and current financial strength.
Energy

The energy sector currently represents about 13.3% of the S&P 500, and 14.7% of the Crummer Portfolio. The sector has performed extremely well coming out of the recession, gaining over 43% in the past six months. Typically, the energy sector performs well at the top of the economic cycle, and is commonly seen as a laggard in the economic expansionary cycle. However, growing demand for refined products has supported the quick rebound and improved financial returns.

The securities in the energy sector are heavily impacted by the commodity prices of oil and natural gas. The price of oil, as represented by the WTI benchmark, has risen significantly to around $105 per barrel, from a low of around $45 per barrel in 2008. Middle East uprisings continue push the price of oil higher, due to an anxiety premium over a supply decrease. This higher price should drive increased revenues in exploration and integrated firms. Conversely, the price of natural gas has remained stagnant at around 4.25/mmBtu, due to a domestic supply glut. Any rise in this price would benefit integrated and drilling firms.

The Crummer Portfolio currently has holdings in five firms, separated into three large cap companies, one mid and one small cap company. The stocks in the portfolio track the overall sector well, with over a 96% correlation. We propose to reduce our stake in Exxon Mobile, as it represents 53% of the sector, and close to 8% of the market value of the entire portfolio. Selling Exxon will provide funds to increase our stake in our current holdings, specifically Helmerich & Payne, and allow us to invest in another company. OYO Geospace is a solid investment that will give us more exposure to small cap equity. The recommended sector stocks provide a solid correlation to the sector index at 90.1%, even with a reduced stake in Exxon.
Chevron Corp. CVX

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- Integrated Structure Allows Company to Take Advantage of Rising Oil Prices
- Company has a Well-Diversified Portfolio of Energy Reserves
- Solid Dividend Yield and Financial Strength

Chevron Corp. is a global integrated oil company and the second largest oil company in the United States. The company targets both oil and natural gas plays, and is engaged in both upstream and downstream operations, primarily in the United States, Africa, and Australasia. The upstream operations involve the exploration, extraction, and shipping of crude oil and natural gas. The downstream operations include refining and marketing the raw materials extracted. In addition, Chevron manufactures and markets industrial-use petrochemicals, and holds stakes in renewable energy operations.

Rising Commodity Prices Strengthen Company

As of July 2010, Standard & Poor estimated that West Texas International spot prices would not break $100 per barrel until 2015. The WTI spot price now stands around $105, while the Brent spot price, often viewed as a more accurate benchmark, stands at around $115 per barrel. Higher oil prices favor the integrated structure of Chevron, as the company has control over the entire supply chain and is able to sell its extracted crude oil for more. If oil prices stay high as expected for the long term, the company stands to increase its revenues and earnings this year, as its costs along the supply chain should stay level. Higher oil prices also provide a larger cash flow for the company, encouraging future oil exploration and new capital expenditures, leading to increased oil reserves.

Chevron is also a large producer of natural gas, increasing its position in the Marcellus Shale gas region with its takeover of Atlas Energy Inc. in February of this year. Although the Henry Hub spot price of natural gas has not risen along with that of crude oil due to a domestic supply glut, the company is well positioned to take advantage of rising prices in the future.

Reserve Level Concerns

Chevron’s oil-equivalent reserve level fell by 7% during the fiscal year 2010. News of the disappointing reserve replacement rate led to a drop in the stock price. During last fiscal year, the company only replaced 24% of its oil-equivalent production. Looking at the numbers, the company has vast amounts of reserves that have not yet been accounted for. Three such projects in the Gulf of Mexico, the Jack/St. Malo, Tahiti II, and Bigfoot...
fields, would make a small but meaningful impact towards replacing the company’s reserves. Including just these three fields, the reserve level would have fallen only 6.5%, and the company would have replaced 31% of its oil-equivalent production. The company has dozens of such fields that are not yet counted as reserves, most with long estimated production lives. Even more so, the influx of cash created by increasing oil prices should provide for more exploration and development projects to keep its reserves stable.

Legislation Concerns

Chevron is currently involved in an environmental lawsuit dating back 17 years from Texaco’s involvement in Ecuador. In February, an Ecuadorian judge fined Chevron $8 billion, in the largest environmental settlement. The case is far from over and should not significantly affect earnings over the coming year.

In October of last year, the U.S. government’s moratorium on deep-water drilling was lifted, allowing companies to apply for permits to drill. It was not until last month that a permit was actually approved, but this should signal the start of more permit approvals. The Gulf Coast region is extremely important in Chevron’s operations, as the moratorium and permit restrictions led to a loss of production of about 10,000 barrels a day, and left vast amounts of reserves inaccessible.

Potential Threats

The uprisings in the Middle East highlight how political instability can have a meaningful impact on a company’s operations. Although Chevron only has Middle East holdings in the partitioned zone between Saudi Arabia and Kuwait, the company has operations in other unstable areas such as Venezuela, West Africa, and South-East Asia. Even more risky, is that 25% of the company has proven reserves lie in Kazakhstan. Political Instability is a large threat to the company as its business involves long-term capital-intensive projects that cannot be easily liquidated.

Future Projects and Financial Growth

Chevron has large-scale projects ready to support the company in the future. Most notable is the Gorgon Project, a liquid natural gas facility in construction off the north-west corner of Australia that is expected to produce 15 million-metric-tons-per-year of LNG. Chevron holds a 47.3% interest in the project, and already has 90% of its supply under contract to be delivered upon opening of the plant in 2014.

Chevron has a diverse renewable energy portfolio, although it currently only contributes a small amount of revenue. The company desires renewable energy to be a part of its future operations, and with the growth in this field, one can expect Chevron to increase its stake, either organically or through acquisitions.

The company’s net income almost doubled in 2010 to $19B, from a low of $10.4B in 2009. The upward trend is expected to continue this year with rising oil prices, possibly surpassing the $23.9B figure in 2008. Likewise, the company’s EPS is expected to grow, along with its dividend, which stands at a respectable 2.8%.

Conclusions and Recommendations

Chevron has legitimate concerns with its reserve replacement rate and the threat of political instability to its operations. However, the company is poised to take advantage of rising oil prices and an influx of cash over the coming year. The company has significant long-term projects that will continue to support the company, and its recent acquisition of Atlas Energy gives it a large natural gas play to diversify its portfolio. Overall, we would recommend Chevron as a buy for the Crummer Portfolio.
Clean Energy Fuels Corp. CLNE

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- Legislation to Support Natural Gas is Gaining Momentum
- Company has Integrated Vertically
- Natural Gas Should Be More Attractive as a Fuel Source with High Oil Prices

Clean Energy Fuels Corp. services natural gas fleet vehicles primarily in the United States and Canada. The company maintains and operates over 200 fueling stations, providing compressed natural gas (CNG), liquid natural gas (LNG), and bio-methane fuel. The company has around 400 fleet customers, ranging from airport, public transit, refuse, and government vehicles. The company first issued public stock in May 2007, and its largest shareholder at 30% is T. Boone Pickens, the company’s co-founder and board member.

Improving Figures, Yet Debt Looming

Clean Energy Fuels has increased the number of fueling stations it serves from 147 in 2004, to 224 in 2011. Although the network of stations has improved, the growth rate of this expansion is relatively slow, most likely because the recession created a slow expansionary environment. The company had a solid rebound this past fiscal year, as its revenue grew by over 60% to $211 million. The company increased the amount of fuel delivered from 101.0 Million gasoline gallon equivalents in 2009 to 122.7 in 2010. Finally, the company’s EPS has improved to (.04) in 2010, from (.60) in 2009.

As of September 30, 2010, the company had over $48 million in debt due within one year and short-term borrowings. Comparatively, the company only had $2.4 million in similar debt the previous year. Unless the company somehow modifies these debt payments, or offsets these figures with increased revenue, the company’s financials should be impacted negatively this next fiscal year.

Support by Administration for Credits

Clean Energy Fuels’ business model is heavily dependent on government subsidies for success. The company’s revenues are supported by a tax credit of $.50 for every gasoline gallon equivalent of CNG or LNG. Although this credit had expired in December 2009, it recently reappeared and passed in H.R. 4853 on December 17, 2011. Even more so, the bill retroactively reimbursed the company back to January 1, 2010. This bill provides a significant percentage of revenue, approximately 13.7%, 11.8%, and 7.6% in years 2008-2010.

Two bills still in Congress would provide further governmental support. The Clean Energy Jobs and Oil Company Accountability Act would provide 50% - 80% of the cost of purchasing new or converting

Recommendation

BUY

Last Price

$17.28

Intrinsic Value

$17.32

Industry

Energy –Marketing
to natural gas vehicles. If passed, it would be easier to convince customers to invest large amounts of capital to convert a fleet of vehicles to run on natural gas. In addition, the bill would provide rebates between $10,000 and $64,000 for purchasing alternative fuel vehicles, subsidies up to $50,000 to install a natural gas station, and loans to convert buildings to produce alternative fuel vehicles. The bill has been read twice and is placed on the Senate Legislative Calendar. It is unclear whether it will pass.

The second bill, dubbed the NAT GAS Act, was referred to recently in a speech by President Obama. The bill would provide subsidies in the purchase of natural gas trucks instead of diesel vehicles, and provides tax credits for natural gas refueling stations. The bill appears to be gaining bipartisan support, and the company’s stock price has recently jumped in optimism of its passing.

**Rising Oil Prices, Depressed Natural Gas Prices**

The West Texas Intermediate spot price of crude oil has risen dramatically since 2009. This rise benefits the company, as gasoline that is more expensive will push companies to search for cheaper ways to fuel their vehicles. Even more so, natural gas is at a depressed price of $4.25/MMBtu, has such a disparity to oil easily shows the benefits of switching to natural gas. This should help the company secure new accounts this year, which should lead to higher revenue. The impact of new accounts was apparent on February 22, as the stock price jumped around 10% upon news that the company secured contracts to provide natural gas to 48 UPS trucks.

However, if the spot price of natural gas falls too low, the company will suffer financially. The company sources much of its natural gas through futures and long-term fixed contracts. The company needs natural gas to stay at a reasonable level to benefit from the contracts, as the cost of natural gas represented around 50% of its total cost of sales. Clearly, the company is bound by the prices of not only natural gas, but also its relationship to crude oil.

**Vertical Integration Offers Benefits**

In October 2009, Clean Energy Fuels completed the acquisition of BAF Technologies, a company specializing in converting vehicles to natural gas operation and other alternative fuels. The company now can offer customers a means to convert their fleets to running on natural gas, as well as supporting warranties and repairs. This is a proper move for the company and makes its proposition more convincing to customers.

The company also purchased IMW Industries in September of 2010, a company that manufactures and services natural gas fueling compressors. This acquisition should provide cost benefits as an international presence, as over 32% of IMW’s revenues came from outside North America.

**Conclusion & Recommendation**

Clean Energy Fuels is taking the right steps to grow both organically and through acquisitions. The company has a few supporting tailwinds, including the rising price of oil and the clean energy movement backed by the Obama administration. The company should secure more contracts this year, and the stock has a large upside, especially if the NAT GAS Act passes as a bill. Over 41% of the company’s shares are institutionally held, showing support for the company’s future among investors. We recommend this stock as a buy for the Crummer Portfolio, as the stock price should appreciate over the coming year.
Exxon Mobil Corp. has grown to become the largest public “super major” energy company in the world. The integrated company controls all aspects of the supply chain, from exploration and drilling, to extracting and shipping, to refining and marketing. The company deals primarily in crude oil, natural gas, petroleum products, and petrochemicals.

**Rising Price of Oil**

The uprisings in the Middle East have shot the spot price of the West Texas Intermediate up to around $105 per barrel. This is still far off the peak of $145 per barrel the commodity hit during July 2008, yet far above the low of $30 per barrel during December 2008. The price of oil largely determines the financial performance of the integrated oil companies for sensible reasons. Since Exxon controls the entire supply chain, rising oil prices enable the company to sell whatever it extracts for more to the end consumer. In general, drilling and operating expenses will stay level, along with refining costs. The increasing price of oil should drive higher revenues over the following year, leading to a larger free cash flow and a greater ability to finance long-term capital expenditure projects to increase the company’s reserves.

Conversely, the Henry Hub spot price for natural gas has not moved upwards and is at a depressed price of around $4.25 per MMBtu. This is largely due to a supply glut in the United States as conventional and unconventional gas plays are abundant domestically and demand is somewhat weak. The Baker Hughes rig count shows that the number of rigs drilling for gas has been decreasing, as the market adjusts for the depressed price. Exxon has significant holdings of natural gas plays through its acquisition of XTO Energy in June of last year. Any increase in the price of natural gas will benefit the company financially.

**Future of Natural Gas?**

Exxon has been heavily scrutinized for its acquisition of XTO, both for the large purchase price and the thought that the company is fundamentally shifting its holdings towards natural gas. Exxon, in its annual Outlook for Energy, indirectly responded to critics by predicting that natural gas will grow the fastest of all major energy types, and overtake coal as the second-largest energy source by 2030. Exxon envisions natural gas as important source of investment for the future, and many other major oil companies have acted similarly.
Recently, in its annual strategy presentation, the company reasserted its focus on oil production. The company plans to add 1.4 million b/d to production in the next few years, in which over 80% will be crude oil. From this, oil production will increase 2-3% per year, reversing a declining trend in oil production over the past decade in which the company only averaged a 95% replacement rate for oil. This year, the company hit a 100% total reserve replacement rate for the 17th consecutive year, but made this benchmark only through its increase in natural gas reserves. The refocus on oil is a hopeful sign for critics of the company’s recent gas investments.

**Share Buybacks and Dividend**

Over the past decade, over 61% of Exxon’s operating cash flow has been used towards dividends and share buybacks. This appears extremely high in comparison to its peers of about 41%. Interestingly, in the recent economic downturn the company borrowed money to help fund these share buybacks. Even last quarter, the company spent over 62% of its net income on share buybacks, and plans to spend $5 billion this quarter. Whether to enhance the company’s EPS support its compensation plans, or to adjust its capital structure, these buyback programs are not expected to end anytime soon. Regardless, Exxon has plenty of cash to fund future capital expenditures, and these buybacks should benefit investors while enacted. Likewise, the company has a respectable 2.1% dividend yield, providing a further incentive for investors.

**Potential Threats**

XTO energy is a leader in unconventional gas extraction, usually involving a process called hydraulic fracturing, also known as fracking, in which mixtures of water, sand, and chemicals are pumped at high pressures to break down the shale layers trapping gasses. There has been controversy in the past months over the safety of fracking practices, and their possible threat to human health. Currently, a bill deemed the FRAC Act is in Congress being reviewed, which would force companies to reveal the mixture used in the fracking process to determine if it is contaminating water supplies. Although Exxon has a stipulation in the acquisition relating to the possible illegalization of fracking, it is extremely unlikely that this practice will be outlawed.

As with any oil company, political instability could threaten the operations of the company. For example, Exxon had assets expropriated by the Venezuelan government in 2007, and currently has operations in the Middle East, specifically Yemen, where uprisings have occurred. This risk is inherent in the industry, and a constant threat to the company’s production levels.

**Conclusion & Recommendation**

The rising price of oil and continual share buybacks should support the stock price in the coming year. Looking forward, the company has amassed a huge amount of reserves, and plans to increase this amount with more oil plays. The question arises if the company has grown too large to maintain meaningful growth, especially concerning the replacement of its reserves. However, with the ambitious goal of doubling production by 2020, we believe the company does have the capability of sustaining a solid growth rate. For these reasons, we recommend Exxon as a buy for the Crummer Portfolio.
Helmerich & Payne is a global contract drilling company operating both onshore and offshore rigs. The company specializes in shallow and deepwater drilling, utilizing its special “Flexrig” fleet to tap into oil and gas basins of difficult accessibility. The company also has holdings in real estate, and a research and development arm in a subsidiary company, TerraVici Drilling Solutions, allowing it to maintain its differentiation through technological improvements.

**Unique Flexrig Fleet**

Helmerich & Payne’s Flexrigs are more mobile and drill faster than traditional rigs. These rigs are able to drill horizontally, increasing their production and range of uses. Flexrigs now account for more than 80% of the company’s fleet, and the company has secured 23 new long-term Flexrig contracts in the past fiscal year. The company continues to improve its technology and the Flexrig is now it is fourth generation, allowing customers to target shallower wells with improved efficiency. This new fleet gives the company a distinct advantage over its competitors in cost savings and improved production rates for its customers allowing the company to charge a premium for its contracts.

**More Rigs, Greater Utilization**

Helmerich & Payne continues to expand its rig fleet and expects to complete 16 rigs by the third quarter of 2011. The total fleet has grown from 213 in 2008, to 257 in 2010, over a 20% gain. Before the recession, the rig fleet was operating at close to maximum capacity, as the U.S. total land fleet was at a 96% utilization rate, referring to a rig that is in operation, being moved or assembled under contract. Currently, the same fleet is at a 73% utilization rate, an improvement from the 68% rate in 2009. Impressively, the Flexrig operates at an 87% rate, and this number should continue to rise. The company continues to experience backlog in demand for its new Flexrigs, indicating that the company should continue to fill orders and lock up long-term contracts in the near future. All of the company’s rigs are under fixed-term or “well-to-well” (expiring after the completion of a well) contracts, providing the company with stable revenue in the long term.
Areas of Potential Growth

Helmerich & Payne’s acquisition of TerraVici Drilling Solutions in 2008 provides an opportunity to boost the technological advantage the company currently holds. The subsidiary uses patented technology to improve the horizontal drilling process. The improvements made should complement the company’s existing drill fleet, as well as improve the efficiency of future Flexrig generations.

The company has a large potential for growth overseas. International land operations contributed around 13 percent of the company’s total revenue in 2010, up from 10 percent in 2009. The increasing price of crude oil should justify new capital budget expenditures among many companies overseas. Although Helmerich & Payne is experiencing a backlog in Flexrigs, the company still has more rigs that are traditional not in use, which if contracted out, would help increase the company’s rig utilization rate. In the long term, while natural gas is currently in a supply gut, a future increase in prices could spur demand in Europe for rigs capable of horizontal drilling. For the time being, the increasing price of oil is a boon to the company, as more than 60% of the company’s fleet is targeting oil and gas liquids, as opposed to more traditional dry gas plays.

Important Financials

Helmerich & Payne has had 38 consecutive years of dividend increases. Even though the dividend yield stands at a meager .4%, it is still noticeable considering the company has spent more than double its net income on capital expenditures the past two years, mainly to expand its fleet.

The company’s U.S. land fleet had a decline in average margin per day in 2010, as average rig revenue per day fell by 15.2% from 2009. This is most likely due to the influx of rigs into U.S. land operations. The total rig count has rebounded from its low of less than 1,000 in 2009 to just over 1,700. This sudden surplus likely pushed day rates lower, which should level out as suppliers adjust properly to demand.

Potential Threats

While rising oil prices have increased demand for available rigs, this correlation highlights how the company is dependent on the market price of fuel commodities for success. The market price of dry gas has not risen along with that of crude oil. This has not severely affected the company in the short term. A prolonged decrease in the price for gas, or even a sharp downturn in the price of oil, would adversely affect potential contracts and future revenue. The company makes large capital investments in the construction of new rigs, and a decrease in demand for these rigs would impair the company financially. On the other hand, an oversupply in the total number of rigs in any of the company’s markets could reduce the day rate of the rigs, threatening the company’s profitability. Finally, in 2010, the company had 11 rigs in operation in Venezuela seized by the Venezuelan government. While this appears to be an isolated event, political turmoil could threaten the property of the company.

Solid Buy for the Year

While threats exist in Helmerich & Payne’s operations, it is clear that the company is poised to take advantage of rising oil prices and increase its market share in the drilling sector. The company enjoys a strong differentiation position based on its technological improvements. There is a high demand for the company’s rigs, and potential for growth with a larger rig fleet and the expansion of its international operations. Due to these reasons, we recommend a buy for this security.
OYO Geospace manufactures equipment used to capture and analyze seismic data of oil and gas reserves, to determine productivity. The company also produces thermal imaging equipment and film, for use in a variety of markets worldwide. Its seismic business segment operates in both land and marine environments, serving customers who are mainly seismic contractors and large oil companies. The company operates primarily domestically, but has an international presence.

**GSR Equipment**

The company has established a competitive advantage with its new GSR (Geospace Seismic Recorder) system. In the past, seismic contractors used a large amount of physical cables to string recording systems to a data processing location. This process is time consuming and requires significant labor to move the cables. The company’s GSR system is cable-free and can be transported in backpacks across all terrains. These technological improvements save its customers time and money, allowing the company to charge a premium for its equipment.

The land-based GSR uses “channels” to acquire data. The typical customer uses between one to four channels to retrieve data. As of the end of fiscal year 2010, the company had delivered more than 39,000 channels to customers, with the plan of increasing its supply by 30,000 the following year. In the first quarter of 2011, the company delivered almost 29,000 channels to customers, 7,900 of which were rented. The company forecasts sales of 11,000 channels and rentals of 12,000 channels in the second quarter. This explosion of demand highlights the solid reputation the GSR system has gained.

The company also operates a marine-based nodal system that uses a similar channel configuration. Its deepwater equipment can acquire data from depths of around 3,000 meters, and the company has seen an increase in demand for its marine products.

**Higher Oil Prices**

The steady climb in the price of oil should lead to more sales and rentals of GSR equipment. Oil drilling and extraction companies should have more free cash to spend on capital expenditures, which should flow to seismic contractors hired to search for new producing fields. In turn, contractors will utilize more of OYO’s equipment, providing the company higher revenues while the
price of oil stays high. Although the company’s financials are inherently linked to the price of commodities, the price of oil should stay high in the coming year, while any increase in the price of natural gas would be a boon for the company. Finally, the company has a reputation for manufacturing durable products that perform well in harsh climates. Oil exploration is moving towards areas with extreme environmental conditions, as easily accessible fields are extracted, which should help increase market share in years to come.

**Supporting Financials**

The company’s net income jumped from $1.7 million in 2009 to over $14 million in 2010. This figure is still down from the company’s net income in 2007 of $19.5 million, which should be surpassed this year. In addition, the company has no long-term debt, which will provide a significant amount of free cash in the coming quarters to expand production and diversify the company’s product line. Finally, OYO has had an average earnings growth of over 12% over the last 5 years.

**Unnerving Signs?**

The company’s stock is relatively illiquid with a relatively small float of 4.2 million shares held by non-affiliates. This leads to a relatively volatile stock price, as volume only averages around 25,000 a day. Interestingly, the company’s top management has been selling off shares in the company. The CEO has sold about 30,000 shares since September of last year, over 10% of his total holdings. Likewise, the CFO and other management figures have been selling stock recently. These sales could simply be moves to provide income or rebalance portfolios, but are troubling nonetheless.

**Subsidiary in Russia**

The company has a subsidiary, OYO-GEO Impulse, based in the Russian Federation. Besides being located in a potentially volatile area, the company’s sales overseas are subject to tariffs regulations and other governmental restrictions. This operation has lost money the past few years, losing $1.3 million in fiscal year 2010, claiming the market was weak for seismic equipment. The company’s revenues in Russia are still far from its 2008 level, and it expects the business climate to improve this year.

**Potential Areas of Growth**

Last quarter, the company broke out of its traditional oil and gas market, and sold an underground GSR monitoring system to a company in Japan. In addition, the company sold a seismic borehole system for use in examining the earth’s stability beneath a nuclear power plant. These two sales show that the company’s technology is transferable to different industries, and has the potential for further growth. Overall, only around 50 seismic contracting companies are operating worldwide, showing a shortage of customers for the company’s products. However, the company realizes that by diversifying its product line, it can increase this customer base.

**Solid Investment**

Although the stock price has rebounded from its low of under $10 a share in the heart of the financial crisis, we believe it has appreciation potential. The company will greatly increase its revenues this year mainly due to sales and rentals of its GSR system, and should see rising demand in other business segments. The company has established a unique position in its industry, and has cornered the premium market. Finally, 53% of the company’s shares are held by financial institutions, showing support for the company in the investment world.
Suncor Energy SU

**Recommendation**  HOLD  
**Valuation**  $50.55  
**52 Week Range**  $44.53  
**As of**  4/6  
**Industry**  Energy - Integrated

- The Company is Concentrating its Position in Oil Sands Production
- Integrated Structure Allows Company to Benefit from Rising Oil Prices
- After Last-Year’s Divestitures, the Company Will Be More Profitable

Suncor Energy is Canada’s third-largest oil producer by market value, primarily through its mining and extraction of oil sands deposits in the Athabasca oil region located in northeast Alberta. The company has an integrated structure that provides for the refining and marketing of the extracted materials through its Sunoco brand. The company is also involved in the joint venture of Syncrude, a consortium of seven companies created to refine specific oil sands deposits into usable products. Suncor Energy also has oil holdings in international and offshore locations, as well as natural gas holdings primarily in Western Canada.

**Refocus on Oil Sands**

Suncor Energy’s 2009 acquisition of its oil rival, Petro-Canada, in an all-stock deal, gave the company significant cost savings upwards of $1 billion per year. Besides these synergies, the newly formed company now has a concentrated position in oil-sands production. Suncor is currently the world’s second-largest oil-sands producer, and expects to focus its future operations on the development of Canadian oil sands reserves, estimated to be the world’s second largest after Saudi Arabia. As an example of this refocusing, the company forecasts it will produce 1 million barrels of oil a day by 2020, 80% of which will come from its oil sands production.

Oil sands production is an unconventional extraction process that is capital intensive and uneconomic if the price of oil is too low. However, new technologies and mergers can reduce costs and justify new capital spending projects, especially to tap into the large size of the Athabasca basin. This strategy should give the company less risky and consistent long-term production quantities.

**Poised to Reap the Rising Price of Oil**

Suncor stands to take advantage of the rising price of oil with its integrated structure. Since the company controls all aspects of the supply chain, whatever it extracts from the ground will now sell for a higher price. As a result, the company will post higher revenues this coming year, as well as earn more cash to spend on capital expenditures, such as ramping up its oil sands production. The company’s oil production jumped at an opportune time last year, rising from 202,300 barrels per day in the first fiscal quarter, to 325,900 barrels per day.
in the fourth fiscal quarter. The upcoming financial statements should reflect this improved economic climate, with higher total revenue and EPS.

As mentioned before, the company has a stake in Syncrude, which contributes about 5% of the company’s revenue. Synthetic crude, the product produced in this operation, is trading close to $15 a barrel premium over the WTI. The premium is not expected to remain at this level, but it should support this year’s financial returns.

**Upcoming Years**

Suncor recently entered into an agreement with the French oil company, Total SA, to develop several projects in western Canada. The partnership plans on jointly developing two mines, as well as restarting construction on the Voyageur Upgrader, with an estimated completion time of 2016 and production amount of 200,000 barrels per day. The latter project itself would increase Suncor’s yearly production by 36.5 million barrels, or about 31% of last year’s total production. This partnership is critical to increasing the company’s oil sands production over the upcoming decade.

**Leaner Company through Divestitures**

Suncor’s natural gas operations have not been profitable for the past two years. The depressed price of natural gas, around $3.70 per mmBtu, has led to operating losses of $88 and $187, in 2010 and 2009, respectively. In addition to the low price, large royalties to the Canadian government have kept its natural gas earnings in negative territory. The company is in the process of divesting many of its natural gas holdings, and sold around $3.5 billion non-core assets last fiscal year. These divestitures pare off selected underperforming assets and contribute cash to the company’s oil sands production.

**Political Threats**

Suncor’s operations in Libya contributed nearly 6% of the company’s total oil production last fiscal year. It is unclear when the country’s civil war is expected to end, but as of now, Suncor has shut down all operations and evacuated all personnel from the country. If the war continues, Suncor will struggle achieve its goal of an 8% increase in production set forth for 2011. Even more so, the scenario highlights the risk of political unrest to the company’s operations. This will further solidify the company’s strategy of focusing on domestic oil sands production.

At the same time, air pollution from oil sands production has been under scrutiny in the Canadian province of Alberta. More tests have been called for to deliver conclusive results, but the practice is now being watched closely. The Alberta Environmental Minister defends the practice, but any regulation could threaten revenue growth.

**Conclusion and Recommendation**

The company’s focus on the oil sands region in Canada should give it a stable resource base to extract from for years to come. The recent acquisition of Petro-Canada and joint venture with Total SA, give the company the financial capabilities to grow its position and production rates in the region. Even more so, with rising oil prices, the high extraction costs become much more feasible. The company has struggled recently with depressed gas prices and the unrest in Libya. However, this will only strengthen the strategy of developing the infrastructure for future oil sands production. Finally, the company’s leaner structure should be beneficial to investors, as the outcome of increased production or new oil discoveries will be more impactful.
Consumer Staples Sector

The Consumer Staples Sector is one of low growth and low correlation to the rest of the market. This is especially true during economic recoveries. Consumer Staples tend to outperform the rest of the market during recessions but lag during recoveries. During recessions as people are reducing spending, they spend less on discretionary items; however, staples sales remain relatively stable. Consequently, during a recovery consumers tend to buy more discretionary items while staples sales once again, remain quite constant. During this recession, it can be expected that the Consumer Staples Sector is likely to continue stable growth and will miss out of much of the upside related to the recovery.

The current recovery is likely to be similar to other recoveries. Commodity price fluctuations during this recovery are likely to hinder profits for the Consumer Staples Sector during this recovery. Many of the companies in this industry are very dependent on commodities and any price fluctuations make it hard for the firms to price their goods and forecast profits and earnings. Price fluctuations will have the added effect of making many companies retain more earnings due to uncertainty in the future.

On a positive note, the Consumer Staples Sector typically represents a low correlation to the rest of the market. This will provide the portfolio with some protection from general market fluctuations. Consumer Staples also represent stable, albeit low growth levels. The Staples Sector has the potential to provide consistent growth and capital gains, allowing other sectors of the portfolio the ability to look for higher growth opportunities.
Avon Products Inc. AVP

### Recommendation
Sell

### Valuation
$19.87

### Last Price
$27.04

### As of
3/31/11

### Industry
Consumer Staple-
Household Products

- Inefficient Sales Force
- Heavily Dependent on Latin America
- Underweight the Sector

Avon Products is a cosmetics company that distributes its products by utilizing a direct sales force rather than through retail channels like many of its competitors. This sales force has been dragging down financial results for the last three years. Avon’s exposure to the Latin American market is also troublesome for the future of the company.

**Avon’s Sales Force**

We believe a direct sales force is a hard strategy to make successful during periods of economic unrest and recovery. There are several reasons for this, the first one being that it is hard to maintain an effective sales force during a recovery. Direct sales forces swell during recessions, which is what Avon has capitalized on. Consequently, during recoveries as unemployment numbers begin to drop people find other more substantive work. Avon has seen this happen several times in its history. Due to Avon’s industry, most if not all of their sales force is made up of women. Avon’s sales force expanded with a combination of formerly unemployed. Since the economy is recovering, many of these employees will leave to go back to jobs similar to what they did before or quit altogether because their families do not need the extra income as spouses return to work.

Avon’s Direct Sales Force relies on costly brochures and promotional materials. These are expensive for the company and help explain part of 4% increase in cost of goods sold in 2010. In the last three years as Avon has expanded the sales force by 6.8%, from 5.8 million to 6.2 million sales associates since 2008. Over this period, it has only experienced a revenue increase of 3.1% while gross margin increased only 1.4%.

While Avon expects revenues to grow due to the sales force increase, it is unknown how soon or if revenues will be affected. Because the increased sales force has had little effect on revenues in the last two years, I believe revenues will likely remain stagnant in the upcoming year.

**Heavy Dependence on Latin America**

Avon has become increasingly more dependent on the Latin American market over the last three years. Over the last four years, Avon has seen Latin
American revenues increase from 33.19% to 42.25% of total revenues in 2010. Avon is increasing operations in the volatile Latin American region. Because 42.25% of Avon’s 2010 revenues came from Latin America, any disruption will greatly affect the firm’s profitability. Because the company has recently built a plant in Brazil, it is unlikely that Avon will reduce its investment in that region despite economic issues. Two of Avon’s three major markets in Latin America are suffering some of the worst impacts of the recession. In 2011, the Heritage Foundation and its Transparency International Index indicated that Mexico fell even further regarding “freedom from corruption. Mexico has ranked below the World average for corruption since 2001. Mexican business growth and economic recovery is being thwarted by crime and corruption according to The Economist. Because Venezuela declared hyperinflation, Avon’s assets including inventory had to be revalued, causing a decrease in operating profit of $81 million in 2010. This represents a 7.4% decrease in total operating profits for 2010. While Avon has seen Latin American profits increase 11.85% in 2010 and 5.65% in 2009, the region is unstable and continued profit growth is not guaranteed.

Valuation

According to a DDM, Avon is overvalued. Given its current growth rate, Avon should not be selling at the $27.42 that it was as of the time of this report. Given Avon’s 10.59% cost of equity, it would have to experience growth of 7.15% to be fairly valued. Over the last three years, it has seen average dividend growth of only 5.6%. Unless Avon’s cost of equity decreases, it must experience significant dividend growth to reach fair value.

Comparing Avon to its peer groups, it does not stand out. The table below compares Avon against three of its largest competitors. Avon’s PE of 19.21 is above the others and its Dividend Yield is not high enough to provide much incentive to hold the stock. The slow growth of the stock and average dividend yield will not produce much in the way of capital gains or cash from dividends.

Conclusion & Recommendation

There are several questionable issues for Avon in the next 12 months. Avon has expanded its direct sales force has not provided much in the way of additional revenue growth and is increasing costs, which increased cost of goods sold by 4% in 2010 compared to 2009. While not all of this increase can be attributed to the sales force expansion, due to the direct selling nature of business much of it can be. Avon’s high dependence on Latin America has harmed recent financial results, a trend that is expected to continue as long as macro-economic trends will create a challenging operating environment in that region. We recommend selling our position in Avon.
Church and Dwight Co (CHD) produce a large number of products under many different brand names. Its goods are used in households around the world as non-durable products. Two of the company’s major brands include the Arm & Hammer line and Trojan condoms. The company has not efficiently been managing its capital structure, which has prevented them from taking advantage of potential growth areas.

**Debt-Equity Structure**

In recent years, CHD has worked to acquire companies to fuel its growth. This has had a negative effect on its capital structure. It has had to begin selling stock as well as using debt to fund these acquisitions. Over the last five years, debt has increased 8% while shareholder’s equity increased over almost 130%. As of 2010, the capital structure included 34% debt, down from 52% in 2005. Compared to the industry, 34% debt is slightly lower than the average. CHD is not using competitive advantage, likely raising its cost of capital compared to many competitors. CHD has room in its capital structure to return to a more leveraged debt structure in order to fuel acquisition growth. However, many analysts believe that this economic recovery will boost and strengthen the M&A market. If this is true, CHD may be inclined to continue its acquisition strategy even though it is not operating at its peak capital-structure. We believe that if CHD continues to make acquisitions, they will be smaller, more inexpensive companies that can be funded through small debt issuances. Making small acquisitions will allow CHD already diversified, to focus on issues such as supply chain integration rather than acquiring new consumer brands.

**Brands**

CHD has recently lost the right to market some of its Crest products. It is not likely that this will have a material negative impact on the company’s financials, and may in fact provide growth. If the company does in fact take advantage of the M&A market, this is likely to be one area of growth. Losing rights to the Crest brand probably had more...
of a morale impact that a financial one, so the
company may look to acquire a replacement brand
line. CHD has had a history of continually
innovating to put more and more products in the
marketplace. CHD has kept the Arm & Hammer
brand innovative even though it is 160 years old.
While CHD may look to acquire a new brand line, it
may also decide to address supply chain through
acquisitions.

**Mature Markets**

Many of CHD’s brands operate in mature markets.
Dental care products and cleaning products are
two such markets that are in a mature stage. These
products are therefore likely to see low growth and
drag down figures for the entire business.
Additionally, 81% of 2009’s revenues were to
customers in the US. While there are distressing
macro trends in some regions of the world, many
other locations are experiencing high growth and
developing markets. By not being very exposed to
some of these developing markets, CHD is missing
an excellent opportunity. CHD needs to increase
foreign operations in order to experience above
average growth for the industry. A positive sign
that CHD is increasing foreign operations can be
seen in its financial results. CHD’s Consumer
International segment experienced net income
growth of over 11% from 2007-2009. If CHD is as
dedicated to foreign growth as it seems, future
growth could be high.

**Valuation**

Comparatively, CHD is in line with its competitors
when looking at several indicators. CHD’s Revenue
growth and EPS growth figures are lower than its
competition for the last five years. However, it is
likely that its EPS numbers have been affected by
the almost 7 million shares of common stock they
have issued in the last five years. The firm’s PE
ratio of 15.38 after extraordinary items is better
than the industry average of 24.9. A technical
analysis using Bollinger Bands and RSI that CHD’s
situation may be improving. Using a DDM, the
company appears to be fairly valued, requiring
moderate growth numbers to be fairly valued.

**Conclusion and Recommendation**

CHD has placed itself in a good position for future
growth. Over the last five years, the firm has
reduced debt in its capital structure by 18%. The
debt reduction has positioned CHD well for future
growth through using advantage. Recent share
issuances have diluted the earnings pool, but this
will likely not continue because of the healthy
capital structure. CHD can continue its expansion
into foreign markets and find higher growth
potential than in its currently mature domestic
market. A valuation analysis indicates that CHD is
in better shape than many of its competitors and a
DDM analysis indicates that it is currently fairly
valued. We recommend holding the stock because
dividends have increased by an average of 22%,
which will provide capital gains for the portfolio.
CHD’s expansion into foreign markets of 11% over
the last three years indicates the company is
looking for higher growth markets, which should
help the stock price. Because of the potential for
growth and the firm’s current capital structure, we
recommend holding the stock in the portfolio.
Colgate-Palmolive Co. CL

Recommendation: Sell
Valuation: $70.11
Last Price: $80.76

As of: 3/31/11
Industry: Personal and Household Products

- Very Dependent on Latin America
- Anemic Growth Rates
- Margins are Not Sustainable

Colgate Palmolive (CL) produces goods for household and personal use. The CL umbrella includes major product lines such as Colgate Oral Care division, Soap and Deodorant division, and many different household cleaners and products. Currently, CL faces issues regarding international exposure and stagnant growth figures.

International Exposure

CL operates in very geographically diverse markets. Operating in over 200 markets worldwide the company is obviously subject to international exposure risks. Because almost 32% of CL’s revenues come from Latin America, it is overly exposed to the macroeconomic issues surrounding many of that region’s major countries. Colgate Palmolive forecasted an EPS reduction between 6-10 cents due to Venezuela’s 2010 declaration of hyperinflation. In contrast, CL is very excited about growth in the Asian Oral Care segment and its associated growth potential. I feel like this positive is outweighed by CL’s negative exposure to Latin America. In addition to issues with Venezuela, Colgate is having trouble with the Brazilian government. Colgate has been engaged in disputes with Brazil since 2001 and it is a very tenuous relationship. If the situation deteriorates during this period of economic struggle, it could cause a major adjustment to Colgate’s future earnings.

Anemic Growth Rates

Colgate has experienced anemic or even negative growth rates for the last four years. CL’s average annual revenue growth since 2008 decreased from a 5-year average of 6.34% to only 1.53%. A revenue decrease is not expected from a company in the consumer staple industry. This is especially disturbing for a consumer staples company because they are not expected to experience as much growth during the recovery as companies in other industries such as Consumer Discretionary and Materials. Much of Colgate’s Latin American earnings came from Brazil, Venezuela, Mexico and Columbia. Since Venezuela and Mexico are facing well-documented economic issues Colgate’s future earnings are still suspect.
Non-Sustainable Margins

Over the last four years, Colgate has seen margins growth decrease year after year. Since 2007, operating margin has shrunk from 22.8% to -3.49% in 2010. Margins have shrunk more than even the revenue figures, which does not bode well. The revenue growth shrinking is an issue, but if margins are shrinking faster that is even worse. At a time when companies have been seeing increased margins due to cost cutting behaviors CL has experienced low growth rates. Companies are already operating at bare-minimum personnel and materials levels and it is likely that Colgate is in the same situation but it is not working for Colgate.

Valuation

Comparatively, Colgate does not compare well with the rest of its industry. According to Bloomberg, Colgate trails its peers in Revenue and EPS Growth. It is important to note that it does however stack up well in terms of ROE and Dividend Growth. When looking at a DDM calculation Colgate Palmolive is overvalued. It is not likely that Colgate Palmolive will be able to achieve the required growth rate in the upcoming year to be considered fairly valued.

Conclusion & Recommendation

Colgate Palmolive is facing some challenging months ahead. It has experienced anemic growth in revenue over the last four years and is not likely to be able to maintain margins indefinitely despite cost cutting procedures. The company’s position in the global marketplace is also troublesome. While it is hoping for high growth in is smallest geographic region (Asia/Africa), the macroeconomic impacts on Latin America, its’ biggest market are likely to counteract any positives it experiences in Asia/Africa. It lags behind its competitors in a comparative analysis and seems to be overvalued. Because of this, we recommend selling CL’s stock and reinvesting it in a more promising Consumer Staple or under-weighting the sector and finding a more appealing choice elsewhere.
CVS Caremark Corp. CVS

<table>
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<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>As of</th>
<th>Industry</th>
</tr>
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- Expanding Product Offerings
- Generic Positioning
- Prior Investments

Expanding Product Offerings

With the acquisition of Caremark, CVS has transformed many of its retail locations. Now instead of being mainly a pharmacy and having front of store merchandise, it is attempting to turn into a medical resource for its customers. CVS locations have begun placing clinics to provide minor medical services such as immunizations and school physicals. Instead of simply filling prescriptions, a new customer base has been tapped. This will reduce CVS’s reliance on its pharmacy operations by diversifying its customer base. The “Minute Clinics” were in 569 CVS locations in 2009 and expanded into more in 2010. These clinics are expected to bring in high levels of dependable revenue. Unlike expensive operating rooms that have difficulty collecting from services rendered, 80% of Minute Clinic’s 2009 revenues came from employers or insurance providers. This represents a stable, secure revenue stream to CVS. Minute Clinics helped CVS experience 10.2% revenue growth since 2008.

Generic Positioning

CVS has been working with its PBM segment to strengthen its generic positioning. By increasing CVS’ generic offerings, it has positioned itself to be a player in the pharmacy market regardless of any legislation. An added benefit of this strategy is the higher margins that typically result from generic vs. brand name drugs. Due to increasing supply, competition a stronger generic segment will help
CVS. While US Patent Law protects brand name formulation for 14 years, foreign Patent Law only protects for 3 years. Because of the patent laws, generic drugs decrease the profitability of “Blockbuster” brand name drugs. Combining this fact and the increased foreign supply of ethical drugs, CVS has positioned itself to attain high margin generics as early as 3 years after a blockbuster brand name drug is introduced.

**Technology**

CVS has been improving its technology and information systems to improve internal and external communication and efficiency. It is making it easier to communicate with pharmaceutical clients and insurance providers using an improved system. It is trying to position itself as the easiest pharmacy to work with for its clients.

**Valuation**

Comparatively CVS ranks in the middle of the pack of its competitors. While its dividend yield does not stand out against the competition, its growth potential is superior. Technically, an RSI analysis indicates that CVS can expect an upward correction in the value of the stock. A DDM analysis also showed CVS to be undervalued assuming moderate historical growth rates.

**Conclusion & Recommendation**

CVS has performed very well in positioning itself for potential growth in the upcoming year. Expanding the Minute Clinic concept to more retail locations will diversify product offerings and should bolster revenues. CVS has worked hard to position itself in the generic drug market to be more appealing to clients while increasing margins. CVS has invested heavily in its information systems to make itself the pharmacy of choice for its corporate customers. For these reasons, we recommend at least holding the stock.
The Coca-Cola Company  KO

<table>
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<tr>
<th>Recommendation</th>
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<th>As of</th>
<th>Industry</th>
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- Strong Brand Awareness
- Diversification
- Vertical Integration

Coca-Cola is one of the most well known brands in the world. It operates in the beverage industry selling soft drinks, water, juice drinks, and other beverages. Coke’s brands include Coke, Adjani, and Minute Maid. Coca-Cola is diversified in the markets it operates in and the products it sells.

**Brand Awareness**

Coca Cola’s Coke brand constantly ranks among the Top Most Recognizable Brands every year according to Business Week and Interbrand. Coca-Cola has utilized this notoriety to expand into nearly every market around the globe. Coca-Cola is able to withstand economic unrest because it has become a staple for many of its millions of faithful end-users.

**Diversification**

Coca-Cola sells over 3500 different products. These products consist of all different types of beverages including Soft Drinks, Fruit Juices, Water, Energy Drinks, Ice Tea, Sports Drinks, Coffees, Milks, etc. Recent social trends have highlighted health and obesity problems associated with soft drinks. Coca-Cola will be insulated from these anti-soft drink sentiments because of its massive product portfolio that includes fruit drinks, milks, and waters. Coca-Cola should not be negatively affected as other soft drink companies that do not have the expansive portfolio.

Coca-Cola is also extremely diverse geographically. Coca Cola’s products are sold in over 200 countries worldwide. Coke will be able to weather economic unrest better than less diversified countries. Being so diversified Coca-Cola is not dependent on any single regional segment. Coca Cola’s largest segment is North America, representing only 31.7% of total revenues. Latin America makes up its smallest operating segment, which bodes well for the macro economy. Because major Latin American countries like Mexico and Venezuela are facing major economic issues, Coca Cola’s light exposure will protect revenues. After Venezuela was declared a hyperinflationary economy and devalued its currency in 2010 Coca-Cola only lost $103 million. The small loss is almost negligible considering the company had 2010 revenues of over $35 billion. Coca-Cola is well positioned...
geographically to maintain revenue growth as the economy recovers.

Because the company operates in so many different regions, it sources materials and ingredients from around the world. Worldwide sourcing helps Coca-Cola keep costs low by finding the cheapest prices anywhere in the world.

Vertical Integration

Coca-Cola recently acquired several of its independent bottling operations. The most notable of the acquisitions is the 2010 acquisition of the North American Bottler known as CCE. The acquisition demonstrated Coca-Cola’s dedication to vertical integration. Coca-Cola will benefit from lower supply costs, operating costs and will exert almost total control over the supply chain. The question remains whether or not paying almost $10 billion in cash and debt was too much for the ability to control costs. I believe that Coca-Cola probably valued the acquisition properly because of its extremely close relationship with the bottlers before the acquisitions.

It is important to note that the acquisition may have affected Coca-Cola’s debt-equity structure. Because the acquisition was designed to be mostly cashless Coca-Cola assumed $7.9 billion of CCE North America’s debt. $1 million of cash changed hands to make up for higher than expected costs associated with the acquisition of CCE. $8 billion in debt is a lot for the company to accept but should not affect the capital structure negatively. Given Coca-Cola’s reputation and breadth of products, it is unlikely that Coca-Cola’s financials were negatively affected.

Valuation

Coca-Cola is undervalued currently according to a Single Stage DDM. A single stage model is appropriate because unlike other sectors, the Consumer Staple sector is not expected to see abnormal growth during the recovery. As a consumer staple, Coca-Cola was not affected as severely by the recession. Coca-Cola outperformed the S&P 500 by over 4% in the last three years. Coca-Cola’s stock price increased 6% while the S&P only grew 1.28%. Because Coca-Cola was not hurt as much by the recession, it will likely not experience as large of an upside after the recession. According to Bloomberg, Coca-Cola leads its sub-industry in many comparative benchmarks. Its revenue and EPS growth rates outstrip the competition while it has better PE, ROE and Dividend Yield figures as well. A DDM valuation indicates that Coca-Cola is fairly valued, requiring only a moderate growth rate.

Conclusion & Recommendation

Coca-Cola’s brand reputation and diverse portfolio position it well for the future. The brand portfolio will insulate the company from “anti-soft drink” social trends. The company is working toward vertical integration in order to control its supply chain and other costs associated with production. Overall, Coca-Cola is in a good position for future growth and should be held if the allocation is to remain the same.
National Presto Industries (NPK or Presto) operates in three different markets. The household appliance segment manufactures and sells items in the household such as pressure cookers and deep fryers. The Defense segment makes training and lethal ammunition for the United States DOD. Finally, the Absorbent Products segment makes items for adult incontinence. The company experiences extremely high growth rates in its diversified product portfolio.

**High Margin Growth**

NPK has experienced incredible growth over the last four years. The company continues to grow and experience extremely high margins. The absorbent product segment is the only segment that does not have over a 20% operating profit. The appliance segment operates at a 27% profit while the Defense segment holds a 24% profit margin. These extremely productive segments continue to see both revenue and profit growth. Presto does a solid job of keeping costs low while increasing productivity to provide superior returns to investors. Presto has seen significant EPS growth over the last three years, going from $6.45 in 2008 to $9.13 in 2009. This 42% increase indicates that the company is a strong investment as long as it continues its recent strategy.

**Diversified Product Markets**

The three different segments that Presto operates in are very diverse which lends strength to the company’s overall portfolio. None of the three segments will ever see sales cannibalized by another segment because they are so different. Because the company only operates one brand in each of the segments, it does not face the issue of one brand pulling sales away from another. The Defense segment is secure because it operates under contracts from the government. This allows the company to forecast revenues.

**Anticipated Revenue Growth**

NPK has consistently seen extreme growth and that is expected to continue. While the absorbent materials segment is the smallest of the three operated by the company, in 2009 the company invested an additional $30 million. If this has any...
effect on the margin growth, it will help the company’s bottom line. This investment shows the company’s dedication to growing the company. If it is willing to invest $30 million into its least productive segment, it is likely that it will continue growth in the other segments as well.

Valuation

Comparatively, Presto is experiencing much higher Revenue and EPS growth than its competitors and the S&P as a whole. It has an anticipated forward PE ratio of 12.3, which is considerably lower than the home furnishings industry. Presto’s dividend yield of 7.2% or $8.25 is much higher compared to its competitors. A Technical analysis using Bollinger Bands and RSI indicates that the stock should see improvement. A DDM analysis shows that the company is quite undervalued in the market currently, requiring only a 3.8% growth rate to be fairly valued. A below average growth rate of 5% values NPK’s stock at $136.47.

Conclusion & Recommendation

Because of the incredible growth potential of the company, it is a clear buy. It operates at extremely high margins that continue to grow year over year for the last 4 years. The diversification of the company’s multiple segments is promising. The different markets that it operates in are also promising for growth. The household appliance segment is likely to grow more than its industry as the economy recovers. The Defense segment will continue growth due to current government actions and the absorbent segment just received $30 million in company investment. For all of these reasons, this company is a buy and could provide both capital gains and large dividends to the investment portfolio.
 Sysco Corporation SYY

<table>
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<tr>
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<td>Retail (Grocery)</td>
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</table>

- Management Seems Confused
- Dependence on Commodities Prices
- Capital Management

Sysco is a food distribution company operating primarily in North America. Sysco’s clients are food service companies, restaurants and institutional food service providers (Universities, Camps, Hospitals, etc.). The upcoming year has the potential to be challenging for Sysco for several reasons. Management does not seem to be following its announced strategies put forth in its shareholder’s meeting. If Sysco maintains its current business model, it could be negatively affected by changing food and energy prices.

**Management Misalignment**

In Sysco’s two most recent annual earnings statements, it has promised to grow the company by expansion. Expansion will be hard to make productive because the market is saturated. Even though management announced growth by acquisition in 2010, it made no financially important acquisitions. All acquisitions for the year accounted for less than .5% of total 2010 revenues. If Sysco wants to grow by acquisition, it needs to target companies that will have an impact on market share and financials. Sysco will not experience meaningful growth if it continues making the same type of acquisitions it made in 2010. The US consistently accounts for around 90% of Sysco’s sales. For Sysco to grow it must enter new markets. The North American market is saturated and Sysco does not seem to be taking advantage of growing markets abroad. It is widely known that several developing countries are expecting higher growth rates than more developed countries like the US. Countries like Brazil, Russia, India and China (BRIC) are at the forefront of economic growth; averaging 29.87% GDP growth from 2006-2010 while the United States only grew by 8.88% over the same period. If Sysco were to expand into these markets, its growth potential would be much higher than in current US markets. Entering these markets through acquisition as the company has stated, or through organic growth would give Sysco enormous growth and market share potential. Historically, the company has done very little expansion abroad, focusing instead on new domestic markets.
Even if Sysco has begun looking at foreign investments and growth, it is unlikely that these efforts will have an effect on 2011 revenues and figures. Because of our time horizon, this is an important goal. To keep the company in the portfolio we would really like to see growth happening in the next 12 months. Combine this with lower than average dividend yields and it is hard to see growth in Sysco’s future for our portfolio.

**Dependence on Fluctuating Commodity Prices**

Because of the nature of Sysco’s business, it is extremely dependent on fluctuations in the price of commodities. Changes in the prices of food will make it hard to quote prices for customers and could end up increasing costs above expectations, causing lower than expected profits. If oil prices change drastically, Sysco will see its own distribution costs increase. Because Sysco is so dependent on transportation, this could pose a major threat to its profitability.

**Dependence on Fluctuating Commodity Prices**

Sysco currently maintains a capital structure that includes less than 40% debt. If the company is serious about expansion, it should be utilizing its ability to add more debt to finance acquisitions and growth. By increasing debt for acquisitions, it could acquire larger companies that will actually have an impact on its financials and competitive market share, rather than minor acquisitions that had negligible effects in 2010.

**Capital Management**

Sysco currently maintains a capital structure that includes less than 40% debt. If the company is serious about expansion, it could utilize its ability to add more debt to finance acquisitions and growth. By using debt for acquisitions, it would be able to acquire larger companies that will actually have an impact on its financials and competitive market share, rather than minor acquisitions that had negligible effects in 2010.

**Valuation**

Comparatively, Sysco has a better-than-peers PE ratio of 12.04 compared to industry PE of 14.7 according to Morningstar. However, Sysco falls behind in Revenue and EPS growth. Technical analysis is of little help in this matter because different value measures indicate little concerning positive or negative corrections. A DDM analysis shows Sysco to be valued at $21.86 per share while it is currently trading at $27.70. This indicates that the stock is currently overvalued.

**Conclusion & Recommendation**

Sysco is a company that has some fundamental problems. Management seems to be struggling to implement its prescribed growth strategy. Sysco could be acquiring and growing in foreign markets, it has decided to pursue new domestic markets with lower growth potentials. It could be using its capital structure to fuel important growth acquisitions, but did not make any significant acquisitions in 2010. Finally, its business model is dependent on highly volatile commodity prices. Unforeseen shifts in commodity prices could greatly damage margins. While a DDM valuation of the company indicates that Sysco is undervalued, a comparative analysis is less decisive. Because of fundamental issues and a mediocre comparative analysis, we recommend selling positions in Sysco.
Financial

Introduction

The financial sector is impacted by global macroeconomic drivers, such as the real estate market collapse and unemployment, as well as industry specific drivers, such as increased regulation, tighter credit qualifications, and consumer deleveraging. Even though the financial sector faces challenges, certain sub-industry groups will be in a stronger position to capture growth as the economy improves in 2011.

Macroeconomic Drivers

Real Estate Market

The residential and commercial real estate markets’ health is directly linked to the financial sector’s health, especially the bank and real estate industry groups. Revenue derived from real estate mortgages are a key source of bank revenue. Unfortunately, the real estate market is in bad shape.

Because real estate prices have decreased significantly, delinquencies and foreclosures rates have increased dramatically—and not only in the US. When borrowers owe more on their mortgage than the property is worth, there is a much greater likelihood they will stop paying on the mortgage and ultimately allow the loan to go into foreclosure. Currently in Florida alone, approximately 1 in 5 properties are worth less than the mortgage(s) against it.

Homes sold an annual rate of 4.88 million in February 2011, down 9.6% from January and 2.8% lower than February 2010. Inventory rose 3.5% to 3.49 million units, an 8.6-month supply at the current rate of sales. The excess home inventory drives down home prices, which is demonstrated by the decrease in median home by 5.2% to $156,100, compared to the previous year. Furthermore, new home sales decreased 16.9% in February 2011, hitting its lowest point since the government began keeping records in 1963.

Additionally, delinquency rates hit a high point in second quarter in 2010 (11.32%); however, by the end of 2010 the delinquency rate was at 9.94% dropping below 10.29%, the rate at the end of 2009. Foreclosure rates for residential real estate declined slightly from 1.4% in December 2009 to 1.3% in December 2010. Federal Reserve predicts another 4.25 million foreclosures in the next 2 years.

According to a study by Edward Pinto of the American Enterprise Institute almost 50% of the mortgage loans outstanding are sub-prime or Alt-A loans. This indicates that the credit risk of existing loans on banks’ books is understated and we have not yet seen all the potential foreclosures. Please refer to below chart of Mortgage Foreclosure Rates.

Based on these statistics, the residential real estate market is not in a strong position. Overall, the future of the housing market is unknown. Standard & Poor’s forecasted that residential real estate housing prices will bottom in 2011, and then remain stable until unemployment drops. However, the housing market could experience a steep negative turn, which would adversely affect the banking and real estate industry.
On the other hand, the commercial real estate market has fared better than the residential market. At the end of 2010, the delinquency rate for commercial real estate loans was 7.97% (2009: 8.74%). Furthermore, commercial real estate continues to have the lowest charge-off rates of any loan type, including credit and residential real estate loans. Loan applications for commercial real estate loans have increased, indicating the commercial real estate market may continue its upward momentum.

Unemployment Rate

The persistence in unemployment presents significant challenges for the financial sector. Unemployment effects consumer spending as well as borrowing for both credit cards and mortgages. Currently US unemployment is 9.0% and Standard & Poor’s projected unemployment to decrease to 7.9% by 2013. The slow improvement of the unemployment rate represents significant challenges for the financial sector. Unemployment rose internationally between 2008 and 2009. Please refer to the table below.

International Impact

The current banking crisis is global. The majority of our current positions operate internationally, thus, the companies are effect by foreign governments’ interventions and regulations. For example, after the Euro-zone debt crisis governments step in with massive loans leaving smaller banks out of the equation. Additionally, different governments have implemented different fiscal policy to emerge out of the financial crisis – Obama launched massive government spending and intervention in the credit markets, while other countries’ leaders, such as Germany and Great Britain, have cut government spending and increase taxes. The impact of the government programs will vary but are very important to the financial industry. For example, because of massive spending programs, The United States’ interest rates will remain low and the government is claiming that inflation is not an issue. However, globally governments are concern about inflation. Lastly, emerging nations, such as the BRIC countries, which have high GDP growth, represent strong markets compared to developed nations, such as the United States

Sector Drivers

Regulations

Federal regulations such as the Dodd Frank Wall Street Reform and Consumer Protection Act (2010), and its embedded Volcker Rule, Regulation E and Basel III will increase expenses and compliance costs for all financial services companies. These regulations aim to increase consumer protection, as well as limit banks’ risk taking activities, such as proprietary trading. Higher risk is usually accompanied by higher returns so limitations on risk taking activities could potentially curtail revenues. Even though the full effects of these regulations remain to be seen, the financial services companies have begun to implement changes based on these new laws and the uncertainty of the impact has decreased.

Basel III is a new global regulatory standard on banks’ capital adequacy and liquidity. The new global regulation requires higher capital ratios for banks. Basel III will be phased in gradually and will be fully implemented by 2019. Thus, banks have adequate amount of time to adjust to the new regulation. The overall impact for US and foreign banks will be to raise capital and liquidity while lowering leverage.
Lastly, since the financial meltdown, the government has been actively involved with the financial sector through massive purchases of financial instruments designed to help the overall economy, banks, and the real estate market. QE2 increased the overall liquidity of the market, aiding financial services companies. Whether or not these interventions are ultimately successful, they do impose new costs on financial companies.

**Consumer Deleveraging**

U.S consumers’ indebtedness has fallen by more than a trillion dollars from its peak in 2008. This decline is partly due to an increased number of defaults (where the debt was written off by the lender) over the same period; however, it is mainly due to a change in consumer spending patterns. Refer to below graph “Nonmortgage Debt Change Other than Charge Offs”. Consumers are borrowing less and paying off debt sooner. This trend negatively affects the banking sub industry by curtailing its interest revenue and loan growth.

**Tightening Credit Requirements**

Due to the financial crisis, banks have increased credit qualifications to qualify for loans and mortgages. In the short term, banks loan growth slowed due to tightening credit; however, in the long term loans and mortgages will be higher quality that in return will lower default and foreclosure risk. Thus, companies that increased loan volume are positioned well for the upcoming year.

**Overview of Recommendations**

The above drivers affect the overall financial sector; however, each driver affects the financial sector’s sub-industry groups differently. We currently have exposure to the following sub-industry groups: Diversified Banks, Other Diversified Financial Services, Regional Banks, Asset Management & Custodial Banks, Investment Banking & Brokerage, and REITS.

**Banks (Regional, Diversified, Other Diversified Financial Services)**

As mentioned above, banks are highly impacted by the health of the real estate market. We recommend selling positions with high exposure to the US residential real estate market due to the risk associated with unknown near-term future of the housing market, as well as, the anticipated increase in foreclosures due to built-up housing inventory and continuing higher unemployment rates. However, banks that have higher exposure to the commercial real estate market and have less nonperforming assets and increased loans are poised for growth and we recommend buying securities that exhibit these traits. Additionally, some banks, such as JPMorgan, are expected to engage in capital deployment programs that could include dividend increases and share repurchase.

**Brokerage Firms**

Investment Banking and Brokerage Firms are in a strong position, especially Goldman Sachs. Regulation reform will increase costs for these companies, however other factors, such as increase M&A activity and the global recovery, combat regulation impact. Additionally, Brokerage Firms are less exposed to the real estate market.
REITS

REITS are a smart investment, especially because of the high dividend yield. Even though the housing market is most likely continued to decline in 2011, the low interest rate environment provides a strong opportunity for mortgage-backed RIETS. We recommend holding, or even increasing our current position with Annaly Investment Partners.

<table>
<thead>
<tr>
<th>Table 1. Unemployment rates adjusted to U.S. concepts, 10 countries, seasonally adjusted</th>
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<td>2009</td>
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<tr>
<td>2010</td>
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<td>Jan 2011</td>
</tr>
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</table>

Sources: Mortgage Bankers Association. Data through 2010Q3.

Mortgage Foreclosure Rates (%)

Other debt change

Source: FRBNY Consumer Credit Panel.
Annaly Capital Management NLY

**Recommendation** | **Valuation** | **Last Price** | **As of** | **Industry**
---|---|---|---|---
Buy | $25.90 | $17.45 | 3/31/11 | Financials

- NLY investment strategy and currently low interest rates drives the intrinsic value of the company upward.
- High Dividend Yield of 14.50%

**Introduction**

Annaly Capital Management is a Real Estate Investment Trust (REIT) that invests in high quality, AAA rated and government guaranteed mortgage-backed securities and short-term investments. As a REIT, Annaly must pay 95% of its income to its investors. We recommend increasing our position due to Annaly Capital Management’s investment strategy, dividend yield, and positive revenue and cash flow trends.

**Fundamental Analysis**

Annaly Capital Management invests in high quality mortgage backed securities. Prime loan delinquency and foreclosures rates are significantly lower than subprime loans. Please refer to chart: Prime vs. Subprime Foreclosure Rates below.

Additionally, Annaly is benefiting from low interest rates. The company has lowered its carrying costs by refinancing many of its existing properties to the current low interest rates. The company increased its mortgage-backed securities by 21% from 2009-year end taking advantage of the low real estate price levels. Lastly, the company’s barbell strategy of combining adjustable, floating and fixed mortgage backed securities allows it to perform well in a wide range of interest rate environments, which is very important in such an uncertain time in the financial sector.

**Financial Statement Analysis**

Annaly Capital Management’s principal business objective is “to generate net income for distribution to investors from mortgage-backed securities and from dividends received from subsidiaries”. Trialing annual dividend yield is 14.5%. Even though the company’s cash flow decreased from 2009 to 2010, it still has a strong free cash flow of $18 per share.

**Technical Analysis**

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<tr>
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<td>Money Flow</td>
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<td>Relative Strength</td>
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**Conclusion & Recommendation**

Annaly Capital Management returns a high dividend as well as a potential future growth that is demonstrated by increasing mortgage backed securities position and investment strategy. Furthermore, the company’s interest rate barbell strategy allows the stock to perform well in any interest rate environment. We recommend increasing our current position of 1,171 shares.
We recommend selling our current position of 865 shares with Bank of America. The combination of the company’s high exposure to the residential real estate market and only moderate improvement in regards to its financial position formulates our sell recommendation.

Fundamental Analysis

Bank of America is the largest servicer of residential mortgages in the United States. Currently the company services $1.7 Trillion of mortgages for other lenders and $375 Billion mortgages on its own balance sheet. In 2008, Bank of America acquired Countrywide Financial for $4.1 Billion. With the acquisition, Bank of America also acquired all of Countrywide’s troubled loans. Bank of America is greatly exposed to the residential real estate market. Currently Bank of America has a below average loan loss coverage ratio of 1.56 (Industry Average: 5.56). Thus, the next wave of foreclosures or any negative change in the housing market will have a negative impact on the company’s financials.

Furthermore, Bank of America only slightly strengthened its balance sheet through decreasing nonperforming assets. In 2010, Nonperforming Assets to Total Loans equaled 3.47% while in 2009 it equaled 3.97%.

Financial Statement Analysis

In 2010, Bank of America experienced an increase in net interest revenue, total deposits and total loans. Total loans increased 4.48% in 2010. Even though Bank of America experienced a stronger year in 2010, we do not forecast this trend to continue in 2011 due to our fundamental analysis.

Technical Analysis

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Conclusion & Recommendation

Our valuation of $12.23 indicates that Bank of America is overvalued. Due to the company’s large exposure to the residential real estate market, we recommend to sell our position.
Branch Banking & Trust BBT

**Recommendation**
Hold

**Valuation**
$28.95

**Last Price**
$27.50

**As of**
3/31/11

**Industry**
Financials

- 50% of BBT’s loan portfolio is commercial real estate loans
- BBT decreased its nonperforming assets in 2010
- In 2010, BBT’s total loans and deposits declined, limiting future core revenue growth

**Introduction**

BB&T is a regional bank focused in the southeast U.S. Due to the mix of positive and negative drivers affecting BB&T, we recommend holding our position.

**Fundamental Analysis**

Fifty percent of BB&T’s loan portfolio is Commercial Real Estate Loans. Recently, Commercial Real Estate loans have fared better than residential loans. Furthermore, Commercial Real Estate has demonstrated signs of stabilization and improvement due to its plateauing default rates and increasing loan application volume. Additionally, BB&T reduced its nonperforming assets in 2010 to 3.83%, from 4.13% in 2009 compared to the industry average of. Lastly, BB&T avoids proprietary trading, and thus, their revenue would not be negatively impacted by the regulations limiting this type of trading.

It is important to note that BB&T decreased its loan loss coverage ratio to 1.43%, compared to an industry average of 5.56% in 2010, which puts the company in a riskier position if there is a negative turn in the real estate market.

**Financial Statement Analysis**

BB&T’s financial statements reveal conflicting signs about the company’s growth potential. BB&T has a strong profit margin of 9.2% compared to the industry average of -1.2%. Additionally, the company increased its net revenue by 5.68% and net interest revenue by 9.83%. In contrast, the company experienced a slowdown in total loans (-0.09% growth in 2010) and total deposits (-6.74% growth in 2010). The slowdown in total loans and deposits will negatively affect future core growth for the company.

**Technical Analysis**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bollinger Bands</td>
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<td>Money Flow</td>
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<td>Relative Strength</td>
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</table>

**Conclusion & Recommendation**

BB&T’s loan portfolio, nonperforming assets decline, and operating margins are positive drivers; however, the slow total loan and deposit growth and lower loan coverage ratio puts the company in a compromising position. Our DDM valuation of $28.95 suggests positive but limited capital gain potential. To be conservative, we recommend holding our current position.
Epoch Investment Partners, Inc. EPHC

**Recommendation**  | **Valuation**  | **Last Price**  | **As of**  | **Industry**  
--- | --- | --- | --- | ---
Buy | $17.44 | $15.38 | 3/31/11 | Financials

- Epoch Investment Partners increased revenues by 71% and net income 98% between 2009 and 2010
- The company has a free cash flow of $36.3 million
- Intrinsic value ranges $14.28 to $25.24, undervalued over the majority of the range

**Introduction**

Epoch Investment Partners, Inc. would be a strong addition to the Sun Trust Portfolio. By acquiring a position in Epoch, the portfolio will be further diversified within the financial sector, due to the addition of this small value stock. Additionally, the company’s strong financial statements indicate they will experience further sustained growth in 2011. Lastly, the stock is significantly undervalued, which will result in a capital growth opportunity.

**Company Bio**

Epoch Investment Partners, Inc is an investment manager that manages mutual funds and equity portfolios for its clients. The company’s target customers are high net worth individuals, investment companies, corporations, and state and municipal governments and pension funds. Epoch’s investment strategy is focused on value companies that generate free cash flow that will be used to benefit its shareholders through share repurchases, increased dividends and/or growth opportunities. They currently have $15.6 Billion assets under management.

**Financial Statements Analysis**

The company experienced a 71% surge in revenues and a 98% increase in net income between June 2009 and June 2010. The second half of 2010 proved to be just as strong. Total revenue and net income amounted to $31,831,000 and $12,379,000 respectively. Additionally, Epoch has a strong cash position. Currently, the company has $36.3 million is free cash flow which could be deployed to increase dividends, repurchase shares or for further growth opportunities.

**Fundamental Analysis**

Epoch is a strong recommendation for the Sun Trust Portfolio because the company is not exposed to the real estate market, thus, further diversifying our portfolio. The company’s strength is its investment managers. Below is a table with the annualized returns of the mutual funds Epoch manages compared to the corresponding index. Since inception, all of Epoch’s managed funds have performed on par or better than the corresponding index. This success is reflected in an increase of 12% between the ends 3Q10 to 4Q10 in Assets under Management.
Technical Analysis

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<tr>
<th>Indicator</th>
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<tbody>
<tr>
<td>Bollinger Bands</td>
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<td>Relative Strength</td>
<td>Neutral</td>
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</table>

Conclusion & Recommendation

We believe the intrinsic value of the stock is $17.44. Our sensitivity analysis shows a range of possible values from $14.28 to $25.24. Over most of this range the stock is undervalued at current prices with considerable upside potential.
Goldman Sachs GS

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
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<tr>
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<td>$158.60</td>
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</tbody>
</table>

- GS globalization indicates high potential for revenue growth for 2011
- ROE of 13.29% indicates the potential for future growth

Introduction

Goldman Sachs is a well-respected investment banking and brokerage company. It provides the following financial services: investment banking, loans, leases, and investment management services to institutes and high-net-worth individuals. Goldman Sachs is currently positioned for growth in 2011 due to the company’s global presence, and ROE. We recommend increasing our position of 85 shares.

Fundamental Analysis

Even though Investment Banking revenues declined between 2010 and 2009, due to a decline in client activity, Goldman Sachs performed better than its peers perform and is highly regarded as a company. Because of its reputation, Goldman Sachs recruits top human capital and cliental, which will fuel revenues during the economic recovery in 2011-2012.

Valuation

The bank’s Investing and Lending segment increased revenues in 2010 by 163% due to an increase in global equity markets and tighter credit spreads. Global Equity Markets are risky; however, globalization of investing and lending is highly advisable for 2011. In the beginning of March 2011, Goldman Sachs’s CEO met with the President of Russia to discuss a direct investment opportunity. Working with the BRIC nations, which are forecasted to grow at a much faster rate than developed countries, will set the stage for growth as well as further diversification of the company’s investments.

Due to Goldman Sachs’s banking, securities, and proprietary trading, the company will be highly impacted by Federal Regulations. It is expected that the company’s legal and compliance expenses will increase. It is unlikely; however, the financial regulations will materially affect Goldman Sachs’s future revenue.

Financial Statements Analysis

Excluding onetime events, 2010 net earnings applicable to common shareholders amounted to $8,909 million compared to $12,192 million in 2009. Goldman’s low P/E ratio of 11.05 is lower than the industry average indicating less pricy stock. Additionally, the company’s ROE of 13.29% compared to the industry average of 4.47% suggests that the company has the ability to grow earnings in the future.

We believe the intrinsic value of the stock is $170.11. Our sensitivity analysis shows a range of possible values from $150.02 to $192.85. Over
most of this range, the stock is undervalued at current prices with considerable upside potential.

Technical Analysis

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<tbody>
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<td>Money Flow</td>
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<td>Relative Strength</td>
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</tbody>
</table>

Conclusion & Recommendation

Even though Goldman is not currently in the strongest financial position, the company has great potential to improve its standing due to its global reach and high ROE and total loan growth. We believe that this stock is a buy.
JPMorgan Chase JPM

Introduction

JPMorgan Chase & Co. is a financial holding company that operates in the diversified financial sub-industry. We forecast that 2011 will be a strong year for JPMorgan due to their leadership and financial standing and recommend an increase in our position.

- JPM leadership,
- Decrease in nonperforming assets
- Increase in core revenues

Financial Statements Analysis

JP Morgan has significant free cash flow. The management announced March 19, 2011 that the excess capital will be used to fuel a new $15 bullion stock repurchase program, $8 billion shares repurchase this year, and to increase dividends by 4% to $0.25 a share.

Moreover, JPMorgan’s total loan growth of 9.39% in 2010 sets the stage for stronger loans with higher potential future gains and lower risk. JPMorgan’s net profit margin of 16.91% compared to the industry average of 12.75% also helps build the stock’s intrinsic value. Overall, JPMorgan has a very strong balance sheet.

Valuation

We believe the stock’s intrinsic value is $50.31. Our sensitivity analysis revealed a range of values between $41.99 and $65.01, leaving plenty of room for considerable gains.

Technical Analysis

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<td>Money Flow</td>
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<td>Relative Strength</td>
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</table>

Conclusion & Recommendation

JPMorgan is a strong buy due to its leadership, increase in loans, high operating margin, excess capital, and strong balance sheet. We recommend increasing our position.
Northern Trust NTRS

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
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<th>As of</th>
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</table>

- NTRS high exposure to Florida, Illinois and California residential real estate markets puts the company in a risky position.
- NRTRS net interest revenue decreased while its total loan growth slightly increased in 2010.

Introduction
Northern Trust’s geographically concentrated residential mortgage portfolio exposes the bank to high risk. Additionally, the company’s nonperforming assets increased in 2010. Even with a very conservative loan loss coverage ratio, the company is in a risky position; thus, we recommend reducing our exposure.

Fundamental Analysis
At the end of 2010, Northern Trust had $10.9 billion in outstanding residential real estate mortgages with $4.0 Billion located in Greater Chicago, $2.9 Billion in Florida and $1.4 Billion in California. All three states lead the nation in seriously delinquent loans and foreclosures. Please refer to “ Seriously Delinquent Rates by States” map below. Furthermore, Northern Trust’s conservative loan loss coverage ratio of 8.03% indicates that Northern Trust’s leadership forecasts future loan losses.

Financial Statements Analysis
Northern Trust only had a 1.17% total loan growth in 2010. Total Loan growth reflects on the core revenue growth potential for 2011. New loans are higher quality due to the strict credit requirements to qualify for loans. Thus, Northern Trust is not in a strong position regarding future revenue growth for 2011 compared to its peers. Furthermore, Northern Trust’s net interest income decreased 8.77% and its net revenue decreased 3.68% in 2010.

Valuation
We believe the intrinsic value of the stock is $43.80. Our sensitivity analysis revealed that range of values is between $37.45 and $50.43—all of which are below the current market price.

Technical Analysis

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<tr>
<td>Relative Strength</td>
<td>Neutral</td>
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</table>
Conclusion & Recommendation

Overall, we forecast that Northern Trust will not experience a large increase in core revenues due to its 2010 growth rates in total loans, net revenue and net interest revenue. Additionally, due to the location of Northern Trust outstanding mortgage loans, we forecast an increase in nonperforming assets, foreclosures and delinquencies rates. As a result, we recommend reducing our allocation.

Seriously Delinquent Mortgage Loans by State
US Bancorp USB

**Recommendation**
Hold

**Valuation**
$28.18

**Last Price**
$26.43

**As of**
3/31/11

**Industry**
Financials

### Financials

- **USB’s expenses are expected to rise due to the Financial Regulations**
- **Technical Analysis revealed that the price appreciation momentum could potentially end**
- **USB decreased nonperforming assets and increased loan coverage ratio**

**Technical Analysis**

#### Indicator

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<th>Indicator</th>
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<tbody>
<tr>
<td>Bollinger Bands</td>
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<td>Money Flow</td>
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<td>Relative Strength</td>
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</table>

**Technical Analysis**

**Conclusion & Recommendation**

US Bancorp financial statements analysis reveals that the bank is in a strong position for 2011. In contrast, the technical analysis and potential negative impact of the regulations reveals potential risks. Our valuation of $28.18 indicates potential capital gain; thus, we recommend holding our current position of 403 shares.

**Introduction**

US Bancorp is a financial services holding company operating in the Diversified Banks Sub Industry. USB has strengthened its balance sheet through decreasing nonperforming assets. Additionally, the bank has a conservative loan coverage ratio, which will protect the bank in case of future downturn in the real estate market. However, due to the regulations’ potential negative impact and the technical analysis, we recommend holding our current position.

**Fundamental Analysis**

US Bancorp expects large increases in expenses due to financial regulations, including a $200 million increase in deposit insurance expenses. Additionally, the bank expects lower debit interchange fees due to the CARD act. In response, USB has not released loan reserves. The company has a loan loss coverage ratio of 2.05%. The conservative loan loss coverage will protect the bank from future downturns in the real estate market.

**Financial Statements Analysis**

In 2010, US Bancorp lowered its nonperforming assets – Nonperforming assets to Total Loans decreased to 2.33% compared to 3.02% in 2009. Additionally, USB has a high operating margin of 23.23%. In 2010, the bank increased its total deposits by 11.47% and total loans by 0.85%. Lastly, US Bancorp has a strong free cash flow of $2.74 per share.
Utilities

We recommend an underweighting of the utilities sector. In 2010 the utilities sector experienced a mild gain of .9% versus a 12.8% gain for the S&P 500. Throughout 2010 and early 2011, due to weakness in the housing and power markets, negative recent news relating to utilities, a recovering U.S. economy, and difficulty in accessing cheap capital, the utilities sector has and will continue to struggle. While the utilities sector may experience moderate growth in 2011, we believe this sector will underperform more cyclical sectors.

U.S. Economy: Weak Housing and Power Markets

The overall U.S. economy is expecting approximately 3.2% GDP growth in 2011 with improvements in the manufacturing sector and others thanks in part to the government’s near-zero interest rate policy and dollar-printing programs. Despite these improvements, the housing market remains weak with the Case-Shiller home price index (20-City Composite) currently down 3.1% from its January 2010 levels. Additionally, the power market continues to suffer from reduced usage and the risk of regulatory constraints (price caps, cap and trade). The U.S. Energy Information Administration (EIA) expects retail sales of electricity to the retail sector to decline by 1.7% in 2011 and electricity retail prices to increase by a very modest 1%.
Recent News: Japanese Nuclear Disaster, Libya, and Egypt

The nuclear disaster in Japan, attacks in Libya, and protests in Egypt have caused much volatility in commodities prices as well as global stock markets. Natural gas and coal will see increased demand as there will almost surely be a “rotation” out of nuclear energy in light of the Japanese disaster. While the EIA forecasts only mild growth of 1% for coal and .7% for natural gas U.S. consumption due to weak residential and commercial consumption, we believe that energy prices will raise putting pressure on utility profits.
Cost of Capital

The utilities sector tends to carry a heavy debt load and build very capital-intensive projects, which makes it sensitive to changes in interest rates and reliant on access to cheap capital for financing. Currently, the 10-year Treasury is up to 3.28% from 2.5% last August making long-term debt issuances more expensive. Periods of high or increasing interest rates are never a good time to own utilities. Long-term interest rates are currently increasing and many expect the Fed to raise short-term interest rates within the next year, utilities earnings growth will be difficult to achieve. The chart below shows that over the past fifty years, utility stock prices have risen during periods of low interest rates. Although interest rates are at historic lows, the next move is likely to be up, putting utility stocks in a bind.
Conclusion

We recommend underweighting the utilities because we believe the sector will underperform other S&P 500 sectors in 2011. Contributors to sector headwinds include the possibility of increasing interest rates, poor sector sentiment due to recent events, and a recovering U.S. economy tilting investor preference toward other sectors. While we do believe that the utilities sector will underperform, VPU’s diversification benefits as well as the sector’s attractive dividend yields and mild, but stable growth potential warrant VPU a place in the portfolio.

Vanguard Utilities ETF     VPU

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Last Price</th>
<th>As of</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hold</td>
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</table>

This investment tracks the performance of a benchmark index that tracks the MSCI U.S. Investable Market Utilities Index. This ETF provides low-cost exposure to the utilities sector with an expense ratio of .25% that is considerably lower than most utility mutual funds and one of the lowest for any utilities ETF.
Telecommunication Services

<table>
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<tr>
<th>Sector Analysis</th>
<th>Outlook</th>
<th>Notable Names</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Positive</td>
<td>Verizon, AT&amp;T, American Tower Corp., Qwest, Sprint, MetroPCS</td>
</tr>
</tbody>
</table>

• Strong growth in Smartphone adoption
• Increasing revenues and margins
• Doubling yearly bandwidth consumption
• Strong growth in data usage such as streaming and cloud computing

The outlook for the Telecommunication Services industry is positive. The industry as a whole is considered fairly priced but some very strong trends in the market such as Smartphone adoptions, increasing margins and data usage should make the sector trend upwards. There are opportunities to explore in the sub industries such as communication infrastructure and bandwidth service solutions.

Current Status and General Outlook

The Telecommunication Services (Telecom) industry is divided into fixed-line and wireless technology. Most large companies quickly moved to offer wireless services as the technology became available. When looking at the large companies in the sector such as AT&T and Verizon they virtually compete in both wire and wireless. The wireless industry has been expanding but at a declining rate. Large companies though have expanded their product offerings and variety by offering bundles, triple or quadruple solutions (internet, landline phone, cell phone and TV solutions). These complete bundles have become more mainstream in the last couple of years increasing revenues for Telecom companies and offering multiple streams of revenue. Smartphone adoption rate has been significant in the last two years and will continue in the next two to three years. Bundled services in tandem with high Smartphone adoption will allow Telecom companies to achieve higher margins moving forward.

The sector is 45% below 2007 highs versus 20% for the S&P 500. Price to cash is 5x versus the market’s 11x. With low but increasing margins at 6.5%, increasing revenues and revenue streams, stock performance over retraction in the past three years the industry is poised to stronger growths in next couple of years.

Smartphones

Last year, 1.5 billion cell phones were shipped, of which 300 million were Smartphones (up from 50 million in 2009). The estimate is 600 million or more Smartphones for 2011. In the fourth quarter of 2010, Verizon had about 25% of the current cell phone customers using Smartphones but 75% of the new customers acquired in this quarter opted for a Smartphone. Smartphone adoption in the U.S. is expected to increase from an estimated 35% in 2010 to 50% by year-end. It is clear that the U.S. is far behind Southeast Asian countries and many western European countries but it is catching up and at an exponentially fast rate. This means higher average revenue per user (ARPU) but even more importantly higher margins for U.S. Telecom companies. ARPU for Smartphones is 50% higher than other devices and data ARPU is nearly 150% higher. Margins for Smartphone services are higher and most companies have been setting data caps and increasing fees almost in consortium. Because of these trends, we should see higher margins and profits for Telecom companies. Data types and data usage has also been increasing significantly, which should increase demand for more bandwidth infrastructure.
More Data

Data hungry consumers want increased bandwidth on the fixed-line and wireless. High bandwidth technologies such as 4G push Telecom companies to expand their demand on communication infrastructure like cell towers. In addition, bandwidth demand has been increasing at more than 50% per year for the past four years and that rate is not expected to decrease any time soon. Streaming video takes the major chunk of these data but technologies such as cloud computing and SaaS, which are more business related, should see very strong growth. Companies that provide bandwidth services especially to businesses should offer a further growth opportunity in the sector.

Conclusion & Recommendations

Increasing revenues and margins will allow Telecom companies to grow their earnings faster than expected in the next two to three years. With the quick adoption of Smartphones, significant increase in data usage and specialized internet services come not only an overall growth for the sector but also stronger growth for sub sectors such as cell tower and bandwidth backbone companies. The sector is a very small part of the S&P 500 and of our portfolio at about 3% and should be overweighed moving forward. Sub industries in the communication infrastructure and specialized bandwidth services should be overweighed within the sector, as they should see even stronger growth within the Telecom industry.
Crummer Investment Management

iShares S&P Global Telecom. iXP

<table>
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<tr>
<th>Recommendation</th>
<th>52-week range</th>
<th>Last Price</th>
<th>As of</th>
<th>Asset Class</th>
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<tr>
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- Diverse exposure to global Telecom companies
- High yield
- Fairly concentrated

The weight of the sector in the S&P 500 and our portfolio is quite low thus; an ETF approach is needed to parallel the sector with minimal transaction costs. An ETF produces a well-diversified investment that reduces overall risk.

**Fundamentals**

The fundamentals of the Telecom industry are strong. More than 90% of Americans have wireless phones and 77% of Americans use the Internet. Wireless phones and internet are seen by almost everyone as necessities. Southeast Asian countries have always been ahead of the curve when it comes to wireless phones and internet but most European countries can compete on sheer number of SIM cards per person, with penetration rates in the triple-digits range.

On the same line as in the industry overview this fund will be able to follow the growth that comes from increased Smartphone sales, which should drive higher revenues and revenues per customer (ARPU) and thus increase margins for the carriers. Many of these carriers offer multiple products and with global demand for phone, internet and television expanding, there should be growth in all their business sectors.

**Portfolio Construction, Fees and Alternatives**

The fund tracks S&P Global Telecommunications Sector Index, which has a few very big firms thus the fund is heavy on the top firms. The top ten holdings make up slightly over 64% of assets, with the top five comprising 48%. U.S. companies make up 30% of the index. 96% of assets are in large-cap stocks, with the remainder in mid-caps. On a

**Fund Description**

A description of the fund as 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 & Poor’s deems part of the telecommunications sector of the economy and important to global markets, as represented by the Standard & Poor’s Global Telecommunications Sector Index. The index is a subset of the Standard & Poor’s Global 1200 Index.
holding weighted basis, the average company market cap is $65 billion. The iShares fund tend to be more expensive than the average ETF but definitely inexpensive when compared to mutual funds. iXP net annual expense ratio is 0.48%, compared to alternative comparable funds that range from 0.24% to 0.50%. Alternatives include IST (no U.S. companies, small, low trading volume), VOX and IYZ (U.S. only assets). iXP has the highest return out of all the previously mentioned ETFs and is a close second in terms of yield (IST: 4.16%)

**Conclusion & Recommendation**

If the sector were to be over weighted, we would need to expand our holdings in iXP. This fund offers a well-diversified global portfolio, which should allow our portfolio to ride with the growth in the Telecom industry.
American Tower Corporation

**Recommendation**  
SELL

**Valuation**  
$55.00

**Last Price**  
$51.82

**As of**  
3/31/11

**Asset Class**  
Large-Growth

- Best in class
- Strong international expansion
- Outperforming market expectations
- Smartphone adoption and international expansion will continue the growth spurt.

Internationally the growth potential is very high but margins are usually lower, such exposure to emerging-market adds risk and uncertainty. Domestically the growth rates are much slower but the tower utilization and thus margins are higher (1.5 tenants per tower internationally versus 2.5 domestically). Overall, Smartphone adoption, 4G and WiMAX should create a strong positive growth factor.

Tower companies have the same operating model. They own wireless broadcast towers that have multiple stacks, which are then leased to Telecom carriers on long-term contracts that escalate in price by 2-5% per year. American Tower’s operating margins outpace those of the competition because AMT has a higher revenue-per-tower ratio. This is an environment where growth in terms of towers is dependent on acquisitions and AMT is the best in sector, which is facilitated by a leverage ratio of 3.5 times compared to Crown Castel at 5-6 times. In a couple of years American Tower will likely convert into a REIT structure after it burns through its tax shields, but this conversion should no compromise the firm’s long term growth prospects.

**Company Description**

American Tower is the premier infrastructure provider for wireless communication. Since the last report, the firm’s tower base has increased from 26,000 to over 35,000.

**Fundamentals**

The fundamental demand drivers are very strong. With the increased wireless coverage domestically but more so globally the demand for cell tower space can only increase. The distinction between domestic and international market is two-fold.
margin, which was still impressive at 66.7% for the quarter.

**Conclusion & Recommendation**

Currently cell tower firms are too over weighted in our Telecom Sector. While American Tower should continue to grow and the outlook continuous to be positive it is necessary to sell some of its shares so that we can create a better diversified portfolio and free money that can be invested in another subsector or asset type.
Crown Castle International Corp. (CCI)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>As of</th>
<th>Asset Class</th>
</tr>
</thead>
<tbody>
<tr>
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<td>Large-Growth</td>
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</tbody>
</table>

- 97% of the coming year’s revenue projections under contract
- Strengthening financials
- Steady improvement in the tenants/tower ratio

Crown Castle International Corporation (Crown Castle or CCI) is one of the largest tower operators in the U.S. with wireless communications coverage to 91 of the top 100 markets and to substantially all of the Australian population. Crown Castle owns, operates and manages over 22,000 and approximately 1,600 wireless communication sites in the U.S. and Australia, respectively (Crown Castle Investor Website).

Company Overview

Just like AMT, Crown Castle owns and operates wireless communication towers. With long-term contracts, ranging from 5-25 years in length and embedded price increases of 3%-4% per year, Crown Castle has reliable recurring revenue and cash flow. Its tower portfolio in the U.S. is very strong. About 54% and 71% of Crown Castle’s towers in the United States and Puerto Rico are in the top 50 and 100 largest and fastest-growing basic trading areas, respectively. The company has not expanded its portfolio of towers in the last year but has worked diligently to increase tower utilization.

Fundamentals

The fundamental demand drivers are very strong. With the increased wireless coverage domestically but more so globally the demand for cell tower space can only increase. The distinction between domestic and international market is two-fold. Internationally the growth potential is very high but margins are usually lower, such exposure to emerging-market adds risk and uncertainty. Domestically the growth rates are much slower but the tower utilization and thus margins are higher. Overall, Smartphone adoption, 4G and WiMAX should offer a strong positive growth factor. Tower companies have the same operating model. Crown Castle strategy at least in the last couple of years has been significantly different from that of American Tower, as recently reaffirmed by their CFO in an investor webcast. The company has a strong portfolio with relatively low risk factors. AboveNet plans to continue to work with the carriers to offer top quality service and increase revenues per tower. Any new addition would have to come at a price where the risks are still low and can be minimized further. The objective is to change the structure to a REIT in a few years and offer the market a low risk asset with a high yield of about 12%.

In numbers

The company has a strong market position: 71% of towers in attractive tower footprint, 8 year weighted average long-term contracted revenues, 91% of assets are under long-term control (10 years or longer), 93% incremental margins on new
revenues since 2007, 73% of revenues generate from top carriers, one billion dollars expected to be available in 2011 for share repurchases, land purchases and acquisitions. CCI has a five-year revenue CAGR of 9% with margins expanding at more than 8% per year and recurring cash flow per share increasing at 16% CAGR. The company has spent more than 50% discretionary cash or $2.3bn in share repurchase since 2004. Continued growth with a conservative financial approach on creating value for shareholders through share repurchase should create strong positive returns for shareholders in the near future and high dividend yields in the mid-long term.

**Conclusion & Recommendation**

Currently cell tower firms are too over weighted in our Telecom Sector. While Crown Castle should continue to offer positive returns, it is necessary to sell some of its shares so that we can have a better-diversified portfolio and free funds to that can be invested in other sub industries and asset types.
**AboveNet Inc**

**ABVT**

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>As of</th>
<th>Asset Class</th>
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- Growing bandwidth demand
- New technologies such as cloud computing will increase specialized bandwidth demand from enterprises
- Company is well positioned in major markets

Recent market trends in streaming, cloud computing and business services such as SaaS will push bandwidth demand to higher grounds, which should accelerate growth for companies such as AboveNet Inc.

**Company Description**

*AboveNet provides high-bandwidth connectivity solutions primarily to large corporate enterprise clients and communication carriers, including Fortune 1000 and FTSE 500 companies. AboveNet’s communications infrastructure and global Internet protocol (“IP”) network are used by a broad range of companies such as commercial banks, brokerage houses, insurance companies, media companies, social networking companies, web-centric companies, law firms and medical and health care institutions. Their customers rely on AboveNet’s high speed, private optical network for electronic commerce and other mission-critical services, such as business Internet and cloud applications, regulatory compliance, disaster recovery and business continuity.* (AboveNet 10-K)

**Fundamentals**

Global bandwidth demand has seen very strong growth in spite of the recession. Bandwidth demand and supply have continued to grow at a staggering 50-60% rate over the past 5 years. More recently, demand for streaming bandwidth has led the general growth in demand. While streaming is mainly consumer driven new technologies such as SaaS, cloud computing, business continuity backup services will give a very strong push to the demand from enterprises. AboveNet is well positioned in major markets with an array of services targeted specifically to businesses. As the wave of cloud computing takes hold, enterprises will be the first to transfer to this new technology. Many of them already use SaaS and cloud computing is the next logical step because it allows great effectiveness in operations, higher efficiency and lower IT costs. AboveNet as stated in their 10-K has already seen a strong increase in demand but what is to come can be truly revolutionary like the move from mainframes to client servers in the early 90’s.

**Financial Performance**

AboveNet has almost doubled their revenues from 2005 to 2010. More impressive though is their gross margin percentage, which has increased every year from 45.7% in 2005 to 65.1% in 2010. The company has shown quickly increasing operating income from negative $4 million in 2006.
to positive $107 million in 2010, with operating cash flow more than tripling during that same period from $51 to $163 million.

**Conclusion & Recommendation**

The Telecom service industry and more specifically companies in bandwidth solutions should see greater growth in the next few years; this should be especially true for enterprises that want to invest in newer technologies such as cloud computing. Investing in this sub sector by buying AboveNet will allow greater sector diversification and a calculated overweighting in the high growth but still stable enterprise bandwidth services industry.
**Technology**

The Technology sector is comprised of technological products and services that firm’s provide for multiple levels of users from personal to professional. Multi-national firms like International Business Machines (IBM), Hewlett-Packard (HP) and Accenture (ACN) comprise this sector by providing some of the most innovative equipment and services within the market. Some of the most notable products in the Computer Hardware industry, a subsector of Technology, include personal computers, servers, chips, microprocessors and printing equipment. During lulls in the economy, companies have a tendency to reduce capital expenditures on updating computer hardware. The Great Recession, therefore, created a downturn in the market for hardware devices between 2008 and 2009. In fact, the average age of personal computers in professional settings is higher than it has ever been; the current industry average is 4 to 5 years. The industry saw a fluctuation in demand of its products over the course of 2010 due to economic uncertainty. PC unit shipments lead the industry growth trend with a 27.1% jump from 1Q09 to 1Q10. While this growth is not sustainable in the end, it provides some evidence that the market is moving in a positive direction. The Computer Hardware industry is likely to have a more apparent rebound compared to its counterpart industry Computer Software and Services, which was not impacted as drastically by the recession. Emerging markets, most notably in Asia, provide another driver for recovery and growth in the industry. The server market has also grown because of economic recovery from a $9.8 billion industry to almost $10.9 billion in 2010. This is primarily due to the sale of Blade servers which consume low amounts of energy while requiring a limited amount of space.

Another subsector of Technology is the Computer Commercial Services industry. This industry is comprised of the intangible, technological services including: outsourcing, payroll, human resources and enterprise storage. Unlike the Commercial Services counterpart industry, Computer Hardware, the recent recovery in the condition of the global economy will not produce the same robust growth. In the past twelve months, the Services industry has grown 4.5%. This is because during economic downturns like the Great Recession, companies are more willing to use capital expenditures on services like consulting in order to minimize the effect on their profit margins. However, there has been an increase in the periods between contract-signing cycles. Companies are wary of the idea of being locked into long-term contracts due to recent economic fluctuations. As the economy continues to improve and companies begin to expand, IT services will begin to grow as well.

The global economic recession has also provided many of the staple firms within the Technology sector the opportunity to grow inorganically through mergers and acquisitions. Companies like IBM, HP, EMC and ADP have competed to gain the assets of target firms. The synergies created through M&A provide attractive forecasts in an industry that prides itself on innovation. Currently, the industry is focusing on two central themes including Cloud Computing and Tablet PCs. Cloud computing is the ability for both personal and professional users to store data on the internet without the need for servers. It is a fast, cheap and efficient means of storage, which is gaining more notoriety every day. Many of the dominant players in the Technology sector are devoting significant capital to R&D in this Cloud Storage to ensure long-term market share. The second trend in recent innovation pertains to the small, portable notebooks known as Tablet PCs. Tablet PCs have been in existence for several years, but have recently gained popularity with the release of the Apple
iPad. Consumers are demanding mobility in their computer hardware and tablet PCs provide just that. Although it may appear that tablets will cannibalize the PC market for hardware producers, the trends have shown that they are, in fact, complimentary products for most users.
Accenture ACN

<table>
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<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Market Price</th>
<th>As of</th>
<th>Industry</th>
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<td>$54.68</td>
<td>4/6/11</td>
<td>Management Services</td>
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</table>

- Diversified Product Offerings and Diversified Geography
- Economic Stability despite Economic Downturn
- High ROE – 64.64%
- Low Debt (LTD is almost 0% of Capital)

Business Segments

Communications & Hi-Tech solutions are catered to the specific needs of Accenture’s clientele in various industries. The firm provides mobile technology, broadband and internet protocol solutions as well as marketing and advertising.

Accenture also consults its clients on their supply chain management, customer care and employee services. Hi-Tech solutions include services in strategy, engineering and enterprise resource management to ensure that clients are becoming more efficient through cost reduction. Accenture also provides assistance in the Media & Entertainment industry in the form of digital marketing, digital rights management and online distribution through its Origin Digital and Digiplug programs.

The Resources segment serves industries like chemical, energy, forest products and mining to name a few. The utilities industry has seen recent fluctuations in demand due to the price of oil and commodities rising. Differentiation within the market, therefore, is the focus for Accenture when they consult their clients in these industries. Assisting companies through the environment of deregulation, while maintaining a strong focus on renewable production systems, is essential to success in the modern business world.

Accenture’s Products segment is encompasses a variety of industries ranging from Air Freight & Travel Services to Consumer Goods to Infrastructure and Transportation. Although these industries are mutually exclusive, Accenture provides similar consulting methods to each. These
services include assistance with manufacturing processes, value chain, advertising and marketing, mergers and acquisitions, IT outsourcing and strategy.

The Financial Services segment advises clients on how to approach the ever-changing global financial markets. Accenture provides consultation in areas industries including Banking, Capital Markets and Insurance. Banking, which represents over half of the revenue from this segment, requires assistance in increasing and retaining customers while offering competitive and lucrative products and services. The Capital Markets group aims to help firms be innovative in their asset management systems. Accenture’s Insurance group offers outsourced functions like claims management and improved IT infrastructure solutions.

Valuation

In order to value the price of Accenture’s stock, I first determined a conservative growth rate by analyzing the company and industry trends along with real GDP growth. From there, I utilized a Dividend Discount Model to determine a stock price of $46.45. Compared to the current market price of $50.13, Accenture is currently undervalued and, therefore, worth purchasing. I also derived a Pro-Forma P/E for the organization, which equated to 20.07. Two of Accenture’s competitors, ADP and Visa Inc. have Pro-Form P/E ratios of 24.12 and 18.3 respectively. The P/E for the S&P 500 is approximately 17, which demonstrates that Accenture’s stock is overvalued compared to other stocks within the same index.

Concerning the Technical Analysis of the stock, I used three indicators to forecast the potential direction of the equity using historical data. The three indicators I used include Bollinger Bands, RSI and the Price/Money Flow chart. After reviewing the three indicators, it is clear that the technical prognosis for Accenture is NEGATIVE. Although the Bollinger Bands provide a neutral trend, the RSI is above 70 and the Price/Money flow chart shows that at the current Price, there is a large discrepancy. The Price is currently much higher than the flow of money to the equity.

Conclusion & Recommendation

Based on the current state and potential of Accenture, I recommend a SELL rating on the stock. The Dividend Discount Model produced a stock price, which is currently lower than the market price, which indicates that the equity is overvalued. The Technical Analysis also provided a Negative prognosis for the stock’s future. I do believe, however, that Accenture is positioned extremely well to take advantage of the economic recovery. Consulting firms are needed in both times of economic growth and recessions. During growth, firms require consulting on to maximize their profits. In recessionary period, consultants assist their clients in reducing costs and becoming more efficient. Accenture’s high ROE and low Debt to Equity Ratio demonstrate how strong and efficient the firm handles its finances. I believe that in the end, Accenture’s stock will rise in the next 3 to 5 years.
Automatic Data Processing (ADP) is one of the world leaders in the computer services industry. The firm specializes in business process outsourcing services. The firm is best known for its payroll services, however ADP also provides solutions to tax and benefits administration as well as human resources. The company also specializes in computing integration services for the automotive industry including truck, car and motorcycle dealers, for example. The company is divided into three business segments including: Employer Services, Professional Employer Organization Services and Dealer Services.

**Business Segments**

Employer Services, the largest of the three business segments, is a global provider of business solutions. Payroll is the largest division of services within the business segment with over 600,000 payrolls worldwide. The United States accounts for 80% of revenue from these services with Europe, Canada and South America combining for approximately 20%. Employer Services also includes outsourcing of business functions like human resources. ADP’s comprehensive outsourcing services (COS) includes various programs depending on the needs of its clients.

ADP Workforce Now and ADP Resource are systems designed to handle functions ranging from administrative tools to 401-k retirement plan management.

Professional Employer Organization Services (PEO) provides comprehensive outsourcing solutions to approximately 6,000 clients around the world. The process allows companies to minimize costs associated with human resources and employee benefits and payroll services through a co-employment structure. This means that PEO clients can focus on the day-to-day operations of their business while ADP handles back office functions.

Automatic Data Processing also provides automotive dealer management systems (DMS) to truck, car, boat, and motorcycle dealerships through its Dealer Services segment. ADP has dealer management systems in over 90 countries around the world, which contain applications for customer relationship management, marketing and communication solutions. Recently, ADP acquired the digital marketing leader in the automotive industry, Cobalt, for $400 million.

### Automatic Data Processing ADP

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<th>Market Price</th>
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<th>Industry</th>
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<td>Business Software &amp; Services</td>
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</table>

- Promising acquisitions, including the purchase of COBALT, a digital marketing firm for $400 million
- Strong revenue growth, 6% per annum
- Low risk (beta of 0.65)
Growth Opportunities

Automatic Data Processing has seen growth in its core business segment of Payroll Services and Management. As the economy continues to recover, the number of companies retaining the services of ADP will grow. The Dealer Services segment will also be affected by improving market conditions. As more cars, trucks, and recreational vehicles are being sold, ADP’s software and management solutions will have a viable market. The recent acquisition of Cobalt demonstrates ADP’s long-term commitment to the Dealers segment. The ability to grow both organically and through mergers and acquisitions provides ADP with the opportunity to expand its current market share in the end.

Valuation

In order to value, the price of Automatic Data Processing’s (ADP) stock; I first determined a conservative growth rate by analyzing the company and industry growth trends along with real GDP growth. From there, I utilized a Dividend Discount Model to determine a stock price of $56.24. Compared to the current market price of $51.31, ADP is currently undervalued and, therefore, is an attractive purchase. I also derived a Pro-Forma P/E for the organization, which equated to 24.12. Two of ADP’s primary competitors are Accenture and Visa Inc., which have Pro-Forma P/E ratios of 20.07 and 18.30. The P/E for the S&P 500 is approximately 17, which demonstrates that ADP’s stock is potentially overvalued when compared to other stocks within the same index.

Concerning the Technical Analysis of the stock, I used three indicators to forecast the potential direction of the equity using historical data. The three indicators I used include Bollinger Bands, RSI and the Price/Money Flow chart. After reviewing the three indicators, it is clear that the technical prognosis for Automatic Data Processing is NEUTRAL. The Bollinger Bands provide a positive trend with ADP’s stock remaining within two standard deviations for more than 95% of the past twelve months. The RSI is above 30 and below 70 (62.92). The Price/Money flow chart, however, shows that the price is currently above the money.

Conclusion & Recommendation

Based on the current state and potential future growth of Automatic Data Processing, I recommend a BUY rating for this stock. The justification of this recommendation is due to a variety of reasons including the firm’s strong financial statements, the undervalued stock price and ADP’s focus on diversifying its offerings portfolio. The technical analysis provides a Neutral prognosis, but 2/3 of the indicators were positive. As the economy continues to recover from the Great Recession, organizations will be looking to improve their overall cost efficiency to maximize profit margins. Automatic Data Processing provides an opportunity for clients to focus on their core competencies without having to worry about back office functions like Human Resources and Payroll management. This creates an attractive environment in the end for companies like ADP.
Crummer Investment Management

Cisco Systems Incorporated CSCO

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<td>Networking and Communication Devices</td>
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</table>

- CEO, John Chambers recently described the future as containing “Uncommon Uncertainty”
- MSO issues hindering company growth
- Reduction in spending trends has reduced future contracts

Cisco Systems Incorporated is a global leader in the field of telecommunications and Internet Protocol (IP) based networking. Known as “The Human Network” Cisco has become an innovator for video conferencing applications allowing users to communicate through voice and video inputs. This allows users to connect on a more personal level while providing increased utility to global collaboration. Cisco’s products simplify network infrastructures while reducing overhead in a secure manner. The portfolio of Cisco’s product offerings includes core technologies, routing and switching, and advanced services.

Business Segments

Routing technology connects public and private IP networks for various applications including video, voice, data and mobile. Like most IT companies, scalability has become a priority for Cisco Systems. Cisco provides a variety of routers, which meet the needs of different levels of consumers from businesses to governments to individuals. Cisco recently delivered its latest product known as CRS-3 Carrier Routing system. This system triples the capacity of its predecessors and is designed to handle the increasing amount of video traffic due to Web 2.0 sites like YouTube.com.

Switching technology is utilized by a variety of consumers ranging from college campuses to business offices to data centers. Switching allows administrators of a network to divert the system in whatever manner it sees fit. End users are provided connectivity to the network through workstations, access point and servers. Cisco offers various types of switches depending on the need and scope of its clients including small businesses to multi-national conglomerates. The Cisco Catalyst 4900 series and Nexus 7000 are currently capable of handling up to one million routes.

Cisco also provides clients with multiple networking options that meet the needs of several types of users. Application Networking is designed to enable reliable performance for business applications across an entire organization. Cisco Wide Application Services (WAAS) is the primary product used for this segment. Home Networking connects multiple devices within a user’s home in
order to create a social experience by sharing video, audio and print data across a common network. **Security** systems provide users with the ability to protect information within their respective networks from public consumption. Cisco utilizes a layered approach towards its security software, which allows users to identify existing threats and prevent future intrusions from occurring. **Storage Area Networking** provides the link between servers and storage devices. Cisco’s MDS 9000 has been updated to include server virtualization which demonstrates the firm’s belief in the future of cloud computing. **Unified Communications** integrates both fixed and mobile networks with voice, video, data and mobile applications. Products ranging from IP phones to server utilize Unified Communications applications as part of their infrastructure.

**Current Issues**

Currently, Cisco is suffering from a global reduction in spending for IT infrastructure. This can be seen in the lack of demand in MSO – Multi Service Operator contracts. MSO’s are cable companies like Brighthouse and Cox. These cable providers have seen decreased amount of demand due to substitute products in the market, which feature more “On Demand” programming. These services are typically cheaper than standard cable packages. The recent recession has reduced a significant portion of discretionary income for consumers and, therefore, more practical options for entertainment are gaining popularity. Cisco is also losing potential revenue due to the reduction in spending by the European market. Many European governments utilize the experience and skill that Cisco provides in terms of IT infrastructure. The Eurozone has been intensely affected by the global recession, which has affected the level of spending negatively.

**Valuation**

Cisco recently issued the company’s first stock dividend of $.06 with a yield of 1.4%. In order to value the price of Cisco’s stock; I first determined a conservative growth rate by analyzing the company and industry trends along with real GDP growth. From there, I utilized a Dividend Discount Model to determine a valued stock price of $9.17. Compared to the current market price of $17.15, Cisco is currently overvalued and, therefore, should be sold. The current market price for Cisco is $17.37. I also calculated a Pro-Forma P/E for the firm, which equated to 14. Two of Cisco’s competitors, Juniper and Extreme Networks have Pro-Form P/E ratios of 38.23 and 13.76 respectively. The P/E for the S&P 500 is approximately 17, which demonstrates that Cisco’s stock is potentially undervalued when compared to other stocks within the same index.

Concerning the Technical Analysis of the stock, I used three indicators to forecast the potential direction of the equity using historical data. The three indicators I used include Bollinger Bands, RSI and the Price/Money Flow chart. After reviewing the three indicators, it is clear that the technical prognosis for Cisco is NEGATIVE. Although the Bollinger Bands provide a neutral trend, the RSI is below 30 (28.94) and the Price/Money flow chart shows that the inflow of money is following the decreasing price of the stock. This correlation provides evidence that the stock price is trending downwards.

**Conclusion & Recommendation**

Based on the current state of the company, I recommend selling the portfolio’s position in Cisco. This is due to many factors including the issues with Multi Service Operators and reduction in future contracts from the European Market. The fact that the CEO, John Chambers, announced that the current business environment contained “Uncommon Uncertainty” for Cisco is another reason why I believe that the short term prospects of this equity are not strong.
Computer Sciences Corporation CSC

**Recommendation:** SELL  
**Valuation:** $28.45  
**Market Price:** $49.74  
**As of:** 4/6/11  
**Industry:** Networking and Communication Devices

- Stock Price fell 2.87% even after beating market expectations  
- Highly Leveraged with D/E Ratio of 39  
- 0% Growth between 3Q10 and 4Q10

Computer Sciences Corporation provides professional services and information technology solutions to clients around the world. The firm aims to help clients utilize IT more efficiently through its 50 years of experience in the industry. CSC specializes in complex IT application for clients ranging from commercial entities to governments. The company offers solutions in two areas of IT including IT and Business Process Outsourcing as well as IT and Professional Services.

**Business Segments**

IT Business Process Outsourcing allows companies to utilize CSC’s knowledge and skills to handle a variety of corporate functions. Outsourced infrastructure includes systems analysis, application development, network operations, desktop computing and data center management. CSC can also be used for corporate functions like supply chain management, call centers, CRM and credit services.

IT Professional Services involves both system integration and consulting clients. Systems integration involves designing, developing and implementing complete information systems. CSC’s consulting arm includes advising clientele on the acquisition and use of IT infrastructure within their business model.

Computer Sciences Corporation also earns revenue by licensing its software systems to specific markets including the financial services industry. The software handles end-to-end business for entities like commercial organizations and governments. These systems are designed specifically for the client and allow for the potential of scalable growth.

CSC is divided into three segments of services including North American Public Sector (NPS), Managed Services Sector (MSS) and Business Solutions and Services (BSS). NPS delivers IT services and solutions to U.S. Federal Government and, more specifically, the Military and the Department of Homeland Security. MSS provides client specific solutions to industries like consumer goods, financial services, manufacturing and telecommunications to name a few. BSS delivers consulting and IT solutions in the form of business process outsourcing and systems integration.

**Poor Performance**

Computer Sciences Corporation has been plagued by poor performance in the past twelve months. In
fact, between the third and fourth quarters of 2010, Revenue growth was 0%. As a result, the firm had to reduce forecasted earnings, which, in turn, reduced the value of the stock. A positive financial statistic is the fact that the Return on Equity (ROE) of Computer Sciences Corporation was 13.6%, above the industry average of 9.09%. Unfortunately, the TTM EPS growth rate was a staggering -27.77%. The company is also highly leveraged with a Debt to Equity Ratio of 39.

Valuation

In order to value the price of Computer Sciences Corporation’s stock; I first determined a conservative growth rate by analyzing the company and industry trends along with real GDP growth. From there, I utilized a Dividend Discount Model to determine a valuated stock price of $28.45. Compared to the current market price of $48.73, CSC is currently overvalued and, therefore, should be sold. I also derived a Pro-Forma P/E for the organization, which equated to 10.32. Two of CSC’s competitors, Microsoft and Oracle have Pro-Forma P/E ratios of 10.88 and 26.34 respectively. The P/E for the S&P 500 is approximately 17, which demonstrates that CSC’s stock is potentially undervalued when compared to other stocks within the same index.

Concerning the Technical Analysis of the stock, I used three indicators to forecast the potential direction of the equity using historical data. The three indicators I used include Bollinger Bands, RSI and the Price/Money Flow chart. After reviewing the three indicators, it is clear that the technical prognosis for Computer Sciences Corporation is POSITIVE. The Bollinger Bands provide a neutral trend, the RSI is above 30 (37.42) and the Price/Money flow chart shows that the price is currently below the flow of money.

Conclusion & Recommendation

Based on the current state and forecasted future of Computer Sciences Corporation, I recommend Selling this position within the Crummer SunTrust Portfolio. My decision is based upon several factors including: Although the Technical Analysis provides a positive outlook, the stock price is highly overvalued at $48.73, The TTM EPS growth rate is -27.77% and the market still did not have enough confidence in the company to maintain the stock price even after the company outperformed the forecasted earnings.
EMC Corp EMC

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<td>4/6/11</td>
<td>Data Storage Devices</td>
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</table>

- Data storage as the strongest IT sector over the past 12 months
- EMC specialization in Network Attached Storage provides a competitive advantage
- Acquisition of Isilon provides EMC with Scale Out technology (storage grows with business)

EMC Corporation specializes in developing, distributing and supporting solutions for both information infrastructure and virtual infrastructure technologies. The firm is one of the world leaders in data storage, which has been in one of the strongest market performers in the Technology sector. In conjunction with EMC's storage capabilities, the firm also offers solutions for automated operations, which alleviates overhead and improves the efficiency of data retrieval.

**Business Segments**

EMC holds a majority stake in VMware, which represents the firm’s position in the virtual infrastructure business. VMware provides a wide range of solutions for virtual infrastructure, which can meet the demands of products, ranging from PC desktops to comprehensive data centers and cloud computing.

EMC's Information Infrastructure enables clients to manage large quantities of data with the potential for future expansion. This improves the ability of the company to access information cheaply and quickly through intuitive interfaced software. The firm has also recognized the industry trend in cloud computing by expanding its current offerings portfolio to incorporate this service. Companies spend excessive amount of capital for the purposes of acquiring and maintaining IT infrastructure including servers. The equipment takes up unnecessary space and requires energy in order to keep them from overheating. Cloud virtualization, security and storage are all possible through EMC's solutions.

EMC offers several types of storage system solutions to its clients. EMC CLARiiON, EMC Symmetrix, EMC Celerra, EMC Centera and EMC Connectrix each provide unique capabilities from unified to content addressed information. These systems can be delivered in two different styles. Storage Area Networks (SAN) are dedicated storage networks, which allow users to access large blocks of information stored in servers. Network Attached Storage (NAS) allows computers on a network to manage and retrieve individual files of information. NAS systems are small and the overall price in the market has decreased making them much more attractive to multiple levels of users.

EMC recently acquired Isilon, which will increase the firm’s presence in the NAS business. Isilon is known for its “scale-out” servers, which increase in
EMC also acquired Data Domain, Inc., which specializes in backup recovery. The integration of Data Domain’s software with EMC Avamar, NetWorker and Disk Library creates a comprehensive data protection system for clients.

Valuation

EMC does not provide a dividend with its stock. In order to value the company, therefore, I used a P/E multiplier analysis. This valuation derived a price per share of $24.20. The current market price for EMC is $26.56. This means that EMC’s stock is currently overvalued and should be sold. I also calculated a Pro-Forma P/E for the firm, which equated to 30.28. Two of EMC’s primary competitors are NetApp and QLogic Corporation, which have Pro-Forma P/E ratios of 30.12 and 23.40 respectively. The P/E for the S&P 500 is approximately 17, which demonstrates that EMC’s stock is potentially overvalued when compared to other stocks within the same index.

Concerning the Technical Analysis of the stock, I used three indicators to forecast the potential direction of the equity using historical data. The three indicators I used include Bollinger Bands, RSI and the Price/Money Flow chart. After reviewing the three indicators, it is clear that the technical prognosis for EMC is NEGATIVE. The Bollinger Bands provide a positive trend with EMC’s stock remaining within two standard deviations for more than 95% of the past twelve months. However, the RSI is above 70 (74.17) indicating that the stock has risen too quickly in the market. The Price/Money flow chart also shows that the price is currently well above the money.

Conclusion & Recommendation

Based on the current state of the company, I recommend a SELL rating for EMC’s stock. This recommendation is based on several criteria. EMC’s current stock price of $26.56 appears to be overvalued based on my valuation. In addition, the technical analysis shows a negative prognosis given the RSI being greater than 70 and the Price/Money Flow chart have a large discrepancy between the current stock price and the flow of money to the equity. The potential synergies from Isilon as well as VMware’s presence in server virtualization provide a strong outlook for EMC in the next 3 to 5 years, however, the current state of the equity does not warrant a BUY recommendation.
Hewlett-Packard HPQ

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- Leading PC shipper in terms of Units and Revenue in the World
- Invested over $3 Billion in Research and Development
- Acquired 3PAR, a specialist in Cloud Computing and Storage

Hewlett-Packard Company provides IT solutions for both data networking and data storage in both the computer hardware and computer commercial services industries worldwide. The company’s wide product and service portfolio penetrates various markets and end users ranging from personal consumers to multi-national corporations. The firm has also created a niche within the business of digital imaging and printing. Through programs like HP Care Pack services, clients and customers have a guarantee from the firm that they will have support for the product lines and services purchased from Hewlett-Packard.

Business Segments

Enterprise storage and servers continues to thrive within the business model, as clients require cheap, reliable and scalable solutions to data storage needs. ESS is divided into three segments including: Industry Standard Servers, Business Critical Systems and HP’s StorageWorks. Industry standard servers range from tower servers to optimized rack systems to HP’s BladeSystem depending on the needs of the client. Business critical systems are designed for firms that are growing and require a scalable system of data storage that can grow with them. These systems utilize HP’s x86 ProLiant servers, which contain more than four processors. StorageWorks is HP’s product and service offering for the typical personal user. These systems range in levels from entry to mid to high-end structures.

HP Software aims to provide users with a multitude of services and systems, which range from IT Management to Business Intelligence to Media Solutions. Enterprise IT management software provides infrastructure, services and operations for the business world. Business Intelligence Solutions allows companies to manage various operations from data protection to archiving in one system, which creates the opportunity for cost reductions. Communications and Media Solutions enables clients to have real-time business support including communications, infrastructure and digital media.

The Personal Systems Group includes PCs for personal and commercial use as well workstations and handheld (mobile) computing. HP has the highest unit volume of computers sold around the world. The PSG has begun to transition towards the
market appreciation of the mobile computing sector with innovative product offerings like the HP Slate 500, which uses Windows 7 Mobile OS. This product leverages the firm against Apple’s rising star; the iPad.

Digital imaging has long been one of HP’s niches within the computer hardware industry. The Imaging and Printing Group provides a wide range of products including printing hardware, supplies and scanning devices. IPG also provides solutions for graphic design for clients through print services solutions.

Growth

Hewlett-Packard has demonstrated its focus on expanding its product offerings through both internal innovation and acquisition of companies with innovative products and services. Although the market determined the price HP paid for Cloud Computing specialist, 3PAR, the potential synergies with the firms may prove to increase long-term earnings for the company. Hewlett-Packard’s position within the Enterprise Storage business has positioned the company to grow as the economic recovery continues within the Information Technology sector. Enterprise Storage is the strongest facet of the industry, and Cloud Computing is certainly the future system that companies will use. The PC market also grew in the past twelve months at a rate of 20%. As the number one PC shipper in the world, Hewlett-Packard has been able to reap the benefits of this positive trend. The firm is well diversified with Business Segments in both IT Hardware and Services, which allows HP to offer turnkey solutions to its clients. This product portfolio ensures that Hewlett-Packard will be able to remain viable in the IT sector during times of economic growth and recessions.

Valuation

In order to value the price of Hewlett-Packard’s stock; I first determined a conservative growth rate by analyzing the company and industry trends along with real GDP growth. From there, I utilized a Dividend Discount Model to determine a stock price of $47.83. Compared to the current market price of $40.97, Hewlett-Packard is currently undervalued and, therefore, is an attractive purchase. I also derived a Pro-Forma P/E for the organization, which equated to 9.53. One of HP’s primary competitors is International Business Machines (IBM), which has a Pro-Form P/E ratio of 14.4. The P/E for the S&P 500 is approximately 17, which demonstrates that HP’s stock is potentially undervalued when compared to other stocks within the same index.

Concerning the Technical Analysis of the stock, I used three indicators to forecast the potential direction of the equity using historical data. The three indicators I used include Bollinger Bands, RSI and the Price/Money Flow chart. After reviewing the three indicators, it is clear that the technical prognosis for Hewlett-Packard is POSITIVE. The Bollinger Bands provide a positive trend with HP’s stock remaining within two standard deviations for more than 95% of the past twelve months. The RSI is above 30 and below 70 (63.98) and the Price/Money flow chart shows that the price is currently below the flow of money, but moving upwards.

Conclusion & Recommendation

Based on the current state of Hewlett-Packard, I recommend a BUY for the stock. The decision to purchase HPQ stock is based on a variety of reasons including: The expected synergies from 3PAR, HP’s drive towards innovation through Research and Development the Valuation of the current stock price versus the Dividend Discount Model and the Positive prognosis from the Technical Analysis.
International Business Machines IBM

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Market Price</th>
<th>As of</th>
<th>Industry</th>
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<tbody>
<tr>
<td>BUY</td>
<td>$182.33</td>
<td>$164.04</td>
<td>4/6/11</td>
<td>Diversified Computer Systems</td>
</tr>
</tbody>
</table>

- IBM is the Nr.1 Server Vendor worldwide
- Strong focus on R&D – 6.6 Billion Investment
- Strong EPS growth (13% over the past 12mth)

International Business Machines (IBM) is a global Information Technology consultant that provides innovative hardware, software and services to its clients in order to improve the efficiency of their business models. In the past IBM was known by its dominance in the PC market, however the firm has changed its own business model to expand its offerings portfolio. Currently, hardware sales represent only 15% of revenue.

IBM has begun to expand its current offerings to include growth initiatives that the firm believes can be leveraged into futures success. Smarter planet aims to integrate technologies like power grids, supply chains, and traffic systems with intelligent design in order to improve efficiency. IBM has also dedicated significant capital to emerging markets as a means of geographic expansion as well as cultivating a global perspective from its employees. Business Optimization provides analytics of data to companies, which allow them to see trends in information. This allows IBM clients to take necessary action in order to mitigate or take advantage of risks and opportunities. Cloud Computing is becoming the focus of most IT companies due to its ability to provide virtualization and management efficiently without the need to expensive and bulky equipment.

**Business Segments**

IBM is divided into five business segments, which provide a variety of products and solutions to its clients. **Global Technology Services** (GTS) provides IT infrastructure and business processing through standardization and automation. GTS services include outsourcing, processing, IT, maintenance and delivery. **Global Business Services** (GBS) provides professional and management services through IBM’s offerings portfolio and strategic alliances. GBS services include consulting and systems integration as well as application management services. **IBM Software** includes middleware and operating systems designed to integrate business applications. IBM’s line of software includes WebSphere, Information Management, Tivoli, Lotus, Rational, and Business Analytics. **Systems and Technology** provides clients with storage capabilities as well as high-powered computing solutions. Some of IMB’s systems include System z, Power Systems and System x which provide infrastructure on a high level.
Storage services range from Retail Store Solutions (point-of-sale operations) to Microelectronics (semiconductors used in IMB systems). **Global Financing** provides clients with the ability to purchase IBM hardware and services through debt. IBM’s financing programs include Client, Commercial and Remanufacturing and Remarketing Finance.

**World Class Innovation**

International Business Machines has taken advantage of the global economic recession over the past several years by increasing its offerings portfolio through acquisitions. IBM has also remained ahead of the innovation curve within the Information Technology sector. Recently, the firm unveiled its latest creation to the world, Watson, via the game show Jeopardy. Watson, named after the founder of IBM Thomas J. Watson, is a supercomputer that utilizes state of the art voice recognition software to analyze and answer complex inputs. Although the presentation of Watson’s abilities on television is a novel idea, the core system that allows Watson to operate speaks to the kind of innovative technologies IBM is capable of engineering.

**Valuation**

In order to value the price of International Business Machine’s (IBM) stock; I first determined a conservative growth rate by analyzing the company and industry growth trends along with real GDP growth. From there, I utilized a Dividend Discount Model to determine a valuated stock price of $182.33. Compared to the current market price of $163.07, IBM is currently undervalued and, therefore, is an attractive purchase. I also derived a Pro-Forma P/E for the organization, which equated to 14.4. One of IBM’s primary competitors is Hewlett-Packard, which has a Pro-Form P/E ratio of 9.53. The P/E for the S&P 500 is approximately 17, which demonstrates that IBM’s stock is potentially overvalued when compared to other stocks within the same index. Concerning the Technical Analysis of the stock, I used three indicators to forecast the potential direction of the equity using historical data. The three indicators I used include Bollinger Bands, RSI and the Price/Money Flow chart. After reviewing the three indicators, it is clear that the technical prognosis for International Business Machines is NEUTRAL. The Bollinger Bands provide a positive trend with IBM’s stock remaining within two standard deviations for more than 95% of the past twelve months. The RSI is slightly below 70 (69.34) indicating that the stock may have risen too quickly in the market. The Price/Money flow chart also shows that the price is currently above the money.

**Conclusion & Recommendation**

Based on the current state of International Business Machines, I recommend a HOLD rating for the firm’s stock. The rationale behind my recommendation is based on several factors. IBM’s dominates the server market, which is still a strong niche in the industry. The ability of the firm to acquire new products and services through acquisitions provides excellent leverage in weaker economies. The valuation of the current stock price denotes that the market is undervaluing IBM, but the technical analysis provides only a Neutral prognosis for the future.
Intel Corporation INTC

Recommendation | Valuation | Market Price | As of | Industry
BUY | $27.53 | $19.95 | 3/31/11 | Semiconductor – Broad Line

- Wintel alliance provides Intel with a market share of 80% of the worldwide PC market
- Largest market share in semiconductors with approx. $40 billion in sales
- Strong R&D focus – $7 billion investment

Business Segments

Intel designs multiple computing components including chipsets, motherboards, wireless connectivity solutions and microprocessors. Microprocessors are the devices, which manage data and control vital functions within the Central Processing Unit (CPU) of a computer. Intel’s processors are equipped with Cores which scale with the usage and are designed to work, in conjunction with its Chipsets, with a variety of products including: notebooks, netbooks, desktops, servers, workstations, communication products, and handheld devices to name a few.

Intel also provides additional product offerings outside of semiconductors. Intel designs memory solutions for its clients in the form of NAND flash memory. This type of memory is used predominantly for portable memory storage purposes including flash drives, memory cards and other devices. It is fast, inexpensive and reliable since there are no moving parts within the devices.

Intel also offers software products like operating systems for numerous devices.

Intel Corp. has enjoyed a long and successful partnership with Microsoft and its operating system, Windows. This alliance, known as Wintel, has provided Intel with the ability to penetrate the international PC market. Currently, Intel processors are in 80% of the world’s personal computers. Recently, however, there has been a trend towards mobile computing that is being driven by the hype over table PCs, like the Apple iPad. Microsoft announced a new partnership with ARM Holdings Inc., which develops mobile operating systems for tablet style PCs. Intel has yet to produce this style...
of operating system, which puts the company at risk of losing market share, and potential future partnerships. It is clear that Intel is posturing itself to become more independent from companies like Microsoft as it develops its own line of Operating Systems to be used in conjunction with its current line of processors.

**Uncertain Future**

Intel Corporation’s unofficial alliance with software giant, Microsoft, may be tested in the near future. It is clear that mobility and portability have become two of the leading drivers for the Information Technology sector. Items like the Apple iPad and iPhone are two examples of successful, mobile products on the market. The microchips that operate these mobile machines are called ARM processors. Currently, Intel does not have a strong presence in these types of processors. In order to remain competitive in the changing environment of the industry, it is essential for Intel to proceed in this direction.

**Valuation**

In order to value the price of Intel Corporation’s stock; I first determined a conservative growth rate by analyzing the company and industry growth trends along with real GDP growth. From there, I utilized a Dividend Discount Model to determine a stock price of $27.53. Compared to the current market price of $20.18, Intel is currently undervalued and, therefore, is an attractive purchase. I also derived a Pro-Forma P/E for the organization, which equated to 9.5. Two of Intel’s primary competitors are Texas Instruments and First Solar, which have Pro-Forma P/E ratios of 14.3 and 18.9 respectively. The P/E for the S&P 500 is approximately 17, which demonstrates that Intel’s stock is potentially undervalued when compared to other stocks within the same index.

Concerning the Technical Analysis of the stock, I used three indicators to forecast the potential direction of the equity using historical data. The three indicators I used include Bollinger Bands, RSI and the Price/Money Flow chart. After reviewing the three indicators, it is clear that the technical prognosis for Intel Corporation is NEUTRAL. The Bollinger Bands provide a positive trend with Intel’s stock remaining within two standard deviations for more than 95% of the past twelve months. The RSI is below 70 (62.90) indicating that the stock may have risen too quickly in the market. The Price/Money flow chart also shows that the price is currently above the money. If that continues, the stock may become overvalued and should be sold before a market adjustment occurs.

**Conclusion & Recommendation**

Based on the current state of Intel Corporation, I recommend a BUY rating for the firm’s stock. The recommendation is based on several factors including: The undervalued stock price based on the Dividend Discount Model, the Wintel Alliance that has placed Intel microprocessors in 80% of the global PC market and the firm’s commitment to staying innovating through extensive capital investment into Research and Development. It should be noted, however, that Intel’s future is predicated upon the firm’s ability to maintain ahead of the innovation curve concerning Cloud Computing. Currently, the firm needs to begin developing ARM based processors in order to compete in what is surely the future of information Technology.
Microsoft MSFT

- 1Q11 Revenue up 25% from 1Q10; $16.2 Billion
- Double-digit EPS growth over past seven years (Currently 13%)
- Dividend increase of 23%

Cloud Computing will affect future sales of the firm as Packaged Software is its core competency. This new OS will attempt to leverage the company’s long-term success, as Cloud Computing is certainly the future of Information Technology.

Business Segments

Microsoft is organized into five divisions, which offer a wide variety of products to consumers ranging from multinational corporations to individuals. Windows & Windows Live is responsible for the Windows Operating System family of products including Windows 7, Windows Vista and Windows XP (Home, Basic, Professional, etc.). This division also includes Windows Live and web services. Server and Tools provides server software, tools and services for information technology professionals. The product line in this division includes Windows Azure, SQL, Visual Studios and BIZ Talk Server to name a few. Around 50% of the division’s revenue comes from licensing agreements alone. Online Services Division is comprised of online offerings including the Bing and MSN websites. Revenue is gained through advertisement from search services and publisher tools. Microsoft Business consists of the Microsoft Office family of products including Office, SharePoint, MS Dynamics and Web Applications. Around 80% of sales in this division come from businesses. IT spending has increased because of economic recovery, which bodes well for the future of this division. Entertainment and Devices develops, produces and markets software programs and consoles for the purpose of entertainment. Products within this division include: Xbox 360, Xbox Live, video game, PC games, Windows Phone, Zune and Mediaroom to name a few.
**Innovation**

Microsoft has determined that Cloud Computing is a trend within the Information Technology sector that simply cannot be ignored. The firm has developed a new Operating System (OS) named Azure. This operating system is going to be used to handle the future needs of cloud users ranging from small businesses to large multi-national corporations. Cloud Computing allows businesses to store vast quantities of information on virtual servers. This eliminates the need for companies to purchase and maintain servers on site. This will reduce overhead by eliminating costs related to the upkeep of servers including energy, time and space.

**Valuation**

In order to value the price of Microsoft’s stock; I first determined a conservative growth rate by analyzing the company and industry trends along with real GDP growth. From there, I utilized a Dividend Discount Model to determine a stock price of $33.26. Compared to the current market price of $25.39, Microsoft is currently undervalued and, therefore, is an attractive purchase. I also derived a Pro-Forma P/E for the organization, which equated to 10.88. Two of Microsoft’s primary competitors are Oracle and Adobe Systems, which have Pro-Form P/E ratios of 26.34 and 23.44. The P/E for the S&P 500 is approximately 17, which demonstrates that Microsoft’s stock is potentially undervalued when compared to other stocks within the same index.

Concerning the Technical Analysis of the stock, I used three indicators to forecast the potential direction of the equity using historical data. The three indicators I used include Bollinger Bands, RSI and the Price/Money Flow chart. After reviewing the three indicators, it is clear that the technical prognosis for Microsoft is NEUTRAL. The Bollinger Bands provide a positive trend with Microsoft’s stock remaining within two standard deviations for more than 95% of the past twelve months. The RSI is above 30 and below 70 (42.04). The Price/Money flow chart shows that the price is currently above the money.

**Conclusion & Recommendation**

My recommendation is to BUY this stock. The justification for this recommendation is due to several factors. The growth expected from the sale of both Windows 7 and MS Office 2010 is too attractive to pass up over the next twelve months. As the new Operating System, MS Azure begins to penetrate the market, the Cloud Computing segment of Microsoft’s business will grow as well. In addition, the valuation of the stock shows that the current price is undervalued and the technical analysis is neutral.
Industrials

Riding the Economic Upswing

We expect the Industrials sector to be a strong performer in 2011. Historically speaking, the industrials sector has performed very well in the early and middle stages an economic recovery out-performing the S&P 500 during these periods. During these healthier financial periods, companies have more cash on hand which they can use to invest in capital-intense projects, such as the construction of a new oil refinery. This, in turn, leads to more projects that are available and more revenues for industrials companies. This also helps some companies, such as aerospace companies, to develop a strong backlog to benefit them not only this year but in the years ahead. Another factor is the fact that over the past few, rough years, companies have adapted their cost structures and improved efficiencies in order to handle the difficult economic times. Now that we are in a better economic period, those Industrial companies that made difficult decisions a few years ago should see improvement and better results with their higher levels of efficiency.

Some risks to this sector include a sudden stop to the economic recovery and oil/materials prices. Oil and material prices directly affect the costs of Industrial goods/services, and a spike in either could strongly affect their costs and profits. To illustrate, a company such as Boeing uses metals to make airplanes, and if the price of aluminum goes up, their costs increase. While these are concerns, we expect the economic recovery to continue and the new cost structures in effect to supersede these risks. We expect the industrials sector to outperform the S&P 500, and, therefore, we have elected to overweight the Industrials sector for the 2011 portfolio.
The Boeing Company is based in Chicago, Illinois. It is the world’s second largest commercial airplane producer behind Airbus and the world’s third largest military weapons maker behind Lockheed-Martin and BAE Systems. Boeing is divided into three operating segments: Boeing Commercial Airplanes (50% of revenues, 47% of operating profits, Boeing Defense, Space & Security (49% and 51%), and Boeing Capital Corp (1% and 2%) which is used to finance aircraft for airlines.

Boeing’s Commercial Airplane (BCA’s) commercial jet aircraft family includes the 737 Next-Generation narrow body model and the 747, 767, 777 and 787 wide body models. The 787 (Dreamliner) is BCA’s newest model, and it is scheduled for its first delivery, following a long delay, in the third quarter of 2011. Boeing’s upgraded 747-8 Freighter is also slated for delivery in the fourth quarter of 2010, with the passenger version scheduled for a year later. Besides just producing planes, BCA also offers aviation support, aircraft modifications, spare parts, training, maintenance documents, and technical advice. Boeing had a commercial aircraft backlog at the end of 2009 of $251 Billion.

Boeing Defense, Space & Security (BDS) designs, develops and supports military aircraft, including fighters, transports, tankers, intelligence surveillance and reconnaissance aircraft, and helicopters. BDS’s main customer in 2009 was the US Department of Defense with approximately 80% of its sales. Some of BDS’ notable programs include the AH-64 Apache helicopter and the F-15 Eagle Fighter Jet.

Industry Trends

Historically, the industrial sector has performed very well during the middle stages of an economic recovery. During this time, there is increased construction, and more revenues invested in capital projects.

Our outlook for Boeing is generally positive. Following a global economic downturn, I see improvement in the global economy and growth in commercial air traffic aiding results in commercial aerospace. However, our outlook is less optimistic on the defense industry as the high levels of deficit spending in the U.S. and a trend toward increasing spending on social programs will mean continued pressure on the U.S. defense budget going forward.
Boost in Production

Boeing expects a strong boost in production, especially in the commercial airplane segment as production increases are expected with the 737 and the 777. This boost in production is also tied to the 787’s expected service entry in the third quarter. There are currently about 850 787s on order, and their release should also help Boeing to see a boost in production. In addition, US airlines expect to continue orders to make their aging fleets more fuel-efficient. The BDS segment will have slower growth because of a small increase in military sales to the US government and a small decrease in space sales due to the end of the US space shuttle program.

Strong Growth in Emerging Markets

Emerging markets, especially those in the Middle East and Asia should continue to see a strong demand for narrow body aircraft. Boeing is in strong position to benefit from this increased demand. Boeing has a current backlog of 3,400 aircraft as of December 2010, and a majority is from these emerging economies.

Financials

Boeing has a strong dividend yield of 2.3%. We estimate an EPS of 4.08 in 2011. Boeing is also the sub-industry leader in return on equity. The company is pouring a lot of capital into R&D, which We believe to be a good move as the company looks to invest it in new technologies to differentiate from its competitors, such as AirBus.

Conclusion & Recommendation

In conclusion, we believe we should put some of our position in The Boeing Co. The company should see a strong boost in sales in 2011, tied to growing demand from emerging economies and the release of the new 787. It also pays a strong dividend and should perform well financially. The risks to Boeing include a sudden economic downturn and delays due to manufacturing difficulties with some of their new programs such as the 787.
Chicago Bridge & Iron Company CBI

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<th>Last Price</th>
<th>52W Range</th>
<th>Current P/E</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buy</td>
<td>$42.40</td>
<td>$36.25</td>
<td>16.64-38.18</td>
<td>17.77</td>
<td>Industrials: General Contractors</td>
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</tbody>
</table>

- Global Recovery creating more Projects
- Well positioned in Emerging Markets
- Dividend Yield: .6%
- Strong Technical Analysis
- Beta:2.34; Forward P/E: 13.33

Chicago Bridge and Iron Company is based in the Netherlands. Chicago Bridge and Iron Company is a global engineering, procurement and construction (EPC) company specializing in turnkey projects for customers that produce, process, store and distribute the world’s natural resources. The company offers a complete package of engineering, procurement, fabrication and commissioning of projects involving hydrocarbon-processing plants, liquefied natural gas (LNG) terminals, pipelines and other steel structures and facilities. In 2010, 52% of revenues came from the Lummus segment, with 40% from steel plate structures and 8% from Lummus Technology.

Industry Trends

Historically, the industrial sector has performed very well during the middle stages of an economic recovery when there is increased construction, and more revenues are being invested in capital projects.

The sub-sector, general contractors, also has a positive outlook. This is due to the increase in new projects that come with economic recovery. In addition, delayed projects in a company backlog begin to commence and revenues from these projects become realized.

Global Recovery= More Projects

Chicago Bridge and Iron Company’s success is dependent on the number of projects it is taking on. As the economy continues to improve, there will be more projects for CBI. This, in turn, will lead to more growth and revenue.

New awards (bids) have decreased 45% in 2010, with the largest decrease in the Lummus segment, which deals with things such as liquid natural gas (LNG). They expect that LNG will propel growth back toward historical levels as orders pick up during the economic recovery. This will lead to a big boost in revenues and a strong growth period over the next several quarters.

Well-positioned in Emerging Markets

Chicago Bridge and Iron Company is well positioned in Emerging markets. In fact, 75% of revenues and 95% of new awards came from outside the United States. At the beginning of this year, the company had a backlog (unfulfilled orders) worth $6.9 billion, and over 80% were from outside the United States. CBI notes that there has not been a significant cancellation of an order in its backlog since 2007.
Two of CBI’s largest projects were in BRIC countries: a propane dehydrogenation unit in China and an ethylene cracking heater award in Russia. In addition to these projects, there should also be a significant growing market for CBI’s service by energy companies, looking for natural gas and oil sands in Canada.

Financial Strength

The company is in strong fiscal shape. It has just reinstated a dividend to begin paying out in March 2011. Its dividends have historically been one of the highest in its peer group. The company’s long-term debt as a percentage of market capitalization has decreased by nearly half from 2009 to 2010. This is usually a good sign of the financial health of the company.

Another way to determine the fiscal health of a company is to look at where it stands relative to its peer group as a whole. When measuring ROE, its sub-sector’s ROE is 8.6% while CBI’s was 21.36%. It has 500 Million cash on hand which is always good, especially with uncertainty remaining about a full global recovery.

Conclusion & Recommendation

Overall, WE rate this stock as a buy. The main support in our reasoning is tied to the fact that the industrial sector tends to rebound strongly during the middle stages of an economic recovery. This should lead to the creation of more projects leading to increased revenue for CBI. This is supported by growth in infrastructure as Energy companies look to expand operations. In addition CBI is well positioned in emerging markets, which should continue to grow rapidly. The balance sheet and technical analysis also support this conclusion. Some risks include a failure of a project to be executed according to its time schedule due to something outside the company’s control. Weather is an example, and it led to delays and increased costs in one instance back in 2008.
Danaher Corp. DHR

Recommendation: Sell  
Valuation: $52.80  
Last Price: $52.17  
As of: 4/6/11  
Industry: Industrials: Industrial Machinery

- Risky Sub-Industry
- Good Strategy
- Strong Balance Sheet
- Dividend Yield: .2%
- Favorable Technical Analysis
- Beta of .85; Forward P/E of 16.21

Danaher Corp. is based in Washington D.C.  
Danaher Corp. is a leading maker of hand tools and process and environmental controls. The company has four reporting segments: professional instrumentation (39% of 2009 sales), industrial technologies (24%), tools and components (9%), and medical technologies, formerly included in professional instrumentation (28%).

The company seeks to expand revenues through a combination of internal growth and acquisitions. The company should continue its tradition of successful acquisition integrations. During 2009, the company bought 15 businesses for an aggregate purchase price of $704 Million, versus 17 businesses for about $423 Million in 2008, and 12 businesses in 2007 for approximately $3.6 Billion.

Industry Trends

Historically, the industrial sector has performed very well during the middle stages of an economic recovery. At which time, there is increased construction, and more revenues invested in capital projects.

Our outlook for the industrial machinery sub-sector is neutral. The industrial economy and machinery usage have been expanding since about mid-2009, and that the global economy, led by stronger growth in emerging economies, is likely to improve. We think this will lead to an improvement in order growth. However, there are still some risks such as slowing economic growth, the conclusion of global stimulus programs, and increasing global commodity costs. The seasonal nature of the sub-

Company Strategy

Aided by acquisitions and global economic growth, Danaher should continue to see a strong stream of revenues going forward. The pace of acquisitions could accelerate sales growth beyond forecasted rates. The company is focusing its expansion on faster-growing, high technology businesses and into new and rapidly growing geographic markets.

The company has one internal issue that could hamper growth. The list of its Board of Directors is classified, and members are elected to staggered terms. This could be a potential hindrance when it
comes to shareholders wanting to change policies that are entrenched and liked by the Board. The fact that the Board is classified makes it hard for anyone to apply pressure to it.

**Strong Financial Performance**

Danaher Corp has been working over the last two or three years to decrease its long-term debt as a percentage of total capital. This is during a time when it also spent a good sum of money on its Beckman-Coulter acquisition, which will finally close in 2011.

The company also instituted a 10 Million-share buyback program. With the reduction in outstanding shares, this should lead to an increase in EPS and greater value for the shareholders. This could lead to greater cash flow for the company if the company purchases the shares at a lower price then they believe their company is worth.

**Conclusion & Recommendation**

Danaher Corp seems like a company that will continue to be a strong competitor in the years ahead. However, there is some risk with its management and sub-industry. We think keeping our current stake in Danaher would be ok, but there are other companies in our portfolio where we feel our money could be better invested. Perhaps, we could sell off some of our position and find a company with higher growth potential.
Heico Corp HEI

Recommendation  | Valuation | Last Price | As of | Industry
Buy            | $66.40    | $62.21    | 4/6/11 | Industrials: Aerospace and Defense

- Favorable Sub-Sector Performance
- Trend toward replacement parts/growing fleet size in EM
- Dividend Yield: .2%
- Favorable Technical Analysis
- Beta of 1.02; Forward P/E of 25.45

HEICO Corp. is based in Hollywood, Florida. HEICO Corp. makes jet engine replacement parts and electronic equipment through two segments: The Flight Support Group and the Electronic Technologies Group. Revenues by market in FY 10 were as follows: Commercial aviation 63%, defense, space and homeland security 23%, and other 14%.

The company offers about 6,000 FAA-approved replacement parts (PMAs) to customers. It also has FAA approval to provide repair and overhaul on over 1,200 components and systems ("DER repairs"). In addition, the group distributes aircraft parts and provides asset management. It also makes thermal insulation products. Major customers include many of the world's largest airlines such as Lufthansa and British Airways. PMA parts sales by geography, as of late 2010, were 47% in the Americas, 35% in Europe/Middle East/Africa and 18% in Asia/Australia. Flight Support Group revenue in FY 10 was 60% parts and 40% repair and overhaul services. HEICO has a market cap of 1.87 billion making it a small-cap stock.

Industry Trends

Historically, the industrial sector has performed very well during the middle stages of an economic recovery. At that time, there is increased construction, and more revenues invested in capital projects.

Our outlook for the aerospace and defense sub-industry is generally positive. Following a global economic down turn, we see improvement in the global economy and growth in commercial air traffic aiding results in commercial aerospace. However, our outlook is less optimistic on the defense industry as the high levels of deficit spending in the U.S. and a trend toward increasing spending on social programs, will mean continued pressure on the U.S. defense budget in the future. Inasmuch as HEICO deals more primarily with commercial aerospace, their sub-sector outlook is favorable.

Favorable Trends for HEICO

Some favorable drivers should help to increase growth for HEICO. First, the International Air Transport Association reported 8.2% revenue passenger growth in 2010. A rise in air traffic should lead to greater demand for HEICO’s parts and services as the need for maintenance increases. As companies tried to streamline and make their operations more efficient during the
recession, they have put more emphasis on acquiring PMA as a way of cutting costs.

It is predicted that global fleet numbers will rise and stay higher for the longer term. This is influenced mainly by emerging economies such as China, Brazil, and the Middle East. With more planes, the market for HEICO’s products and services will expanded permanently.

**Strategic Partnerships**

HEICO has many key strategic partnerships, which are helpful for its business. Lufthansa, American, United, Delta and Japan Airlines are its current partners, and they have just announced a partnership with British Airways. One good thing that could come from this partnership is closer ties with Rolls-Royce, one of the Big 3 jet engine part producers. They currently do not make replacement parts for RR engines, this creates a strong opportunity to gain market share.

**Conclusion & Recommendation**

HEICO’s sector and subsector are both favorable for growth. HEICO’s status as a small-cap growth company carries weight as we look to diversify our portfolio as a whole, and include more small-caps. With this in mind, we feel we should add to our current holding.
Jacobs Engineering Group

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>As of</th>
<th>Industry</th>
</tr>
</thead>
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<tr>
<td>Buy</td>
<td>$57.00</td>
<td>$51.97</td>
<td>4/6/11</td>
<td>Industrials: Construction and Engineering</td>
</tr>
</tbody>
</table>

- Favorable Industry Trends
- Unique Business Model
- Big Acquisition
- No Dividend
- Neutral Technical Analysis
- Beta of 1.33, Forward P/E of 15.78

Jacobs Engineering is based in Pasadena, California. Jacobs Engineering focuses on providing a broad range of technical, professional and construction services to a large number of industrial, commercial and governmental clients worldwide. The company offers project services; consulting services; operations and maintenance services; and construction services, via offices primarily in North America, Europe, Asia and Australia.

In FY 10 (Sep.), JEC's revenues by sector were: refining (downstream), 31%; national government (environmental, defense and NASA), 23%; chemicals, 12%; pharma-bio (pharmaceutical and biotech), 6%; oil and gas (upstream), 6%; infrastructure, 9%; buildings, 9%; and pulp and paper, high tech, food and consumer products, 4%. The higher-margin technical professional services component accounted for 52% of revenues and 57% of backlog in FY 10, with the balance derived from field services (construction). As of December 31, 2010, backlog was $13.0 Billion ($7.9 Billion technical professional), down 1.5% sequentially and 13% from a year earlier.

Industry Trends

Historically, the industrial sector has performed very well during the middle stages of an economic recovery. When there is increased construction and more revenues are invested in capital projects.

Our outlook for the construction & engineering sub-industry group remains positive. We expect bidding for new awards to gradually pickup during 2011, while pent-up demand for delayed or postponed projects, drives backlog growth later in the year. Another positive factor is that several major C&E companies should benefit from power generation projects, including coal-fired plants, oil & gas, and nuclear power plants. President Obama's additional $50 Billion infrastructure plan to rebuild roads, railways and airport runways should benefit new awards near term. However, infrastructure spending will be limited, in our view, due to state and local government budget shortfalls.

Strong Business Strategy

JEC has a unique business model which we feel positions it to succeed in the future. It puts a strong emphasis on building relationships with clients in hope of gaining repeat business. It also focuses on more small projects, as opposed to fewer large ones, which are less risky, yet contribute strong and steady revenues. An
advantage of this is less competition for smaller projects.

In December 2010, the company agreed to acquire the bulk of Norway-based Aker Solutions ASA’s process and construction (P&C) unit for $675 Million. JEC sees modest accretion in FY 11. We believe this transaction will aid JEC’s expansion in mining and metals markets, and with its entrance into South America, as well as further strengthening its presence in China and other global regions. As most of its consumers are in the developed world, we see this move as a way to strengthen ties in South America and build business in China.

Financial Indicators

As of December 31, 2010, total debt was 2.7% of capitalization, one of the lowest levels in the engineering & construction industry. JEC also raised its EPS guidance for FY 11 to $2.40 to $2.85, from $2.30 to $2.80, based on its acquisition (Aker), which is expected to close in the second quarter, subject to conditions. Conversely, one negative financial factor is that JEC does not pay a dividend; however, this should not have a major effect, as the company should continue to grow and have a strong EPS.

Conclusion & Recommendation

In conclusion, we see Jacobs Engineering Group as a buy. The sector and sub-sector environment are both favorable for growth. The company is well run and has a unique proprietary business model, which allows it to differentiate itself from its competitors. We are also very positive on their recent acquisition of Aker Solutions. We believe this will lead to an increase in shareholder value. When weighed with its intrinsic value, this stock will strengthen our portfolio.
United Technologies Corp  UTX

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<td>4/6/11</td>
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</table>

- **Strong Industry Trends**
- **Large Backlog in Airline Industry**
- **Strong Financials**
- **Dividend Yield: 2.1%**
- **Favorable Technical Analysis**
- **Beta of 1.05; Forward P/E of 12.86**

United Technologies is based in Hartford, Connecticut. United Technologies is a multi-industry holding company that conducts business through six segments: Carrier, Otis, Pratt & Whitney, UTC Fire & Security, Hamilton Sundstrand, and Sikorsky. Carrier (21% of sales and 11% of operating profits in 2009) is the world's largest maker of heating, ventilating and air-conditioning (HVAC) and refrigeration systems. Otis (22% of sales and 35% of operating profits) is the world's largest maker of elevators and escalators. Otis designs, manufactures, sells, installs, maintains and modernizes, a wide range of passenger and freight elevators for low-, medium-, and high-speed applications, as well as a broad line of escalators and moving walkways. International revenues were 80% of total segment revenues in 2009.

Pratt & Whitney (24% of sales and 26% of operating profits) is a major supplier of jet engines for commercial, business & general aviation, and military aircraft. Pratt & Whitney also sells industrial gas turbines (for industrial power generation) and space propulsion systems. Sikorsky (12% of sales and 9% of profits) is one of the world's largest manufacturers of military and commercial helicopters, and provides aftermarket helicopter and aircraft products and services. Sikorsky is the prime contractor on the UH-60M Black Hawk helicopter. About 58% of UTX's revenues came from commercial and industrial operations in 2009, 21% from military aerospace and space, and 21% from commercial aerospace.

**Industry Trends**

Historically, the industrial sector has performed very well during the middle stages of an economic recovery, when there is increased construction, and more revenues invested in capital projects.

Our outlook for the aerospace and defense sub-industry is generally positive. Following a global economic downturn, we see improvement in the global economy and growth in commercial air traffic, aiding results in commercial aerospace. However, our outlook is less optimistic on the defense industry as the high levels of deficit spending in the U.S. and a trend toward increasing spending on social programs will mean continued pressure on the U.S. defense budget in the future.

**Pratt & Whitney**

Pratt and Whitney is one of the world’s three largest suppliers of jet engines. There are currently large backlogs of commercial aircraft at both Airbus and Boeing. This bodes well for production levels to be high through 2013. Another factor that
bodes well is the inception of the new Boeing 787 “Dreamliner”, which will provide new service opportunities.

**Boost in Construction**

As the commercial and residential real estate markets improve, we expect sales increases with Otis and Carrier. Notably, fourth quarter orders from Otis in China were up 30% from the previous quarter. Of course, this is dependent on the economy and its continued resurgence.

**Strong Financials**

The company is in strong financial position to continue to develop and grow while rewarding its shareholders. For the 10 years ending in 2009, UTX recorded compound annual growth of 8.1% for sales, 16.4% for income from continuing operations, 17.4% for earnings per share, and 15.0% for dividends per share. The company also has higher earnings per share. Return on invested capital (ROIC) was 15.6% in 2009, slightly above a 15.4% average for the S&P 500 Aerospace & Defense sub-industry. Free cash flow was 8.6% of sales in 2009, versus a peer average of 7.4%. The company also has a dividend yield of 2.1%.

**Conclusion & Recommendation**

In conclusion, we believe we should increase our position in United Technologies Corp. The company has a strong balance sheet, a great portfolio of companies, a strong position in growing/emerging economies, and happens to be in a sub-sector, which should continue to grow and strengthen as the economy recovers. The company performs very strongly against its peers, and its diverse portfolio makes it a safe and worthwhile selection for our portfolio.
Materials Sector

At this point, the SunTrust Crummer Portfolio sits slightly underweight at 3.74% in relation to the S&P weighting of 3.96%. Due to effective realignment of cost structures and predicted further rises in key commodity prices, we recommend overweighting the materials sector. In 2010, the sector gained 19.9% in comparison to 12.8% achieved by the S&P 500. Before this success in the past year, the sector was hit hard by recession, demanding significant cost-cutting measures to be taken by many major players in the sector. These measures position such companies well for the near future as we expect to see further recovery in both domestic and overseas-developed markets, as well as continued growth in emerging markets. Particularly in the BRIC nations, we expect to see increasing demand for metals and mining products because of additional growth. The combination of these factors ensures a further rise in world industrial production, whilst continually high barriers to entry in the mining industry keep supply at similar levels. This increase in demand is predicted to boost prices of key commodities higher over the coming twelve months, as shown by the chart below. Some risks to the sector include slower than predicted emerging market growth and potentially constricting impacts of recent natural disasters in Japan. In spite of these potential factors, the sector is expected to strengthen over the coming 12 months. With the combination of the following equity recommendations and the allocations made by our management team, our prospective holdings in the materials sector illustrate a historical correlation of 0.98.
Vale S.A. (ADR) VALE

**Recommendation**  
Buy

**Valuation**  
$37.13

**Last Price**  
$33.60

**As of**  
4/6/11

**Sector**  
Materials

- World’s largest iron ore miner
- Predicted gains in steel demand on global growth
- Promising domestic growth opportunities

Through its subsidiaries, the Brazilian company VALE S.A. is the world’s largest iron ore miner and second largest nickel producer. Additionally the company operates large logistics systems in Brazil including railroads, maritime terminals and a port, which are integrated into its mining operations. We expect to see further gains in steel demand based on an estimated global economic growth of 3.5%. Most notably, we expect to see further rises in demand for steel and nickel in China and the rest of East Asia. In 2010, approximately 70% of the world’s seaborne iron ore was shipped to Chinese Ports, whilst the country also accounts for 44% of the world’s demand for nickel. On the Brazilian front, we expect to see increased sales because of plans for a $30 Billion private and public investment in urban infrastructure in preparation for the World Cup in 2014, Copa America in 2015 and Olympics in 2016. Combined with these domestic plans, Vale S.A. has many internal growth opportunities at its doorstep in Brazil. This increase in demand from emerging markets drives our five-year growth rate of 12%.
The Dow Chemical Company is the largest U.S. chemical company, providing consumers with chemical, plastic and agricultural products and services. Divided into eight segments, Dow serves a range of industries including appliance, automotive, agricultural, building and construction, chemical processing, electronics, furniture, house wares, oil and gas, packaging, paints, coatings and adhesives, personal care, pharmaceutical, processed foods, paper, textile and carpet utilities and water treatment. Through the 2009 acquisition of Rohm & Haas and increased R&D spending, Dow has shifted its broad portfolio to focus on less cyclical specialty chemicals and plastics. As a historical weakness to the company, this change serves to make the company more robust in uncertain markets, whilst increasing the company’s presence in emerging markets. In 2010, Dow continued to post strong revenues of $53.7 Billion (26% increase over 2009) and earnings of $7.5 Billion (36% increase). However, Dow’s growth outlook is limited by its exposure to commodity price increases, which caused a 31% increase in raw material expenses in 2010. Additionally, the risk of slower than expected domestic and global growth rates offset internal successes.
Monsanto produces leading seed brands, develops biotechnology traits that assist farmers in controlling insects and weeds and provide other seed brands with genetic material and biotech traits. Monsanto’s “Roundup” herbicides are used for agricultural, industrial and residential weed control and is sold in over 80 countries worldwide.

The company operates in two separate segments: agricultural productivity, seeds, and genomics. Recent internal changes strive to improve the management of corporate overhead in the next twelve months through a new round of restructuring. Meanwhile, the 2008 acquisition of De Ruiter and focus on their patent-protected seeds offers a positive outlook for their seeds and genomics segment. However, the combination of patent protection expiration for the active ingredient in their Roundup herbicides and increased global production of generic glyphosate led to price cuts in their agricultural productivity segment. This trend continues from 2010 as the industry was hit by gross overcapacity, which led to severe price cuts throughout the company’s offerings. These price pressures and recent structural changes drive our flat growth forecasts of single digit revenue growth. Additionally, public sentiment towards Monsanto’s transgenic seed production continues to hurt the company’s revenues. If the public does not want to eat genetically modified food, farmers will not continue to buy Monsanto’s products.

**Recommendation**

Sell

**Valuation**

$63.59

**Market Price**

$69.16

**As of**

4/6/11

**Sector**

Materials

- Questionable success of latest round of restructuring
- Seeds and genomics looks positive
- Price pressures and public sentiment to flatten revenue growth
Crummer Investment Management

Equity Analyst: Dean Walker

Rio Tinto (ADR)  RIO

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>52-Week Range</th>
<th>As of</th>
<th>Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buy</td>
<td>$84.18</td>
<td>$72.97</td>
<td>4/6/11</td>
<td>Materials</td>
</tr>
</tbody>
</table>

- Exposure to emerging market growth
- Expectation of rising key commodity prices to boost sales
- Massive reduction in net debt solidifies balance sheet

Based in London, Rio Tinto is one of the world’s largest mining companies. It is involved in each stage of metal and mineral production. The company is divided into the following business units: Iron Ore, Aluminum, Copper (includes gold), Energy (coal and Uranium), diamonds, minerals, and other operations. Since their acquisition of Alcan in 2007, Rio Tinto became the largest producer of aluminum in the world. Our buy recommendation and growth forecast of 12% stems from a strong fundamental outlook as RIO looks to capitalize on a predicted increase in Chinese and Indian demand for iron ore, copper and aluminum because of increased industrialization. This is fueled by continued GDP growth in China and India in 2010, at 10.3% and 8.3% respectively. The base metals mined by Rio Tinto are staples for developing economies that have been experiencing such significant growth.

Additionally, the recent natural disasters in Japan suggest a strong demand for raw materials in the next 12 months for reconstruction purposes. We also expect prices of iron ore, copper and aluminum to rise through 2011 in because of increased global demand and limited supply growth. In addition to strong expected performance from the iron ore segment, aluminum and copper are expected to generate strong revenues over the coming 12 months. Although Rio Tinto have declared their interest in further divestment of their aluminum segment over the next 5 years, strong returns are touted for the next 12 months due to the delinking of alumina (a key input to aluminum) prices. For every $0.05 shift in aluminum, RIO’s earnings are predicted to move by 1%. RIO’s reduction in net debt from $39 Billion to $4.2 Billion in the last 18 months provides a sound balance sheet with which the company rewarded loyal shareholders with an increase in 2010’s dividend of $0.18. Additionally, a $5 Billion share buyback program for 2012 has been announced. In conclusion, we recommend a strong buy for this international mining powerhouse.
International flavors and fragrances is a global leader in the manufacture of products used to enhance the aromas and tastes of consumer products. IFF generates more than 75% of its revenues over seas with a majority focus on the developed markets of North America, Western Europe and Australasia. This stable mid-cap company holds a 17% share of a $16 Billion global industry, which is protected by high barriers to entry. Their plans to capture more of this market are illustrated by further international expansion into China and Singapore to the extent of $100 Million over the next three years. This further exposure to emerging markets (currently 40% sales) looks to offset slow growth in mature markets. Our forecasted growth rate of 12% lies just below IFF’s 2010 sales increase of 13%. Our positive outlook for this stock is driven by the company’s strong, stable cash flows (sales to top 25 customers represented 50% of sales) and ample liquidity that stems from frugal debt control. This is illustrated by their cash holdings of $131 Million against due debt payments of $122 Million in 2011. Additionally, the company is known as a particularly “shareholder friendly” firm because of their aim to return 30%-35% of annual earnings to shareholders in the form of dividends. Taking into account all aspects of our research, we recommend IFF as a buy.
Fixed Income Assets

Allocation Recommendation

Low short-term interest rates depressing treasury yields, a steep yield curve increasing risk uncertainty, declining credit spreads and the willingness of investors to move money into riskier assets combine to make fixed income relatively less attractive than equities in 2011. We recommend an allocation at the low end of the portfolio’s range for fixed income assets.

2011 Outlook

The yield curve is currently steeper than what is typical exiting a recession and moving into a recovery. The Fed holding interest rates down to stimulate the economy has kept short-term treasury yields low, while the steepness of the curve suggests expected inflation and interest rate growth in the future as economic expansion continues. Credit spreads are above historical averages for possible excess returns in non-treasuries, but low treasury yields are the primary reason. In fact, corporate bond yields are below historical averages, so potential price returns are not as attractive in 2011 as in years past.

Short-term interest rates are not likely to increase this year as the Fed keeps them low to continue stimulating the economy. Additionally, the expectation that inflation may grow below targets will put little pressure on short-term rates. The Philadelphia Fed predicts inflation will be 1.7% for the year, which is below the Fed’s target rate. Inflation will likely remain below targets until we see a marked decline in unemployment. However, the expected completion of QE2 in June could strengthen inflation expectations; bringing rates up and eroding bond prices. As this recovery is not a traditional demand-supply recovery, there is an additional level of uncertainty in the fixed income markets.

Fixed Income Classes

Treasuries – Short-term treasuries are projected to have very low yields, offering little opportunity for solid returns. Longer-term treasuries have good yields, but are more exposed to the interest rate and inflation risk contained in the yield curve.

Agencies – Agencies are expected to slightly outperform treasuries.

Corporates – Corporates could offer solid single digit growth this year. Financials should see a reduced spread tightening, allowing for some additional income opportunities.

Mortgages – Mortgages will also outperform in 2011, due to strong bank demand for Agency MBS and a slow-down in the growth of prepayments.

TIPS – The ten-year TIPS spread suggests an inflation rate of approximately 2.5%. Because we do not expect inflation to grow at this rate, TIPS will likely underperform in 2011.

Conclusion

Our recommendation is to position our fixed income portfolio at the lower end of the range in 2011. We also recommend that we sell 100% of our current position in TIPS (VIPSX) because they are not expected to perform well and are not included in the investor policy statement. For 2011, we recommend the purchase of the Vanguard Total Bond Index Fund (VBMFX). Finally, we ask that future classes look at our proposal for the fixed income sector moving forward.
**Allocation Changes**

<table>
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<tr>
<th>Symbol: VIPSX</th>
<th>Recommendation: <strong>SELL</strong></th>
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</thead>
<tbody>
<tr>
<td><strong>Price:</strong> $13.35</td>
<td><strong>Total Assets:</strong> $32.4B</td>
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<tr>
<td><strong>Expense Ratio:</strong> 0.22%</td>
<td><strong>Avg Maturity:</strong> 8.70y</td>
</tr>
<tr>
<td><strong>Avg Duration:</strong> 5.33y</td>
<td><strong>Yield:</strong> 2.42%</td>
</tr>
</tbody>
</table>

We recommend that 100% of our position in TIPS be sold to align the fixed income portion of the portfolio with the overall bond market. While TIPS have shown to be effective in protecting a portfolio from its exposure to inflation risk, they do not adequately represent the U.S. bond market and hinder our return potential. This fund demonstrates return patterns that are highly differentiated from U.S. Treasuries, and the levels of inflation required for TIPS to outperform are improbable in the upcoming year. Until the U.S. achieves significant declines in the unemployment rate, it is unlikely that inflation will rise substantially.

We also suggest that TIPS be considered as an asset class separate from fixed income for the purposes of this portfolio in the future. Fundamental and behavioral differences separate them from the traditional fixed income classes. First, they react differently to inflation, which is one of the primary risk factors in fixed income. Rather than declining in value, TIPS will realize increased coupons and cash flows from higher than anticipated inflation. TIPS also show highly differentiated return patterns when compared to other assets within fixed income. When conducting a style analysis of the asset class, low $R^2$ values are obtained regardless of the benchmarks used suggesting that their returns cannot be thoroughly explained by other assets in the market.

By eliminating our current position in TIPS, we have the opportunity to generate additional returns by following the U.S. bond index. Our current position has little diversification within the sector and the index has a more favorable outlook considering the low inflation projections for 2011.

<table>
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<th>Symbol: VBMFX</th>
<th>Recommendation: <strong>BUY</strong></th>
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<tr>
<td><strong>Price:</strong> $10.65</td>
<td><strong>Total Assets:</strong> $86.8B</td>
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<tr>
<td><strong>Expense Ratio:</strong> 0.22%</td>
<td><strong>Avg Maturity:</strong> 7.00y</td>
</tr>
<tr>
<td><strong>Avg Duration:</strong> 5.00y</td>
<td><strong>Yield:</strong> 3.34%</td>
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</table>

The Crummer SunTrust Portfolio should purchase shares of the Vanguard Total Bond Market Index fund, which utilizes Barclay’s Total US Bond Index as its benchmark. This will provide the portfolio with a higher degree of diversification within fixed income when compared to our current holding of TIPS. This fund has approximately 45% of assets invested in the corporate and mortgage sectors which are expected to outperform in 2011. This, accompanied by the position the fund has in treasuries and agencies, will fulfill the role of hedging the portfolio’s equity risk while also generating greater potential returns. Due to inflation expectations that are below the TIPS spreads, each fixed income class within this fund should produce greater yields than TIPS.

Moving forward, this fund could be replaced with various mutual funds and ETFs to recreate the BarCap Total US Bond Index. Unfortunately, the ETFs required to implement this strategy are still too young to be reliable. This policy, which is outlined in the appendix, will allow more freedom in allocations within the different fixed income sectors. This approach will enable future analysts to achieve greater returns by generating tactical positioning recommendations based on market trends.
Appendix
Crummer/SunTrust Portfolio Investment Policy Statement
(Revised April 6th 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.


5.4 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 realized 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.
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:

<table>
<thead>
<tr>
<th>Target Rates of Return, Components, and Spending Policy</th>
<th>Long Term</th>
<th>Short Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative and Trading Expenses</td>
<td>½ - 1%</td>
<td>½ - 1%</td>
</tr>
<tr>
<td>Allowance for Inflation</td>
<td>2 - 3%</td>
<td>Consumer Price Index</td>
</tr>
<tr>
<td>Distribution from Portfolio</td>
<td>3½ - 5½%</td>
<td>Approximately $25,000</td>
</tr>
<tr>
<td>Portfolio Real Growth</td>
<td>2 - 2½%</td>
<td>&gt; 0%</td>
</tr>
<tr>
<td>Target Total Return</td>
<td>8 -11½%</td>
<td>Dependant On Above</td>
</tr>
</tbody>
</table>
### Table B

**Crummer/SunTrust Portfolio Equity Portfolio Sectors**

<table>
<thead>
<tr>
<th>S&amp;P 500 Sector</th>
<th>Benchmark</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer Discretionary</td>
<td>S&amp;P Consumer Discretionary Index</td>
</tr>
<tr>
<td>Consumer Staples</td>
<td>S&amp;P Consumer Staples Index</td>
</tr>
<tr>
<td>Energy</td>
<td>S&amp;P Energy Index</td>
</tr>
<tr>
<td>Financials</td>
<td>S&amp;P Financials Index</td>
</tr>
<tr>
<td>Healthcare</td>
<td>S&amp;P Healthcare Index</td>
</tr>
<tr>
<td>Industrials</td>
<td>S&amp;P Industrials Index</td>
</tr>
<tr>
<td>Information Technology</td>
<td>S&amp;P Information Technology Index</td>
</tr>
<tr>
<td>Materials</td>
<td>S&amp;P Materials Index</td>
</tr>
<tr>
<td>Telecom</td>
<td>S&amp;P Telecom Index</td>
</tr>
<tr>
<td>Utilities</td>
<td>S&amp;P Utilities Index</td>
</tr>
</tbody>
</table>

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

### Table C

**Crummer/SunTrust Portfolio Asset Allocation Guidelines**

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Low</th>
<th>Mid</th>
<th>High</th>
<th>Benchmark</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large Cap - Growth</td>
<td>10%</td>
<td>20%</td>
<td>30%</td>
<td>Russell 1000 Growth</td>
</tr>
<tr>
<td>Large Cap – Value</td>
<td>10%</td>
<td>20%</td>
<td>30%</td>
<td>Russell 1000 Value</td>
</tr>
<tr>
<td>Mid Cap – Growth</td>
<td>5%</td>
<td>7.5%</td>
<td>10%</td>
<td>Russell MidCap Growth</td>
</tr>
<tr>
<td>Mid Cap – Value</td>
<td>5%</td>
<td>7.5%</td>
<td>10%</td>
<td>Russell MidCap Value</td>
</tr>
<tr>
<td>Small Cap - Growth</td>
<td>5%</td>
<td>10%</td>
<td>15%</td>
<td>Russell 2000 Growth</td>
</tr>
<tr>
<td>Small Cap – Value</td>
<td>5%</td>
<td>10%</td>
<td>15%</td>
<td>Russell 2000 Value</td>
</tr>
<tr>
<td>International Equity</td>
<td>5%</td>
<td>10%</td>
<td>15%</td>
<td>MSCI – EAFE</td>
</tr>
<tr>
<td>Fixed Income</td>
<td>12%</td>
<td>15%</td>
<td>18%</td>
<td>Vanguard Total Bond Market Bond Index Fund</td>
</tr>
</tbody>
</table>

Derivatives: 10% Max
Cash: as needed

Minimum weight for any asset class is 5%
Fixed Income – Moving Forward

Tactical Strategies

In the future, we believe it would be useful for the fixed income analysts at Crummer Investment Management to capitalize on tactical opportunities within fixed income to help increase potential returns and mitigate portfolio risks. Because different types of fixed income assets behave differently depending on the economy, the analysts can overweight asset classes with potential for strong performance while underweighting those with reduced income opportunities. To begin this process, the analysts should rebuild the total bond index fund by selecting several different funds or ETFs that combine to mirror the returns of the index. Once selected, these separate funds can then be over weighted or underweighted according to market conditions to improve performance.

Primary Objective

To select a combination of funds that will provide the same returns as the overall bond index and then allocate more/less to each fund given present market conditions.

Benefits

The primary benefits to this approach are as follows:

- A possibility to reduce portfolio risk
- Potential to increase returns from fixed income
- Increased flexibility in fixed income allocations
- Can overweight or underweight at very low cost

Recommendation

For 2011, Crummer Investment Management will hold the Vanguard Total Bond Market Index mutual fund (VMBFX). To recreate the bond index, we recommend that you look at the following funds:

- Vanguard Short-Term Treasury Mutual Fund (VFISX)
- Vanguard Intermediate-Term Treasury Mutual Fund (VFITX)
- Vanguard Long-Term Treasury Mutual Fund (VUSTX)
- Vanguard Mortgage Back Securities ETF (VMBS)
- Vanguard Short-Term Corporate Bond ETF (VCSH)
- Vanguard Intermediate-Term Corporate Bond ETF (VCIT)
- Vanguard Long-Term Corporate Bond ETF (VCLT)

These funds make up 94.6% of the total treasuries and bonds held in the total bond index. Using EnCorr Attribution, these funds produce an R-square value of 99.81, explaining almost 100% of the returns of the total bond index. Although this analysis looks promising, it lacks conclusive data, as several of the ETFs listed above have only been in existence for 12-15 months. We recommend you review these funds in 2012 in order to start gathering more significant data that can be used for the portfolio’s benefit. When finally put into place, this approach could improve the performance of the fixed income investments for Crummer Investment Management.
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, “When shall we 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.

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 shows overbought (above 70) and oversold (below 30) conditions.

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).
Value at Risk

Value at Risk (VaR) is a widely used risk measure of the risk of loss on a specific portfolio of financial assets. VAR calculates the maximum loss expected (or worst case scenario) on an investment, over a given time period and given a specified degree of confidence.

We used the VaR method to determine the maximum amount of the portfolio, with a 1% probability, that we could lose over a one-year period, assuming markets are normal and there is no trading.

Our findings:

- **VaR with current weights:**
  
  $171,851

- **VaR with proposed weights:**
  
  $167,400

Therefore, although we are reallocating over $100,000 of the portfolio from fixed income to stocks, we are still reducing the VaR of the portfolio.
### Portfolio Sector Correlations

<table>
<thead>
<tr>
<th>Sector</th>
<th>Portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500 Sec/Cons Disc TR</td>
<td>0.8244</td>
</tr>
<tr>
<td>S&amp;P 500 Sec/Health Care TR</td>
<td>0.7991</td>
</tr>
<tr>
<td>S&amp;P 500 Sec/Energy TR</td>
<td>0.9012</td>
</tr>
<tr>
<td>S&amp;P 500 Sec/Financials TR</td>
<td>0.7844</td>
</tr>
<tr>
<td>S&amp;P 500 Sec/Materials TR</td>
<td>0.8630</td>
</tr>
<tr>
<td>S&amp;P 500 Sec/Cons Staples TR</td>
<td>0.7093</td>
</tr>
<tr>
<td>S&amp;P 500 Sec/Utilities TR</td>
<td>0.9950</td>
</tr>
<tr>
<td>S&amp;P 500 Sec/Industrials TR</td>
<td>0.8077</td>
</tr>
<tr>
<td>S&amp;P 500 Sec/Telecommunications TR</td>
<td>0.6386</td>
</tr>
<tr>
<td>S&amp;P 500 Sec/Information Technology TR</td>
<td>0.9585</td>
</tr>
<tr>
<td>BarCap US Agg Bond TR USD</td>
<td>0.9926</td>
</tr>
</tbody>
</table>
## Buy/Hold Recommendations:

<table>
<thead>
<tr>
<th>Name</th>
<th>Symbol</th>
<th>Recommendation</th>
<th>Price 4/05/11</th>
<th>Starting Shares</th>
<th>Recommended Shares</th>
<th>Difference</th>
<th>Value 04/05/11</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abbott Laboratories</td>
<td>ABT</td>
<td>Buy</td>
<td>$ 49.99</td>
<td>125</td>
<td>200</td>
<td>75</td>
<td>$ 9,998.00</td>
</tr>
<tr>
<td>Abercrombie &amp; Fitch Co.</td>
<td>ANF</td>
<td>HOLD</td>
<td>$ 65.57</td>
<td>50</td>
<td>250</td>
<td>200</td>
<td>$ 16,392.50</td>
</tr>
<tr>
<td>American Tower Corporation</td>
<td>AMT</td>
<td>Hold</td>
<td>$ 50.74</td>
<td>130</td>
<td>90</td>
<td>-40</td>
<td>$ 4,566.60</td>
</tr>
<tr>
<td>Autoliv Inc.(ADR)</td>
<td>ALV</td>
<td>BUY</td>
<td>$ 75.50</td>
<td>75</td>
<td>285</td>
<td>210</td>
<td>$ 21,517.50</td>
</tr>
<tr>
<td>Automatic Data Processing</td>
<td>ADP</td>
<td>Buy</td>
<td>$ 51.79</td>
<td>200</td>
<td>200</td>
<td>0</td>
<td>$ 10,358.00</td>
</tr>
<tr>
<td>BB&amp;T Corporation</td>
<td>BBT</td>
<td>Hold</td>
<td>$ 27.28</td>
<td>415</td>
<td>125</td>
<td>-290</td>
<td>$ 3,410.00</td>
</tr>
<tr>
<td>Chevron Corporation</td>
<td>CVX</td>
<td>Buy</td>
<td>$ 109.33</td>
<td>155</td>
<td>155</td>
<td>0</td>
<td>$ 16,946.15</td>
</tr>
<tr>
<td>Chicago Bridge &amp; Iron</td>
<td>CBI</td>
<td>Buy</td>
<td>$ 42.10</td>
<td>100</td>
<td>285</td>
<td>185</td>
<td>$ 11,998.50</td>
</tr>
<tr>
<td>Church &amp; Dwight Co., Inc.</td>
<td>CHD</td>
<td>Hold</td>
<td>$ 79.35</td>
<td>146</td>
<td>150</td>
<td>4</td>
<td>$ 11,902.50</td>
</tr>
<tr>
<td>Clean Energy Fuels Corp.</td>
<td>CLNE</td>
<td>Buy</td>
<td>$ 16.98</td>
<td>370</td>
<td>370</td>
<td>0</td>
<td>$ 6,282.60</td>
</tr>
<tr>
<td>The Coca-Cola Company</td>
<td>KO</td>
<td>Hold</td>
<td>$ 67.47</td>
<td>125</td>
<td>125</td>
<td>0</td>
<td>$ 8,433.75</td>
</tr>
<tr>
<td>Crown Castle International</td>
<td>CCI</td>
<td>Hold</td>
<td>$ 42.61</td>
<td>103</td>
<td>90</td>
<td>-13</td>
<td>$ 3,834.90</td>
</tr>
<tr>
<td>CVS Caremark Corporation</td>
<td>CVS</td>
<td>Buy</td>
<td>$ 35.00</td>
<td>300</td>
<td>325</td>
<td>25</td>
<td>$ 11,375.00</td>
</tr>
<tr>
<td>The Walt Disney Company</td>
<td>DIS</td>
<td>HOLD</td>
<td>$ 42.43</td>
<td>100</td>
<td>100</td>
<td>0</td>
<td>$ 4,243.00</td>
</tr>
<tr>
<td>The Dow Chemical Company</td>
<td>DOW</td>
<td>Hold</td>
<td>$ 38.66</td>
<td>150</td>
<td>165</td>
<td>15</td>
<td>$ 6,378.90</td>
</tr>
<tr>
<td>EMC Corporation</td>
<td>EMC</td>
<td>Hold</td>
<td>$ 25.93</td>
<td>400</td>
<td>350</td>
<td>-50</td>
<td>$ 9,075.50</td>
</tr>
<tr>
<td>Exxon Mobil Corporation</td>
<td>XOM</td>
<td>Sell A Portion</td>
<td>$ 85.42</td>
<td>595</td>
<td>180</td>
<td>-415</td>
<td>$ 15,375.60</td>
</tr>
<tr>
<td>Goldman Sachs Group, Inc.</td>
<td>GS</td>
<td>Buy</td>
<td>$ 158.91</td>
<td>85</td>
<td>110</td>
<td>25</td>
<td>$ 17,480.10</td>
</tr>
<tr>
<td>HEICO Corporation</td>
<td>HEI</td>
<td>Buy</td>
<td>$ 61.98</td>
<td>187</td>
<td>250</td>
<td>63</td>
<td>$ 15,495.00</td>
</tr>
<tr>
<td>Helmerich &amp; Payne, Inc.</td>
<td>HP</td>
<td>Buy</td>
<td>$ 68.69</td>
<td>120</td>
<td>300</td>
<td>180</td>
<td>$ 20,607.00</td>
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<tr>
<td>Hewlett-Packard Company</td>
<td>HPQ</td>
<td>Buy</td>
<td>$ 40.29</td>
<td>200</td>
<td>200</td>
<td>0</td>
<td>$ 8,058.00</td>
</tr>
<tr>
<td>Intel Corporation</td>
<td>INTC</td>
<td>Buy</td>
<td>$ 19.71</td>
<td>530</td>
<td>400</td>
<td>-130</td>
<td>$ 7,884.00</td>
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<tr>
<td>International Business Machines Corp.</td>
<td>IBM</td>
<td>Buy</td>
<td>$ 163.99</td>
<td>175</td>
<td>110</td>
<td>-65</td>
<td>$ 18,038.90</td>
</tr>
<tr>
<td>iShares S&amp;P Global Telecommunicat. (ETF)</td>
<td>IXP</td>
<td>Buy</td>
<td>$ 62.01</td>
<td>150</td>
<td>200</td>
<td>50</td>
<td>$ 12,402.00</td>
</tr>
<tr>
<td>Jacobs Engineering Group Inc.</td>
<td>JEC</td>
<td>Buy</td>
<td>$ 51.94</td>
<td>230</td>
<td>285</td>
<td>55</td>
<td>$ 14,802.90</td>
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<tr>
<td>Johnson &amp; Johnson</td>
<td>JNJ</td>
<td>Buy</td>
<td>$ 59.80</td>
<td>500</td>
<td>250</td>
<td>-250</td>
<td>$ 14,950.00</td>
</tr>
<tr>
<td>JPMorgan Chase &amp; Co.</td>
<td>JPM</td>
<td>Buy</td>
<td>$ 46.58</td>
<td>350</td>
<td>250</td>
<td>-100</td>
<td>$ 11,645.00</td>
</tr>
<tr>
<td>McDonald's Corporation</td>
<td>MCD</td>
<td>BUY</td>
<td>$ 76.60</td>
<td>275</td>
<td>200</td>
<td>-75</td>
<td>$ 15,320.00</td>
</tr>
<tr>
<td>Merck &amp; Co., Inc.</td>
<td>MRK</td>
<td>Buy</td>
<td>$ 33.51</td>
<td>150</td>
<td>125</td>
<td>-25</td>
<td>$ 4,145.00</td>
</tr>
<tr>
<td>Microsoft Corporation</td>
<td>MSFT</td>
<td>Hold</td>
<td>$ 25.78</td>
<td>550</td>
<td>350</td>
<td>-200</td>
<td>$ 9,023.00</td>
</tr>
<tr>
<td>Staples, Inc.</td>
<td>SPLS</td>
<td>BUY</td>
<td>$ 20.44</td>
<td>200</td>
<td>250</td>
<td>50</td>
<td>$ 5,110.00</td>
</tr>
<tr>
<td>Stryker Corporation</td>
<td>SYK</td>
<td>Buy</td>
<td>$ 60.52</td>
<td>150</td>
<td>150</td>
<td>0</td>
<td>$ 9,078.00</td>
</tr>
<tr>
<td>Suncor Energy Inc. (USA)</td>
<td>SU</td>
<td>Hold</td>
<td>$ 45.24</td>
<td>300</td>
<td>100</td>
<td>-200</td>
<td>$ 4,524.00</td>
</tr>
<tr>
<td>Name</td>
<td>Symbol</td>
<td>Recommendation</td>
<td>Price 4/05/11</td>
<td>Starting Shares</td>
<td>Recommended Shares</td>
<td>Difference</td>
<td>Value 04/05/11</td>
</tr>
<tr>
<td>------------------------------------------------</td>
<td>--------</td>
<td>----------------</td>
<td>---------------</td>
<td>----------------</td>
<td>--------------------</td>
<td>------------</td>
<td>----------------</td>
</tr>
<tr>
<td>Teva Pharmaceutical Industries Ltd (ADR)</td>
<td>TEVA</td>
<td>Buy</td>
<td>$50.81</td>
<td>125</td>
<td>190</td>
<td>65</td>
<td>$9,653.90</td>
</tr>
<tr>
<td>United Technologies Corporation</td>
<td>UTX</td>
<td>Buy</td>
<td>$85.40</td>
<td>200</td>
<td>200</td>
<td>0</td>
<td>$17,080.00</td>
</tr>
<tr>
<td>U.S. Bancorp</td>
<td>USB</td>
<td>Hold</td>
<td>$26.51</td>
<td>403</td>
<td>200</td>
<td>-203</td>
<td>$5,302.00</td>
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<tr>
<td>Vale (ADR)</td>
<td>VALE</td>
<td>Buy</td>
<td>$34.27</td>
<td>300</td>
<td>350</td>
<td>50</td>
<td>$11,994.50</td>
</tr>
<tr>
<td>Vanguard Utilities ETF</td>
<td>VPU</td>
<td>Decrease</td>
<td>$69.44</td>
<td>340</td>
<td>300</td>
<td>-40</td>
<td>$20,832.00</td>
</tr>
<tr>
<td>Annaly Capital Management, Inc.</td>
<td>NLY</td>
<td>Hold/Buy</td>
<td>$17.46</td>
<td>1171</td>
<td>300</td>
<td>-871</td>
<td>$5,238.00</td>
</tr>
<tr>
<td>RidgeWorth Prime Quality MMkt A</td>
<td>SQUIXX</td>
<td>Cash</td>
<td>$1.00</td>
<td>15987.72</td>
<td>29524.24</td>
<td>13536.52</td>
<td>$29,524.24</td>
</tr>
<tr>
<td>Snap-on Incorporated</td>
<td>SNA</td>
<td>BUY</td>
<td>$61.56</td>
<td>0</td>
<td>310</td>
<td>310</td>
<td>$19,083.60</td>
</tr>
<tr>
<td>Lowe's Companies, Inc.</td>
<td>LOW</td>
<td>BUY</td>
<td>$26.78</td>
<td>0</td>
<td>225</td>
<td>225</td>
<td>$6,025.50</td>
</tr>
<tr>
<td>OYO Geospace Corporation</td>
<td>OYOG</td>
<td>Buy</td>
<td>$99.35</td>
<td>0</td>
<td>60</td>
<td>60</td>
<td>$5,961.00</td>
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<td>Epoch Holding Corp</td>
<td>EPHC</td>
<td>Buy</td>
<td>$16.35</td>
<td>0</td>
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<td>275</td>
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<td>Rio Tinto plc (ADR)</td>
<td>RIO</td>
<td>Buy</td>
<td>$72.31</td>
<td>0</td>
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<td>125</td>
<td>$9,038.75</td>
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<td>International Flavors &amp; Fragrances Inc.</td>
<td>IFF</td>
<td>Buy</td>
<td>$64.22</td>
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<td>250</td>
<td>250</td>
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<tr>
<td>National Presto Industries Inc.</td>
<td>NPK</td>
<td>Buy</td>
<td>$113.13</td>
<td>0</td>
<td>100</td>
<td>100</td>
<td>$11,313.00</td>
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<tr>
<td>The Boeing Company</td>
<td>BA</td>
<td>Buy</td>
<td>$73.23</td>
<td>0</td>
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<td>200</td>
<td>$14,646.00</td>
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<tr>
<td>AboveNet, Inc.</td>
<td>ABVT</td>
<td>Buy</td>
<td>$66.42</td>
<td>0</td>
<td>100</td>
<td>100</td>
<td>$6,642.00</td>
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<tr>
<td>Vanguard Total Bond Market Index Inv</td>
<td>VBMFX</td>
<td>Buy</td>
<td>$10.53</td>
<td>0</td>
<td>7632</td>
<td>7632</td>
<td>$80,364.96</td>
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<tr>
<td>Vanguard Small-Cap Value ETF</td>
<td>VBR</td>
<td>Buy</td>
<td>$72.26</td>
<td>0</td>
<td>450.0</td>
<td>450.0</td>
<td>$32,517.00</td>
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Portfolio Value as of 04/05/2011: $677,405.60
## Securities Recommended for Sale:

<table>
<thead>
<tr>
<th>Name</th>
<th>Symbol</th>
<th>Price 4/05/11</th>
<th>Shares</th>
<th>Value 04/05/2011</th>
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<tbody>
<tr>
<td>Accenture Plc</td>
<td>ACN</td>
<td>$54.93</td>
<td>200</td>
<td>$10,986.00</td>
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<tr>
<td>Amazon.com, Inc.</td>
<td>AMZN</td>
<td>$185.29</td>
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<td>$19,455.45</td>
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<td>Avon Products, Inc.</td>
<td>AVP</td>
<td>$27.39</td>
<td>100</td>
<td>$2,739.00</td>
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<td>Bank of America Corporation</td>
<td>BAC</td>
<td>$13.47</td>
<td>865</td>
<td>$11,651.55</td>
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<tr>
<td>Cisco Systems, Inc.</td>
<td>CSCO</td>
<td>$17.22</td>
<td>600</td>
<td>$10,332.00</td>
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<tr>
<td>Colgate-Palmolive Company</td>
<td>CL</td>
<td>$80.84</td>
<td>200</td>
<td>$16,168.00</td>
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<tr>
<td>Computer Sciences Corporation</td>
<td>CSC</td>
<td>$49.58</td>
<td>277</td>
<td>$13,733.66</td>
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<tr>
<td>Covance Inc.</td>
<td>CVD</td>
<td>$58.68</td>
<td>300</td>
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<tr>
<td>Danaher Corporation</td>
<td>DHR</td>
<td>$52.27</td>
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<tr>
<td>EMC Corporation</td>
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<tr>
<td>Hasbro, Inc.</td>
<td>HAS</td>
<td>$47.12</td>
<td>75</td>
<td>$3,534.00</td>
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<td>Monsanto Company</td>
<td>MON</td>
<td>$73.32</td>
<td>92</td>
<td>$6,745.44</td>
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<td>Northern Trust Corporation</td>
<td>NTRS</td>
<td>$51.70</td>
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<td>$7,082.90</td>
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<td>SYSCO Corporation</td>
<td>SYY</td>
<td>$28.51</td>
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<td>$7,127.50</td>
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<td>Vanguard Inflation-Protected Secs Inv</td>
<td>VIPSX</td>
<td>$13.24</td>
<td>2,414.18</td>
<td>$31,963.74</td>
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$179,417.24
### Post Recessionary Returns

#### 20 Months Post 3 Recessions
- Cons Disc: 17.76%
- Materials: 16.54%
- Financials: 15.56%
- Industrials: 12.64%
- Cons Staples: 10.89%
- Energy: 7.8%
- Health Care: 5.94%
- Utilities: 3.64%
- Tech: 2.99%
- Telecom: 0.34%

#### 20 Months Post Current Recession
- Cons Disc: 17.42%
- Materials: 16.06%
- Financials: 14.9%
- Industrials: 12.68%
- Cons Staples: 10.37%
- Energy: 8.07%
- Health Care: 5.18%
- Utilities: 3.29%
- Tech: 2.99%
- Telecom: -0.34%

#### 32 Months Post 2 Recessions
- Cons Disc: 17.13%
- Materials: 15.86%
- Financials: 14.41%
- Industrials: 12.37%
- Cons Staples: 10.03%
- Energy: 7.8%
- Health Care: 5.18%
- Utilities: 3.64%
- Tech: 2.59%
- Telecom: 1.25%

#### Non Recession
- Cons Disc: 15.67%
- Materials: 13.26%
- Financials: 11.77%
- Industrials: 10.96%
- Cons Staples: 10.19%
- Energy: 9.41%
- Health Care: 7.8%
- Utilities: 5.94%
- Tech: 3.64%
- Telecom: -2.89%
### Sector Allocations

<table>
<thead>
<tr>
<th>Sector</th>
<th>Current S&amp;P 500 Weights</th>
<th>Proposed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer Discretionary</td>
<td>10.47%</td>
<td>17%</td>
</tr>
<tr>
<td>Utility</td>
<td>3.20%</td>
<td>4%</td>
</tr>
<tr>
<td>Materials</td>
<td>3.71%</td>
<td>9%</td>
</tr>
<tr>
<td>Industrial</td>
<td>11.26%</td>
<td>14%</td>
</tr>
<tr>
<td>Energy</td>
<td>13.14%</td>
<td>13%</td>
</tr>
<tr>
<td>Financial</td>
<td>16.10%</td>
<td></td>
</tr>
<tr>
<td>Consumer Staple</td>
<td>10.27%</td>
<td>10%</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>2.99%</td>
<td>3%</td>
</tr>
<tr>
<td>Technology</td>
<td>17.95%</td>
<td>12%</td>
</tr>
<tr>
<td>Health Care</td>
<td>10.91%</td>
<td>9%</td>
</tr>
</tbody>
</table>
Portfolio Class Allocations: Current and Proposed

Proposed Allocation