Crummer SunTrust Portfolio Recommendations: Crummer Investment Management [2015]

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Crummer SunTrust Portfolio
Recommendations

Crummer Investment Management

ROLLINS
CRUMMER GRADUATE SCHOOL OF BUSINESS
Dear Members of the Committee,

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

We have benefitted from some outstanding guest speakers who have been generous with their time and expertise: John Race, DRZ; Professor William Seyfried, Crummer; Aram Green, Clearbridge Advisors; Jay Menozzi, Semper Capital Management; Phillip Rich, Seaside Bank; Scott Connor, SunTrust Investment Advisory Group; Rick Ahl, Ahl Investment Management; Lien Nguyen, Tupperware Brands; Derek Grimm, Merrill Lynch.

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

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

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

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

Last year the portfolio was tilted away from sectors expected to lag economic growth like consumer staples and financials towards sectors like consumer discretionary and industrials. These sectors performed in line with our expectations with consumer discretionary outperforming consumer staples and industrials outperforming financials. We have a similar strategy this year, as explained in the following pages.

We look forward to sharing the results of our analysis with you in person.
# Crummer Investment Management Team

<table>
<thead>
<tr>
<th>Sector/Analyst Type</th>
<th>Team Member</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer Discretionary Sector</td>
<td>Heather Cunningham</td>
</tr>
<tr>
<td>Consumer Staples Sector</td>
<td>Seonag Doherty</td>
</tr>
<tr>
<td>Energy Sector Analyst</td>
<td>Marten Mueller</td>
</tr>
<tr>
<td>Financial Sector Analyst</td>
<td>Will Edwards</td>
</tr>
<tr>
<td>Fixed Income Analyst</td>
<td>Hongda Qiao</td>
</tr>
<tr>
<td>Healthcare Sector Analyst</td>
<td>Jeffrey Dirkin</td>
</tr>
<tr>
<td>Industrial Sector Analyst</td>
<td>Tomas Cabrera Ranaldi</td>
</tr>
<tr>
<td>Technology Sector Analyst</td>
<td>Alison Frederick</td>
</tr>
<tr>
<td>Materials Sector Analyst</td>
<td>Christian Fielitz</td>
</tr>
<tr>
<td>Telecommunications Sector Analyst</td>
<td>Kathryn Joseph</td>
</tr>
<tr>
<td>Utilities Sector Analyst</td>
<td>Kathryn Joseph</td>
</tr>
</tbody>
</table>

From left to right: Will Edwards, Alison Frederick, Tomas Cabrera Ranaldi, Jeff Dirkin, Seonag Doherty, Heather Cunningham, Christian Fielitz, Kathryn Joseph, Dr. J. Clay Singleton, Hongda Qiao, and Marten Mueller
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Executive Summary

The Crummer SunTrust portfolio’s Investment Policy Statement requires us to base our tactical sector allocations on our best guess of the market’s trend over the next year. While we respect the challenge of correctly predicting the larger moves in the economy and its impact on the market, we have analyzed as much data as we could to aid our tactical sector allocation strategy. In forming this opinion, we heard from economists, portfolio managers, financial analysts, and financial advisors who guided our economic outlook for the coming year.

The class maintains a muffled optimism towards the overall economic picture. After the crescendo of 2013, the market grew 13.0% in 2014. We expect the market to continue to move positively in 2015, but the market’s growth rate will be softer compared to the prior two years. GDP should grow at 2.8% this year largely due to an increase in consumer spending. Unemployment will tick down as jobs are added and more “discouraged” workers reenter the workforce. Inflation will remain low; the Fed will keep short-term interest rates low as low inflation and a strong dollar gives it little reason to raise rates.

GDP
The U.S. economy will grow at 2.8% this year, up from 2.4% in 2014. Consumers have benefitted from the availability of more jobs and lower energy prices. Those two factors have put more disposable income into consumers’ pockets and, as a result, consumer spending will rise throughout the year. With consumer spending on the rise and consumer confidence at its highest level since 2007, companies will begin to increase investment in new production capacities.

Unemployment
Unemployment will continue to decrease. We expect job growth to equal 2014’s job growth of around 3.1 million for the year. In 2016, we anticipate job growth to slow to a more sustainable rate of 2.4 million new jobs. We expect to see unemployment around 5.3% after the rate fell to 5.5% in February of this year. This accounts for relatively strong job growth as well as better job prospects bringing more people back into the labor pool.

Inflation
Inflation will remain low this year. After a slight 0.8% increase in the Consumer Price Index (CPI) last year, prices will jump to 1.3% in 2015. Inflation will stay well below the Federal Reserve’s 2.0% target rate as a strong dollar brings lower prices to imported commodities and continues to put downward pressure on global oil prices. At some point, the strengthening economy will put upward pressure on inflation, but that is not likely to occur until 2016 or later. Oil prices will recover slowly towards the end of the year and the U.S. Dollar will continue to gain strength.
Interest Rates
The Federal Reserve will keep short-term rates between 0.00% and 0.25% through the end of 2015. The Fed feels little pressure to raise rates for several reasons. Oil prices will keep the CPI low in the near term as products across almost every industry see lower transportation and import costs. The Fed’s balance sheet was around $4.5 trillion at the end of 2014, and any attempts to shrink the balance sheet quickly would put downward pressure on markets. Another important factor, although rarely discussed by the Fed, is that any hike in the interest rates could strengthen the rapidly appreciating dollar even further.

Long-term rates will climb slightly over the course of the year. We expect 10-year Treasuries to end the year around 2.4% and 30-year fixed rate mortgages to end at 4.1%. The long-term expectation of low inflation is also contributing to keeping rates low.

Oil
The price of West Texas Intermediate has fallen to new lows as of this March. Despite the reduction in rig count, U.S. output continues to grow. Storage facilities are rapidly filling and the OPEC has made it clear that it will not attempt to buoy the falling oil price. As the price drop continues to hurt U.S. oil companies, domestic production will slow. Meanwhile, the International Energy Agency has suggested global demand is picking up. These two trends will lead to prices between $60 and $65 per barrel, later this year.

Currency
We looked at several indicators that suggest the U.S. Dollar (USD) is strong at the beginning of 2015. The USD is likely to appreciate through 2015 as long as foreign central banks keep lowering interest rates and the Fed continues to keep short-term rates at or near 0.00%. The Big Mac Index confirms that the USD has reached record strength compared to a global basket of currencies.

Market impact
While we do not expect the market to continue to build at the rate it did in the past year, we have reason to believe it will continue to grow positively. The Fed is likely to leave rates alone as employment, inflation, and the rising dollar give the Fed little reason to raise rates. Low rates will continue to benefit the equity market and help boost GDP.

In the past two years, the market grew rapidly and as they say, “a rising tide lifts all boats”. In an environment with more subdued growth, stock selection is paramount. Our class will need to select companies that resonate with the current economic conditions for the portfolio to increase in value.
Performance of the Crummer SunTrust Portfolio

The Crummer SunTrust Portfolio invested the first $100,000 SunTrust contribution in April 1999. Subsequent contributions brought the total investment to $500,000. Since inception, the portfolio has generated more than $180,000 in scholarships. As the chart below shows, the portfolio performance lagged the S&P 500 index until early 2002. Between then and April 2013, the portfolio outpaced the index by a considerable margin. For the last two years, the portfolio has again fallen behind the S&P 500, while the stock market has done extraordinarily well, mostly because the portfolio holds bonds.
2014 – 2015 Plan Year Performance Highlights

For the period May 2014 through February 2015, the S&P 500 index outgained the portfolio by 2.5%. However, absolute performance without adjusting for risk is incomplete. The portfolio’s since-inception annual return is 12.6% (with a standard deviation of 14.2%) versus the S&P 500 index’s return of 13.6% (with a standard deviation of 15.2%) over the same period. This risk-return comparison is all the more noteworthy because the portfolio has held varying amounts of bonds over time, suggesting the S&P 500, while popular, is not the best benchmark for the portfolio. This comparison is provided more as a continuation of past annual reports than as the best measure. Compared to a 60.0% equity and 40% bond benchmark portfolio over the period since inception, both the S&P 500 and the portfolio have underperformed by 5.0% per year with significantly higher standard deviations.

Equity Sector Performance

The portfolio’s tactical equity investments are allocated among the S&P’s ten sectors: Consumer Discretionary, Consumer Staples, Energy, Financials, Healthcare, Industrials, Information Technology, Materials, Telecommunications, and Utilities. Last year the portfolio was tilted away from sectors that were expected to underperform, e.g. Consumer Staples and Financials, and tilted toward sectors expected to outperform such as Consumer Discretionary and Industrials. The column “Sector Index” of the chart below shows that the sectors performed about as expected with the sector indexes for Consumer Discretionary outperforming Consumer Staples (2.3% to 1.8%) and Industrials outperforming Financials (22.9% to 15.0%). The column “Crummer SunTrust” shows the portfolio’s performance and the column “Under/Over Benchmark” indicates the margin of performance in each sector. The portfolio outperformed the relevant index (numbers in black) in the Consumer Discretionary, Financial, Industrial, Technology, Telecommunications and Utility sectors. In the other sectors (numbers in red), Consumer Staples, Energy, Healthcare, and Materials, the portfolio did not perform as well as the index. These differences are largely due to the portfolio’s security selection.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Sector Index</th>
<th>Crummer SunTrust</th>
<th>Over/Under Benchmark</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer Discretionary</td>
<td>2.33%</td>
<td>3.55%</td>
<td>1.22%</td>
</tr>
<tr>
<td>Consumer Staples</td>
<td>1.80%</td>
<td>-2.33%</td>
<td>4.13%</td>
</tr>
<tr>
<td>Energy</td>
<td>-8.86%</td>
<td>-1.64%</td>
<td>8.89%</td>
</tr>
<tr>
<td>Financial</td>
<td>15.01%</td>
<td>1.48%</td>
<td>13.53%</td>
</tr>
<tr>
<td>Healthcare</td>
<td>-11.31%</td>
<td>2.81%</td>
<td>14.12%</td>
</tr>
<tr>
<td>Industrial</td>
<td>22.92%</td>
<td>1.20%</td>
<td>21.72%</td>
</tr>
<tr>
<td>Materials</td>
<td>1.30%</td>
<td>-28.88%</td>
<td>30.01%</td>
</tr>
<tr>
<td>Technology</td>
<td>2.46%</td>
<td>37.57%</td>
<td>35.11%</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>0.81%</td>
<td>1.42%</td>
<td>0.60%</td>
</tr>
<tr>
<td>Utilities</td>
<td>1.02%</td>
<td>20.55%</td>
<td>19.53%</td>
</tr>
</tbody>
</table>
**Bonds and Cash**

The portfolio began the year beginning May 2014 with 4.0% allocated to cash (to fund scholarships), 84.0% allocated to equities, and 12.0% allocated to bonds (PIMCO 1-5 year TIPS and Templeton Global Bond Total Return Fund). The bond investment lost 1.9% over the year. After the proposed trades, the portfolio will hold less than 1.0% in cash and will generate $30,000 in scholarships.
Portfolio Design

The Crummer SunTrust Portfolio Investment Policy Statement (IPS) provides guidelines for a wide range of alternatives for tactical and strategic allocation decisions (refer to page 93 for a copy of the IPS). Strategically, we allocated funds among asset classes to reflect our economic outlook for a return to more normal markets. The management team looked at the past performance and volatility of each asset class, in order to identify the most desirable allocation. The asset class benchmarks and their target ranges are provided by the IPS as constraints to make the asset class allocation suitable for the portfolio’s long-term strategy. After designing the portfolio, we conducted a mean-variance optimization to compare our recommendation to an optimal portfolio (the portfolio with the smallest risk for a desired level of expected return). Our portfolio, while not mathematically optimal, is reasonably efficient (refer to Page 99 for more discussion of mean-variance optimization).

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

The charts included in this section show the proposed strategic and tactical allocations compared to last year’s portfolio. Our overall allocation recommendation for 2015 is 84.0% equity, 12% bonds, and 4% cash.
**Strategic Allocation**

The proposed equity asset allocation is titled towards “Growth” stocks with 51.0% in “Growth” and 41.0% in “Value.” The remaining 8.0% is international exposure, exclusively through American Depositary Receipts (ADR). The size breakdown is: 53.0% “Large”, 24.0% “Mid”, and 15.0% “Small”. The international equities (8.0%) could be classified as “Large”. For stocks classified as “Core”, we allocate their market value equally to value and growth. A “Large Growth” tilt is consistent with our view of a gradual return to a more settled economy and a gradually increasing stock market. Compared to 2014, our proposal focuses on “Growth” rather than “Small” stocks.

**Proposed Equity Allocation 2015**

- **Large Growth**: 31%
- **Large Value**: 22%
- **Mid Growth**: 12%
- **Mid Value**: 12%
- **Small Growth**: 8%
- **Small Value**: 7%
- **International**: 8%

**Proposed Equity Allocation: 2015 in comparison to 2014**

<table>
<thead>
<tr>
<th></th>
<th>Small Value</th>
<th>Small Growth</th>
<th>Mid Value</th>
<th>Mid Growth</th>
<th>Large Value</th>
<th>Large Growth</th>
<th>International</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2015</strong></td>
<td>7%</td>
<td>8%</td>
<td>12%</td>
<td>12%</td>
<td>22%</td>
<td>31%</td>
<td>8%</td>
</tr>
<tr>
<td><strong>2014</strong></td>
<td>11%</td>
<td>10%</td>
<td>10%</td>
<td>7%</td>
<td>25%</td>
<td>29%</td>
<td>8%</td>
</tr>
</tbody>
</table>
The table below shows the proposed market weights in comparison to the IPS target range. The portfolio is at the high end of the IPS range in “Large Cap – Growth” and exceeds the specifications of the IPS for “Mid Cap – Growth” and “- Value.” This deviation is intentional to accommodate some of the “Mid Cap” stocks we found that offer unusual opportunities. “Large Cap – Value” and both “Small Cap” allocations are near the middle of their ranges. We believe our proposal reflects our market forecast.

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Proposed Market Weight</th>
<th>IPS Target Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large Cap - Growth</td>
<td>30%</td>
<td>10-30%</td>
</tr>
<tr>
<td>Large Cap – Value</td>
<td>22%</td>
<td>10-30%</td>
</tr>
<tr>
<td>Mid Cap – Growth</td>
<td>2%</td>
<td>5-10%</td>
</tr>
<tr>
<td>Mid Cap – Value</td>
<td>2%</td>
<td>5-10%</td>
</tr>
<tr>
<td>Small Cap - Growth</td>
<td>8%</td>
<td>5-15%</td>
</tr>
<tr>
<td>Small Cap – Value</td>
<td>7%</td>
<td>5-15%</td>
</tr>
<tr>
<td>International Equity</td>
<td>8%</td>
<td>5-15%</td>
</tr>
<tr>
<td>Fixed Income</td>
<td>12%</td>
<td>12-18%</td>
</tr>
<tr>
<td>Cash</td>
<td>4%</td>
<td>As needed</td>
</tr>
</tbody>
</table>
Tactical Allocation

Our tactical sector allocation is weighted towards pro-cyclical sectors such as Consumer Discretionary and Industrials as shown below.

Proposed and Sector Market Weights, March 2015

The table below compares our proposed sector allocations to market weights as of the end of March 2015.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Proposed</th>
<th>Market</th>
<th>Tilt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer Discretionary</td>
<td>16%</td>
<td>13%</td>
<td>3%</td>
</tr>
<tr>
<td>Consumer Staples</td>
<td>6%</td>
<td>10%</td>
<td>-4%</td>
</tr>
<tr>
<td>Energy</td>
<td>9%</td>
<td>8%</td>
<td>1%</td>
</tr>
<tr>
<td>Financials</td>
<td>16%</td>
<td>16%</td>
<td>0%</td>
</tr>
<tr>
<td>Healthcare</td>
<td>16%</td>
<td>15%</td>
<td>1%</td>
</tr>
<tr>
<td>Industrial</td>
<td>12%</td>
<td>10%</td>
<td>2%</td>
</tr>
<tr>
<td>Information Technology</td>
<td>21%</td>
<td>20%</td>
<td>1%</td>
</tr>
<tr>
<td>Materials</td>
<td>2%</td>
<td>3%</td>
<td>-1%</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>1%</td>
<td>2%</td>
<td>-1%</td>
</tr>
<tr>
<td>Utilities</td>
<td>1%</td>
<td>3%</td>
<td>-2%</td>
</tr>
</tbody>
</table>
Our proposed portfolio over-weights the Consumer Discretionary and Industrial sectors and under-weights Consumer Staples, consistent with our view of a recovering economy, a muffled increase in the stock market, and flat bond market with very modest increases in interest rates between March 2015 and May 2016. We also allocated less than the 5.0% IPS minimum to Telecommunications and Utilities to add modestly to pro-cyclical sectors, again consistent with our economic view and current market weights. This equity portfolio is well positioned to take advantage of our forecasts without being overly dependent on a robust recovery.

**Sector Rotation Analysis**

Sector rotation, as a top-down trading strategy, has been popular for many years and touted to achieve better than total stock market returns. The Crummer SunTrust Portfolio Investment Policy Statement is predicated on such a sector rotation approach. Our analysis, reported below, shows that portfolio managers who can correctly anticipate the business cycle and rotate sectors will reap substantial rewards. Delivering on that promise, however, is not as simple as following a simple trading rule but appears to require considering the complex interaction of economic and market conditions.

Two assumptions must be true, at least partially, for these superior returns to materialize: that the market is a leading indicator of the Business Cycle (BC) and, that certain industrial sectors out-perform the total market at particular phases of the same. Skill in assessing the current phase of the BC and hence, timing entry and exit trades in the relevant sectors will determine excess returns. While it is understood that assessing the BC phase is difficult, but assuming that it can be done effectively, does Sector Rotation really achieve its objectives? A test using historical BC data and optimum hypothetical trade execution was undertaken. The result was a resounding “maybe.”

**Overview of Sam Stovall’s Sector Rotation Method**

Sam Stovall, editor of *S&P’s Industry Reports*, popularized sector rotation through his *Guide to Sector Investing* books published 1995 and 1996, in which he laid out the basic empirical observations he made to support the strategy he was propounding.

- **Business Cycle Phases.** Five phases were assigned to the BC, which he labeled as Phase I, II, III, IV, and V respectively or early, mid, and late expansionary phases, and early and late recessionary ones. He associated each BC phase with the relative strengthening or weakening of a group of four economic indicators.

- **Industry Performance and Business Cycle Phase.** Stovall analyzed performance data for 88 different industries for four complete business cycles from 1969 to 1994, using data from the National Bureau of Economic Research (NBER) to determine for which economic indicator cluster and therefore, BC phase, each industry outperformed the Market, more often than not. *Note: Stovall applied statistical analysis to the results calculating averages and standard deviation. The data volume makes these results unreliable.*

- **Sector Assignment.** Related industries were grouped into eleven sectors. These formed the basis for the ten S&P 500 Sectors Indexes tracked from 1989 onward. These were mapped onto the Business and Stock Market Cycles. See Figure 1a and 1b.
Investigation
Investment returns in the market as represented by S&P 500 Index versus hypothetical timed investment in the sector indexes were compared from December 1989 to December 2014. NBER data was used to determine BC peaks and troughs, and S&P market and sector return data were obtained from FactSet. A two-step process was used to find the optimum sector trading dates: first the BC Phase beginning and end dates were identified, then the estimated lag time between the market and the BC.

Following Stovall’s method, dates for phases I – V were assigned to each complete BC; each of the expansionary periods was divided in three equal length phases, and the recessionary periods into two.

Next, stock market peak and trough dates were layered onto the BC data to calculate the average number of lag months. Lag time being the number of months the BC turning point follows the similar stock market one. The small number of complete BCs in the period, and the paucity of data, make the average lag months’ results spurious, as
shown by the unacceptably large standard deviations; see table 1. As already noted, Stovall’s data has the same issue, which makes his original conclusions questionable.

Consequently, various lag times were tested to see which produced the best returns. Calculations using 0, 1, 3 month lag times were tried and it was found that 1 month gave the highest excess return premiums. In other words, if the turning points in the BC were consistently and correctly anticipated by 1 month, then this sector Rotation method would have produced higher premium returns over the S&P 500, than the other tested lag times. From December 1989 to December 2014, investment in the S&P 500 index would have given a total return of 359.6% whereas application of a sector rotation strategy could have produced a total return of 790.1 %, as shown in table 2.

Table 1: Average Business Cycle/Market Lag Table 2: Total Return Results

<table>
<thead>
<tr>
<th>Peak/Trough Start</th>
<th>Peak/Trough End</th>
<th>No Months</th>
<th>S&amp;P Peak/Trough</th>
<th>Lag/Months</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 1980</td>
<td>July 1980</td>
<td>0</td>
<td>February 1980</td>
<td>-1</td>
</tr>
<tr>
<td>November 1981</td>
<td>July 1990</td>
<td>92</td>
<td>August 1982</td>
<td>T 3</td>
</tr>
<tr>
<td>July 1990</td>
<td>March 1991</td>
<td>8</td>
<td>May 1990</td>
<td>P 4</td>
</tr>
<tr>
<td>March 1991</td>
<td>March 2001</td>
<td>120</td>
<td>October 1990</td>
<td>T 5</td>
</tr>
<tr>
<td>March 2001</td>
<td>November 2001</td>
<td>8</td>
<td>August 2000</td>
<td>P 7</td>
</tr>
<tr>
<td>November 2001</td>
<td>December 2001</td>
<td>73</td>
<td>September 2002</td>
<td>T -10</td>
</tr>
<tr>
<td>December 2001</td>
<td>June 2009</td>
<td>18</td>
<td>October 2007</td>
<td>P 2</td>
</tr>
<tr>
<td>June 2009</td>
<td>November 2010</td>
<td>89</td>
<td>T 0</td>
<td></td>
</tr>
<tr>
<td>Av length Contraction</td>
<td>11.84 6D</td>
<td>4.79</td>
<td>1994 - Contraction</td>
<td>2.17 SD</td>
</tr>
<tr>
<td>Av length Expansion</td>
<td>68.57 6D</td>
<td>38.12</td>
<td>1994 - Expansion</td>
<td>8.41 SD</td>
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</table>

Results Table Period 9/89 - 12/14

<table>
<thead>
<tr>
<th>Months</th>
<th>Total Return %</th>
<th>$1000 Invested 10/89</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500 Index</td>
<td>359.63 $</td>
<td>3,596.30</td>
</tr>
<tr>
<td>BC lags S&amp;P by</td>
<td>0 702.53 $</td>
<td>7,025.30</td>
</tr>
<tr>
<td>1 790.09 $</td>
<td>7,900.90</td>
<td></td>
</tr>
<tr>
<td>3 577 $</td>
<td>5,770.00</td>
<td></td>
</tr>
</tbody>
</table>

Test Limitations
The major limitation to the validity of the results is, the already articulated, lack of data, which makes them statistically unreliable. The trial and error method of determining the correct stock market leading months (lag time) was additionally flawed, because the evidence suggests (Table 1) that the average lag time is different in the expansionary and recessionary periods for the same BC. This variation was not accounted for in the test. The period included a long expansionary period followed by an unusual financial crisis, which caused the recession. With more data, an examination of comparative recessions would be informative since each is different in causal factors and duration.

Final Thoughts
The high premiums calculated using a version of this strategy suggest there may be something in it. Spot-on timing would be handsomely rewarded. However, because the historical record is so limited and inconsistent, no simple predictive formula for sector rotation trading is likely to be reliably successful. Successful sector rotation appears to require considerable skill and probably requires the simultaneous consideration of a host of general and specific economic and market factors. The conclusion that investment success is difficult should come as no surprise.
Sector Analysis
Outperforming the S&P in 2014

The Consumer Discretionary sector consists of businesses that sell nonessential goods and services and is heavily influenced by economic performance. Consumers tend to cut discretionary spending in economic downturns. Companies in this sector include retailers, media companies, consumer services companies, apparel companies, and automobile and component companies. In 2014, the consumer discretionary index rose 19.7%, outperforming the S&P 500, which only rose 17.9%. This consumer discretionary index has 85 constituents with a mean total market capitalization of more than $29.1 billion. Consumer confidence is the primary growth driver in this sector. The sector performed well last year because of consumer’s continued sentiment that the economy is moving from a recovery phase into an expansionary phase. In addition to an economic environment that favored consumers, the job market began to look healthier and the housing market improved.

Sector Outlook

Consumer Confidence

Consumer confidence will grow in 2015. Consumers are regaining a steady income in the midst of a more stable job market, leading them to feel more confident. While the Consumer Confidence Index (CCI) will not reach pre-recessionary levels in 2015, this index is a good indication for the growth of consumer discretionary spending. The unemployment rate at the beginning of this year was 5.8% as compared to 7.4% in 2013, and the outlook is positive. The Conference Board Consumer Confidence Index rose between February and March 2015 from 98.8 to 101.3. In addition, consumers are deleveraging and the total Debt-to-Income ratio has been experiencing a downward trend, showing that consumers are regaining confidence to take on more credit and increase spending.

Demographic Trends

“Baby Boomers” are the largest demographic in the United States. According to the U.S. Census Bureau, the population 65+ numbered 46.2 million in 2014 and is expected to grow to 56 million by 2020. While the Employee Benefits Research Institute states that consumers with employment-based retirement plans are more confident now than they have been in recent years, many live on a fixed income and we do not expect a significant growth in disposable income for this demographic in the near future. At 74.8 million people, the 18-34 cohort is the fastest growing segment of the population and accounts for approximately $200 billion in spending power, a number that is expected to double by 2020. “Millennial” customers are discerning buyers – according to a 2013 Columbia Business School survey, more than 50.0% of Millennials use smartphones to research products as they are shopping. To cater to these needs, companies need to focus on e-commerce and social media as touch points vital to matching changing consumer tastes and creating demand.

Income Disparity

Despite these positive spending trends, there is growing disparity between “haves” and “have-nots”. This disparity is due to several factors including government austerity measures, like the cut in funding of food stamp programs, and the rise in healthcare costs. These factors will cause significant headwind for lower-income consumers. Student loan debt, and the associated interest payments, is another factor limiting the disposable income of a considerable demographic group. The International Monetary Fund (IMF) made a statement in March warning “wide income inequality can slow economic growth.”
Abercrombie & Fitch Co. (ANF)

**Introduction**

Abercrombie & Fitch operates as an American retailer of casual wear for young men, women, and children, selling through the Abercrombie & Fitch, Abercrombie Kids, Hollister and Gilly Hicks brands. The company operates 799 stores in the U.S. and 170 stores in Asia, Australia, Canada, Europe, and the Middle East with an e-commerce site, generating total revenues of $3.7 billion in 2014.

**Fundamental Analysis**

Abercrombie is facing plunging sales while attempting to keep up with the ever-changing teen fashion preferences, so much so that it is willing to remove the company’s well-known logo in order to appeal to the mass market. Fiscal results for 2014 showed an unimpressive 5.4% decline in net income. Sales have decreased 13.8% from 4.1 billion to 3.7 billion in 2014.

The company’s plan to improve earnings through “leveraging the international appeal of [its] brands to build a highly profitable, sustainable, global business” did not reach the anticipated success in 2014, with a same store sales decline of 8.0% overall with particular attention to the 12.0% decline in international stores operations. The worldwide expansion of this brand helps Abercrombie compete against other value-priced retailers like Aeropostale and American Eagle.

We expect that as the overall consumer discretionary market improves, Abercrombie will benefit in excess of the market, in a large part through the international presence of its Hollister brand. The fact that management is attempting to grow the company without the very logo or branding strategy that shaped the corporate culture results in a questionable outlook on whether or not its expansion plan will be profitable.

**Financial Statement Analysis**

Abercrombie & Fitch has seen no signs of revenue growth and a sluggish EBT margin moving from 4.5% in 2013 to 4.4% in 2014. Net margins drastically dipped from a 5.3% peak in 2012 to the current 1.4% net margin. Similarly, return on equity has fallen to 3.3% reflecting on an all-time high back in 2012 where return on equity was 12.9%.

**Conclusion & Recommendation**

Across all its product lines, Abercrombie’s major short-term external growth driver is consumer disposable income. Consumer disposable income is projected to increase 17.0% by 2015 and close to 50.0% by 2020. In the longer term, Abercrombie will not achieve growth by pursuing branding and cost-reduction strategies. Furthermore, these tactics will not propel the company enough to outperform its peers in this competitive industry. Considering these growth forecasts, our model estimates the company is overvalued by roughly 22.0%. We recommend to sell our position this year.
Gamestop Corp. (GME)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>BUY</td>
<td>$47.03</td>
<td>$38.36</td>
<td>NMF</td>
<td>Mid Value</td>
<td>3.6%</td>
</tr>
</tbody>
</table>

**Technical Analysis**

<table>
<thead>
<tr>
<th>Bollinger Bands</th>
<th>Neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>Money Flow</td>
<td>Positive</td>
</tr>
<tr>
<td>Relative Strength</td>
<td>Positive</td>
</tr>
</tbody>
</table>

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

After experiencing a period of negative net margins, GameStop showed improvement and reached 3.9% in 2014. As the new console installment base grows (for Xbox One and PS4, released in 2013), the company has reached an EBIT margin of 7.1%. Sales of new and used games are the source of GameStop’s gains, and high margins are expected to increase further.

**Financial Statement Analysis**

With a sales increase of almost 3.0% since 2013, GameStop has also witnessed steady growth in gross margins to 28.3% from 25.6% since the recession, due to a steady decrease in cost of goods sold to 71.7% from 74.2%. In 2014, GameStop boasted an 11.0% increase in net income from the previous year. The company’s poor financial performance at the end of 2012 resulted in a negative net income of $270 million only to skyrocket back to the black in 2014 at $393 million. Return on equity also provides promising figures of 18.2% in 2014 compared to 15.6% in 2013. The company has been issuing dividends since 2012 and plans to continue to do so in the future.

**Conclusion & Recommendation**

Management has demonstrated the ability to manage expenses and focus on expansion of the digital divisions. The strong position of the company’s reward program and the tepid response for the new generation of gaming consoles should maintain or increase consumer demand for used games resulting in just below 1% revenue growth in the coming year. We recommend increasing our position as it is undervalued by 22.6%.

Introduction

GameStop is a retailer of video game products and PC entertainment software and has recently delved into its new mobile business. The company sells new and used video game and PC entertainment hardware, software, and accessories. It publishes the Game Informer magazine, which has 7.9 million subscribers, and operates the video gaming website kongregate. The company operates 6,457 stores in North America, Europe, and Australia. In 2014, GameStop acquired 53 high-volume retail store locations through its wholly owned subsidiary, Spring Mobile, an AT&T wireless products and services retailer.

Fundamental Analysis

GameStop commands an 80% share of the used video game market, which differentiates the company from the majority of its competitors that primarily sell new content. Historically, used games have generated roughly 50% of the company’s gross profits, primarily due to used games commanding almost double the gross profits of new games.
## Nike Inc. (NKE)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>BUY</td>
<td>$123.86</td>
<td>$99.88</td>
<td>24</td>
<td>Large Growth</td>
<td>1.1%</td>
</tr>
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</table>

### Technical Analysis

- **Bollinger Bands**: Neutral
- **Money Flow**: Neutral
- **Relative Strength**: Neutral

### Introduction

Nike, Inc. designs, develops, markets and sells footwear, apparel, and equipment, accessories and services. Its athletic footwear products are designed primarily for specific athletic use, although a large percentage of the products are worn for casual or leisure purposes. The company focuses on NIKE Brand and Brand Jordan product offerings in seven key categories: running, basketball, football, men’s training, women’s training, NIKE sportswear, and action sports. It also markets product designed for kids, as well as for other athletic and recreational uses.

### Fundamental Analysis

Nike reported $27.8 billion in sales in 2014. The company has been experiencing sales growth since 2010. Nike’s footwear segment accounts for 58% of its total revenue.

The company’s net income margin has been steadily positive since 2009, ranging from 9.0 to 10.0%. Sales and comparable-store sales have both been increasing due to enhanced store formats and improved performance of the company’s website. The gross margin rate has also increased by 4.0% since last year due to better management of costs.

Higher volume sales and higher disposable income have provided a growth outlook for the continued increase in Nike’s revenue. The coming years prove promising for the company as it reaps the benefits from its marketing investments and continued innovative product lines, keeping in line with consumer demand.

### Financial Statement Analysis

In 2013, Nike, Inc. reported a net income of $3.1 billion or $3.12 per share. Total sales increased 9.7%, a considerable comparison in sales growth, which was just 5% the previous fiscal year.

The company’s return on assets has remained steady over the past three years and its return on equity grew to 24.5% in 2014 from 22.9% in 2013. Same store sales have grown at a notable 10.0%. The company’s dividend yield has remained consistent over the past three years.

### Conclusion & Recommendation

Nike operates in a very competitive environment with pressure from international, off-price, and e-commerce retailers. The company’s latest challenge is not focusing on retaining loyal customers, but capturing the 18-24 year old segment by creating meaningful conversions from Nike’s highly-revered marketing campaigns.

Our intrinsic value of Nike lands at $123.86, more than 24.0% above the stock’s current trading price, which is why we strongly recommend a buy position on this promising stock.
Introduction
Nordstrom is a leading retailer of national and exclusive branded apparel, shoes, accessories and cosmetics. The company provides a private label credit card, two Nordstrom VISA credit cards, and a debit card for customer purchasers through its wholly owned federal savings bank, Nordstrom FSB. Cardholders receive loyalty program points that can be redeemed for products and services. Currently, Nordstrom operates 116 full-line stores, an online store, and 173 off-price Rack stores.

Fundamental Analysis
Nordstrom has a shared inventory platform that allows it to manage and turn its inventory better than its industry competitors. The full-line and internet stores’ inventories are completely integrated, allowing for consistent merchandise assortment, improvements in regular-price selling, inventory turns of over 5.1 times per year (as compared to an industry average of 3x), improvements in regular-price selling, and no over reliance on promotions. The company has industry leading sales of $493 per square foot and focuses on higher margin items like apparel, footwear and fashion accessories instead of lower margin hard goods like other department stores.

The company’s growth strategy includes expansion into Canada, as well as new channels like their Rack stores and HauteLook.com. The company plans to add an additional 38 Rack stores by 2016. Rack net sales increased 17.0% last year, driven by 27 new store openings, and same store sales increased four percent.

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

Financial Statement Analysis
Nordstrom achieved several milestones in 2014 including a record high in sales (of $13.51 billion) and earnings per diluted share (of $3.72). The company’s return on assets remained steady and return on equity fell by 4.0% but still well-above the range showing shareholders that Nordstrom has funds for the continued future growth of the company.

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

Our model determined that Nordstrom’s intrinsic value is $102.67, or 28.0% above the current market price. Therefore, we recommend increasing our current position in this company.
**PepsiCo. (PEP)**

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>BUY</td>
<td>$117.23</td>
<td>$95.95</td>
<td>19</td>
<td>Large Core</td>
<td>2.7%</td>
</tr>
</tbody>
</table>

**Technical Analysis**

- Bollinger Bands: Neutral
- Money Flow: Positive
- Relative Strength: Neutral

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**Introduction**

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

**Fundamental Analysis**

PepsiCo’s Frito-Lay division is the world’s largest snack food company. It controls almost 40.0% of the world’s snack market. While soft drink demand is slightly decreasing throughout North America and Europe, snack consumption volume increased three percent in the Americas and two percent in Europe last year. PepsiCo has done a good job of addressing changing customer demand by expanding its portfolio of products to include health conscious ingredients like fruit, vegetables and whole grains, as well as offerings “that provide a functional benefit, such as addressing the performance needs of athletes.”

PepsiCo will continue to invest in developing and emerging markets. Over the last five years, revenue from emerging markets has tripled. The company plans to invest $5.0 billion in Mexico by 2019. Mexico has the world’s largest per capita consumption of soft drinks and bottled water. In addition, Sabritas, PepsiCo’s Mexican subsidiary, has roughly an 80.0% market share in the country.

Recently, PepsiCo announced a new multi-year partnership with Live Nation as the music company’s official carbonated soft drink and bottled water partner, replacing previous partner Coca-Cola, who had secured this partnership in 2009. The company will have exclusive pouring rights at 75 of Live Nation’s U.S. amphitheaters, clubs and theaters, and will also provide exclusive “Out of the Blue” experiences with Live Nation artists on tour.

**Financial Statement Analysis**

PepsiCo’s revenue growth has recovered after a negative growth year in 2012 with gross income increasing by 1.5% in 2014. The company witnessed an 8.4% growth in operating cash flow reaching $10.5 billion. PepsiCo’s free cash flow has grown almost 50.0% to $7.65 billion since 2009 and its operating cash flow has grown over 40.0% to $10.51 billion in the same timeframe.

**Conclusion & Recommendation**

PepsiCo is well positioned in the domestic and global market to witness steady long-term growth. Domestic cost cutting programs should drive up margins in the short-run and recent partnerships combined with infrastructure investments in key emerging markets should sustain growth in the longer-run. Even with these modest growth forecasts, our discounted cash flow model estimates the company is currently undervalued by at least 22.0%. We recommend our position be increased.
Regal Entertainment Group (RGC)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
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<tbody>
<tr>
<td>BUY</td>
<td>$27.87</td>
<td>$23.15</td>
<td>27</td>
<td>Small Value</td>
<td>3.9%</td>
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Technical Analysis

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

Introduction

Regal Entertainment Group operates the largest and most geographically diverse theatre circuit in the United States. It develops, acquires and operates multi-screen theatres primarily in mid-sized metropolitan markets and suburban growth areas of larger metropolitan markets throughout the United States. The company holds the largest market share in its industry, manages 7,394 screens across 42 states and Washington, DC, and employs 24,201 people. Almost 80.0% of the company's screens feature stadium seating, with the company's theaters having an average of 12.7 screens per location. Regal operates under one business segment: theater exhibition operations.

Fundamental Analysis

The company truly capitalizes on being the most prevalent and geographically diverse theater in the United States. It has recently expanded its revenue stream beyond the core business of admissions that accounts for 58% of sales by increasing the quality and offerings of concessions. The company took on a significant amount of debt to finance the acquisition of Hollywood Theaters and Great Escape Theatres in 2014 that led to a boost in sales and market share. Its recent partnership with MovieTickets.com will ensure that the benefits of targeted online sales will be realized in many of its geographically diverse locations.

Financial Statement Analysis

The earnings per share during the fourth quarter of the 2014 fiscal year experienced a 76.5% growth, whereas the year before the same time period had a negative growth of 39.3%. Our projections show the potential for an even larger dividend payout in 2015.

Conclusion & Recommendation

Regal Entertainment Group strongest growth driver is rising consumer confidence. Consumer confidence is projected to increase by up to 2.0% each of the next five years.

With the company's core offerings leading the market, Regal's major short-term growth driver is per capita consumer disposable income, which is expected to grow approximately 2.4% each year through 2020. In the longer term, we expect enhanced concessions offerings, its online partnership, and excellent customer service to allow it to outperform its peers, leading to continued growth.

We determined the company to be undervalued by 20.0%. Therefore, we recommend buying a position in this company.
Consumer Staples

Surprising Outperformance
Consumer Staples is a defensive sector that includes companies whose businesses are less sensitive to economic cycles. It includes manufacturers and distributors of food, beverages, and tobacco, and producers of household goods and personal products. This sector is a good hedge as it outperforms during recessions and maintains steady performance during economic upturns.

Over the last year, the consumer staples sector has been generally weak as companies struggle to control costs in the sluggish macroeconomic environment. Despite the slow recovery, stock performance has been strong. In 2014, the S&P 500 Consumer Staples sector increased by 15.4%. The sector will likely continue to rise in the coming year due to a strengthening economy, low fossil fuel costs in the immediate future, an improving labor market, and higher disposable income.

Innovation and “Good” Products Key to Create Differentiated Value
In a saturated market, consumer product companies must continuously innovate to create differentiated value and remain successful. Innovation has been a key driver for companies like P&G and General Mills for delivering strong, long-term results. Companies are also increasingly shifting their focus to more sustainable and healthier products to meet changing consumer demand. With increasing health consciousness, rising environmental concerns, and growing regulatory pressures, it is essential for companies to adapt to the changing demand conditions to remain relevant in the market.

Many Consumer Staples companies promoted their sustainable and diverse product offerings to consumers. Those that failed to do so have performed poorly in relation to competitors. Keurig Green Mountain is one such company that did not innovate to create fully recyclable pod K-Cups and, as a result, faced enormous backlash from environmentally conscious consumers.

Volatile Global Environment
The Consumer Staples sector faces many challenges as the international economic environment remains volatile, yet the U.S. economy is projected to grow steadily. The Eurozone remains unstable and China’s growth continues to slow. Companies with a large portion of operations in the U.S. will benefit from the strengthening dollar.

Despite some promising examples, the Consumer Staples sector faces many challenges as the economic environment in the U.S. improves ever so slowly. The Eurozone, despite improving conditions, remains unstable and China’s growth is slowing. We have positioned Consumer Staples at 6.1% of the portfolio, 3.7% below its current market weight of 9.8%.
The Andersons Inc. (ANDE)

**Recommendation**
BUY

**Valuation**
$50.92

**Last Price**
$39.71

**Adjusted P/E**
12

**Style**
Small Value

**Dividend Yield**
1.4%

### Technical Analysis
- Bollinger Bands: Neutral
- Money Flow: Neutral
- Relative Strength: Neutral

### Introduction
The Andersons, Inc. (ANDE) is a diversified agribusiness that engages in railcar leasing and repair, turf products production, and consumer retailing. The company operates in six segments: Grain, Ethanol, Rail, Plant Nutrient, Turf, and Specialty & Retail. This small value company has a market capitalization of $1.1b and generated $4.5b in revenue last year.

### Fundamental Analysis
The Andersons is a well-diversified company with operations across a wide range of categories that offer solid growth prospects in the coming years. In 2014, ANDE achieved its second consecutive year of record results, led by the strong performance of the ethanol business.

Key macroeconomic indicators are driving business growth for Andersons. An expanding world population, growing demand for protein, and strong preference for North American crops continue to drive growth for the company.

The Andersons made key acquisitions in 2014 that strengthened the company's storage capacity and its position in core business states, including Michigan and Texas, which will facilitate future growth. Auburn Bean & Grain contributed an additional six grain facilities and four agronomy locations.

Other investments across the company’s operations indicate a holistic approach to growth. The company diversified its rail business with the addition of barges to its portfolio. An increase in planted acres will expand the soybean business. The turf group strategically built inventories while the retail group reduced costs to boost profitability. Investments in risk management and grain marketing will complement the company-wide expansion and long-term investments.

### Financial Statement Analysis
ANDE ended 2014 with strong financial performance and a solid balance sheet. Working capital was $226.7m in December 2014, down only slightly from the year prior. Long-term debt fell to $298.6m from $375.2m indicating the company’s ability to pay down debt. The Andersons also maintained ample access to liquidity with an $850m revolver, which supported its grain business.

### Conclusion & Recommendation
Strategic acquisitions in growing regions of the country, a diversified product portfolio, and strong management direction contribute to our recommendation to buy ANDE. The company is organically diversified, with one business unit performing well during years that others do not.

Even with modest growth forecasts, our dividend discount model estimates the company is currently undervalued by more than 20.0%. At a current price of $39.71 we recommend investing in the company as it will bring rewarding returns. Our one-year target price represents a 28.23% stock price increase to $50.92.
Keurig Green Mountain Inc. (GMCR)

Recommendation: SELL

Valuation: $63.82

Last Price: $113.20

Adjusted P/E: 42

Style: Large Growth

Dividend Yield: 1.0%

Technical Analysis

<table>
<thead>
<tr>
<th>Bollinger Bands</th>
<th>Neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>Money Flow</td>
<td>Negative</td>
</tr>
<tr>
<td>Relative Strength</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

Introduction

Keurig Green Mountain, Inc. engages in the specialty coffee and coffee making business. The company consists of three operating segments: Specialty coffee, Keurig, and Canadian. The company sells K-cup portion packs, whole bean and ground coffee, and single-cup brewing systems. The $18.8b market capitalization company generated revenues of $4.7b and net income of $593m in 2014.

Fundamental Analysis

Green Mountain’s growth strategy relies heavily on driving purchases of Keurig brewing systems in order to generate demand for single portion K-Cup packs. To facilitate this strategy, Green Mountain sells its home brewing systems at cost, generating little or no profit. Increasing public condemnation of the unsustainable, plastic K-Cups raises concerns whether Keurig will continue its previous successes. Particularly as the company has not committed to achieving fully recyclable products until 2020 — a commitment customers are not satisfied with.

Green Mountain announced its international expansion strategy with focus on the UK, Australia, South Korea, and Sweden. This decision is risky in the current environment due to the strong market share Nespresso has captured in Europe as well as volatile foreign exchange rates in many of these markets.

Due to the company’s heavy reliance on product innovation strategies, we are not optimistic Green Mountain represents a valuable investment. Release of a new cold brewing machine is unlikely to boost sales, particularly as consumer preferences are rapidly changing, the market is consolidating, and the Keurig brand reputation is declining.

Financial Statement Analysis

Green Mountain has experienced unsustainable revenue and earnings growth over the last five years (95.0% in 2011, 46.0% in 2012, and 12.0% in 2013), which is unlikely to continue in the near future. GMCR’s strong historic performance is likely due to the low competition in the market. GMCR’s low total debt to enterprise value indicates the company has the opportunity to use significant leverage to finance growth. Overall, low dividend payments and unlikely growth prospects provide scrappy returns to investors, making the security a sell.

Conclusion & Recommendation

As the company’s growth and financial performance is highly dependent on sales of Keurig brewing systems and portion packs, changes in consumer preferences, volatile foreign exchange rates, and fierce competition from sustainable players such as Nespresso are potential threats to Keurig’s business. Our sell recommendation for GMCR is based on our negative view of management decisions and ability to adapt to the changing environment. According to our dividend discount model the company is significantly overvalued at $113.20 and unlikely to maintain past performance over the next few years.
**Tyson Foods Inc. (TSN)**

**Recommendation**: BUY

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

<table>
<thead>
<tr>
<th>Valuation</th>
<th>Last Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>$51.07</td>
<td>$38.16</td>
</tr>
</tbody>
</table>

**Adjusted P/E**: 11

**Style**: Mid Value

**Dividend Yield**: 1.0%

Tyson Foods, Inc. is a multinational food production company headquartered in Springdale, AR that sells fresh, frozen, and refrigerated products. The company has five operating segments: Chicken, Beef, Pork, Prepared Foods, and International. Tyson is the largest meat producer in the world and second largest food production company.

### Fundamental Analysis

Tyson’s operations are heavily concentrated in the U.S., with domestic sales accounting for 96.0% of 2014 revenue. The company’s single largest customer is Wal-Mart, which represented 14.6% of sales last year. Strong U.S. sales have benefited the company’s performance, particular in 2014, due to the increasing strength of the dollar compared to previous years.

Tyson’s primary competitive advantage is its diverse product portfolio and scale of operations. Tyson has a strong management team that celebrated record sales in 2014, up 23.0% from the previous year. The 2014 acquisition of Hillshire Brands fits well with the company’s effort to expand the wider-margin prepared-foods business, and it presents long-term benefits including growth acceleration. In total Tyson is expected to achieve more than $300m in synergies from the acquisition.

Strong chicken demand and lower than average feed costs contributed to the strong financial performance of the company. In early 2015, prices of cereal products continued to fall, reaching a 4-year low. This trend is expected to continue through 2015. Additionally, increasing health consciousness from consumers is driving demand for high-margin, protein-based meals.

Tyson has a strong management team that controls costs well and continues to make strategic investments. Management announced the sale of its Brazil and Mexico operations last year, contributing $575m cash to the company’s balance sheet and decreasing the company’s exposure to negative FX risk. We expect the strong past guidance to continue in future years.

### Financial Statement Analysis

In absolute terms, sales have grown steadily since 2006, reaching $37.5b in 2014 (9.1% YoY growth). Net income growth similarly remained strong growing by 1.9% to $864b. Tyson has maintained a high gross margin, largely due to well-managed costs; SG&A/sales has remained less than 3.35x over the last 8 years. EPS improved 17.5% YoY in 2014, backed by strong sales performance and higher operating margins. Overall, strong financial performance, strong growth prospects, and strategic investments make the stock a buy.

### Conclusion & Recommendation

Our strong buy recommendation for Tyson is grounded in our optimistic growth projections, particularly over the next two years, due to strategic direction, expected synergies from the Hillshire Brands acquisition, and favorable environmental and demand conditions.
Unilever PLC ADR. (UL)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>SELL</td>
<td>$31.47</td>
<td>$42.51</td>
<td>17</td>
<td>Large Core</td>
<td>3.5%</td>
</tr>
</tbody>
</table>

Technical Analysis

- Bollinger Bands: Neutral
- Money Flow: Negative
- Relative Strength: Neutral

Introduction

Unilever Plc is a multinational consumer goods company with product lines across Personal Care, Foods, Refreshment, and Home Care sectors. The company is headquartered in London, United Kingdom and operates in three regions: Asia, Africa and Central and Eastern Europe, and the Americas and Western Europe, and sells products in 190 countries. In 2014, Unilever experienced negative YoY growth with total revenue of $58.6m in 2014.

Fundamental Analysis

Weak consumer demand influenced underlying sales growth (-3.4%) resulting in lower earnings of $9.3m (-8.6% YoY growth). Currency depreciation in Unilever’s international markets posed significant challenges for the company’s operations. Heavy reliance on growth in emerging markets (57.0% of total sales) contributes to such challenges. The widespread, weak consumer demand in these markets, particularly China, negatively impacted the company in the last year. Developed markets, Europe in particular, also struggled for growth last year, contributing to negative investor sentiment. With much of its portfolio flat or declining in developed markets, Unilever desperately must increase cash and profitability levels in order to finance strategic growth.

The company’s most recent annual report says it expects “economic pressures to continue” with “consumer demand in emerging markets likely to remain subdued.” With this negative growth outlook, the company’s capital-intensive investments (building new plants in China, Indonesia, the Philippines, and Africa) are high risk in a volatile environment and unlikely to yield positive returns in the near future.

Financial Statement Analysis

Unilever has seen increasingly declining revenue growth since 2013, with -3.4% growth last year. Although revenue growth was poor, the company was able to manage costs to achieve positive net income margins with total growth of 6.0% in 2014. Despite small successes, our dividend discount model and EPS analysis suggests the stock is significantly overvalued. Given its recent performance, 2015 projections, and current environment, Unilever is not a valuable investment.

Conclusion & Recommendation

Across all markets, Unilever is not expected to achieve notable growth in the short term. Major economic drivers including weak consumer demand, negative pricing, and volatile exchange rates indicate the unlikely growth prospects for the company.

We recommend selling UL because of stiff competition, slowing economic growth in key markets, volatile exchange rates, negative pricing, and no expected rise in consumer spending. Unilever will not achieve 20.0% growth in 2015 and is, therefore, not a fruitful investment for the Crummer SunTrust Portfolio.
Energy

2014 Performance
Overall, the energy sector performed unfavorably in 2014. We analyzed each company’s stock price between March 27th, 2014 and our closing date, March 27th, 2015 to get a better picture of their performance. Two companies showed positive stock returns: PBF Energy’s stock price increased by 11.3%, while Enbridge’s share price grew by 4.9%. In contrast, Spectra Energy decreased by 7.6%, Canadian Natural Resources lost 19.9%, and StealthGas lost 55.9%.

As a result of the tremendous investments in midstream infrastructure in the U.S and Canada, a global oversupply of crude oil and natural gas caused commodity prices to plunge since July 2014.

The prices of all invested energy companies dropped following the fall in commodity prices. Yet, while the prices of Enbridge, Spectra Energy, PBF Energy, and to a certain extent Canadian Natural Resources were able to adjust by October 2014, StealthGas was correlated too strongly and its share price declined synchronously with the price of oil. It took until mid-December 2014 before StealthGas’ stock price settled.

Opportunities and Challenges in 2015
We believe the oversupply of energy commodities will persist in 2015, as production increases. While we estimate the price of crude oil to settle between $60 and $65, its volatility will remain high and sophisticated predictions are difficult. As a result, close to 50.0% of our proposed investment in the energy sector remains exposed to commodity prices. For the companies we continue to hold, we looked for management’s ability to counteract the plunge in oil prices. The remainder of our investment reflects the opportunity we see in companies largely independent from commodity prices, such as energy infrastructure companies, whose business models benefit from an oversupply of crude oil and natural gas.

To further decrease our risk and to take advantage of current market movements, we considered other innovative approaches to diversify the energy sector. In particular, we looked at energy infrastructure-related MLP (Master Limited Partnerships) ETFs that track an underlying index. We were attracted to the Global X MLP & Energy Infrastructure ETF that focuses on energy infrastructure, making it an attractive addition to our sector strategy. Although ETF’s are normally liquid, the Global X MLP ETF, like similar ETF products, poses a price risk if market sentiment shifts. Another potential drawback is that we currently hold two energy infrastructure companies, Spectra Energy and Enbridge, that the Global X MLP ETF also holds. To avoid double dipping, we are recommending reducing our exposure to these two companies in favor of the Global X Energy & Infrastructure MLP ETF.
Advanced Energy Industries Inc. (AEIS)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
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<td>$34.36</td>
<td>$25.61</td>
<td>19</td>
<td>Small Core</td>
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</table>

### Technical Analysis
- **Bollinger Bands**: Neutral
- **Money Flow**: Positive
- **Relative Strength**: Neutral

### Introduction
Advanced Energy Industries Inc. designs, manufactures, sells, and supports power conversion products that transform power into various forms. Its products enable manufacturing processes that use thin films for assorted products, such as semiconductor devices, flat panel displays, or thin film renewables. The company also supplies thermal instrumentation products for advanced temperature controls. The company operates in two business segments: thin films deposition power conversion and thermal instrumentation and solar energy.

### Fundamental Analysis
At the end of last year, Advanced Energy Industries announced a search for strategic alternatives in regards to its solar inverter involvement, due to the retirement of certain central inverter products. As a result, at the end of 2014 the company recorded a $14.0 million non-cash inventory charge which reduced net income and earnings per share.

In August 2014, Advanced Energy announced the acquisition of UltraVolt, which has a broad portfolio of high voltage power supplies and modules. The deal is expected to be completed in 2015. This addition immediately impacts revenues and increases profitability. Earlier in 2014, the company also acquired UK-based HiTek Power Ltd. to expand its thin film product offering.

Semiconductor investments are expected to go up by 5-10% and flat panel displays are expected to rise as well, both providing additional growth opportunities. This is primarily due to developments in next generation high-definition liquid crystal displays.

### Financial Statement Analysis
In 2014, revenues increased by 6.6% to $583.1 million and net income increased by 46.0% to $46.9 million. The company’s EBITDA decreased to $63.7 million, while its P/E ratio went down 20.3% to 20.8%. Advanced Energy currently intends to retain all future earnings to finance its business and does not anticipate paying cash or other dividends in the foreseeable future. Its free cash flow per share rose by 167.3% to $1.69. Earnings persistence for the company is 87.2, scaled from 0 to 100, where a higher result indicates healthier earnings. This is a measure of persistence in a company’s earnings per share.

### Conclusion & Recommendation
To continue growth and expand its portfolio, Advanced Energy acquired two promising companies in 2014. We expect investments into semiconductors to further increase and provide additional profits. We appreciate the company’s decent financial result, despite its $14.0 million non-cash inventory charge.

We see a lot of long-term prospects in Advanced Energy Industries and recommend adding it to our portfolio and holding it for a long term.
Canadian Natural Resources Limited (CNQ)

Recommendation | Valuation | Last Price | Adjusted P/E | Style | Dividend Yield |
--- | --- | --- | --- | --- | --- |
HOLD | $50.46 | $38.67 | 18 | Large Growth | 2.6% |

Technical Analysis

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

Introduction

Canadian Natural Resources Limited, one of Canada’s largest companies, is engaged in the acquisition, development and exploitation of crude oil and natural gas. Oil sales provide by far the most income, revenues are 9 times higher than for natural gas sales. Operations focus on Canada, the UK sector of the North Sea and offshore West Africa. The company is expected to have approximately 5.5 billion oil equivalent barrels in reserves and 3.6 billion barrels in oil sands reserves.

Fundamental Analysis

CNQ has a broad and diversified portfolio, geographically and product-wise, with low risk exploration and development projects yielding above average growth. In 2014, total crude oil and NGL production increased by 11.0%, while total natural gas production climbed 34.0%.

The company is working on improving cost management and capital flexibility in response to the volatile price for crude oil. Besides reducing capital guidance from $11.7 billion to $6.1 billion, it also cut management’s salaries by 10.0% and seeks to monetize its royalty lands business in 2015.

Canadian Natural Resources is financially healthy and able to adjust to changing markets. A capital ratio of 32.6% allowed management to increase dividends over the past 15 years and also illustrates how the company can increase its debt financing if earnings do not suffice. However, its long-term projects need significant capital outlays and years of development before cash flows will be generated. Cost and time overrun in its current projects negatively impacted its stock performance. The company needs to find solutions to lower such negative stock impacts from its long-term projects.

Financial Statement Analysis

In 2014, the company’s sales grew by 9.0% to $17.1 billion and net income climbed by 61.5% to $3.5 billion. Cash flow from operations increased by 28.1% to $9.6 billion, due to higher levels of crude oil, NGL, natural gas and synthetic crude oil sales volumes. Despite its reduction in capital guidance, Canadian Natural Resources displays good long-term growth opportunities. The low current P/E ratio of 9.47x makes an investment even more attractive, as we believe management will successfully lead it through this volatile time.

Conclusion & Recommendation

We value Canadian Natural Resources’ diversified portfolio, future projects, and financial strength. Management is proving its ability to adjust capital structures to counter volatile commodity prices. Its improved cost management will lay the foundation for future growth. The company is exposed to currency translation risks and the price of crude oil, while certain risks will persist, the company is strong enough to overcome them. We recommend reducing our position nonetheless to accommodate for this year’s risky and uncertain market environment.
Enbridge Inc. (ENB)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
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<tbody>
<tr>
<td>HOLD</td>
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<td>$61.06</td>
<td>46</td>
<td>Large Growth</td>
<td>2.6%</td>
</tr>
</tbody>
</table>

**Technical Analysis**

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<tbody>
<tr>
<td>Bollinger Bands</td>
<td>Neutral</td>
<td></td>
</tr>
<tr>
<td>Money Flow</td>
<td>Positive</td>
<td></td>
</tr>
<tr>
<td>Relative Strength</td>
<td>Neutral</td>
<td></td>
</tr>
</tbody>
</table>

**Introduction**

Enbridge Inc. transports, generates, and distributes energy in Canada and the U.S. The company is involved in natural gas transmission and midstream businesses and operates through liquids pipelines, gas distribution, gas pipelines, processing and energy services, and sponsored investments. Most revenues come from gas pipelines and energy services. It operates one of the largest liquids pipeline networks in North America. Most operating income is generated by sponsored investments into renewables and alternative energy. Enbridge operates in a highly regulated market with strong barriers to entry.

**Fundamental Analysis**

Enbridge aims to be the industry leader in safe, environmentally-conscious, and reliable energy delivery. Environmental issues are frequently raised in planning and decision-making. This will improve the already strong organizational structure.

In 2014, Enbridge invested more than $1.1 billion in leak detecting programs throughout its liquids pipelines segment. It is serious in following through its pioneering efforts and we see growth potential in its increasing efficiency.

Enbridge plans to invest $37.0 billion in growth projects over the next few years. A portion will be used to expand U.S. pipeline network and to renew its older pipelines. Further investments into renewable and alternative energy projects, such as wind, solar, geothermal, and waste heat recovery will foster future growth.

**Financial Statement Analysis**

In 2014, Enbridge’s sales grew 11.2%, albeit income from pipeline transportation remained almost equal. Net income increased by 102.9% to $1.2 billion, due to a hefty increase in operating and unusual expenses. Its high net income was partly redistributed to shareholders, triggering an 11.1% dividend growth. Further underscoring its good financial performance in 2014, its EBITDA increased by 18.2% to $3.8 billion and return of equity rose to 9.0%.

**Conclusion & Recommendation**

We believe Enbridge’s financial performance will help expand its business segments and pay dividends to shareholders. Rising oil and gas production levels in the U.S. require additional infrastructure spending and will lead to continued midstream growth, which Enbridge will capitalize on. The company produces reliable cash flows with little sensitivity to volume or commodity prices, more than 75.0% of its earnings are tied to fee-based contracts with terms exceeding 20 years.

We recommend holding Enbridge until it is fully valued. MLPX, an energy and infrastructure ETF we recommend investing in holds Enbridge shares among others. To avoid double-dipping, we recommend selling part of our Enbridge shares.
Global X MLP & Energy Infrastructure ETF (MLPX)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
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<tbody>
<tr>
<td>BUY</td>
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<td>$18.48</td>
<td>N.A.</td>
<td>Mid Cap</td>
<td>2.9%</td>
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</tbody>
</table>

Technical Analysis

- Bollinger Bands: N.A.
- Money Flow: Positive
- Relative Strength: Neutral

Introduction

As discussed in the energy sector overview, production of natural gas and oil continues to grow in 2015. Consequently, demand for energy infrastructure, such as pipelines and storage facilities, is expected to increase. As an innovative approach to take advantage of this increasing demand, and to further diversify our returns, we looked at several energy infrastructure MLP (Master Limited Partnerships) ETFs.

The Global X MLP & Energy Infrastructure ETF outperformed its category and achieved a total return of 16.5% in 2014. By comparison, the plunge in oil prices resulted in a -7.8% return for the S&P 500 energy index.

General Structure

Our recommended ETF uses a replication strategy and provides results that correspond to the price and yield performance of the Solactive MLP & Energy Infrastructure Index (underlying index), but it does not intend to outperform it. The underlying index tracks the performance of MLPs and energy infrastructure corporations. These own and operate assets used in energy logistics, such as pipelines, storage, or other assets used in transporting, storing, gathering, and processing natural gas, natural gas liquids, crude oil or refined products. Thus, the Global X Energy & Infrastructure MLP ETF addresses the very few opportunities we currently see in the energy sector.

Holdings

The Global X ETF invests 96.5% in energy infrastructure, with the remaining 3.5% in utilities. Unlike what its family name suggests, 90.8% is actually invested in U.S. companies and limited partnerships, with the remainder invested in Canada.

Incepted in August 2013, the ETF allocates around 65.0% of its assets in its top 10 holdings including Williams Companies, Enbridge, Kinder Morgan, Marathon Petroleum Corporation, and Spectra Energy. As discussed in the sector overview, we recommend reducing our investment in Spectra Energy and Enbridge to avoid double dipping.

Taxes

Unlike buying shares of a stock, when we would purchase a stake in the recommended MLP ETF, we actually acquire units of the partnership, similar to investing in a REIT. One of the biggest benefits of REITs and MLPs is their tax advantages, as both are considered pass-through entities under the U.S. federal tax code.

While shareholders in a corporation face double taxation, paying taxes first at the corporate level and then at the personal level when earnings are received as dividends, “unitholders” in a partnership are only taxed once when they receive distributions.
Similar to municipal bonds, these tax advantages are priced in the MLP ETF. Because of our non-profit status, we will not be able to take advantage of this tax break. However, despite this inability, the recommended Global X MLP & Energy Infrastructure ETF is still an attractive investment based on its return and diversification potential.

**Fundamental Analysis**

In order to get a better picture of how different energy infrastructure MLP ETFs have performed, we used the statistical analysis software EnCorr. We compared the recommended ETF with the Source Morningstar U.S. Eny InfrasMLP ETF (MLPS) and the Alerian MLP ETF (AMLP). In the following analysis, we will reference each ETF by its ticker.

Benchmarks were Morningstar’s MLP Focus and the Cushing 30 MLP TR. Due to the recent inception of MLPX in August 2013, analyzing return attributions or attribution-styles would not provide sophisticated and reliable results, so the fundamental analysis is limited to describing the return-risk relationships and fees.

**Return-Risk Relationship**

In 2014, MLPX produced an annual return of 16.5% with a standard deviation of 17.2%, compared to MLPS’s 1.5% and 16.5%. The Alerian ETF returned 4.8% and had the lowest standard deviation of 10.8%. Compared to the other two ETFs, MLPX offered a significantly higher return, while only having a slightly higher volatility. For further comparison, the S&P 500 energy index produced a return of -7.8% with a standard deviation of 16.4%. This implies that an investment in any of the three described ETFs would have been significantly more profitable than investing in the S&P 500 energy index.

Taking into account the 18 observations for all three ETFs since September 2013, MLPX's beta is 1.02, while MLPS's and AMLP's beta are 1.10 and 0.74, respectively. This means MLPX is reacting 8.0% less sensitively to market movement than MLPS, but 28.0% more sensitively than AMLP. R-Squared exceeds 85.5% for all series.

However, the most important statistic derives from the Sharpe Ratio. This ratio is widely used to indicate the risk-adjusted return. For 2014, MLPX had a ratio of 0.32x, compared to 0.05x and 0.15x for MLPS and AMLP, respectively. The S&P 500 energy index had a Sharpe Ratio of -0.11x. This means that MLPX offered by far the best risk-adjusted return.

**Fees**

MLPX charges net expenses of 45 basis points (bps), while MLPS’s fees are 50 bps, and AMLP’s are 543 bps. We also appreciate MLPX’s low fees in regard to its other peers, with the category average charging 71 basis points.

**Conclusion & Recommendation**

As the total production of natural gas, crude oil, and natural gas liquids will increase in 2015, demand for energy infrastructure will rise. This makes the recommended ETF, from which we expect a return above 15.0%, an attractive addition to our portfolio.

The Global X Energy & Infrastructure MLP ETF invests in a variety of energy infrastructure companies. Among these are our current holdings, Enbridge and Spectra Energy. We believe that the recommended ETF can better capture the returns of the entire industry segment than a potential increase in our investments in Enbridge and Spectra Energy alone could. To avoid double dipping, we recommend reducing our stakes in Enbridge and Spectra Energy in favor of the Global X Energy & Infrastructure MLP ETF.

Furthermore, we appreciate the recommended ETF’s low fees compared to its category average, since these will be subtracted from the ETF’s total return. In respect to its beta and Sharpe Ratio, we are hopeful that the recommended ETF will produce similar statistical results like in 2014.

We recommend buying units of the Global X MLP Energy & Infrastructure ETF and holding it until demand in energy infrastructure is declining, or until the energy market is more predictable and better investments can be identified. This investment allows us to further diversify our returns and we propose allocating approximately 16.0% of our energy sector funds towards it.
PBF Energy Inc. (PBF)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>HOLD</td>
<td>$42.54</td>
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<td>Small Value</td>
<td>4.5%</td>
</tr>
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</table>

Technical Analysis

- Bollinger Bands: Oversold
- Money Flow: Positive
- Relative Strength: Neutral

Introduction

PBF Energy Inc., one of the largest independent petroleum refiners and suppliers of unbranded transportation fuels, went public in December of 2012. The company also transports heating oil, petrochemical feedstocks, lubricants, and other petroleum products in the U.S. It owns and operates three oil refineries and related assets in New Jersey, Delaware, and Ohio, and operates in two business segments: refining and logistics.

Fundamental Analysis

In mid-2014, PBF Energy completed a project to expand its Delaware railroad terminal, which increased capability of its refinery from 40,000 barrels per day (bpd) to 80,000 bpd. The company has similar projects planned for 2015, which should increase throughput and efficiency.

PBF Energy’s profitability depends mainly on product margins and the price of crude oil, with both having fluctuated in 2014. To adjust to the volatile energy market, the company focuses on reducing transportation and distribution costs and increasing efficiency and reliability of its services.

The decline in the price of crude oil strongly affected its 2014 performance and showed strong risk exposure. However, management was able to utilize on the company’s diversified portfolio to bounce-back the stock price.

Financial Statement Analysis

In 2014, sales increased by 3.5% from 2013, but the 6.0% rise in cost of goods sold significantly reduced net income from $214.1 million to $78.3 million. This was due to declining oil and refined products prices, which cost the company an estimated $690.1 million. Excluding this impact, higher volumes and a better operating efficiency increased the company’s gross margin compared to 2013.

As a result, the company’s EBITDA fell from $535.9 to $184.1 million. Nevertheless, we suppose 2014’s P/E ratio of 7.61x is a result of an over-sensitive market. PBF Energy paid dividends of $1.20 in 2014, and we expect similar payouts to shareholders for 2015.

Conclusion & Recommendation

We suspect management can improve efficiency and throughput while reducing some costs to increase profitability. Higher volumes and an expanded infrastructure will foster the company’s future growth.

Volatility is a problem with PBF. Yet despite last year’s stock price decline, it was our second best performer and we expect 2015’s performance to be better.

We see potential in PBF Energy and do not think it is fully valued yet. Still, we recommend reducing our investment to lower our risk exposure.
Spectra Energy (SE)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
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<tr>
<td>HOLD</td>
<td>$46.72</td>
<td>$36.04</td>
<td>19</td>
<td>Large Value</td>
<td>3.8%</td>
</tr>
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**Technical Analysis**

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

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**Introduction**

Spectra Energy provides natural gas and related energy trading and marketing services. It operates in four business segments. Spectra Energy Partners provides transmission, storage, and gathering of natural gas and transportation and storage of crude oil and NGL through pipelines in the Midwest, Northeast, and Southeast of the U.S. and Canada. Its distribution segment serves residential, commercial, and industrial customers in Ontario through its subsidiary Union Gas Ltd. Its Western Canada Transmission & Processing segment is comprised of BC pipelines, BC field services, Canadian midstream and empress NGL and provides fee based natural gas transmission. The field service segment consists of investment into DCP Midstream.

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**Fundamental Analysis**

In January 2015, Spectra Energy agreed to acquire Brazoria Interconnector Gas Pipeline LLC. This addition will expand and further strengthen its service offering of pipeline transportation of natural gas.

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One of Spectra’s key competencies is economies of scale in gathering and processing natural gas and DCP Midstream, which accounts for a third of earnings. We believe Spectra will use its market knowledge and existing customer base to successfully adjust to changing markets and foster the company’s position.

While a reduction in demand for natural gas and oil and low market prices of commodities adversely affect the company’s operations and cash flow, long-term projects and reliable cash flows gave Spectra Energy the confidence to plan a dividend increase of $0.14 per year through 2017.

**Financial Statement Analysis**

In 2014, Spectra Energy’s sales went up by 5.3% to $5.8 billion, while net income increased by 4.2% to $1.1 billion. Earnings persistence for the company is 93.33, scaled from 0 to 100, where a higher result indicates healthier earnings. This is a measure of persistence in a company’s earnings per share. Dividends per share increased from $1.22 to $1.38. The company’s debt/equity ratio grew slightly and is currently at 63.5%.

**Conclusion & Recommendation**

Despite a poor performance in the second half of 2014, we believe Spectra has reached a low at the beginning of 2015 and we are confident that management’s ability to adjust to changing market conditions will be displayed by a rising stock price. Its financial result was promising and we predict dividends will increase as proclaimed by the company. MLPX, an energy and infrastructure ETF we recommend investing in, includes Spectra Energy among others. To avoid double-dipping, we recommend selling part of our Spectra Energy shares.

We are confident in the company’s long-term projects and reliable cash flows and recommend holding the stock for a longer period.
StealthGas Inc. (GASS)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
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</thead>
<tbody>
<tr>
<td>SELL</td>
<td>$5.52</td>
<td>$6.68</td>
<td>13</td>
<td>Small Value</td>
<td>N.A.</td>
</tr>
</tbody>
</table>

**Technical Analysis**

- **Bollinger Bands**: Neutral
- **Money Flow**: Negative
- **Relative Strength**: Weak

Introduction

StealthGas Inc. provides international seaborne transportation services to the liquefied petroleum gas sector. The company primarily carries crude oil, gasoline, petroleum and byproducts of natural gas and oil. These petrochemical gas products can be propane, butane, butadiene, isopropane, propylene and vinyl chloride monomer. In 2014, these products were shipped on 44.1 vessels on average. StealthGas has been exposed not only to the volatility of the oil price, but also to Greece’s econ-political struggles and the distrust of foreign investors.

Fundamental Analysis

The company operates in a niche market that had not fallen victim to the oversupply problems other shipping sectors were experiencing in 2013 and beginning of 2014. However, that changed in mid-2014 when the oil price plunged. As described in the sector overview, StealthGas’ stock price fell 55.9% since March 27th, 2014, due to a strong correlation with the price of crude oil. StealthGas’ fees depend on the value of its cargo.

In 2014, close to a fifth of its vessels were docked and not used for shipping any cargo, which implies that the cost of operating ships exceeded their generated income. We estimate that StealthGas would need the price of crude oil to be above $95.0 to be profitable.

More than 37.0% of its 54-ship fleet is over 20 years old. In November 2014, StealthGas announced the acquisition of two new LPG vessels, expected for delivery in late 2017. However, this investment will not sufficiently rejuvenate its fleet and the company has not expressed plans to acquire more ships.

Financial Statement Analysis

In 2014, sales grew by 8.6% to $132.0 million, while net income fell 40.1% to $12.7 million. This decrease was primarily due to 13.0% higher interest expenses and $7.5 million reported as “unusual expenses.” However, StealthGas was able increase retained earnings to better position the company for 2015. Its last dividend payments go back to 2008. StealthGas is currently not in a financial position to resume paying out dividends.

Conclusion & Recommendation

Despite StealthGas showing some potential due to its low stock price, we do not believe it can significantly bounce back from 2014. In 2015, we expect a strong dollar forcing foreign exchange losses, and the global oversupply of oil and natural gas will reduce the company’s shipments. In previous years, we hoped StealthGas could ship utilize on the oversupply of commodities and ship from the U.S. to foreign markets. Unfortunately, this has not happened yet. Though its price fell 55.9% in the past year, only our most optimistic discount models project Stealth Gas to be undervalued by more than 20.0% percent. The risk of continuing our investment in StealthGas outweighs the potential reward. We recommend refraining from investing in StealthGas and use the funds for more promising investments.
# U.S. Silica Holdings Inc. (SLCA)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
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<tbody>
<tr>
<td>BUY</td>
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<td>$29.75</td>
<td>16</td>
<td>Small Growth</td>
<td>2.0%</td>
</tr>
</tbody>
</table>

## Technical Analysis

- **Bollinger Bands**: Neutral
- **Money Flow**: Positive
- **Relative Strength**: Neutral

## Introduction

U.S. Silica Holdings, Inc. is a producer of a specialized mineral called commercial silica, which is a critical input in the oil and gas proppants end market. The company operates in the business segments of oil and gas proppants and industrial and specialty products. For the former, it provides fracturing sand used to stimulate the flow of hydrocarbons in oil and natural gas wells. This fracturing sand is also an irreplaceable material for the latter. It is used in glass-making and chemical manufacturing. The company provides fracturing sand for industries producing container glass, fiberglass, specialty glass, flat glass, building products, fillers and extenders, chemicals, recreation products and filtration products.

## Fundamental Analysis

U.S. Silica’s core competencies are mining, processing, logistics and material science. These attributes allow cost-effective production and delivery of a wide range of over 260 products. This diversity is important, as the change in supply and demand in oil leads to current demand and price fluctuations.

The company receives stable cash flows from industrial products, which are influenced by housing starts, vehicle sales and industrial production. We believe these drivers provide growth opportunities, since it currently only accounts for 25% of revenue. This decreases the company’s dependency on the oil price.

In July 2014, U.S. Silica announced the acquisition of Cadre Service, a leading sand mining company in Texas. Cadre Service is a strategic addition to the company’s assets and will bring higher volumes. In the long-term, we expect oil and gas drilling to grow, demanding more of U.S. Silica’s fracturing sand. U.S. Silica Holdings admits an increased diesel price adversely affects operations and that the recent decline in oil price reduced drilling activities in North America. As a result, demand for fracturing sand is expected to decrease by 14.0% in 2015, before bouncing back.

## Financial Statement Analysis

U.S. Silica’s 2014 revenues increased by 61.0% to $876.7 million and net income rose by 61.6% to $121.3 million. Return on equity rose from 27.7% to 34.0%. The company increased its dividend payments by 33.0% to $0.50 to reflect its growth. This equals a dividend yield jump from $1.10 to $1.95 in the past two years. The company reduced days of inventory in hand from 49.3 days to 39.1 days and significantly decreased its net operating cycle from 61.1 days to 43.3 days. Its EBITDA jumped from $150.9 million in 2013 to $221.4 in 2014.

## Conclusion & Recommendation

U.S. Silica has experienced some tremendous growth in the past. We see even more growth opportunities in providing fracturing sand to glass makers and chemical manufacturers. We also expect a long-term growth in demand for oil and gas proppants, which provides advantages for the company. We recommend purchasing U.S. Silica and holding it for a longer position.
Financials

2015 Outlook
A muffled recovery in the U.S. economy has supported financial sector earnings in recent months. Loan demand has been showing improvement along with employment growth. Moreover, indicators have shown small business lending returning to levels seen prior to the financial crisis. As economic conditions improve, the economic environment will become more conducive to increased lending, which will be an important source of revenue for banks.

Interest Rates
Companies with exposure to the U.S. economy will be better positioned than their global peers. The U.S. economy remains in a mid-cycle expansion phase, with speculation beginning to turn toward a potential increase in U.S. interest rates, while Europe appears to be in a mid-cycle slowdown and Asian growth is decelerating. Banks and financial companies with U.S.-focused businesses may outperform global peers, although stock selection is important given current valuation levels. There is much market speculation about U.S. interest rates—whether they are headed higher, and, if so, when and to what magnitude. We believe that interest rates will remain unchanged through most of 2015—there is potential for a shallow increase toward the end of the year or beginning of next year.

Increased Regulation
Increased regulatory pressure on banks and financial services companies has led to higher costs for compliance, controls, regulatory systems, and other areas. The scope of regulation also is expanding from banks to other parts of the financial services industry, such as insurance companies and asset managers. Meanwhile, rising litigation, as well as an increase in individual criminal prosecutions, has prompted companies to become defensive or even to exit certain businesses. This can lead to unintended consequences such as companies postponing projects because of regulatory uncertainty.
American International Group Inc. (AIG)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
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<tbody>
<tr>
<td>HOLD</td>
<td>$65.55</td>
<td>$54.03</td>
<td>12</td>
<td>Large Value</td>
<td>1.0%</td>
</tr>
</tbody>
</table>

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

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

Fundamental Analysis
AIG has paid the entire loan amount back to the U.S. government after the rescue plan from the federal government in 2008. AIG is again 100.0% owned by its common shareholders. New management has focused on its core business and divested non-core assets. AIG is expected to sell off its 46.0% ownership in AerCap, which is valued at over $4.0 billion. Its current share price is well below book value and its aggressive repurchase plan will likely continue throughout 2015.

Financial Statement Analysis
Last year AIG spent $4.9 billion on stock buybacks. It has already approved another $2.5 billion for 2015. Combined with its 1% dividend yield, this amounts to a healthy 7.5% total payout yield. AIG may accelerate this buyback plan considering its stock is currently trading significantly below its book value of $77.68. An increase in its announced buybacks would further increase its total payout yield and management has indicated that the approved $2.5 billion for 2015 buybacks might be just a start for the year.

Additionally, AIG spent $5 billion on repurchasing high coupon debt in 2014 and issued debt with lower interest rates. This hurt its 2014 Q4 results but will prove beneficial in the future. This will save AIG about $250.0 million in annual interest payments.

Conclusion & Recommendation
We believe that AIG’s shares are a HOLD as we expect the company to continue to increase revenue and operating earnings by leveraging its leading insurer position given its diversified and unique franchise in both domestic and international markets. It is among the top sellers of workers compensation, professional liability, and property coverage globally.

AIG is successfully divesting its non-core assets and increasing liquidity and credit profile, enabling the company to focus on its core insurance businesses. AIG has also aimed to reduce exposure to businesses with inadequate pricing and increasing loss trends through simplified reinsurance and capital arrangements. The company is also focusing on reducing operating expenses, which will increase operation margins. Using our DCF model, we believe that AIG’s shares are undervalued, which supports our HOLD recommendation.
BlackRock Inc. (BLK)

<table>
<thead>
<tr>
<th>Recommendation</th>
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<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
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<tr>
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<td>$361.63</td>
<td>19</td>
<td>Large Growth</td>
<td>2.2%</td>
</tr>
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</table>

Technical Analysis

- Bollinger Bands: Neutral
- Money Flow: Positive
- Relative Strength: Neutral

Introduction

BlackRock (BLK) is the largest asset manager in the world, with over $4.65 trillion in assets under management. Its acquisitions of iShares changed its profile from a fixed income into a multi-product manager. BLK’s business is truly global with 45.0% of its revenues coming from outside the United States. BLK has franchises in institutional fixed income, ETFs, alternatives, and cash.

Fundamental Analysis

BLK is the largest asset manager in the world, and it has a very strong franchise in many areas. BLK’s business is global with 45.0% of its clients coming from outside the United States. However, with a weak international economy this could be damaging to BLK’s earnings. Additionally, increased operating expenses is a concern along with increased regulatory compliance costs and marketing costs leading to higher expenses.

Conclusion & Recommendation

We believe that BLK’s shares are a SELL. Elevated expenses, high dependence on fee-based revenues, and regulatory restrictions on BlackRock’s revenue sources are concerning. While the company is still in strong financial standing, we believe that the market is not accounting for the above-mentioned risks, leading to the company being over-valued.

Financial Statement Analysis

A persistent rise in adjusted operating expenses with a CAGR of only 4.6% over the past four years is concerning. The company generates about one third of its revenues from overseas markets. This number has increased each year for the past several years. There has been a number of risks in these markets stemming from economic and political instability and foreign exchange fluctuations. We believe that this will negatively affect its growth. Finally, 87.0% of its revenue comes from administration and securities lending fees. The increased dependence on these fees puts the company at risk.
Discover Financial Services (DFS)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
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<td>$56.57</td>
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<td>Large Value</td>
<td>1.7%</td>
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Technical Analysis

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<tbody>
<tr>
<td>Bollinger Bands</td>
<td>Positive</td>
</tr>
<tr>
<td>Money Flow</td>
<td>Positive</td>
</tr>
<tr>
<td>Relative Strength</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

Introduction

Discover Financial Services (DFS) is a direct banking and payment services company in the United States. The company offers credit cards, personal, student and home loans as well as deposit products. DFS operates in more than 185 countries. DFS offers its services through three difference networks. The Discover Network is its financial credit card payment network. The PULSE network is its ATM, debit, and electronic funds transfer network. Finally, Diners Club International is its global payment network. DFS operates in two segments. Its Direct Banking segment issues credit cards to individuals and small businesses; it also offers student loans, home loans, personal loans, and prepaid cards. Its other segment is Payment Services known as its third party issuance business where it issues credit and debit cards for third part parties.

Fundamental Analysis

As the industry leader in customer satisfaction and loyalty, DFS has a large moat and ranks among the top credit card companies in the country. The muffled economic recovery has helped drive DFS’s revenue as unemployment rates and consumer spending continues to improve. It continues to launch new products tailored to meet specific customer needs in order to attract new customers. DFS regularly forms alliances to boost card acceptances and expand its network, giving it a competitive advantage. The partnerships with Google Wallet, eBay’s PayPal, and Obopay are helping in this regard by drawing the technology-friendly young crowd.

Financial Statement Analysis

DFS’s stock price suffered after the release of fourth quarter earnings due to missing estimate earnings. Low earnings are attributed to an increase in loan-loss reserves. This allows an opportunity to purchase DFS at a substantial discount. Last year the DFS board approved a $3.2 billion buyback plan to continue through 2016. Over the past year, it has repurchased $1.5 billion and is well positioned to continue repurchasing shares throughout this year. Since 2011, it has increased dividends regularly as seen in 2014 with a 20.0% increase in cash dividends. Card sales volume increased by 5.0% and loans increased by 6.0%. We believe that the strengthening economy with lend to even greater sales in 2015. Finally, DFS’s student loan portfolio has proved successful with a four year 71.0% CAGR.

Conclusion & Recommendation

We believe that DFS shares are a BUY. DFS is competitively positioned to profit from the recovering economy and increased disposable income. An extensive student loan portfolio, global expansions, prudent capital management, and increased card sales will drive growth.
JPMorgan Chase & Co. (JPM)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
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<tr>
<td>BUY</td>
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<td>$59.55</td>
<td>10</td>
<td>Large Value</td>
<td>2.9%</td>
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</tbody>
</table>

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

Introduction
JPMorgan Chase & Co., a financial holding company, provides various financial services across 60 countries worldwide. The company operates through four segments: Consumer and Community Banking, Corporate & Investment Banking, Commercial Banking, and Asset Management. JPM’s profitability is dependent on consumer and commercial borrowing activity, investment banking, and the overall health of the financial markets.

Fundamental Analysis
JPM has chosen to emphasize the retail and small business lending markets. We believe that this provides a great differentiation versus the other integrated financial institutions. With borrowing in the current interest rate market remaining cheap, JPM is positioned to gain business as the markets turn and consumers continue to increase borrowing and investing.

The key source of JPMorgan’s earnings stability is its business diversification. There is a wide range of organic growth opportunities available for the company, such as

Financial Statement Analysis
The consensus estimate is that JPM’s revenue growth will improve by 2.0 to 4.0% in 2014 driven by growth of net interest income, loans, and net interest margin. JPM in 2013 was able to increase consumer deposits by 10.0%, commercial loans by 7.0%, and deposits by 3.0%, and finished the year with a record $1.6 trillion in assets under management. This growth is now increasing earnings as JPM recently announced a 10.0% dividend increase and intends to repurchase up to $6.4 billion in common stock over the next 12 months. Furthermore, as the economy improves, short-term interest rates may rise in 2015. Therefore, both loan and deposit balances could grow in this improving economy.

Conclusion & Recommendation
We believe JPM’s shares are a BUY as the company has a wide range of organic growth opportunities available to it. With some help from higher interest rates, this performance could result in a growing top line. We also think its legal costs peaked in 2014 and earnings could improve significantly once these legal costs are behind the company. JPM is reducing costs by bringing down operating expenses.
LendingClub Corp. (LC)

<table>
<thead>
<tr>
<th>Recommendation</th>
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<th>Last Price</th>
<th>Adjusted P/E</th>
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<tr>
<td>BUY</td>
<td>$26.00</td>
<td>19.55</td>
<td>N.A.</td>
<td>Small Growth</td>
<td>N.A.</td>
</tr>
</tbody>
</table>

Technical Analysis

- Bollinger Bands: Positive
- Money Flow: Neutral
- Relative Strength: Positive

Introduction

LendingClub Corp. is an online marketplace that facilitates loans to consumers and businesses and offers investors an opportunity to finance the loans. Its objective is to transform the banking and consumer finance industry to make it more cost efficient, transparent, and consumer friendly. Its marketplace connects borrowers and investors and provides a variety of services including screening borrowers for loan eligibility and facilitating payments to investors. The platform was originally intended to match individual and small business borrowers with individual investors. However, with increased popularity, it has become increasingly used by large institutional investors, which now account for up to 90.0% of capital deployed, by some estimates. The company is unique for the finance industry in that it is less affected by interest rate changes because it does not carry loans on its balance sheet.

Fundamental Analysis

Launching its IPO in December of last year, LendingClub is the largest peer-to-peer lender in the world. The financial technology company has been on an enormous growth trajectory, more than doubling its revenue annually since its inception in 2006 and attracting investors such as Google and Fidelity. In 2014, LC originated $4.4 billion in new loans, collecting fees ranging from 1.1% to 5.0% per loan.

LendingClub recently announced partnerships with Google and Alibaba to expand its loans beyond the amounts it currently offers and enable a large, new audience to use the service. In this partnership, LendingClub will offer lines of credit up to $600,000 for business customers of Google and Alibaba. This partnership will provide an influx of new customers in which the company will be able to charge higher origination fees.

Financial Statement Analysis

LendingClub fourth quarter earnings estimates were $66.0 million. It beat these estimates by more than 5.0% at $69.6 million. The company is expecting to generate $350 million in revenue for 2015, but with the announced partnership with Google and Alibaba in February, this could jump to $400.0 million.

Conclusion & Recommendation

We believe that LendingClub is a BUY. Although investing in such a young company poses additional uncertainties, LendingClub is undervalued and has enormous growth potential. LendingClub originated $1.4 billion in loans in the fourth quarter of 2014—more than double that of the same quarter in 2013. In 2014, LendingClub originated $4.4 billion in loans. To put that number in perspective, consider that the company originated just $3.2 billion in its history prior to 2014. This disruptive business model is rapidly transforming the industry for both borrowers and creditors.
Morgan Stanley (MS)

<table>
<thead>
<tr>
<th>Recommendation</th>
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<tbody>
<tr>
<td>SELL</td>
<td>$37.16</td>
<td>$35.83</td>
<td>15</td>
<td>Large Value</td>
<td>1.1%</td>
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Technical Analysis

- Bollinger Bands: Neutral
- Money Flow: Positive
- Relative Strength: Neutral

Introduction

Morgan Stanley is a global investment bank that has a well-rounded breadth of business lines. MS operates in three segments: Institutional Securities, Global Wealth Management, and Investment Management. Investment management consists of traditional asset management, merchant banking, and real estate investing activities.

Fundamental Analysis

Morgan Stanley has suffered from a number of recent managerial issues from high operating expenses, losing several large wealth management teams, losing its CFO to Google, and receiving negative PR for its “Hunger Games” parody. Additionally, Morgan Stanley has significant exposure to structured investment vehicles and commercial mortgage-backed securities, which may lead to future write-downs. The company experienced intense pricing competition in some of its businesses in recent years, particularly in trading commissions. Thus, competitive pressures are expected to dent revenue growth prospects as its peers may seek to obtain market share by reducing prices.

Financial Statement Analysis

MS has been under fire from the U.S. Department of Justice in regards to its sale of residential mortgage-backed securities. The company has recently reached a $2.6 billion settlement with the Department of Justice, which will lead to a 46% hit out of the company’s 2014 earnings which will drag down investor confidence. The company’s reputation suffered owing to its role in the financial crisis leading to a reduction in sales. Furthermore, MS took a $1.8 billion hit to cash flows in 2014 due to exchange rate headwinds. This is could intensify in 2015 as the dollar continues to remain strong relative to the Euro.

Conclusion & Recommendation

Morgan Stanley’s is suffering from numerous issues and we believe that the company is currently over valued resulting in a SELL recommendation. Its performance has lagged behind competitors and its reputation has continued to deteriorate over the past year.
Travelers Companies, Inc. (TRV)

<table>
<thead>
<tr>
<th>Recommendation</th>
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<th>Last Price</th>
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<th>Dividend Yield</th>
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<tbody>
<tr>
<td>SELL</td>
<td>$106.27</td>
<td>$107.13</td>
<td>11</td>
<td>Large Value</td>
<td>2.0%</td>
</tr>
</tbody>
</table>

**Technical Analysis**

- Bollinger Bands: Neutral
- Money Flow: Positive
- Relative Strength: Neutral

**Fundamental Analysis**

Travelers crushed last quarter’s EPS consensus number by 21.0%, which was the ninth time in the last ten quarters that the company beat analyst estimates. The company also beat consensus revenue estimates, which was its eighth time in ten quarters. This has driven up the company’s price causing it to be over-valued, as the company will not be able to meet increasing higher estimates suggesting that TRV will have a price correction.

**Financial Statement Analysis**

Travelers’ stock price gained over 31.0% in the last twelve months, which is more than double the average insurance stock (15.1%) and more than quadruple the performance of the average financial stock (5.5%). These price increases are due to better than expected earnings. This was driven by less than anticipated catastrophe losses and stronger than expected favorable loss reserve releases. However, the less than anticipated catastrophes over 2014 were anomalies and future years could prove more catastrophic, hurting TRV’s earnings.

Travelers has a significant exposure to asbestos and environmental claims as well as related litigation owing to high market shares of historical acquisitions. In the past, the company had to make reserve additions for its asbestos exposure. We are concerned that Travelers may continue to take extraordinary reserve additions for both asbestos and environmental exposure.

**Conclusion & Recommendation**

We believe that TRV’s stock is overpriced and take a SELL position. TRV’s recent better than expected earnings has created a substantial increase in its stock price leading to the company’s stock price being over-valued. Furthermore, recent restructuring in management and international acquisitions create additional risks.
**U.S. Bancorp (USB)**

<table>
<thead>
<tr>
<th>Recommendation</th>
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<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
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<tbody>
<tr>
<td>SELL</td>
<td>$46.37</td>
<td>$42.86</td>
<td>14</td>
<td>Large Growth</td>
<td>2.3%</td>
</tr>
</tbody>
</table>

**Technical Analysis**

- **Bollinger Bands**: Neutral
- **Money Flow**: Positive
- **Relative Strength**: Neutral

**Introduction**

U.S. Bancorp is a commercial bank that offers commercial lending, mortgages, and retail banking to consumers and small businesses. U.S. Bancorp is the fifth-largest U.S. money center bank, with over $400 billion in assets under management. The company has major operations in real estate banking, consumer and small business lending, wealth management, and payment services.

**Fundamental Analysis**

U.S. Bancorp continues to encounter many investigations and lawsuits from both investors and regulators. Though the company resolved certain litigations related to the sale of risky mortgage-backed securities, many of the cases are yet to be resolved. All these are expected to lead to increased expenses and litigation provisions in the near term. We are also concerned about the regulatory issues, which are expected to pose as headwinds for the company’s profitability going forward. Such regulations are likely to reduce fee income growth prospects, increase compliance costs, and subject the company to a number of restrictions. Though such measures are aimed at improving the overall health of the banking system, we believe that such stringent capital norms might somewhat limit the company’s flexibility with respect to its lending volumes and investments in growth initiatives.

**Financial Statement Analysis**

Net interest margins have been trending downward since 2011. Its net interest margin was 3.2% in 2014, 3.4% in 2013, 3.6% in 2012, and 3.7% in 2011. Given the low interest environment, we believe that this downward trend will continue in the short-run. Additionally, USB’s efficiency ratio has been volatile over the past several years. It has gradually climbed from 48.4% in 2010 to 53.2% in 2014. This increase in efficiency ratio is concerning.

**Conclusion & Recommendation**

Based on our analysis we believe that USB’s stock is a SELL. The net interest margin will likely remain under pressure, as interest rates remain low. Unresolved litigations and strict regulatory reforms are expected to drive expenses and temper profitability going forward.
Healthcare

Introduction
While the S&P 500 healthcare sector was up over 23% last year, the strong positive macro trends will continue to spur growth. The main drivers for growth in the healthcare sector are a rapidly aging population, increasing access to care, technological advancements and product innovation, and an industry wide effort to cut costs. These trends will continue to increase spending on healthcare in the U.S. and globally.

Macro Overview
For the next 19 years, 10,000 individuals will turn 65 every day. By 2030, the percent of Americans that have reached retirement age will have grown from 13.0% to 18.0%. In addition to the population getting older, the population is getting increasingly more overweight with 65.0% of American adults overweight. To be blunt, as the population becomes increasingly old and fat, healthcare spending will increase dramatically.

More people have access to healthcare than ever before. In the U.S., the Affordable Care Act has expanded coverage to more than 10 million previously uninsured people and that number will continue to grow. Growth in the U.S. is particularly important because the nation spends more on healthcare per capita than any other country in the world. Globally, emerging markets are rapidly increasing access to care from the most basic care in Sub-Saharan Africa to the growth of more modern healthcare in China.

New products and technologies are emerging that are improving care and the way that healthcare companies run their businesses. Large pharmaceutical companies are innovating at an unprecedented rate, finding solutions for previously incurable diseases. A large part of this innovation is coming from biological medicine. Biological medicine, or BioPharma, is any medicine that is extracted or synthesized from biological sources. This previously unknown way of making medicine has provided successful solutions to illnesses from cancer to gene therapy. As with most new innovations, BioPharma’s products are relatively expensive and difficult to copy. The additional expense of BioPharma will further increase spending on healthcare going forward.

While there are many positive trends for healthcare providers, there is also industry wide pressure to cut costs. At about $8,000 per person, the U.S. spends more than any country in the world on healthcare. Norway is a distant second spending around $5,000 per person. About 18.0% of U.S. GDP comes from healthcare, and that number could continue to grow. In the U.S. and globally, there is a push to reduce the ballooning spending on healthcare. However, the great thing about healthcare is that demand is relatively inelastic.

Equity Selection and Summary
The outlook for healthcare is favorable. Pressure to decrease costs necessitates using caution when selecting equities in this space. Some companies in the space will be squeezed to reduce spending. It is important to look for companies that are diversified, have products that are difficult to copy, and have strong market share. These three factors will play a role in whether the companies will benefit from the increased spending or be squeezed by the pressure to reduce costs.

Strong macro drivers in this space that will undoubtedly create winners and losers in the years to come. In order to benefit from these trends companies must have a diversified portfolio. Businesses that strong market share and are difficult to replicate will benefit the most. All of the equities below have been evaluated based on its ability to benefit in this environment.
Abbott Laboratories (ABT)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
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<td>$46.76</td>
<td>31</td>
<td>Large Core</td>
<td>2.0%</td>
</tr>
</tbody>
</table>

### Technical Analysis
- **Bollinger Bands**: Neutral
- **Money Flow**: Positive
- **Relative Strength**: Neutral

### Introduction
Abbott Laboratories is a diversified provider of healthcare and related products. The corporation has created a number of leading and revolutionary pharmaceuticals, such as Humira, Norvir, and Depakote.

### Fundamental Analysis
Abbott is a world leader in many areas of the healthcare industry and offers investors both growth and income. The company is well positioned to grow from the many tailwinds in the healthcare industry and has reliably increased its dividend.

Abbott has a broad and balanced portfolio with Medical Devices representing 27.0% of sales, Established Pharmaceuticals representing 16.0% of sales, Diagnostics representing 23.0% of sales, and Nutrition representing 34.0% of sales. This balanced portfolio protects the company from a downturn in any one sector of healthcare and allows the company to benefit from the many positive macro tailwinds mentioned in the sector overview.

### Conclusion & Recommendation
Abbott Laboratories is one of the best positioned companies to benefit from the macro economic tailwinds in the healthcare sector. The company has uniquely positioned itself for better than expected growth through exposure to strong emerging markets. Along with the growth, the company reliably pays a dividend. All of this suggests that Abbott is undervalued at current levels.

Compared to other large healthcare manufacturers Abbott has exposed geared itself to benefit from the growing penetration in emerging markets. This geographic exposure gives the company higher growth potential and as the company is first in nutrition and blood screening globally, it is uniquely able to benefit from emerging market growth.

Over the course of 2014, Abbott has made underlying improvements in gross margin, particularly in cutting costs in corporate functions and diagnostics. This resulted in a 2014 gross margin of 56.9%. Abbott’s performance is indicative of its strong management team continuing to improve its current business. That same team is skilled at adding to its portfolio, which the company is poised to do.

### Financial Statement Analysis
Abbott’s balance sheet is only 0.7x levered (net debt) and will soon be receiving about $5.3 billion from divesting the EPD business. With an additional $3.8 billion in free cash flow, Abbott easily has $15.0 billion in balance sheet capacity to add to its portfolio of businesses and return cash to shareholders. While it is hard to tell what Abbott will do with the flexibility on its balance sheet, the management team has a long history of adding value through M&A and it is likely history will repeat itself here.
Amgen (AMGN)

Recommendation | Valuation | Last Price | Adjusted P/E | Style | Dividend Yield
--- | --- | --- | --- | --- | ---
BUY | $198.12 | $163.38 | 24 | Large Growth | 1.6%

Technical Analysis

<table>
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<th>Tool</th>
<th>Recommendation</th>
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<tbody>
<tr>
<td>Bollinger Bands</td>
<td>Neutral</td>
</tr>
<tr>
<td>Money Flow</td>
<td>Positive</td>
</tr>
<tr>
<td>Relative Strength</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

Introduction

Amgen is a global biotechnology company focused on the development, manufacturing, and commercialization of novel biotherapeutics primarily in cancer, nephrology, inflammatory diseases, and now bone diseases. The company’s core business is its erythropoietin stimulating agents and neutrophil stimulating franchises.

Fundamental Analysis

Amgen is an attractive stock because of its strong pipeline, relatively undervalued biosimilars business, and commitment to improving margins and returning cash to shareholders.

Amgen has several new yet mid/late stage pipeline drugs (PCSK9, CGRP migraine drug, anti-sclerostin, etc) reporting data or coming to the market in the next 12-18 months. PCSK9 is particularly attractive as an injectable mechanism for lowering cholesterol. The estimates for this drug are relatively modest for such a huge market. The news flow for these drugs can act as a catalyst to push the stock higher in the near term.

Wall street views Amgen’s biosimilars business as a hedge. Depending on how regulators view biosimilars, the company is at risk of some of its core business eroding. In response the Amgen has developed its own biosimilar’s business, but the business is more than a hedge. The biosimilar section of the business could do $3.0 billion dollars in 2016. If the regulators favor biosimilars, then Amgen is positioned to grow that part of its business.

Amgen has said that the guidance that the company gave on improving margins was conservative. It is likely that Amgen will beat expectations on margin improvements. Increasing margins as well as improving the overall business will help the company return cash to shareholders. Amgen could raise dividends as much as 30% in the next year, with even more growth to follow.

Financial Statement Analysis

Amgen has provided guidance on margins through 2018 (52.0 – 54.0%). This represents a meaningful increase over recent performance (37.0% in 2013, 44.0% in 2014). Management admitted that those estimates were relatively conservative and most believe Amgen will beat those numbers.

Conclusion & Recommendation

Amgen is a well diversified biopharmaceutical provider. The company has a pipeline loaded with exciting new products and a budding biosimilars business that will act as a hedge against regulatory risk as well as a profit center for the company. The company also will materially increase its dividend in the coming years. Amgen is a strong player in the market that is committed to creating value for shareholders which makes the company a great addition to the portfolio.
Exelixis, Inc. (EXEL)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
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<tr>
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<td>$2.54</td>
<td>N.A.</td>
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<td>0.0%</td>
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</table>

Technical Analysis

- Bollinger Bands: Negative
- Money Flow: Negative
- Relative Strength: Negative

Introduction

Exelixis is a biopharmaceutical company that focuses on small molecule therapies for different types of cancers. The California based company is focusing its resources on the commercialization of Cometriq for the treatment of progressive thyroid cancer.

Fundamental Analysis

Exelixis’ future depends on the success of its drug Cometriq. In 2014, there were two major negative events that showed weakness in the development of Cometriq. In March 2014, Exelixis’ stock was hammered after the independent data monitoring committee suggested that the COMET-1 study be run to completion during an interim analysis. This was the first sign that the COMET-1 study would fail, leading the stock to be down over 70.0% during 2014.

In addition to the failure of the COMET-1 study, Exelixis has been hit hard with concerns surrounding its use of cash. With Cometriq as a treatment for metastatic castration-resistant prostate cancer off the table investors are questioning whether or not the company has the cash to survive until it reports its two other important late-stage results in its METEOR and CELESTIAL trials for renal cell carcinoma and hepatocellular carcinoma. Data from these studies does not come out until 2015 and 2017. The company appears to have enough cash to sustain through its METEOR study, but a negative result would be detrimental to the company.

There is some hope for Exelixis if they can persevere and the upcoming trials are successful. The company trimmed down from over 200 employees to 70 in 2014 and is running a much leaner operation in order to conserve cash. Additionally, Exelixis is beginning to broaden its portfolio of products working with other large drug companies to find solutions.

Financial Statement Analysis

Exelixis financial statements are show large and increasing operating losses. The company has had massive declines in revenue and operating margin since 2011 and the trend appears it will continue. The big question for the company is how long its cash will hold out. With around $80 million in cash and at 100.0% debt to assets, it appears the company will be able to sustain until late 2015 at which point it will need an infusion of cash.

Conclusion & Recommendation

Exelixis future is highly geared to the success or failure of the METEOR study. It is hard to tell at this moment what the results will be, but there are few near term catalysts that could send the stock back to previous levels. The company’s risk vs. reward equation makes it a poor investment choice at this moment.
**Express Scripts Holding Co (ESRX)**

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<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
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<td>Large Growth</td>
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### Technical Analysis

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

The mail order pharmaceuticals business was a significant part of Medco. It is easy to see that the convenience and efficiency of mail order medicine will drive the growth of the sector going forward. As pressure to cut costs reverberates throughout the healthcare system, more business will move towards the more efficient mail order model.

As more and more branded drugs go generic it improves ESRX business significantly. The company benefits from multiple generic manufacturers bidding against one another for a product instead of one branded manufacturer. Biosimilars are particularly important to PBMs because biological products are higher margin. In the same way that a drug going generic helps ESRX, the availability of biosimilars will significantly improve earnings.

### Financial Statement Analysis

Many people misunderstand ESRX’s earnings and cash flow. ESRX’s long history of successful acquisitions has left them to have extremely high depreciation expenses. Once the PBM market consolidation slows, ESRX will no longer have these one time costs and you will see a significant increase in earnings. For example, in 2014, the company generated around $2.0 billion in net income compared to around $4.5 billion in free cash flow.

### Conclusion & Recommendation

This company is a dominant player in a growing space. The management team has proven time and time again that they are able to make lucrative acquisitions and this should continue. When you combine the inorganic growth potential with the many tailwinds ESRX has to grow its current business, you have a very attractive investment. The huge free cash flow generation sweetens the deal even further.
Novartis AG (NVS)

Recommendation: BUY

Valuation: $123.5

Last Price: $100.40

Adjusted P/E: 24

Style: International

Dividend Yield: 2.7%

Technical Analysis

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

Introduction

Novartis is a global biopharmaceutical company. The company has five segments: Pharmaceuticals; Alcon, which includes surgical, ophthalmic pharmaceutical and vision care products; Sandoz, which includes generic pharmaceuticals; vaccines and diagnostics, which include human vaccines and blood-testing diagnostics; and consumer health, which includes over-the-counter medicines (OTC) and Animal Health.

Fundamental Analysis

Novartis has a strong pipeline of products coming online through 2020. In the near term, Novartis will launch Cosentyx, Serelaxin, and LCZ696 which combined could be worth as much as $14.0 billion in sales to the company.

Cosentyx is a psoriasis drug with sales potential of $3.8 billion. Cosentyx was approved in Europe and the US in January 2015 and is now being launched in the US. The product will have at least a one year head start over the competition. This combined with the higher efficacy and equal price point of the drug should generate strong sales.

Serelaxin is used in acute heart failure patients with a sales potential of $3.0 billion. There are approximately 15 million cases of acute heart failure each year. Interim results for the phase III trial for the drug are expected at the end of 2015 and will be a catalyst for the stock.

The much publicized LCZ696 for chronic heart failure has potential sales of more than $8.0 billion. The results from testing have been remarkable as LCZ696 has lowered mortality by 20.0% when compared to the current industry leader Enalapril. Novartis is now awaiting the green light from the regularity authorities for its commercialization in August 2015 in the USA and in Q4/15 in Europe.

Along with a strong pipeline, Novartis is completing an asset swap with GlaxoSmithKline that will focus the company on its most profitable enterprises. The deal was finalized in March and will be moving forward.

Financial Statement Analysis

Novartis has posted a record performance as of late and the stock has hovered near all time highs. Looking at the company on a relative valuation however, the company does not look that expensive. Trading at 18x forward earnings, the company is at a discount to other players in this space. As Novartis is an industry leader, it should be trading at a premium to its peer group.

Conclusion & Recommendation

Novartis is a best in class manufacturer that has an innovative and profitable pipeline of drugs. The company has too many blockbuster drugs to name in this report and is continually innovating in the most lucrative areas. The company has also refocused its assets and management attention on manufacturing these products, which is what they do best. Novartis is nearing all time highs and only going higher.
NuVasive Inc (NUVA)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
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<td>Small Growth</td>
<td>N.A.</td>
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</tbody>
</table>

**Technical Analysis**

- Bollinger Bands: Neutral
- Money Flow: Positive
- Relative Strength: Neutral

**Introduction**

NuVasive is a medical device company focused on the design, development, and marketing of products for the surgical treatment of spine disorders. The company takes a minimally invasive approach to spine surgery, which has improved efficacy and reduced recovery time for patients.

**Fundamental Analysis**

Minimally invasive surgeries have been growing and NuVasive is the leader in minimally invasive spinal surgery. Minimally invasive surgery has grown to about 30% of the spine market, however that is far below the penetration of minimally invasive procedures in other segments.

NuVasive has a lot of room to grow. Management has set a goal for 80% penetration of the spine market and is moving toward that goal quickly. The company currently has 10% of the spine surgery market in the U.S. and 4.0% internationally. NuVasive is growing considerably faster than its competition in both of those markets. The company grew by 37.0% in international markets last quarter.

NuVasive also has some exciting new innovations in the pipeline. The new integrated global alignment concept is promising. The technology allows for the implanted devices to make fine spinal alignment adjustments as the patients require them. This will add to NuVasive’s already strong history of innovation.

**Financial Statement Analysis**

NuVasive’s earnings are reflective of a rapidly growing company. The company has produced strong cash flow, but large capital expenditures have weighed down earnings. Management has been working towards 20% operating leverage which they achieved in the final quarter. The company will move to operating leverage in the mid-20s going forward. This operating leverage combined with industry leading growth will improve earnings rapidly.

**Conclusion & Recommendation**

Minimally invasive procedures have been growing rapidly and NuVasive has been leading the charge in spinal procedures. The company will lead minimally invasive technology towards 80.0% penetration in the near term. As pressure to reduce healthcare costs mounts, more payers will prefer minimally invasive procedures that cut down on total cost of care. The company also continues to innovate with exciting new products that will boost margins. Finally, the companies goal to increase operating leverage will bolster earnings.
PDL BioPharma Inc (PDLI)

<table>
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<tr>
<th>Recommendation</th>
<th>Valuation</th>
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<th>Adjusted P/E</th>
<th>Style</th>
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Technical Analysis

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<tr>
<td>Bollinger Bands</td>
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<td>Money Flow</td>
<td>Negative</td>
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<tr>
<td>Relative Strength</td>
<td>Neutral</td>
</tr>
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</table>

Introduction

PDL BioPharma Inc is a biopharmaceutical company that manages patents and royalty assets as well as develops cancer and immunological disease treatments. The Nevada based company is currently focused on intellectual property asset management, acquiring new income generating assets, and maximizing value for its shareholders.

Fundamental Analysis

The majority of PDL BioPharma’s income has come from a collection of “Queen” patents that relate to humanized antibodies. Those patents expired at the end of 2014. PDL Biopharma did win a lawsuit against GlaxoSmithKline to extend part of the Queen revenues through 2016, but the company’s need to replace those revenues is growing with every day.

The company has invested $780.0 million in non-dilutive growth capital and financing for clinical stage companies. Whether or not those investments can create enough shareholder value to replace the “Queen” patents revenue; however, is uncertain.

In addition to the uncertain revenue stream, the firm experienced issues with accounting practices in 2014. On September 16, 2014, the Company disclosed in a regulatory filing that PDL BioPharma was notified by its independent accounting firm, Ernst & Young LLP, that it was resigning effective September 11, 2014, which was confirmed in a letter delivered to the Company. Following this news, PDL BioPharma’s stock dropped more than 12% to close at $8.48 per share on September 17, 2014. The disagreement was over accounting for Depomed as a financial asset rather than intellectual property. PDL BioPharma has since adjusted to account for Depomed at fair value, but the stock has not recovered.

Financial Statement Analysis

PDL BioPharma’s balance sheet shows that they have just under $300 million in cash as the company readies itself to buy more intellectual property to license. Of the $581.0 million in revenue PDL BioPharma posted in 2014, $488 million was related to the “Queen” patents.

Conclusion & Recommendation

PDL BioPharma’s future is relatively uncertain. The company’s biggest source of revenue partly matured at the end of 2014 and will completely mature by 2016. The company is working hard to find ways to replace that revenue, but it is difficult to replace such a large chunk of the company’s revenue with a bunch of small deals. This is especially true when one considers that PDL BioPharma only has a 10 person team. The company will shrink as it works to replace the “Queen” patents and the stock will suffer during that stretch.
Roche Holding AG (RHHBY)

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<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
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<th>Adjusted P/E</th>
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Technical Analysis

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

Introduction

Roche is a Swiss-based company operating in two segments: Pharmaceuticals and Diagnostics. The company owns majority stakes in US biotech firm Genentech and Japanese pharmaceutical company Chugai. Major products include Avastin, Herceptin and Rituxan.

Fundamental Analysis

Roche is an attractive company because of its solid base business, near term pipeline providing many catalysts, and strong balance sheet.

The company has performed well over the past four years largely due to the performance of the firms oncology products. Avastin, among others, makes Roche a leader in oncology. The company’s oncology drug portfolio accounts for almost 52.0% of the company’s net revenues. The company’s base business is firm and the new pipeline drugs will continue to put Roche at the top of the oncology market.

Along with oncology, auto-immune drugs represent a large part of shareholder value. The company is expecting to see growth in this segment as well as it increases penetration in emerging markets.

Roche has several near term catalysts that can push the stock higher. Phase 3 data for adjuvant breast cancer drug APHINITY is due in early 16 could be highly positive for the company. Data regarding PI PD-L1 in combination therapy for lung cancer as well as PD-L1 in combination with Avastin represents another area of potential growth. Ocrelizumab phase 3 data in multiple sclerosis due in the next 12 months.

Financial Statement Analysis

Roche has considerable flexibility in its balance sheet for acquisitions. Roche has over $12.0 billion in cash to make accretive acquisitions. After successfully taking a stake in Genentech, Roche will be looking for other value added areas to deploy capital.

Conclusion & Recommendation

Roche is the leader in oncology and auto-immune diseases. The products in those segments are strong and the pipeline suggests that Roche is only going to improve its market position in the near term. There are many catalysts on the horizon in the next 12 months that can push the stock even higher. Finally, investors should be looking forward to what Roche does with the large amount of cash on its balance sheet because of the companies history of value added acquisitions.
West Pharmaceutical Services (WST)

Recommendation | Valuation | Last Price | Adjusted P/E | Style | Dividend Yield |
BUY | $70.94 | $57.66 | 32 | Mid Growth | 0.8% |

Technical Analysis

<table>
<thead>
<tr>
<th>Technical Analysis</th>
<th>Rating</th>
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<td>Money Flow</td>
<td>Positive</td>
</tr>
<tr>
<td>Relative Strength</td>
<td>Negative</td>
</tr>
</tbody>
</table>

Introduction

West Pharmaceutical Services (WST) is a leading manufacturer of components used for injectable drug delivery systems, including rubber stoppers and syringe plungers, and also offers contract manufacturing services to the healthcare and consumer products industry. The company is currently adding to its product portfolio to include more proprietary products.

Fundamental Analysis

West is launching a variety of drug delivery systems that should see wide adoption as they address key challenges for customers. Furthermore, the company will benefit in the long term from the growing popularity of biological medicine and vaccines as the delivery systems required are more complex. This should drive sales growth and margin expansion over the next several years.

Growing popularity of biological medicine and biosimilars as both require the complex delivery systems. The growth in this part of the industry will spur growth in the company’s high value and high margin packaging system products. Management has guided for high single digit organic sales growth in 2016, and bulls are suggesting low double digit growth. The 2.0% growth in 2015 can be attributed to the impact of the strength of the dollar.

In addition to the growth from the packaging systems management is positive on the companies emerging proprietary delivery systems. Crystal Zenith (CZ) could see drug filings as early as 3Q/15. If this business gets through trial it will add substantially to the bottom line and help the company beat expectations.

WST has a growing backlog and shrinking inventory that indicates the strong demand for the companies products.

Financial Statement Analysis

Revenue has grown at a 4.5% CAGR over the last 4 years and all signs suggest that rate should accelerate. WST has grown its operating margin over that same time frame. The company’s growing backlog provides revenue visibility, and if it weren’t for the currency effects, the growth would be even stronger. The balance sheet is strong as total debt has been shrinking over the past 4 years.

Conclusion & Recommendation

All signs suggest that WST is a high quality company operating in a growing market. The company has a growing backlog to go along with improving margins and revenue. The new products in the delivery systems segment could yield even more rapid growth. The company also has significant market share and no clear direct competitors. This company is primed for continued growth.
Industrials

Overview
The industrial sector involves firms that manufacture and distribute goods, are involved in construction, aerospace, employment services, technology conglomerates engineering products and other related activities.

Since the end of the financial crisis and worldwide recession, industrial indicators have reacted positively to the improving outlook of the worldwide economy. While the employment market has seen continued improvement since the recession officially ended, measures such as labor participation rate and proportion of part time jobs continue to worry some analysts.

The deteriorating situation in the European Union and a slowing down in emerging markets should be monitored for potential impact in the following trading period, but we do not believe that these issues are an immediate concern.

Fundamental Outlook
The industrial sector benefited by an improving job market and increase in business and consumer confidence over the last few years. Furthermore, the Federal Reserve has maintained interest rates at record lows, boosting business investment and credit access for a long period. While these factors have benefitted the sector in the past, we believe there is still room for significant growth.

Industrial capacity utilization improved in 2014, but remains below long term averages. In our opinion, as companies continue to see increases in margins and profit, capacity should continue to increase in 2015, while continuing to incur in significant capital expenditures.

Furthermore, the average age of equipment in the United States is close to an all-time high, indicating that businesses have been putting off replacing it over the last several years. As economic activity and financial performance continue to increase, we believe companies will start replacing ailing equipment in an effort to increase efficiencies. This in turn should benefit businesses in the sector.

Conclusion and Recommendation
In general, fundamentals for the Industrial sector remain positive as the economy continues to pick up steam. In our opinion, business and consumer confidence will continue to increase and provide a boost to sector performance.

We believe that, given our current position in the overall business cycle, the industrials sector should outperform the market return over the next twelve months. As a result, we recommend overweighting the Industrial sector in detriment of other, less favorable sectors.
3M Company (MMM)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>SELL</td>
<td>$170.62</td>
<td>$163.50</td>
<td>22</td>
<td>Large Core</td>
<td>2.2%</td>
</tr>
</tbody>
</table>

Technical Analysis

- Bollinger Bands: Neutral
- Money Flow: Neutral
- Relative Strength: Neutral

Introduction

3M Company is a diversified, global conglomerate with a focus on technology and industrial products. The company currently operates three major business segments: Industrial, Safety & Graphics and Electronics & Energy. 3M was founded in 1902 and is headquartered in St. Paul, Minnesota.

Fundamental Analysis

3M generates a majority of its revenue from sales in its Industrial segment. As with similar companies in this line of business, we believe 3M will benefit from increased economic activity and equipment upgrades by US businesses.

Despite impressive 2014 performance, the company continues to suffer from negative currency exchange rates. With significant operations in unstable countries such as Venezuela, and the current depreciation of the Euro, we believe 2015’s increase in revenue will once again be negatively impacted when repatriating funds.

Recently, management announced a 20% increase in the quarterly dividend in 2015. Furthermore, the company has consistently returned funds to shareholders by share repurchase programs.

While management expects an increase in organic sales of around 6.0% this year, we believe that the negative exchange rate movements will significantly cut into this number.

Financial Statement Analysis

The company’s current financial position is strong, with margins that top most of its direct competitors.

Furthermore, free cash flows have seen consistent increases over the last couple of years, and management has put these funds to good use by increasing investment in R&D while at the same time returning funds to shareholders in a consistent basis.

Conclusion & Recommendation

While 3M is undoubtedly a strong company with the potential to benefit from a healthier economy, its correlation with other portfolio stocks justify our decision to SELL the stock.

With the funds generated from closing our 3M position, we expect to acquire other stocks that provide the portfolio with additional exposure to businesses currently not represented.
FedEx Corporation (FDX)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>HOLD $203.22</td>
<td>$164.59</td>
<td>$164.59</td>
<td>19</td>
<td>Large Growth</td>
<td>0.5%</td>
</tr>
</tbody>
</table>

Technical Analysis

- Bollinger Bands: Positive
- Money Flow: Neutral
- Relative Strength: Positive

Introduction

FedEx Corporation provides transportation and business services as well as e-commerce under the corporate umbrella. The company provides its services through four segments: FedEx Express, FedEx Ground, FedEx Freight and FedEx Services. The company was founded in June of 1971 and is currently headquartered in Memphis, Tennessee.

Fundamental Analysis

As the global economy improves, the company will reap the benefits of increased economic activity. The continued growth of e-commerce, expected to increase at a rate of 6.0% annually over the next five years, will have a positive impact across all of the company’s business segments.

Since the final months of 2014, global oil prices have decreased significantly. FedEx Corporation should continue to see improvements in profitability as fuel costs, a significant part of the cost structure, remain at low levels for the rest of 2015.

Early in 2015 the company introduced a new pricing structure that combines weight and dimensional pricing. This new model is expected to boost revenues as larger packages will start contributing more to the company’s revenue.

Finally, management recently acquired GENCO, a reverse logistics provider. The newly acquired company should add its $1.6 billion in revenues to FedEx, as well as an increased presence in the product returns segment.

Financial Statement Analysis

In 2012, the company first announced the details of a “Profit improvement program”, with the intention of cutting around $1.7 billion in savings by the end of 2016. Over the last twelve months, net income has increased over 51.0% relative to the previous period.

Over the last three years, the company reduced its cost of goods sold to the lowest level, as a percent of sales, since the beginning of the recession. Both of these factors helped FedEx to outperform its closest competitors, as measured by net income growth, over the last few years.

Conclusion & Recommendation

Based on the recent success of the profit improvement program, low fuel prices and increase in economic activity we believe that FedEx offers significant upside and recommend to HOLD our current position for at least one more year.
Honeywell International Inc. (HON)

**Recommendation**
HOLD

**Valuation**
$123.95

**Last Price**
$102.96

**Adjusted P/E**
20

**Style**
Large Core

**Dividend Yield**
2.0%

**Technical Analysis**
- **Bollinger Bands**: Neutral
- **Money Flow**: Neutral
- **Relative Strength**: Neutral

**Introduction**
Honeywell International is a US based conglomerate with a focus on technology and manufacturing. Key business segments include aerospace, performance materials, automotive, chemicals and home and industry products.

**Fundamental Analysis**
Honeywell is currently one of the largest conglomerates in the world, and operate in a large variety business segments in more than 100 countries. We believe that such a diversified structure will produce positive returns while reducing risk and exposure to extraordinary events.

While month-to-month increases in industrial production have been relatively flat, we believe in a strengthening consumer confidence and spending that will fuel growth. More specifically, Honeywell should benefit from increased economic activity, low fuel prices and increases in residential and commercial construction.

**Financial Statement Analysis**
Honeywell currently benefits from a very healthy cash situation. The company’s cash from operations significantly surpasses both financing and investment outflows, leaving enough room for potential dividend increases or share re-purchase programs.

Free cash flow growth over the last three years reached an average of over 15% annually. We expect this trend to continue over the following years.

Based on the strong cash position, management announced the company will be increasing its M&A spending by $10.0 billion over the next five years. Whether the company decides to acquire multiple smaller companies or just a couple of large ones, revenues should get a boost from the new operations.

**Conclusion & Recommendation**
Honeywell’s diversified position, both geographically and across business segments, as well as its strong cash position lead us to believe that the company is well positioned to benefit from increased economic activity. As a result, we recommend to HOLD to this position.
Lockheed Martin Corporation (LMT)

**Recommendation**
BUY

**Valuation**
$246.34

**Last Price**
$202.23

<table>
<thead>
<tr>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>18</td>
<td>Large Core</td>
<td>2.9%</td>
</tr>
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</table>

**Technical Analysis**

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

**Introduction**

Lockheed Martin Corporation is an aerospace and defense company headquartered in Bethesda, Maryland. The company operates in multiple segments, with aeronautics, space and information systems accounting for close to 70% of revenues. In 2014, the US Government accounted for close to 79% of company revenue.

**Fundamental Analysis**

Lockheed Martin benefits from relative revenue stability because of its significant government contracts. Although US Government defense spending was affected by budget cuts over the past year, the company is better positioned than most of its competitors due to its unique product line and intensive R&D.

The F-35 Raptor project will become the largest contract in the company and the country’s history. As a result, the company should expect to see benefits in its financial statements for the duration of the project. As of this writing, over 2,400 planes are scheduled for delivery.

Lastly, Lockheed Martin announced a $2.0 billion dollar share repurchase program to be completed in around 3 years and increased its annual dividend by 13.0% in 2014.

**Financial Statement Analysis**

While Lockheed Martin’s revenue has increased at a slow pace, 0.2% over the last five years, its net margin has grown significantly and recently achieved pre-recession levels. In 2014, net margin increased over 22.0% relative to 2013, in large part due to decreases in operating costs.

Over the last couple of years, the company generated over $3.5 billion in operating cash flows. In both years, cash flows generated by operations were high enough to cover both investing and financing cash flow deficits, indicating a healthy cash position.

**Conclusion & Recommendation**

In 2014, Lockheed Martin earnings per share and quarterly dividend increased by double digits. While we do not expect such a high growth rate to persist in the medium to long term, we do expect to see growth rates in the 8.0 to 10.0% range.

While the portfolio includes a number of different companies in the sector, we believe that the addition of the aerospace and defense company would provide us with more diversification.

Finally, based on our economic outlook, the strong financial position of the company and management’s efforts to increase value, we rate the stock as a BUY.
Paychex Inc. (PAYX)

**Recommendation**

HOLD

**Valuation**

$66.83

**Last Price**

$49.55

**Adjusted P/E**

28

**Style**

Large Growth

**Dividend Yield**

3.1%

**Technical Analysis**

<table>
<thead>
<tr>
<th>Metric</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bollinger Bands</td>
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<tr>
<td>Money Flow</td>
<td>Neutral</td>
</tr>
<tr>
<td>Relative Strength</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

**Introduction**

Paychex Inc. provides payroll, benefits, insurance management and other human resource services to small to medium sized business willing to outsource. The company was founded in 1971 and is currently headquartered in Rochester, NY.

**Fundamental Analysis**

Paychex generates over 60% of its revenue from offering payroll management services to small to medium sized business. As a result, we expect the company to continue benefiting from an improving and healthier job market, as businesses continue to expand.

The company is constantly introducing new products and services to respond to new market trends. Specifically, the passing and implementation of the Affordable Care Act continues to create new revenue streams for the company, as small to medium sized businesses elect to outsource compliance and insurance functions. As Congress continues to modify parts of the law, we expect more businesses to outsource insurance functions to Paychex and similar companies.

Finally, the company continues to significantly expand both its mobile and software services, activities that should help boost revenues and businesses look for simpler way to manage HR functions without completely outsourcing.

**Financial Statement Analysis**

Paychex current financial position is strong. Revenues increased more than 11.0% over the last 12 months, and more than 8.0% the period before that. Furthermore, net margin remained stable at a better than average 24.0%.

The board of directors approved a second round of share repurchases to follow the first one implemented in 2007-08. Announced in May of 2014, the company expects to buy back $350.0 million of its own stock.

Finally, a higher than average dividend yield of more than 3.0% makes the company stock look more favorable than most of its close competitors.

**Conclusion & Recommendation**

Paychex strong financial performance over the last few years, constant introduction of new products and services, and large client base suggest the company is well positioned to take advantage of future growth opportunities.

Based on our analysis and economic outlook, we recommend to HOLD Paychex for at least one more year.
Snap-on Inc. (SNA)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>HOLD</td>
<td>$219.24</td>
<td>$180.92</td>
<td>20</td>
<td>Mid Core</td>
<td>1.5%</td>
</tr>
</tbody>
</table>

**Technical Analysis**
- Bollinger Bands: Neutral
- Money Flow: Neutral
- Relative Strength: Neutral

**Financial Statement Analysis**
Snap-on’s business segments have increased revenues between 6.0 and 10.0% year-over-year while significantly reducing cost of goods sold and selling and administrative expenses. Consequently, increases in profitability margins currently set the company apart from the rest of its closest competitors.

Besides strong financial performance, management has been returning excess cash flow to shareholders on a regular basis, with the last dividend increase announced reaching an impressive 21.0% relative to the previous dividend.

**Conclusion & Recommendation**
Snap-on’s performance year over year has been extremely positive. Based on the financial position of the company, management’s use of cash and positive economic outlook we believe that the company will continue to outperform the market and recommend to HOLD for the next twelve-month period.

---

**Introduction**
Snap-on Incorporated markets and manufactures high-end tools, diagnostics, repair information systems and other system solutions for professional users. Besides operating on several segments, the company also offers franchising opportunities. Snap-on was founded in 1920 and is currently headquartered in Kenosha, Wisconsin.

**Fundamental Analysis**
Snap-on’s highest revenue producing segment is the company’s Tool Group. Given the product’s characteristics, we believe that demand for the company’s core products is significantly more stable than other, more discretionary choices. Improving economy should positively contribute to company revenues in the short to medium term.

The financial services segment is also set to continue growing as the company continues to expand their franchise model, particularly in the United States.
Information Technology

**Growth in IT budgets will create demand for application software and IT consulting**

With muffled economic growth, companies are poised to increase spending on IT as corporate profits rise. This expenditure includes investments in hardware, software, and consulting services. The augmented growth towards a more digital business platform pressures competitive companies with larger cash balances to invest in IT consulting and the products that are suggested through that. The move towards cloud-based software continues and the need for data security becomes more pertinent to the success of a business.

**Software capabilities and mobile devices**

As hardware prices fall and cloud computing becomes commonplace, software capabilities will experience high growth in 2015. Rapid technological changes require consistent innovation and production of new software compatible with a number of platforms. It is predicted that these new demands and threats that are associated will stimulate the production of predictive analysis and artificial intelligence. The software publishing industry value-added is expected to increase at an annual rate of 3.5% while the GDP’s annualized growth rate is predicted to be 2.5% over the same period.

As of 2014, Pew Research reported that 90% of Americans owned a cell phone and 58% of those had smartphones. Mobile devices continue to infiltrate the daily activities of consumers and businesses. This creates a higher demand for applications and software that prove compatible with these mobile devices. With smaller storage thresholds, mobile devices are becoming increasingly more reliant on cloud storage. This widespread usage will also create higher demand for security software compatible with mobile devices.

**Cyber Security is poised for growth in 2014**

As companies continue to migrate to cloud-based platforms, the need for data security becomes pertinent. These trends will allow for IT security to grow at an annualized rate of about 12.1% over the next five years. With the increased proficiencies of hackers, it becomes necessary for all public and private businesses to invest in data security measures. The threat and consequences of experiencing a cyber-breach has proven incredibly detrimental to companies ranging from retail to healthcare. Companies are forced to take proactive steps in order to ensure the security of their data. This includes government sectors. This increased demand from corporations, consumers, and government agencies will drive profit growth in this industry. The chart below illustrates how the S&P 500 Information Technology Index (in blue) has outpaced the S&P 500 (in green) within the last year.
Amdocs Ltd. (DOX)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>BUY</td>
<td>$85.93</td>
<td>$54.09</td>
<td>15</td>
<td>Mid Core</td>
<td>1.3%</td>
</tr>
</tbody>
</table>

Technical Analysis
- Bollinger Bands: Neutral
- Money Flow: Neutral
- Relative Strength: Neutral

Introduction
Amdocs, Limited develops, implements and manages software and services aimed to enable service providers in the introduction of new products. These software and services assist with computer systems integration for communications, media and entertainment and are associated with business support systems and operational support systems.

Fundamental Analysis
Amdocs, Ltd. recently announced a partnership with Singtel that will provide major business transformation projects in key markets such as Singapore and Australia. The company was also awarded a five-year contract with Vivo, Telefonica’s Brazilian brand and the group’s largest in Latin America. This contract is Amdocs’ fourth deal with Telefonica, also affiliated with the company in Argentina, Peru, and Chile.

While currency risk has become an increasing problem, the growth in emerging markets is expected to be robust. The aforementioned global awards do not stand as the only promise of growth. Amdocs has also entered into a five-year contract with U.S. Cellular. In order to remain competitive in all fronts, the company also continues to release new products and services.

Financial Statement Analysis
Amdocs, Ltd. reported free cash flow of $173 million for the first fiscal quarter of 2015. The Board of Directors raised the quarterly dividend payout by 10%, effective this month, which amounts to $0.17 per share. Based on the stock re-purchase program from March 2014, Amdocs shows a reliability in their repurchase program, already buying back $102 million ordinary shares in the first fiscal quarter of 2015.

Conclusion & Recommendation
With expected revenue growth, based on the new contracts under way, Amdocs, Ltd. will continue to buy back stocks and increase dividends paid with some of the cash on hand.

Based on a dividend discount model, we determined that this company is undervalued. We recommend purchasing shares.
**Apple Inc. (AAPL)**

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>BUY</td>
<td>$223.98</td>
<td>$123.25</td>
<td>16</td>
<td>Large Growth</td>
<td>1.7%</td>
</tr>
</tbody>
</table>

**Technical Analysis**

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

**Introduction**

Apple, Inc. designs, manufactures and markets a number of products including mobile communication and media devices, personal computers, and portable digital music players. Apple utilizes not only retail and online stores, but also wholesalers and direct sales force to sell its products worldwide. Through the use of online applications, such as the iTunes and iBook stores, the App store and Mac App store, the company sells a variety of related software, services, peripherals, networking solutions, and third-party digital content and applications. The company was founded by Steven Paul Jobs, Steve Wozniak and Ronald Gerald Wayne on April 1, 1976 and is headquartered in Cupertino, CA.

**Fundamental Analysis**

With the introduction of the iPhone 6 and iPhone 6 Plus in mid-September 2014, Apple has reaped the benefits of over 10 million units sold within the first three days of release. Total revenue increased by almost $12 million from 2013 to 2014. We expect growth to continue in the next fiscal year, due to the impending release of the Apple Watch and the continued growth of Apple Pay.

Apple also acquired Beats in August 2014. This allowed the company to diversify further and gain a place in the music streaming industry. Reports indicate that the company is negotiating with top artists, such as Taylor Swift, to provide exclusive music to customers, thus gaining an advantage over competitors such as Spotify.

**Financial Statement Analysis**

Following the stock split in June 2014, Apple stock continues to show positive momentum. Profits increased by almost 10% from 2013 to 2014 even with an increase of operating expenses. With such strong finances, Apple should continue to increase dividends paid and stock buybacks. At the end of 2014, Apple had already repurchased about $73 billion in shares and paid about $27 billion in dividends.

**Conclusion & Recommendation**

Through the increased diversification strategy and continued organizational momentum, Apple, Inc. will maintain its strong positioning against its competitors.

Through a dividend discount model, the company is highly undervalued. With this valuation, accompanied by a compelling growth story, we recommend an increase in the position.
Information Technology

Cadence Design Systems Inc. (CDNS)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>SELL</td>
<td>$24.11</td>
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<td>20</td>
<td>Mid Growth</td>
<td>N.A.</td>
</tr>
</tbody>
</table>

**Technical Analysis**

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</thead>
<tbody>
<tr>
<td>Bollinger Bands</td>
<td>Negative</td>
</tr>
<tr>
<td>Money Flow</td>
<td>Neutral</td>
</tr>
<tr>
<td>Relative Strength</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

**Introduction**

Cadence Design Systems, Inc. designs and develops integrated circuits and electronic devices. It also provides maintenance and engineering services for the software, hardware and IP product offerings. The company is headquartered in San Jose, California.

**Fundamental Analysis**

Foreign exchange risk remains a problem for Cadence. With the dollar growing in strength, we estimate growth in terms of revenues but not at a relative pace to the industry and industry competitors.

Cadence does continue to have success with their advanced designs. Unfortunately, these designs are geared towards a unique market of products that utilize advanced semiconductor content. As more consumers require sleeker and more energy-efficient devices, the demand for these designs should grow. Cadence’s products have also found application in the mobile computing arena.

Cadence announced an agreement with ARM in March 2015. This agreement allows reciprocal access to relevant IP portfolios, as well as the rights to both companies to manufacture test chips containing Cadence IP and ARM IP and provide development platforms to customers. This agreement should prove beneficial in terms of accelerating time to market for customers.

**Financial Statement Analysis**

Cadence reports marginal growth in terms of gross income and EBIT, which have been decreasing the past three years. From 2011 to 2012, the company reported a 19.41% increase of gross income, while the percent change from 2013 to 2014 was a mere 7.47%. The resulting net income was down 3.3% from 2013. Which proves a success considering the change in net income between 2012 and 2013 was negative 62.7%.

**Conclusion & Recommendation**

Using a free cash flow analysis, Cadence Design Systems is marginally undervalued. We recommend selling half of the current holdings. The headwind arising from the strong dollar will effect financial results, but the Company should continue growing at a rate of about 10%.
EMC Corporation (EMC)

Recommendation | Valuation | Last Price | Adjusted P/E | Style | Dividend Yield
---|---|---|---|---|---
HOLD | $39.01 | $25.17 | 16 | Large Core | 1.8%

Technical Analysis
- Bollinger Bands: Neutral
- Money Flow: Neutral
- Relative Strength: Neutral

Introduction
EMC Corporation develops, delivers and supports a range of information infrastructure and virtual infrastructure technologies, solutions and services. The company operates in three broad business segments: EMC information infrastructure, Pivotal and VMware Virtual Infrastructure.

Fundamental Analysis
EMC leads in the information technology storage space segment. As companies continue to move towards a more software-defined way of computing, EMC should benefit. Although the currency situation is unfavorable, revenues are expected to increase due to new product release and a joint venture with Cisco. Analysts speculate that EMC may look to acquire another IT company in the near future. With a large cash balance, this is a viable option.

The company proves reliable in stock repurchases based on the $160 million buy back of VMware stocks in 2013 and the $3 billion common stock buy back in 2014. EMC also returned approximately $900 million in quarterly dividends. The Company intends to continue stock repurchases in 2015, with an estimate of $3 billion worth of common stock.

EMC has a number of events planned for 2015, including the Global Partner Summit and EMC World, which will include a number of keynote speakers and performances by artists such as One Republic and Fall Out Boy. The ability to maintain active relationships with clients allows the company to continue growing each active contract and gaining new ones.

Financial Statement Analysis
Each business segment and geographic segment proved healthy with year over year revenue growth. EMC Information Infrastructure was up 2%, VMware up 16% and Pivotal up 27%. As for geographic regions, revenue from the United States was up 7%, Europe, Middle East and Africa increased by 6%, Asia Pacific and Japan grew 2%, Latin America was up 8%, and revenue from the BRIC+13 markets grew 7% in the fourth quarter.

Conclusion & Recommendation
Based on the company’s global and domestic growth and diversification strategy, revenues and free cash flows should continue to increase.

Using a dividend discount model, EMC proves undervalued by at least 20%. Therefore, we recommend holding this position.
Gartner Inc. (IT)

**Recommendation** | BUY | **Valuation** | $197.79 | **Last Price** | $82.42 | **Adjusted P/E** | 38 | **Style** | Mid Growth | **Dividend Yield** | N.A.
---|---|---|---|---|---|---|---|---|---|---|---

**Technical Analysis**
- Bollinger Bands: Neutral
- Money Flow: Neutral
- Relative Strength: Neutral

**Introduction**

Gartner, Inc. is an information technology research and advisory company. It operates through three business segments: Research, Consulting and Events. The Research segment provides independent and objective research and analysis for CIOs, IT professionals, technology companies and the investment community. The Consulting segment offers customized solutions for clients as well as proprietary tools used to measure and improve IT performance. Lastly, the Events segment hosts symposia, conferences and exhibitions geared to assist with networking and learning opportunities. The company has locations across the globe and tends to clients in 85 countries.

**Fundamental Analysis**

As we shift into a business environment dependent on digital components, it becomes pertinent for companies to improve their use of technology to remain competitive. Gartner leverages their position as the world’s leading information technology research and advisory company to increase contracts and therefore revenues. Gartner increased the worth of its active contracts by 14.0% in the fourth quarter of 2014. This is in part due to the increase in employees currently working for the company. Gartner has recently taken on an operation to increase total headcount in order to meet the vigorous demand for the services provided. Management reports that this operation is still in effect and the worth of active accounts should continue growing in 2015.

The company’s diversification strategy involving research, consulting and events allows Gartner to reach a number of clients, that they may not otherwise encounter, that benefit from its services.

**Financial Statement Analysis**

While foreign exchange risk proved harmful to Gartner in the last year, the gross margins remained positive. Even during the most recent recession, gross margins were consistently above 50.0%. The company achieved a top line of $584 million in the fourth quarter, allowing annualized revenue to increase by about 13%.

**Conclusion & Recommendation**

Since shares declined by 9.0% after investors were unnerved by a missed earnings estimate in November, the stock is greatly undervalued. The Company’s maintained expansion of the consulting segment and the underlying growth metrics that remain intact indicate that the company will recover from this missed estimate and continue growing.

Using a free cash flow analysis, Gartner is attractively undervalued. We recommend a buy position due to the company’s position in the industry and continued growth forecasts.
**Imperva, Inc. (IMPV)**

**Recommendation**

SELL

**Valuation**

$1.19

**Last Price**

$41.26

**Adjusted P/E**

N.A.

**Style**

Small Growth

**Dividend Yield**

N.A.

**Technical Analysis**

<table>
<thead>
<tr>
<th>Bollinger Bands</th>
<th>Negative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Money Flow</td>
<td>Neutral</td>
</tr>
<tr>
<td>Relative Strength</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

**Introduction**

Imperva, Inc. provides data security solutions focused on providing visibility and control over business data across systems within the data center. The Company’s SecureSphere Business Security Suite is a broad solution designed to prioritize and mitigate risks to high-value business data, protect against hackers and malicious insiders and address and streamline regulatory compliance. The company operated through two segments: Imperva and Incapsula.

**Fundamental Analysis**

With clients in over 90 countries, foreign exchange risk proves influential. As the dollar continues to strengthen, the company will experience increased headwinds. While the Company does have

There has also been speculation regarding the acquisition of Imperva by EMC Corporation. Imperva does not indicate intentions to implement a stock repurchase program in 2015. With a decreasing cash balance, which is in part due to recent acquisitions in 2014, it proves difficult to make decisions that allow the company to return value to the shareholders.

In response to the low cash balance, Imperva offered three million shares of common stock to the public at $39 per share in March 2015. The company intends to use these proceeds for business activities that could include some acquisitions.

**Financial Statement Analysis**

With a negative net income and decreasing reported cash flows, it is difficult to justify the financial health of this company. The company did use a large portion of available cash for three different acquisitions in 2014, which included Incapsula and Tomium Software.

The negative net income trend has only worsened since 2008 and does not show signs of improving. Although the company estimates growth in 2015, it is not prudent to remain invested in IMPV.

**Conclusion & Recommendation**

Imperva has seen a recent downward trend that is does not bode well for the future. Our valuation, using a free cash flow analysis, indicates that the stock price is greatly overvalued. Therefore, we recommend selling this position.
Insight Enterprises, Inc. (NSIT)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>HOLD</td>
<td>$49.63</td>
<td>$28.19</td>
<td>13</td>
<td>Small Value</td>
<td>N.A.</td>
</tr>
</tbody>
</table>

Technical Analysis

- Bollinger Bands: Neutral
- Money Flow: Neutral
- Relative Strength: Neutral

Introduction

Insight Enterprises, Inc. offers information technology solutions to businesses and public sector institutions. The solutions offered are virtualization, collaboration, security and cloud computing. It operates in three geographic segments: North America, Europe, Middle East, Africa and Asia Pacific.

Fundamental Analysis

While PC sales have decreased, businesses still have a demand for desktop computers and notebooks. Demand for the Company’s software will continue to grow as Company’s become more reliant on security solutions and increased efficiencies in business productivity.

North America acts as the company’s largest segment. This bodes well with the strengthening of the U.S. dollar. Enhanced marketing efforts in the Europe, Middle East, and Africa division is also finally paying off. Asia only represents a small division of the business but provides considerable promise.

Insight Public Sector was recently awarded a contract to provide IT solutions with NASA. This contract will allow Insight a unique opportunity to work with all federal agencies and government contractors. Entering into this sector will give Insight a clear advantage in gaining further contracts. It may even set them up for contracts with foreign governments.

Financial Statement Analysis

Insight repurchased approximately 2.1 million shares of common stock for $50.4 million during 2014. The Board of Directors have since approved the repurchase of another $25 million in stock. If the company utilizes all available stock repurchases, the number of shares outstanding could be reduced by 4.0%.

Conclusion & Recommendation

Through the use of free cash flow analysis, Insight Enterprises is undervalued by at least 20.0%. We recommend holding this position because of the recent entrance into the government sector, promise in emerging markets and the Company's ability to maintain an upward trend in cash flows and revenues.
KEYW Holding Corp (KEYW)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>SELL</td>
<td>$2.97</td>
<td>$7.73</td>
<td>N.A.</td>
<td>Small Core</td>
<td>N.A.</td>
</tr>
</tbody>
</table>

Technical Analysis

<table>
<thead>
<tr>
<th>Analysis</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bollinger Bands</td>
<td>Neutral</td>
</tr>
<tr>
<td>Money Flow</td>
<td>Neutral</td>
</tr>
<tr>
<td>Relative Strength</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

Introduction

The KEYW Holding Corporation is a holding company that engages in providing cyber security, cyber superiority, and geospatial intelligence solutions to its customers. Its customers include U.S. Government defense, intelligence and national security agencies as well as commercial enterprises. The company operates through two business segments: Government Solutions and Commercial Cyber Solutions.

Fundamental Analysis

KEYW Holding Corporation has recently acquired Ponte Technologies, LLC and Milestone Intelligence Group, Inc. The acquisition should allow the company to increase capabilities for providing services to both government and commercial customers. KEYW also announced award of a $38 million ceiling contract to provide cyber training and infrastructure upgrades to a U.S.-based customer. This contract comprises of a one-year base period contract with the ceiling amount of $38 million. While this is promising, it does not ensure the contract will bring in revenues over one year, nor does it assure the revenues will amount to $38 million.

Considering the industry’s growth pattern, KEYW Holding Corporation does not prove in line with the growth rate.

Financial Statement Analysis

With a negative net income growth of 21% between 2013 and 2014, it becomes clear that the company is not maintaining the adaptability that it once boasted. Sales decreased by 2.75% in the last year while expenses continued to grow. Free cash flow saw negative change of 97%. The available cash is used for debt servicing and acquisitions. There is no plan to implement a stock repurchase program in 2015.

Conclusion & Recommendation

According to our valuation, KEYW is overvalued. We recommend selling this position. Regardless of recent acquisitions and contracts, the company is not in line with the growth rate of the industry. Therefore, we estimate that the stock has realized full value and will not prove beneficial to this portfolio.
Materials

The Materials sector includes companies that manufacture chemicals, construction materials, glass, paper, forest products and related packaging products as well as metals, minerals and mining companies, including producers of steel. The sector is very dependent on external factors such as interest rates, employment, housing markets, weather conditions, and automobile manufacturing. In accordance with our economic outlook, we anticipate greater demand for some industries represented in the sector, but not for all.

In 2014, the Materials sector generated annualized returns of 6.7% compared to the S&P 500 return of 14.7%. The spread between market and sector return started to widen in October 2014 and remained significant since. On a 5-year basis, Materials has the second worst return of 42.4%, behind the Energy sector. During the same time, the market return was equal to 76.0%.

The steel industry is likely to benefit from a combination of rising GDP, increasing car sales and construction, and building of inventory in general. The automotive sector and the housing market appear to be in the midst of a sustainable, albeit gradual, recovery. Oversupply and excess capacity, however, will continue to put pressure on margins and profits. The metals and mining industry will continue to suffer from weaker demand from China and Russia. Without meaningful economic growth in key markets around the world, prices are unlikely to rise. The steel industry will benefit from a growing U.S. economy and the corresponding demand for new cars and houses. Companies that diversify and implement cost-cutting initiatives are likely to succeed in this challenging environment. Conversely, the chemical industry as a whole will remain healthy in an expanding U.S. economy. In general, we anticipate a very active M&A market with companies seeking growth and synergy effects on one hand, and struggling entities divesting non-core assets on the other hand.

Overall, the year 2015 remains a story of (over) supply. While some indicators led us to believe that we passed the turning point, we remain risk-averse. In order to both mitigate risk and benefit from significantly undervalued companies with a convincing growth story, we recommend a wider range of companies within selected industries than last year. Our stock picks are diversified international and U.S. companies with an identifiable economic moat and sizeable upward potential.
Cabot Corporation (CBT)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>BUY</td>
<td>$53.00</td>
<td>$42.98</td>
<td>14</td>
<td>Small Value</td>
<td>1.9%</td>
</tr>
</tbody>
</table>

Technical Analysis

- **Bollinger Bands**: Positive
- **Money Flow**: Positive
- **Relative Strength**: Positive

Introduction

Cabot Corp. was founded in 1882 and is headquartered in Boston, Massachusetts. The company engages in manufacturing and supplying organic chemicals and products (e.g. aerogels, carbon blacks, drilling fluids, inkjet colorants, metal oxides, and rubber). The company manages its operations through four different segments: Advanced Technologies, Performance Materials, Purification Solutions, and Reinforcement Materials.

Fundamental Analysis

Cabot Corp. [CBT] is expanding its core business in the United States, which will strengthen its market leading position in the purifications solutions segment. The Mercury and Air Toxics Standard [MATS] from December 2011 will take effect in April 2015 and is designed to limit the emissions of toxic air pollutants such as mercury, arsenic and metals from coal and oil-based power plants. Carbon Corp. offers a wide range of activated carbon and recently announced the opening of a new liquidate coal mine in Marshall, Texas.

CBT’s global footprint provides a strong basis for long-term growth. In recent years, CBT has focused on building strategic assets in emerging markets. CBT finalized the acquisition of the Mexican carbon black specialist NHUMO in 2013. Following the growing demand for automobiles, revenues from carbon blacks are projected to increase steadily in the coming years. Moreover, as a provider of high quality products, CBT can demand a premium relative to competitor products.

The Boston-based specialist is building an innovative portfolio of products that will strengthen competitiveness and offset low commodity prices in other areas of the business. CBT was recently recognized for a high-performance insulating plaster that contains a new aerogel and which has the ability to reduce energy consumption of buildings. The product won the “most innovative product” award at the BAU 2015 in Munich, the leading industry trade fair.

Financial Statement Analysis

CBT’s revenues rose by 5.3% to a total of $3.6b in 2014. Over a period of 5 years, the company increased sales by a 10.2% CAGR. Gross income and EBIT improved by 10.4% and 15.6%, respectively, corresponding to industry leading margins of 20.1% and 10.2%. EBIT increased by a CAGR of 59.4% since 2009, and totaled $371m in 2014. The company has a dividend yield of 1.9%. Over the last 5 years, dividends per share increased by 3.1% annually.

Conclusion & Recommendation

In the short term, Carbon Corp. will benefit from changing laws in a growing U.S. economy. In the long term, CBT offers a strong and future-oriented portfolio that will benefit from sustainability trends around the world. The company has significant upward potential and is currently undervalued by more than 20.0%. We recommend: BUY.
**POSCO Sponsored ADR (PKX)**

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>HOLD</td>
<td>$75.20</td>
<td>$56.15</td>
<td>17</td>
<td>International</td>
<td>2.7%</td>
</tr>
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**Technical Analysis**

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bollinger Bands</td>
<td>Positive</td>
</tr>
<tr>
<td>Money Flow</td>
<td>Neutral</td>
</tr>
<tr>
<td>Relative Strength</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

**Introduction**

POSCO is the largest steel producer in South Korea. The company generates revenues through its three main segments: Steel, Engineering and Construction, and Trading. The Steel segment is engaged in producing a variety of plates, rods, and silicon steel sheets made of cold, hot, and stainless steel. The Engineering and Construction segment provides services ranging from planning to designing to constructing civil, commercial, and governmental projects and buildings (e.g. plants or residential areas). The Trading segment consolidates operations related to the import and export of raw materials and steel products.

**Fundamental Analysis**

POSCO is the technology leader in the competitive, global steel industry and dominates the South Korean market with more than 50.0% market share. It has the world’s most advanced and efficient blast furnace plants, which partially offset higher inputs costs and relatively less access to sustainable, low-cost sources of raw material. The company initiated an extensive restructuring plan, aiming at reducing capital expenditures [CapEx] by 25.0% annually.

Former CTO and new CEO, Mr. Kwon Oh-joon, reaffirmed plans and continued talks with potential buyers to sell the Engineering & Construction business, widening its economic moat. The segment currently accounts for roughly 1/6 of total revenues and more than 1/3 of CapEx. Considering the growing M&A market and consolidation initiatives of the industry, we believe that POSCO’s shareholders will benefit from this effort.

We expect steel demand in the U.S. to follow the economic growth forecast of 2.0% to 3.0% Year-over-Year [YoY]. Demand from India and Southeast Asia, projected to grow between 5.0% and 7.0% YoY, will offset the relatively slow growth in developed countries.

**Financial Statement Analysis**

Despite slower growth in China, Europe, and the United States, POSCO sales grew by 16.3% CAGR between 2009 and 2014. The current price to book value [P/Bk] of 0.55x is well below its 5y average of 0.74x and the industry average of 1.16x, disproportionately reflecting the relative weakness of the materials sector. We expect EPS to rebound to more than $5.00 in 2016 and grow in the following years between 10.0% and 15.0% with recovering worldwide economies, and the completion of the restructuring efforts. Gross and EBITDA margins remain competitive at industry levels of 11.3% and 9.8%, respectively.

**Conclusion and Recommendation**

POSCO’s current valuation is well below fair value. The technology leader is consolidating its current operations to the core business and laying the ground for higher margins and profits through aggressive control of CapEx. We recommend: HOLD.
Rio Tinto plc Sponsored ADR (RIO)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>HOLD</td>
<td>$55.00</td>
<td>$41.88</td>
<td>NMF</td>
<td>International</td>
<td>5.0%</td>
</tr>
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Technical Analysis

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<table>
<thead>
<tr>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Bollinger Bands</td>
<td>Negative</td>
</tr>
<tr>
<td>Money Flow</td>
<td>Neutral</td>
</tr>
<tr>
<td>Relative Strength</td>
<td>Negative</td>
</tr>
</tbody>
</table>

North America, Europe, and Australia and leverages its presence in a number of emerging markets around the world. Whereas earnings for iron ore declined by 18.0% in 2014, aluminum, diamonds, and copper grew by 124.0%, 15.0%, and 11.0%, respectively. RIO is extending its prime mining real estate by seeking strategic partnerships around the world. It recently announced a new copper partnership to exploit the largest undeveloped copper deposit worldwide in Oyu Tolgoi, Mongolia.

After the acquisition of Alcan at the pinnacle of the financial crisis, the company focused on deleveraging the balance sheet and regaining market trust. We believe this will make RIO more resilient to the changing environment or allow for strategic investments in the foreseeable future.

Financial Statement Analysis

Our analysis of RIO’s operations shows mixed results. In 2014, both sales and operating income fell by 7.0% and 12.6%, respectively. However, RIO’s net income on $47b in sales rose by 77.9% to $6.5b, corresponding to a free cash flow growth of 183.3% to $6.4b. The company increased dividends per share by 14.9% to $2.02 per share, averaging a 3.2% yield on dividends over a 5-year period and a CAGR of 24.4% between 2009 and 2014. RIO reported EPS of $3.50, significantly higher than the median of $0.23 and only surpassed by the smaller Russian company MMC Norilsk Nickel JSC.

Conclusion & Recommendation

Based on our calculations, RIO is trading below its long-term fair value. Accounting for uncertainties, we believe RIO will continue to be a solid security in our portfolio as it generates above-average returns. Shareholders benefit from reliable dividend payments and share buyback programs even in a downside market.

We recommend: HOLD
Steel Dynamics, Inc. (STLD)

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>BUY</td>
<td>$23.80</td>
<td>$19.50</td>
<td>22</td>
<td>Mid Growth</td>
<td>2.7%</td>
</tr>
</tbody>
</table>

Technical Analysis

- Bollinger Bands: Positive
- Money Flow: Positive
- Relative Strength: Positive

Introduction

Steel Dynamics, Inc. was founded in 1993 in Fort Wayne, Indiana and is a diversified carbon-steel producer and metals recycler. The mini-mill producer operates through three different business segments: Steel Operations, Metals Recycling & Ferrous Resources Operations and Steel Fabrication Operations. Steel Dynamics competes with a large portfolio of products ranging from flat-rolled and structural steel to special-bar-quality steel and rails to joists, girders, and decking for commercial and governmental buildings.

Fundamental Analysis

Steel Dynamics’ [STLD] is the largest low-cost steel producer in the United States and specialized in flat-rolled, high-strength sheet steel used for cars. Its unique production process and product composition as well as its low operating leverage operation allow STLD to generate respectable margins in a buyer-dominated industry. The use of liquid pig iron allow the flat-rolled steel to reach levels of strength required for a wide range of products, most importantly cars. The company spent more than $2.9b on acquisitions of metal recycler OmniSource, iron nugget producer Mesabi Nugget, and high-tech mini-mill operator Severstal Columbus in a successful attempt to vertically integrate and grow its core business. STLD’s electric arc furnaces require less capital investment than traditional blast furnaces, resulting in favorable per unit operating costs.

STLD is strategically located in the Midwest, allowing for relatively lower freight costs. The recycling business benefits from the proximity to large industrial companies while the steel production business enjoys large consumption from the Eastern Provinces of Canada.

Financial Statement Analysis

STLD’s revenues grew by 17.2% CAGR since 2009 to a total of $8.7b in 2014. EBIT totaled $564m, up by 46.6% from the previous year. The corresponding operating margin of 6.4% is the industry benchmark. Dividends grew by 7.2% CAGR over the last 5-year period. In 2014, $0.46 DPS correspond to 2.4% dividend yield. EPS excluding nonrecurring charges increased by 74.7% to $1.44. On a fully diluted basis, EPS are equal to $0.67.

Conclusion & Recommendation

We believe STLD will disproportionately benefit from increased investments in new real estate and growing production of cars for the U.S. and world markets. STLD’s product mix, low cost operations, and favorable location in a growing U.S. economy will create meaningful returns and are likely to result in continuously growing dividend payments to shareholders. The current price is not reflecting our positive outlook for the company and the strong market position. We recommend: BUY.
Teck Resources Limited Class B (TCK-US)

Recommendation | Valuation | Last Price | Adjusted P/E | Style | Dividend Yield |
---|---|---|---|---|---|
BUY | $18.80 | $13.86 | 19 | International | 5.6%

Technical Analysis

<table>
<thead>
<tr>
<th>Method</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bollinger Bands</td>
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</tr>
<tr>
<td>Money Flow</td>
<td>Neutral</td>
</tr>
<tr>
<td>Relative Strength</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

Introduction

Teck Resources Ltd. was founded in 1951 and is headquartered in Vancouver, Canada. The company is engaged in mining and mineral processing and development. TCK operates through four business units focused on: Copper, Steelmaking Coal, Zinc, and Energy.

Fundamental Analysis

Teck Resources [TCK] is the world’s second largest producer of metallurgical coal [MC] (between 26m and 27m tons), used by integrated steel mills to produce coke. The company suffered from declining prices for MC, which offset per unit cost benefits of higher production volumes. We believe that the relative strong cost position as number two in the world will help generate profits in emerging markets, including China, but do not see a permanent rebound to former peak prices.

TCK invested heavily in the production of oil sands. It will start the operation of the new plant in Alberta, Canada in 2017. It will have a capacity of 180,000 barrels per day.

TCK has access to highly profitable mineral resources such as zinc, lead, and cooper through its operations in Alaska (Red Dog Project) and Peru (Antamina mine). The high-grade mine north of Lima (Peru) is considered to be a viable source of profitable growth even under suppressed market prices. A shift from MC to high-grade copper and zinc, used in the conductor and steel development business, will help mitigate relatively weaker returns. TCK’s strong cost position and continuous efforts to improve efficiency will ensure profitably in the long-run. The strong U.S. Dollar will help the Canadian company in the short term as materials are generally denominated in the North American currency.

Financial Statement Analysis

In 2014, TCK’s revenues declined by 14.4% to $7.8b after negative growth of -11.8% and -11.2% in the previous two years. EBIT totaled $1.0b, which is 48.9% less than in 2013. The current P/Bk ratio of 0.49x is well below the 5-year average of 1.20x. EPS dropped 64.6% on a fully diluted basis to $0.57, following totals of $1.61 and $1.38 in 2012 and 2011, respectively. With the only exception in 2009, TCK continuously paid dividends to shareholders, growing at 13.4% CAGR since 2010. Most recently, TCK has a dividend yield of 5.6%, corresponding to $0.81 DPS.

Conclusion & Recommendation

Despite the recent drop in revenues and operating profit, we believe that TCK is a promising security for a diversified portfolio. Short and long-term diversification efforts promise to be fruitful and create new sources for long-term competitive advantage. In the near future, TCK is also an attractive acquisition target for larger industry players seeking diversification. We value that the company has reliably returned cash flow to shareholders despite its challenges. Our fair value estimate indicates that the stock is trading at a significant discount. We recommend: BUY.
**Vale S.A. Sponsored ADR (VALE)**

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>SELL</td>
<td>$7.80</td>
<td>$5.67</td>
<td>324</td>
<td>International</td>
<td>5.9%</td>
</tr>
</tbody>
</table>

**Technical Analysis**
- Bollinger Bands: Neutral
- Money Flow: Neutral
- Relative Strength: Neutral

**Introduction**

Vale SA was founded on June 1, 1942 and is headquartered in Rio de Janeiro, Brazil. The company operates through three core segments: Bulk Materials, Base Metals, and Fertilizers. Vale engages in the production and trade of iron ore and various raw materials, used in the steelmaking process. It also produces and sells nickel, copper, and aluminum. The Fertilizer segment is operating in three groups, based on the major nutrients: potassium, phosphate, and nitrogen.

**Fundamental Analysis**

Vale is the largest low-cost producer of iron ore in the world. While production efficiencies of the fully integrated mining operation in the resource rich area of Carajás are considered industry benchmark, the company faces headwinds from an unfavorable external environment.

Rising worldwide supply of iron ore has put pressure on prices since 2013. Experts forecast prices as low as $64/ton by 2020. That is less than 47.0% of the average price of $135/ton last year. Furthermore, research studies indicate that the steel demand from China, Vale’s main market, reached its peak in 2014. In any case, it is likely to decline in the near future, leaving production capacities unused.

In Brazil, the company is confronted with several regulatory and legal battles, increasing uncertainty and raising costs. Licensing barriers might limit the production output in Carajás, temporarily annihilating positive effects of the world's largest iron ore expansion project “Serra Sul (S11D).” The government is debating a new mining law, aimed at increasing mining royalties by more than 100% to 4% of gross revenue, corresponding to a maximum of an additional $2.2bn in 2014. Vale is also in negotiations with the government to settle a legal issue over a $15bn income tax claim for non-Brazilian subsidiaries.

**Financial Statement Analysis**

Since 2012, revenues dropped from $62.0b to $37.5b in 2014 (-39.5%). While the company was able to generate a positive net income of $405m, Gross-, EBITDA-, and Operating margins declined by 46.1%, 49.9% and 39.9%, respectively. On a positive note, Vale increased its dividend by 21.1% to $0.46 per share, compared to 2013. However, the DPS remains under 5-year average of $0.67. The adjusted 5-year P/E ratio of 324x is skewed as ratios range from 4.9x in 2011 to 1,480x in 2013.

**Conclusion and Recommendation**

Despite Vale’s favorable position as largest low cost provider, we believe the company will face significant headwinds in the near and long-term. Lower demand from China, falling iron-ore prices, and the high risk of permanent cost increases prevent profitable growth and threaten the current market position. While our valuation indicates that the company is trading at a discount to its fair value, we believe that Vale’s exposure to an unfavorable external environment is too high, considering the identified risks. We recommend: SELL.
Telecommunications Services

Sector Overview

Wireline and wireless are the two sub-sectors in the Telecommunications sector and neither is growing in the United States.

The wireline sub-sector has been subject to consolidation into three dominant companies, Verizon, AT&T and CenturyLink, although there are still the mid-sized Frontier and Windstream and about 200 small regional private firms. Business and consumers are pushing for more hosted cloud services and expanded broadband speed to accommodate video streaming. Hence, speed rather than price is becoming the competitive advantage in the industry. In 2014, 84% household contributed to at least one paid TV service nonetheless wireline revenue declined. In February 2015, the Net Neutrality law was passed by Congress, this means that differential pricing based on legally tiered web-access speed, which had offered an area of potential revenue growth for the sector, will not occur.

The wireless sub-sector likewise is dominated by the same three companies. Further consolidation is unlikely due to regulatory concerns about the oligarchical nature of the business. Wireless services are saturated, over 104% by population, and so methods to counteract the pervasive poaching of customers and to ensure customer retention drives the market.

Searching for revenue some companies (for example Windstream, American Tower and Crown Castle) have turned to leveraging their property holdings through the issuance of REITS. Another innovation, with potential growth opportunity, is the creation of Mobile Virtual Operation. Prepaid Sim cards and no contract plans have also been making some headway, but these are low revenue, low margin services and as yet not a significant bottom-line contributor for larger companies.

Investment Objective and Strategy

The Telecommunication sector is a small part of our portfolio but it can give a path for portfolio diversification. Growth in the United States is limited and last year’s returns were disappointing. Overseas markets offer areas of opportunity, particularly in those areas which have less wireless penetration and growing populations and wealth, such as several African and Asian countries. Direct investment in these nations is not possible in many cases and may be unacceptably risky in any case, so indirect investment through subsidiary holdings of mature non-native companies is the route chosen to achieve our objectives.
China Telecom Corp ADR (CHA-US)

**Recommendation**
BUY

**Valuation**
$81.9

**Last Price**
$62.78

**Adjusted P/E**
18

**Style**
Large Core

**Dividend Yield**
1.8%

**Technical Analysis**

<table>
<thead>
<tr>
<th>Metric</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bollinger Bands</td>
<td>Neutral</td>
</tr>
<tr>
<td>Money Flow</td>
<td>Positive</td>
</tr>
<tr>
<td>Relative Strength</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

**Introduction**

China Telecom Corp Ltd is an integrated communications company that provides a range of services including wireline and mobile voice services, internet and add on services in the Peoples’ Republic of China. The largest telecom provider in the world as measured by market capitalization ($259b.) it has about 156m wireline, 100m broadband and 186m mobile customers and a record of substantial growth in each of these sectors. The company is a subsidiary of the holding company, China Telecommunications Corporation.

**Fundamental Analysis**

China Telecom benefited from the 2008 Chinese telecommunications restructuring by being able to grow their wireless customer base. According the March 2015 6-K report, the company Chairman is satisfied that the strategy of promoting an” internet-oriented transformation” is bearing fruit. The mobile subscribers grew to 186m and the 3G/4G network, which grew by 15.1% in 2014. Wireline broadband subscribership of 107m represents 40.0% of the total number of broadband customers in China. This was the company’s second largest growth area, up 6.8% in 2014. However, like most other telecom companies around the world, wireline voice-access numbers were down, losing 7.9% of its users. The company launched its new “Speedy Connect” prepaid cards to capture more wireless users. It is also studying investment in Mexico, as the first step to broaden its geographic focus. China’s economy is slowing, but still has a comparatively high GDP growth rate of more than 7.0%. This fact, plus the sizeable untapped rural population, give the company growth opportunities within its borders for the next few years.

**Financial Statement Analysis**

China Telecom achieved the highest revenue growth of its peers in the industry of 3.1%. The new tax (VAT) negatively affected the astonishing 33.0% EBITDA margin, reducing net margin to 5.6%, still above the industry average of 5.0%. The dividend growth is low due to reinvestment of earnings into new ventures, but stable with a yield of 1.8% with an indicated 2015 payout of 1.2255 Yuan.

**Conclusion & Recommendation**

China Telecom is an aggressive company in a market with large numbers of potential customers. The company recognized the value of wireless services for China’s vast rural areas and it has refocused its offerings to take advantage of this consumer segment. The outlook is positive for China Telecom, which leads to the buy recommendation.
**Orange SA ADR (ORAN-US)**

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>BUY</td>
<td>$19.00</td>
<td>$16.38</td>
<td>19</td>
<td>Mid Value</td>
<td>4.1%</td>
</tr>
</tbody>
</table>

**Technical Analysis**

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

**Introduction**

Orange SA, previously France Telecomm-Orange Group, provides businesses, consumers and other users with fixed and mobile telecommunications, data transmission, internet and media, and other value added services. Orange operates in France, Spain, and Poland and has a smaller presence in Algeria, Egypt and other African and Middle Eastern countries, either directly or through investments in local telecom companies.

**Fundamental Analysis**

In 2013, Orange embarked on a course of restructuring and divestiture of unprofitable holdings. These activities continue with the announced sale of 49.0% of its video streaming site, Daily Motion but now the emphasis is on acquisition of strategic assets such as the February 2015, purchase of Orascom’s stake in Egypt’s Mobinil for €209.6m, and the bid for Spanish held Jazztel, not yet, approved by the European regulators. Orange and Nokia have formed a JV to create a fully integrated virtual environment, Telco Cloud, perceived by many as the next logical for innovation. Apart from Egypt and Morocco, Orange’s goal is to increase investment in several sub-Saharan countries whose average GDP growth is greater than 6.0%. In this way, the company can access growth markets and gradually reduce its reliance on moribund Europe. The CEO, according to the February 17, 2015 earnings call, is satisfied with the progress that has made towards repositioning the company for growth and increasing profitability.

**Financial Statement Analysis**

Sales for 2015 are stabilizing after the drop of more than 4.0% from 2013 to 2014. The company expects to reap benefits from its restructuring efforts in the form of reduced costs and that together with continued expense management, EBIT will to increase by 9.0%. Cash flow likewise will rise by about 10.0%. The company expected dividend yield to remain constant at about 4.2% compared with that of 2014 of 4.2%. Currency exchange contributed to non-operating income in 2014 and should do so in 2015. EPS at a low in 2014 of $0.62 should reach $1.02 in 2015.

**Conclusion & Recommendation**

Orange SA has stripped itself of unprofitable investments and positioned itself for growth by accessing the large African markets. The aggressive manner in which management has followed through on its goals for growth, together with strict cost controls make this one of few companies with a positive outlook for the future, hence the buy recommendation.
Utilities

The Federal Reserve – This Year, Next Year, Sometime Certainly
The tantalizing question as to when the Fed will raise interest rates is still unanswered. The media noted that the March 2015, Federal Open Market Committee (FOMC) forward looking statement had dropped the previously used word “patient” in the announcement regarding its approach to interest rate hikes. However, at the March 18, 2015, press conference after the meeting, Chairwoman Yellen depressed the expectation of an immediate rise in the Federal Funds Rate by saying that current interest rate policy "remains appropriate." In 2012, the FOMC announced that they would maintain the Federal Funds Rate close to zero at least through 2015. In 2014, Chairwoman Yellen declared that the Fed would probably increase the interest rate in 2015. Many market analysts thought it would be in Q1, but that period has passed. Additionally, the unemployment rate has fallen to below 6.5% (the level the Fed announced in December, 2012 as needed before a rise in Fed rates would take place) and the third round of quantitative easing finally ended on October 29, 2014. Therefore, the way is clear for a Fed Funds rate rise, but the timing is debated, Q 2 or 4, 2015 or Q1 2016; however, general consensus is that it will be within the next 12 months.

Utilities Overview
The Utility sector is driven by fuel and borrowing costs. The low interest rates, and the precipitative drop in energy prices in 2014, have benefited the utility companies, but have been the cause of higher than normal stock price volatility. Larger utility companies are hedged against price moves in fuel costs, particularly in gas and coal, the major sources of power plant fuel and the smaller companies have been able to profit from the lower energy prices. As a result, shareholders should see higher yields from increased profits. In the longer term, the high regulatory environment which governs consumer pricing reduces the opportunities for revenue growth so when the driving costs rise, dividend yields fall, since increase costs are not easily passed on to consumers. Anticipated rises in energy prices and interest rates in the coming year, will reduce margins and dividend growth and may already be affecting the sector returns. Nonetheless, dividend yields still make utility stocks a reliable interest-rate sensitive alternative to bonds in the diversified portfolio.

Investment Objective and Strategy
Based on the outlook of 2015 economic growth and stock market forecast, the team sets the objective for the Utilities sector as seeking income through regular payment of dividend, probably best found within the United States.

The small allocation to this sector suggests that diversification through multiple holdings is not the optimal strategy, rather we will invest in one stock with stable dividend yields.
**Vanguard Utilities Fund ETF (VPU)**

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Valuation</th>
<th>Last Price</th>
<th>Adjusted P/E</th>
<th>Style</th>
<th>Dividend Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>HOLD</td>
<td>$117.52</td>
<td>$95.56</td>
<td>16</td>
<td>Medium Value</td>
<td>3.2%</td>
</tr>
</tbody>
</table>

**Technical Analysis**

- **Bollinger Bands**: Positive
- **Money Flow**: Positive
- **Relative Strength**: Neutral

---

**Introduction**

Vanguard Utilities Fund (VPU) is an exchange-traded fund incorporated in the United States. It seeks to track the performance of MSCI Investable Market Utilities Index. VPU contains a range of different sized companies and the holdings weighted by market cap.

**Fund Description**

The Fund holds about 78 stocks; no one holding is greater than 8.0% of the market value; however, the top ten names by size constitute over 45% of the fund. It pays quarterly dividends.

As the top utility sector ETF performer in 2014, the Fund had a total return of 15.5% and an average dividend yield of 3.4%; its 2014 payout of $3.08 was a -1.4% decrease from 2013, but the anticipated dividend for 2015 is $3.292 reflecting the benefits of low fuel costs.

The Fund’s expense ratio is a sector low of 0.12% and the turnover rate 7.0% also below sector fund average. Good diversification across large and small sector stocks and the stability of utilities due to regulation, contribute to the low risk measures relative to the S&P Utility Sector Index; beta of 1.00 and Sharpe Ratio of 0.87x.

**Sector Analysis**

There is consensus among the utility sector analysts (S&P, Deloitte, Seelt and Zacks) that 2015 will be a year to watch this sector. The growing economy and, with it increased housing, means an anticipated increase in power generation of 1.1% (Energy Information Administration). Elements of long time industry restructuring, such fuel source changes to natural gas, increased use of renewables and electrical storage capacity increase, should start to be operational. The utilities sector returned in 2014 12.4% as compared with the S&P 500’s 14.1%. Earnings were up by 9.3% on 4.0% revenue growth. For 2015, growth in earnings of 3.7% is projected on revenue growth of 2.1%. Dividend yields and EPS are estimated to be 5.9% and 9.6% respectively.

**Conclusion & Recommendation**

VPU, contains a broad selection of the utility stocks, closely tracking the sector. Therefore, it captures the stability of the large firms’ dividend payments and the increased profits of the smaller companies due to lower fuel costs, without straying into the riskiest of the small utility providers.
Fixed Income Assets

2015-2016 Outlook
Speculations of a potential rise in the short-term interest rate have driven the bond market up and down since the beginning of 2014. The uncertainty would likely to continue throughout the year 2015 as the debate of interest raise carries on within the board of the Federal Reserve. In the recent meeting of the Federal Open Market Committee (FOMC) in March, policy makers have declared that they would not haste into the decision of raising short term rate in April, which has been anticipated by the market as the time for monetary policy changes. In the meeting’s notes, the committee stated that it will hold on to the accommodating interest rate to secure maximum employment as well as price stability. The rising rate is potentially postponed to the second half of the year. Several officials favored a June rate increase and others suggest that the Fed should hold off the decision until later of the year. A couple of them even wanted to wait until 2016. Officials expressed concerns that a quick tightened credit might weaken the economy more than expected, given the slowed economic growth rate by the end of 2014 and beginning of 2015. Another factors that hinders the policy change is the surging dollar which contributed to lower export, low inflation and holds down U.S. bond yield. Based off the information, we reckon that the short-term interest rate will remain low for a substantial period of time though 2015. However, as the debate goes on within the Federal Reserve, investors are still exposed to uncertainty and volatility is expected in the bond market. The ultimate goal with the fixed income investment in the portfolio is increase yield without much duration sacrifices. To achieve that, allocations below were suggested. Specifically, three funds are selected to form a diversified portfolio: Principal High Yield (CPHYX), Templeton Global Total Return (TTRZX), and USAA High Income Fund (USHYX). The proposed allocation structure is as below.

<table>
<thead>
<tr>
<th>Recommended Bond Allocation</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>USAA High Income Fund</td>
<td>60.00%</td>
</tr>
<tr>
<td>Principal High Yield</td>
<td>25.00%</td>
</tr>
<tr>
<td>Templeton Global Total Return</td>
<td>15.00%</td>
</tr>
</tbody>
</table>
Current allocation comprises two funds: PIMCO 1-5 Year US TIPS Index Fund (STPZ) and Templeton Global Total RT (TTRZX). The structure is shown as the table below: the allocation has a weighted average duration of 2.029 years and weighted average trailing twelve-month yield of 6.320%

<table>
<thead>
<tr>
<th>Current Allocation</th>
<th>Duration</th>
<th>Weight</th>
<th>WA Duration</th>
<th>TTM</th>
<th>WA TTM</th>
</tr>
</thead>
<tbody>
<tr>
<td>TTRZX</td>
<td>1.85</td>
<td>77%</td>
<td>1.422</td>
<td>7.96</td>
<td>6.121</td>
</tr>
<tr>
<td>STPZ</td>
<td>2.63</td>
<td>23%</td>
<td>0.607</td>
<td>0.86</td>
<td>0.199</td>
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<tr>
<td>Total</td>
<td></td>
<td></td>
<td>2.029</td>
<td></td>
<td>6.327</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Proposed Allocation</th>
<th>Duration</th>
<th>Weight</th>
<th>WA Duration</th>
<th>TTM</th>
<th>WA TTM</th>
</tr>
</thead>
<tbody>
<tr>
<td>CPHYX</td>
<td>3.69</td>
<td>25%</td>
<td>0.923</td>
<td>5.90</td>
<td>1.61</td>
</tr>
<tr>
<td>USHYX</td>
<td>3.84</td>
<td>15%</td>
<td>0.576</td>
<td>5.58</td>
<td>0.0315</td>
</tr>
<tr>
<td>TTRZX</td>
<td>1.85</td>
<td>60%</td>
<td>1.110</td>
<td>7.96</td>
<td>1.797</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>2.609</td>
<td></td>
<td>7.088</td>
</tr>
</tbody>
</table>

The proposed new allocation has a weighted average duration of 2.609 with a weighted average trailing twelve-month yield of 7.088.

**TIPS-SELL-PIMCO 1-5 Year US TIPS Index Fund**
Investors add this fund to their portfolio to protect themselves against inflations. The price index for personal consumption expenditure (PCE), a Fed.-preferred measure of inflation, has fell short of the central bank’s target of 2% for the 34th consecutive months. A strong dollar and low oil price has led to lower commodity price and thus results in low inflation. With the U.S. led recovery slowing down and softening global economies, the trend of low inflation is likely to continue in the foreseeable period. If the inflation hits 2%, the Federal Reserve would take action in monetary policy change to cool down the economy. Therefore, we do not see the value of keeping the low yield TIPS fund in the portfolio and recommend selling it.

**World Bond- HOLD-60% Allocation- Templeton Global Total RT (TTRZX)**
The fund seeks total return through investment in the global market. Value is added through interest income, capital appreciation and currency gains. Sector structure is 59.79% government, 18.31% corporate, and 21.80% cash and equivalent. The fund is well diversified geographically with 29.65% in Europe/Africa, 28.39% in Americas, 28.21% in Asia, and 13.75% in other regions. It has an attractive yield with fairly low effective duration. However, with a soft global recovery and slowed emerging markets, we see potential stalling price. As the return/risk rating is fairly high, we recommend hold of this fund and reduce the weight from 77% to 60% to leave room for other allocations.

**High Yield Corporates—40% Allocation-Principal High Yield (CPHYX) 25%- USAA High Income Fund (USHYX) 15%**
Corporate high yield bond typically perform well in economic upturns. They offer nice return on coupon and low exposure to interest rate changes. Default risks and quality risks are low as consumer confidence surges and economy expands. Selected two high yield bonds provides relatively high return with decent amount of risks. The average credit quality of USAA high Income Fund is slightly higher than Principal High yield A (BB versus B). The mortgage based securities in the USAA High Income fund add more diversification to the portfolio. We believe that the addition of high yield corporate bonds will take advantage of the low interest rate environment and provide us competitive returns.
Conclusion

As we expect a more volatile bond market throughout the year 2015. Selected fixed income portfolio would generate considerable return as we enter riskier sectors. Although we do not believe the chance of a sharp rise in short-term interest rate is high, there are speculations of the interest movement in the market. The combination of High yield and international bonds mitigates the risk of a potential interest raise in the next half of the year. Overall, we believe the proposal would add more return without too much risks.
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 realize income and, therefore, the Portfolio need not generate income to fund its spending policy. The cash requirements can be met by liquidating securities before May 1 (see Section 7) and will usually be covered by normal sell recommendations.

Sector & Asset Allocation

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

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

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

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

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

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

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

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

10.2.1.6 International–equity investments in companies domiciled outside the U.S. are limited to American Depository Receipts (ADRs) listed on major U.S. exchanges or to mutual funds or exchange traded funds.
10.2.2 Each of the three size styles is combined with value and growth to produce seven equity styles: large growth, large value, mid growth, mid value, small growth, small value, and international.

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

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

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

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

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

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

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

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

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

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

Rebalancing Procedure

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

**Table B**

<table>
<thead>
<tr>
<th>Crummer/SunTrust Portfolio Equity Portfolio Sectors</th>
<th>Benchmark</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500 Sector</td>
<td></td>
</tr>
<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</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Bond Market Bond</td>
</tr>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>Index Fund</td>
</tr>
<tr>
<td>Derivatives</td>
<td>10%</td>
<td>Max</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>as needed</td>
<td></td>
<td></td>
<td></td>
</tr>
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</table>

**Minimum weight for any asset class is 5%**
Mean-Variance Efficiency Analysis

Mean-variance efficiency analysis is part of modern portfolio theory. Although not a widely used guide to constructing portfolios, this analysis can identify where the proposed portfolio might be improved. To conduct this analysis we assembled historical data for the ten equity sectors and constructed the efficient frontier shown in the chart below. The efficient frontier identifies those portfolios with various amounts of the ten sectors that have the lowest risk (standard deviation). The chart also plots the individual sectors and the proposed portfolio.
Of most interest in this analysis are the two portfolios: proposed (in green) and mean-variance efficient (in orange on the efficient frontier). The proposed portfolio offers an expected annual return of 11.2% with a standard deviation of 15.1%. The corresponding MVO efficient portfolio has the same risk but a higher expected return, 13.1%. Unfortunately, this increase in return requires a sector allocation that places 78% in the Healthcare sector, 21.0% in Information Technology and 1.0% in Energy (shown in the chart below).

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

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

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

- Middle band – a simple moving average (SMA)
- Upper band – shows a standard deviation above the middle band
- Lower band – shows a standard deviation below the middle band

When the price is at the lower band, it is expected to revert upward toward the middle band. When the price is at the upper band, it is indicating a reversion downward to the middle band. However, the Bollinger Bands can also indicate price breaks to the upside and downside if the price goes outside of either band with strong volume.

Money Flow Index
The Money Flow Index is an oscillator that uses both price and volume to determine if money is flowing in or out of a security. Money flow is positive when there is buying pressure and negative when there is selling pressure. This number is multiplied with the RSI and gives a range from 0 to 100. This indicator tells whether a stock is overbought (80 or above) or oversold (20 or below).

RSI
The RSI, developed by J. Welles Wilder, is the Relative Strength Index. The RSI is a momentum oscillator that monitors both the speed and change of price movements. The indicator ranges from 0 to 100 and indicates overbought (above 70) and oversold (below 30) conditions.
Value at Risk

“Value at risk (VaR) measures the worst expected loss under normal market conditions over a specified time interval at a given confidence level.” - Financial Modeling, Simon Beninga. VaR is another technical tool that helps us to evaluate the changes we propose and is widely used in investment banking. It is required for commercial banks under Basel III.

One way to interpret this concept is that VaR answers the question: Over the next year, how much would the Rollins SunTrust Portfolio lose in the event of a major market breakdown, which has a 5% probability. The idea is not to drive the VaR to zero because riskless portfolios earn the risk-free rate of return. Rather, we want to compare the VaR between alternative portfolios. Our VaR calculation uses the historical returns for each sector and assumes no trading during the next year. We calculate VaR for the portfolio with current market and proposed sector weights to determine whether we are risking more money by carrying out our proposed allocations.

Our Findings:

- VaR with our proposed sector weights at 5% confidence level: $660,174.37
- VaR with current portfolio sector weights at 5% confidence level: $664,264.33

Our VaR analysis suggests that our proposed sector allocation reduces our portfolio risk by $4,090 compared to current sector allocations. This slight decrease in VaR can be explained by our focus to strengthen consumer discretionary, healthcare, and IT, while we lower the weight on consumer staples, financials, industrials, and utilities. This means that compared to last year’s changes, we will risk less money with our new allocation.