

The background of the page features a large, light blue watermark of the University of Connecticut seal. The seal is circular and contains the text "UNIVERSITY OF CONNECTICUT" around the top and "1881" at the bottom. In the center of the seal is a stylized leaf or tree emblem.

# University of Connecticut Student Managed Fund

MBA Fall Report- 2013

**Managers**

George Cerwinski, Lead Manager  
Pornpong Lueang-A-Papong, Portfolio Manager  
Robert Shedrawy, Treasurer/Secretary  
Xin Wang, Technology Manager  
Jonathan Coombes  
Murali Kuchipudi  
Yan Zhu

**Dear Foundation Members and Investment Advisory Board Members,**

On behalf of the MBA Student Managed Fund managers, we want to thank you for this valuable opportunity. Participating in the management of the SMF has afforded us the opportunity gain invaluable real world experience in designing an investment process, executing portfolio strategy, determining optimal asset allocation, performing quantitative and qualitative security analysis, and finally presenting our investment performance. We have also had the opportunity to learn and utilize important industry tools such as Bloomberg and Morningstar for our analysis and portfolio strategy. There is no doubt that the skills that we developed while part of the Student Managed Fund will be of immense value as we go on to jobs in Financial Services or any other industry. The development and application of these skills are an instrumental component of our MBA education.

Analyzing a company and the investment quality of its securities is more than financial statements and ratios; it is an art that requires us to apply all aspects of our MBA education from Accounting to Marketing. To develop our economic outlook, sector allocations, and individual company analysis we drew on our diverse work experience, as well as our MBA coursework in Economics, Strategy, Marketing, Finance, and Accounting.

While the purpose of this program is first and foremost educational, we must also ensure that we uphold our fiduciary responsibility to the university by following the guidelines, goals, and constraints set forth in the Prospectus, and strive to earn a reasonable risk adjusted return relative to our benchmark, the S&P 500. To ensure we properly manage toward these guidelines, the team developed a formal process to arrive at our investment decisions. All proposals were accompanied by a detailed and thorough analysis, as well as, stimulating discussions ensuring all ideas were fully vetted before any action was taken.

In the subsequent report, we will share how we developed our portfolio strategy, tailoring our asset allocation to reflect the team's unique view of the economy and business environment. While the prospectus positions the Student Managed Fund as domestic equity only, we acknowledge the fact that this is truly a global economy and, therefore, consider how our sector allocations and individual companies fit into the world economy.

The focus of this report is primarily to demonstrate how we arrived at our strategy, process, and procedures to ensure we act in the best interests of the foundation and Student Managed Fund Program. We will also discuss our economic and sector views, as well as, the results of our portfolio management efforts over our holding period, including security purchases, asset allocation, and portfolio performance to date.

We believe you will find this report both informative and interesting. We have enjoyed this opportunity and look forward to another semester of working with the foundation.

Sincerely,

George Cerwinski, Lead Manager  
Pornpong Lueang-A-Papong, Portfolio Manager  
Robert Shedrawy, Treasurer/Secretary  
Xin Wang, Technology Manager  
Jonathan Coombes  
Murali Kuchipudi  
Yan Zhu

## Table of Contents

Executive Summary .....	4
Investment Philosophy and Style .....	4
Strategy .....	5
Investment process .....	6
Macro-Economic Analysis .....	6
Sector and Industry Analysis .....	6
Individual Stock Analysis.....	6
Valuation Methodology.....	7
Processes and Procedures .....	8
Training and Development .....	8
Channels of Communications .....	8
Stock Pitches .....	8
Portfolio Analysis .....	9
Benchmark and Portfolio Asset Allocation.....	9
Holding Period Performance Review .....	10
Performance Analysis .....	10
Recap & Looking Ahead .....	13
Recap of our first three months .....	13
Looking Ahead.....	14
Best & Worst Performing Holdings.....	15
Best performing: United Health Group (UNH).....	15
Worst performing: Ford Motor Co. (F) .....	16
Sector Outlooks .....	18

## Executive Summary

### **Benchmark and Style:**

- The fund's benchmark is the S&P 500, accordingly the fund is structured as a Mid to Large cap value portfolio
- The fund's asset allocation is market cap weighted, however we actively over or under weight sectors relative to benchmark based on our economic and sector analyses
- The fund's prospectus provides the flexibility to invest up to 20% of the fund in fixed income securities; our management team allocated 0% of the portfolio to fixed income due to rising interest rates

### **Philosophy and Strategy:**

- We follow a hybrid selection process beginning with top-down approach with our economic outlook and sector analysis and follow with a bottom-up approach to invest in securities that will outperform their sector on a risk adjusted basis
- Fundamental analysis focused on business characteristics, financial health, growth, and valuation
- Purchase securities only at a price that provides at least a 15% discount from their intrinsic value calculated from discounted cash flow models
- Corporate Social Responsibility is highly valued and actively considered

### **Economic and Market View:**

- We began our investing process with the view that the domestic economy would continue on the overall positive trends as the market remained at record highs
- We also held the views that domestic political circumstances such as the Affordable Care Act and the Government Shutdown would cause periods of uncertainty
- Based on these macro views, we concluded that the market would remain positive yet volatile

### **Process:**

- Four of the managers are responsible for one S&P 500 market sector, while three managers are responsible for two sectors. Each manager has recommended two stocks from their respective sectors.
- All asset allocation and security recommendations vetted by entire management team and require 75% approval to pass

### **Review and Outlook:**

- Our investment period has been volatile, yet posted continued gains and has witnessed a 16 day government shutdown and the implementation of the Affordable Care Act as well as continued uncertainty in the European economy
- Overall market conditions have positively impacted our portfolio return during our short investment period; our total risk and systematic risk has been equal that of the market
- We remain confident that our process and methodology will result in our goal of generating a risk adjusted return greater than that of the benchmark

## Investment Philosophy and Style

The investment philosophy our team developed is primarily value investing. We use discounted cash flow analysis to determine the intrinsic value of individual securities and only purchase ones that we believe are undervalued by at least 15%. In building our portfolio we went with a top-down approach first focusing on the overall economy and then developing views on individual sectors, identifying those we think will outperform or underperform the overall market. To implement our top-down approach each manager was assigned one or two S&P 500 sectors. Managers then spent time analyzing trends within that sector including interest rates, government regulation, business cycles, technological advancements, Supply/Demand, credit quality, and earnings potential. Sector reports were presented to the team, and then we developed a sector allocation plan based on our outlooks, and then the focus shifted to the bottom-up approach as managers were free to explore investment opportunities within their assigned sectors.

We are focusing on Mid to Large cap companies with market caps greater than \$5 Billion that have strong financial fundamentals, demonstrate consistent earnings, and are undervalued by the market. Managers will present their investment proposals at weekly meetings and must receive 75% approval from the team in order to execute a purchase order. At the request of the foundation we also consider the Corporate Social Responsibility of all potential investments which we assess using various tools in Bloomberg. We plan to beat our benchmark, the S&P 500, by adjusting our sector allocations to align with our outlooks, choosing only the best companies within our assigned sectors, and actively monitoring and reassessing our holdings and sector allocations to respond to any market or economic developments. All investments are fully vetted, comply with the prospectus, and meet the goals of the fund.

We have a long term investment time horizon of 3 – 5 years and are working to position our portfolio to outperform our benchmark over that timeline. Some long term trends we have identified are rising interest rates, improving job market, manufacturing re-shoring, a recovering housing market, and improving consumer confidence. We believe these trends will continue for the next couple of years and thus try to identify investments that compliment these beliefs.

Ultimately our goal is to outperform the S&P 500 over the stated investment horizon of 3 to 5 years. However, we acknowledge that our performance will be measured during the short academic year. Therefore, we try to pick stocks that have both short term and long term upside potential. While our approach is primarily value investing we encourage managers to also consider growth companies within their respective sectors. Small allocations to growth companies with solid fundamentals that fit into our investing framework may help us achieve success in the short run while maintaining our long term value based focus.

## Strategy

Our fund's strategy is an actively managed portfolio strategy, with the aim of generating alpha in order to outperform our benchmark, the S&P 500. We plan to invest our \$1.6 million in 25 to 30 common stocks of US companies, in 10 sectors. Each holding will be less than 5% of our total portfolio. The target number of securities is subject to change, with the agreement of MBA managers, depending on the situation of the macro economy, industries, and companies.

The 10 sectors we chose to invest in are Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, IT, Material, Telecom and Utilities. Each manager was assigned 1 to 2 sectors, depending on sector size. Our decision to diversify our investments across the 10 sectors is designed to help us manage risk. After taking a broad range of macro and micro economic considerations into account, including recent events such as the passing of the Affordable Care Act, and the temporary government shutdown, each manager assigned a proposed weighting to his or her sector, based on risk/return prospects over the next 3-5 years. The defined weightings were "in-line", "overweight" or "underweight", compared to the S&P 500. We plan to reach our targeted sector weights by the time we have completed our investments.

Under our hybrid investment philosophy, while focusing on an assigned sector, each manager looks for companies with mid to large capital (\$5 billion) and selects companies that have good prospects for future business development, earnings strength and potential, and competitive strength in today's economic environment. Meanwhile, the financial performances of these companies over the last five years were carefully considered, including historical revenue, profit margin, net income, free cash flow, dividend, and market value. After carefully comparing these measurements, we chose companies that have outstanding financial performance over the past five years, as well as competitive business strategies and profit potential.

In order to further control our investment risk, we tried to manage our systematic risk by avoiding companies that are heavily weighted in the European market, due to current uncertainty in many European economies. Secondly, we managed timing risk by deciding to adjust investment weights over 4 rounds to account for potential changes in the economic environment during our investment period. Finally, we decided to further manage risk by placing an emphasis on mid to large cap companies, rather than small cap companies.

Although the Student Managed Fund prospectus permits us to invest up to 20% of our portfolio in fixed income assets, we decided to invest 100% of our fund in securities. Firstly, the rising interest rate makes us concerned about future prices in this asset class. The investment might face losses if the interest rate continues to grow. Moreover, compared to performing thousands of analyses on thousands of fixed income assets, we prefer to use our hybrid strategy to choose the best stocks in the best industries for our portfolio, which could provide comparable yield.

## **Investment process**

Our approach to investing is a hybrid of both a top-down and bottom-up perspective. We began as a group by analyzing the state of the macro-economy, before delving down into sector and industry analyses. Based on our consensus opinion of each sector and industry, we began to select individual stocks for detailed analysis and valuation. During the individual stock analysis stage, however, we allowed for some flexibility for each manager to uncover undervalued stocks using a bottom-up approach. The three main stages of our approach are explained below.

### **Macro-Economic Analysis**

We began our investment process by researching and discussing the macro-economic trends that are likely to have a strong impact on overall market conditions over our proposed five-year holding period. Based on each manager's findings and subsequent debate, we aligned our opinions and expectations to the extent that we were able to form a base-line perspective from which to conduct sector and industry analyses. The main factors we considered include the following:

- GDP growth rate
- Unemployment rate / labor participation rate
- Interest rates
- Geopolitical events

### **Sector and Industry Analysis**

We proceeded by analyzing the characteristics of each sector of the S&P 500, and the industries, in terms of trends and future expectations. We were thus able to identify which sectors we believed would outperform the S&P 500 benchmark over the holding period. This formed the basis of our portfolio analysis and created a strong framework from which we could approach our valuation of individual stocks. We used a variety of professional resources to carry out our analysis. These included Bloomberg, Morningstar Direct, S&P Net Advantage, Value Line, Thomson ONE banker, and Yahoo Finance. While the most pertinent factors varied by sector and industry, some the common areas of consideration included the following:

- Corporate earnings and reports
- Consumer confidence
- Credit availability
- Government regulation

### **Individual Stock Analysis**

Managers were assigned to each sector of the S&P 500 in order to perform a more detailed analysis of the individual stocks within. The top-down approach we had so far taken enabled each manager to focus his or her search on a group of select industries, within the sector, that the group had collectively identified as preferable. However, managers were not bound to a single "best" industry within each sector from which to select a stock for investment. In fact, we decided that each manager would be granted the freedom to select and pitch a stock from any industry within his or her designated sector. Managers used the group's selected industries as a starting point from which to begin to analyze individual securities. From here, managers could explore all companies in their sector as they learned more. The flexibility of this approach was designed to allow managers to cast a wider net in the search for alpha, and thus incorporate some of the benefits of a bottom-up process.

Individual stocks were analyzed from both qualitative and quantitative perspectives. Each manager looked closely at each company's business model, the products and services offered, and management style. While each company was viewed in terms of its unique strengths and weaknesses, our search placed an emphasis on companies with the following attributes:

- Strong and sustainable business model
- Well-balanced/diversified business units
- Strong and predictable earnings
- Estimated intrinsic value higher than market value
- Growth potential
- Ethical approach to business

While any perspective on the ethics of a company is inherently subjective, we chose to use the quantitative, third-party measures of ethical business practices provided by Bloomberg CSR scores as a standard of comparison. While all CSR scores were taken into account, we identified the following Bloomberg CSR scores as the most pertinent and important to us as a group:

- Human Rights
- Business Ethics Policy
- ESG Disclosure
- Equal Opportunity
- Emission Reduction
- Environmental Disclosure Score

In terms of more quantitative analysis, we looked closely at performance metrics and ratios between industry competitors and against standard benchmarks. Some of the more important metrics included the following:

- ROA and ROE
- P/E and PEG ratios
- Operating margins
- Leverage ratios

Once these basic qualitative and quantitative considerations were evaluated, the stronger companies were chosen for a rigorous examination of financial performance and future earnings potential. We calculated a Fair Value for each stock using the Discounted Cash Flow (DCF) method. We also performed sensitivity analysis and identified the crucial factors that could affect the accuracy of our valuations in terms of both risks and potential upside.

### Valuation Methodology

We used the Discounted Cash Flow (DCF) method to value non-financial company stocks and the Excess Return Valuation (ERV) method to value financial company stocks. We used historical trends and growth rates to develop projected income and cash flow statements which we used to predict future free cash flows. These Free cash Flows were then discounted in order to arrive at an intrinsic value for the security.

- **WACC:** We used the Weighted Average Cost of Capital (WACC) as the discount rate for each stock. The CAPM formula was used to determine the cost of equity. Beta, taken from Bloomberg, was used along with the current 10-year US Treasury bond yield as the risk free rate, and a 5.9% geometric historical market risk premium. This was combined with a cost of debt that represents either interest expense as a percentage of long-term debt or a Bloomberg estimate.
- **DCF:** Discounted Cash Flow model is used to evaluate the present value of the stocks. For non-financial

companies, Free Cash Flow is calculated through (NOPAT+ Depreciation- Change in net working capital –Net Capital investment) for a five years period. For financial companies, Excess Return is calculated by comparing Return on Equity to Cost of Equity. The assumptions for our Free Cash Flow projections varied stock-by-stock and manager-by manager. These assumptions were scrutinized by the group during each stock pitch, made prior to a final investment decision.

- **Terminal Value:** Projections were made to a point in time where the manager felt that growth could be seen as stable enough to apply a terminal growth rate for future years into perpetuity. The used terminal growth rates for non-financial companies were in the range of 1% to 4% varied by different industries. The resulting Terminal Value was added to the present value of the preceding years' free cash flows to arrive at the final intrinsic value.
- **Equity Value per Share:** After subtracting net debt from the enterprise value and continue to divide the result by current diluted shares outstanding, the managers eventually get the intrinsic value per share for stock.
- **Total Return Estimates:** We assessed the return capability for stocks by calculating Compound Annual Growth Rate based on estimated intrinsic value and dividends per share for individual stocks for 3- years periods and 5-years periods respectively.

## Processes and Procedures

### Training and Development

The team received training from various resources which helped in designing better strategies for the fund. In the initial meetings Dr. Rakotomavo and Dr. Ghosh gave advice on stock selection framework, DCF, sector allocations and availability of resources such as Bloomberg, Morningstar etc...Dr. Rakotomavo gave a stock analysis demo on Bloomberg which the team found very useful. Everyone was able to see the immense information and data that Bloomberg has. On top of that the team also received training from a Bloomberg representative who showed shortcuts and important resources to save time during analysis. The team was also given access and training to Morningstar which gave additional helpful resources. Also certain important features of various resources were highlighted. For example the team found the industry report from S&P Net advantage very insightful and helpful. Overall the training and guidance, especially the Bloomberg access gave the team all the key resources that a professional stock analyst would have.

### Channels of Communications

The team regularly met every Wednesday between 9:30 am to 1:30 pm in GBLC room 304 during which all the key brainstorming, training, stock pitches and administrative tasks took place. All the important documents like analyst reports, trade tickets etc. were stored in a common shared location so that all the necessary people have access. All managers are expected to attend all meetings and inform the team in case there is any conflict. Usually at the end of every meeting, the team finalized on the agenda and action items for the next meeting. The team also regularly monitored the time line for various tasks so that the necessary deadlines are met in a timely fashion. Meeting Minutes are taken during the meetings and uploaded into the common shared location.

### Stock Pitches

Each Manager is expected to pitch two individual stock purchase recommendations to the group in their assigned sector by the end of November, 2013. The manager who pitches the stock is expected to present a one page report. A sample One Page Report is included in this report.

The pitch process will consist of a 10-15 minute presentation followed by a 10-15 minute Q&A session. All managers present at the meeting (with the exception of the pitching manager) will vote whether to buy the stock. The voting process is open and voting managers will raise their hand to indicate a buy. The stock must receive a 75% buy votes from the managers in order to buy that stock. If the stock is a buy, the pitching manager



will complete a Buy Order Trade Ticket, including any negative votes explained, and put it in the SMF drop box. The Secretary will review and subsequently send the order along with the One Page Report to faculty for execution as soon as possible.

If the stock is voted down, the pitching manager will have a brief period to answer questions and provide additional insight to convince group of the validity of the recommendation. One re-vote by the entire group will be allowed. If the stock is voted down again, the pitching manager will have until the next pitch day to make another recommendation.

It is each manager's responsibility to monitor the performance of their stock recommendations. A stop loss trade ticket is also submitted for each stock that is bought. The stop loss price is 15% less that the price at which the stock is bought.

## Portfolio Analysis

### **Benchmark and Portfolio Asset Allocation**

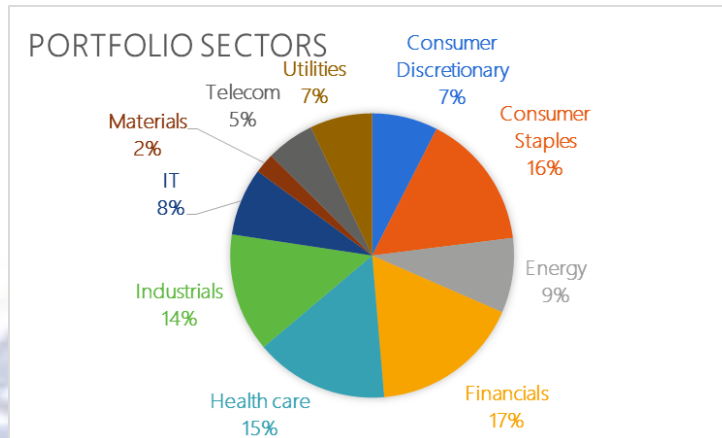
As stated in in the prospectus, our performance is tracked relative to the S&P 500. We are seeking alpha from undervalued companies with demonstrated financial strength.

At the beginning of the semester, we took over the portfolio which was fully invested in the S&P 500 SPDR ETF. Our plan is to have a well-diversified portfolio, so we plan to have about 25 – 30 stocks in our portfolio, exposed to all sectors. We decided to liquidate approximately one-fourth of the SPY position to satisfy each investment round, two in fall semester and two in spring semester.

We began the first investment round by focusing on sectors with the most positive outlooks: Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, and IT. In the second investment round, we invested in Materials, Telecom, Utilities, Industrials, Health care, Financials, and Consumer Staple. The following figures show the current weight of our portfolio relative to the benchmark and our plan looking forward.

Sector	Current %	S&P 500 Weight
Consumer Discretionary	7.5%	12.4%
Consumer Staples	15.5%	10.2%
Energy	8.5%	10.5%
Financials	17.1%	16.1%
Health care	15.2%	13.0%
Industrials	13.5%	10.9%
IT	7.7%	17.9%
Materials	2.3%	3.5%
Telecom	5.5%	2.4%
Utilities	7.1%	3.1%
	100.0%	100.0%

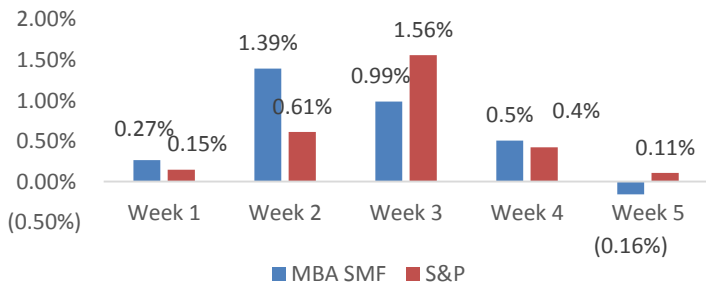
**Current Weight of the Portfolios:**



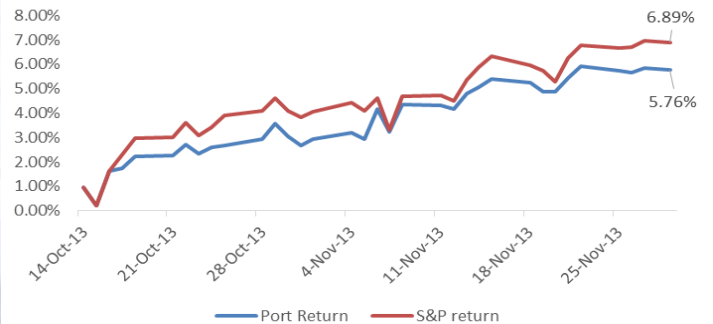
**Holding Period Performance Review**

Our team assumed management responsibility in September of 2013. At this time the fund was fully invested into the S&P 500 ETF. After two trading rounds, our positions are as follows:

**Portfolio Weekly Return**



**Portfolio Growth**



During the last five trading weeks, started on 10/24/2013, our portfolio slightly outperform S&P 500 in week 1, week 2, and week 4. However, in Week 3 and week 5, our portfolio underperforms S&P 500. As of 11/29/2013, the total return of our portfolio is 5.76%, compared to 6.89% of the market.

**Performance Analysis**

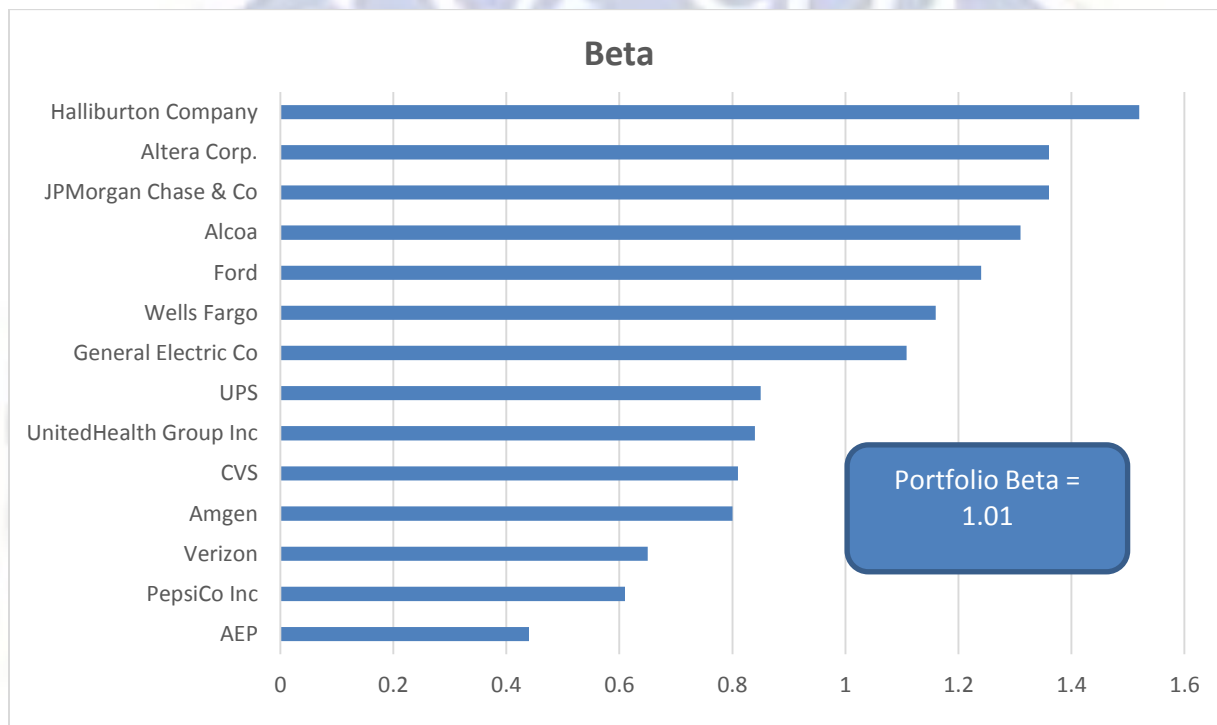
The UConn foundation has a long-term investment mandate for the SMF program. The performance of our portfolio is measured in comparison to the S&P 500 Index for equity securities. Our objective is to exceed the risk adjusted return of the S&P 500. We measure this using the following metrics:

- **Sharpe Ratio** – Measures the portfolio’s risk-adjusted performance, and is defined as the excess return of the portfolio over the standard deviation of the portfolio
- **Treynor Ratio** – Measures the portfolio’s the reward to volatility and it is measured as the excess return of the portfolio over the Beta of the portfolio
- **Alpha** – Measures the difference between the portfolio’s actual return and its expected return given the portfolio beta. A positive alpha indicates that the portfolio has performed better than the expected returns as predicted by the portfolio beta.

We purchase stocks that have a current market price which is at least 15% lower than its intrinsic value based on our valuations. We also set stop losses for all of our stocks that we purchase. The consensus in the group was to set the Stop Loss at 15% of the purchase price of the stock. We measure returns of our portfolio on a weekly basis. Individual sector managers also monitor performance of their sector holdings on a daily basis and provide updates in the weekly team meetings.

**Portfolio Beta = 1.01**

Currently, our portfolio consists of 14 stocks, diversified in all sectors. The beta range of our stocks is between 0.44 and 1.52. Halliburton (HAL) – Energy sector – has the highest beta of 1.52 in our portfolio, while American Electric Power (AEP) – Utility sector – has the lowest beta of 0.44. Majority of the stocks have beta close to one. The portfolio’s beta is 1.01, implied that we are bearing about the same systematic risk as the market.



**Jensen’s Alpha = 0.40%**

Jensen’s Alpha measures the difference between the portfolio’s actual return and its required return given the portfolio beta. Our portfolio represents 0.40% above that predicted by the capital asset pricing model (CAPM), given the portfolio’s beta and the average market return.

**Treynor Ratio = 0.005**

Treynor Ratio measures the reward to volatility and it is measured as the excess return of the portfolio over the Beta of the portfolio, which means our portfolio yields 0.5% per one unit of systematic risk, which measures by beta.

**Sharpe Ratio = 0.603**

Sharpe Ratio measures the portfolio’s risk-adjusted performance, and is defined as the excess return of the portfolio over the standard deviation of the portfolio. A negative Sharpe ratio indicates that a risk-less asset would perform better than the security being analyzed. Our portfolio provides return 0.603 times the total risk.

**Conclusion** - Our fund's performance for our holding period was 5.76% compared to 6.89% for the S&P 500 (as of November 29, 2013). The portfolio's Sharpe Ratio, which measures risk adjusted return per unit of total risk, was 0.603 compared to 0.623 for the index. This difference suggests that our portfolio experienced smaller returns over the risk free rate compared to the benchmark. The portfolio had a beta of 1.01. The Treynor Ratio, which measures risk adjusted return per unit of systematic risk, was 0.005 compared to 0.006 for the benchmark, suggesting our portfolio was slightly less efficient in managing market risk as the S&P 500.

	MBA SMF	S&P 500
Mean Weekly Return	0.513%	0.611%
Geometric Weekly Return	0.510%	0.608%
S.D	0.763%	0.896%
Beta	1.010	1.000
Sharpe Ratio	0.603	0.623
Treynor Ratio	0.005	0.006
Jensen's Alpha	0.40%	n/a

## Portfolio Snapshot as of 11/29/2013

Sector	Security	Symbol	Price/Share	Shares	Position Total	Weight	Div. Yield	Cost/Share	Cost Basis	Purchase Date	Gain/Loss
Consumer Discretionary	Ford Motor Co	F	\$17.08	3,232	\$55,203	3.3%	2.35%	\$18.00	\$58,176	10/24/2013	-5.11%
<b>Sector Total</b>					<b>\$55,203</b>	<b>3.3%</b>					
Consumer Staples	PepsiCo Inc.	PEP	\$84.46	680	\$57,433	3.4%	2.81%	\$83.36	\$56,685	10/24/2013	1.32%
	CVS Caremark Corp	CVS	\$66.96	870	\$58,255	3.5%	1.50%	\$65.60	\$57,072	11/18/2013	2.07%
<b>Sector Total</b>					<b>\$115,688</b>	<b>6.9%</b>					
Energy	Halliburton Company	HAL	\$52.68	1,116	\$58,791	3.5%	0.99%	\$50.85	\$56,749	10/24/2013	3.60%
<b>Sector Total</b>					<b>\$58,791</b>	<b>3.5%</b>					
Financials	JPMorgan Chase & Co	JPM	\$57.22	990	\$56,648	3.4%	2.93%	\$52.82	\$52,292	10/24/2013	8.33%
	Wells Fargo	WFC	\$44.02	1,650	\$72,633	4.3%	2.51%	\$43.56	\$71,874	11/18/2013	1.06%
<b>Sector Total</b>					<b>\$129,281</b>	<b>7.7%</b>					
Health care	UnitedHealth Group Inc.	UNH	\$74.48	830	\$61,818	3.7%	1.50%	\$68.02	\$56,457	10/24/2013	9.50%
	Amgen	AMGN	\$114.08	460	\$52,477	3.1%	1.60%	\$116.50	\$53,590	11/18/2013	-2.08%
<b>Sector Total</b>					<b>\$114,295</b>	<b>6.8%</b>					
Industrials	General Electric Co	GE	\$26.66	2,150	\$57,319	3.4%	2.91%	\$26.57	\$57,126	10/24/2013	0.34%
	United Parcel Service	UPS	\$102.38	410	\$41,976	2.5%	2.40%	\$100.62	\$41,254	11/18/2013	1.75%
<b>Sector Total</b>					<b>\$99,295</b>	<b>5.9%</b>					
Technology	Altera	ALTR	\$32.25	1,750	\$56,438	3.3%	1.60%	\$32.52	\$56,910	10/24/2013	-0.83%
<b>Sector Total</b>					<b>\$56,438</b>	<b>3.3%</b>					
Material	Alcoa	AA	\$9.61	1,858	\$17,855	1.1%	1.22%	\$9.05	\$16,815	10/24/2013	6.19%
<b>Sector Total</b>					<b>\$17,855</b>	<b>1.1%</b>					
Utilities	American Electric	AEP	\$47.06	1,088	\$51,201	3.0%	4.30%	\$48.21	\$52,452	10/24/2013	-2.39%
<b>Sector Total</b>					<b>\$51,201</b>	<b>3.0%</b>					
Telecom	Verizon	VZ	\$49.62	806	\$39,994	2.4%	4.20%	\$50.35	\$40,582	11/18/2013	-1.45%
<b>Sector Total</b>					<b>\$39,994</b>	<b>2.4%</b>					
<b>Total Equity Value</b>					<b>\$738,040</b>	<b>43.8%</b>					
<b>Total Cash</b>					<b>\$102,005</b>	<b>6.0%</b>					
<b>SPY ETF</b>					<b>\$846,175</b>	<b>50.2%</b>					
<b>Total Account Value</b>					<b>\$1,686,220</b>	<b>100.0%</b>					

### Recap & Looking Ahead

#### Recap of our first three months

The upcoming enactment of the Affordable Care Act and Federal debt limit crisis in October were our immediate concerns when we initiated the SMF early this fall. We all recognized that the results of these political actions would have significant bearing on the various sectors, particularly Healthcare, Industrials, and Finance. We wanted to take a cautiously optimistic position in these sectors and looked at stocks with Beta near 1. Depending on the results of these events we wanted to be able to adjust our weighting in relation to benchmark.

The make-up of our management team made sector weighting our portfolio inherently a longer process as we have purchased positions in 14 holdings. Our strategy has been to take a single position in the Materials, Telecommunication, and Utilities sector while building towards a market weighting over our following two trades.

The continued earnings growth on flat revenues has fed fear of a bubble into some aspects of the market. Retail investors continuing to enter the market based on record performances has pushed the pricing on some equities quite high past their fundamentals. Some analyst and activist investors have warned of potential sell offs in the near future.

The Eurozone has lagged behind world trends and continues to rebound slower than expected. While Europe has seen marginal improvements in trade surpluses and has even lower interest rates, the crisis is still ongoing as unemployment levels are expected to remain above 12% through 2014. The continent has escaped its recession but has struggled to gain momentum since. Overall our outlook on European and Emerging markets remains pessimistic.

Some long term trends we have identified are rising interest rates, improving unemployment, manufacturing re-shoring, a recovering housing market, and improving consumer confidence. We believe these trends will continue for the next couple of years and thus try to identify investments that compliment these beliefs.

Our analysis of the markets and the sentiments expressed by analyst suggested that the market had factored in the government shutdown concerns this October and market conditions have remained positive. Market volatility and continued marginal consumer confidence has negatively affected some sectors in the market. Only one of our holdings has seen significant value decline despite the fact that the fundamental business model of this company has not changed.

### **Looking Ahead**

All seven fund managers came to the program with strong backgrounds and diverse expertise, but most of us had little previous investment experience. With a semester's worth of learning and progressing, we all have noticed that we have a much better understanding in stock valuation and management of a portfolio than when we started in September. Our learning curve has improved steeply both through individual research and group discussion.

During the winter break, we will continue to monitor our positions, continually assessing our risk exposure and re-evaluating our current portfolio.

It has been a tremendous learning experience so far and we really appreciate for all people involved in providing us with this learning opportunity.

Going into spring semester, we will emphasize our focus on finding the companies with the following attributes unless the fundamentals change:

- Strong and fit business model
- Steady revenue and earnings
- Diversified and balanced operations
- Great growth and value prospects

We will explore the possibility of seeking out growth stocks to further improve our performance vs. the S&P 500.

We want to ensure companies we invest in have a good business model to begin with. We highly focus on revenue growth, margin improving, and committed management team. Since there is a high volatility in the current market, companies with a balanced portfolio and sound predictable earnings are preferable.

Some of the fundamentals we are closely monitoring:

- Specific events such as the continued turmoil of the Affordable Care Act and the debt limit resolution until Feb. 7
- Regulation changes that might affect specific sectors
- General economy both domestic and international
- Technology change
- Trend in each sector

During the upcoming semester we will dive deeper into the current macro-economic trends within each sector in order to determine the appropriate weighting as we go forward in building our portfolio. Our goal is to use a combination of a top-down market view alongside our bottom-up valuation in order to continue outperforming our benchmark, the S&P 500.

## Best & Worst Performing Holdings

### **Best performing: United Health Group (UNH)**

<b>Sector:</b> Health care	<b>Price@11/29/2013:</b> \$74.48	<b>Intrinsic Value:</b> \$114.42
<b>Industry:</b> Managed Care	<b>Purchase Price:</b> \$68.02	<b>Market Cap at Intrinsic Value:</b> \$116.36B
<b>Market Cap:</b> \$75.75 B	<b>52 Week Range:</b> \$51.09-\$75.88	<b>Unrealized Gain/Loss:</b> 9.50%

**Business Summary:** UnitedHealth Group Incorporated operates as a leading diversified health care company in the United States. Its business is mainly consisted of United Healthcare segment and OPTUM segment. United Healthcare segment offers consumer-oriented health benefit plans and services. OPTUM segment provides OptumHealth- health management service, OptumInsight -software and information products, consulting service and OptumRx- pharmacy benefit management services and programs.

**Investment Thesis:** As the largest player in Managed Care industry, UnitedHealth Group reported positive results for the 2013 Q2, the company keeps its high speed growth and its YOY total revenue increased by 11.4%. In past four years, its growth of Medicare Advantage and Medicaid enrollment has offset the decrease of commercial risk business, producing incremental revenue and profits. At the same time, from 2012, the company made several acquisitions and expand to international markets. Although the reform might bring the headwinds to the company, we believe that the company has ability to overcome the difficulties.

### **Performance:**

- Our analysis using discounted FCF over 5 years suggested that the stock had an intrinsic value of \$114.42
- We purchased the stock at \$68.02 on October 24th. A positive Q3 earnings announcement although below the analysts' expectation and caused the stock price to drop after announcement, the stock price increased from \$66.94 to 74.48 within five weeks.
- The primary drivers for the increase in stock price were
  - The reduced medical cost ratio brings the company increased earnings per share.
  - Affordable Care Act brings potential of increased enrollment, expansion and broader coverage to UnitedHealth Group
  - The reform will be also beneficial to company's OPTUM segment which focuses on consulting and technology services

**Our Plan for United Health Group:**

- We continue to believe UNH is undervalued as a whole. The forward P/E ratio is 12.85 with outstanding reward to shareholders via dividends and share buyback supports the increase in stock price.
- We believe that UNH will generate decent profit from Obamacare. The company’s membership grew by 24% in the first nine months of 2013.
- We will continue to monitor UNH as its stock price approaches our calculated intrinsic value.



**Worst performing: Ford Motor Co. (F)**

<b>Sector:</b> Consumer Discretionary	<b>Price@11/29/2013:</b> \$17.08	<b>Intrinsic Value:</b> \$26.89
<b>Industry:</b> Auto Makers	<b>Purchase Price:</b> \$18.00	<b>Market Cap at Intrinsic Value:</b> \$102.6B
<b>Market Cap:</b> \$68.3B	<b>52 Week Range:</b> \$9.71 – \$18.02	<b>Unrealized Gain/Loss:</b> (5.11%)

**Business Summary:** Ford Motor Company competes in the global automotive industry and is the second largest auto maker in the US. Ford operates in two sectors: Automotive and Financial Services. The Company manufactures or distributes automobiles across six continents. Its automotive brands include Ford and Lincoln. The Company's automotive sector includes Ford North America, Ford South America, Ford Europe, and Ford Asia Pacific Africa regions.

**Investment Thesis:** As the only major US automaker that didn't declare bankruptcy or accept a government bailout during the great recession Ford has an excellent opportunity to recapture Market share and reclaim dominance amongst the automakers. The success of the "One Ford Plan" has allowed F to fix its balance sheet, sell unprofitable brands, renegotiate retiree benefits plans, and improve the quality of their vehicles. Ford expects to reduce its platforms from 27 to 9 which could save the company billions and allow them to respond more quickly to demand shifts. Ford resumed its dividend in 2012 and doubled it in 2013, August sales were the strongest since 2006 growing at 12.4%, and Q2 \$2.3BN profit in North America was the best in company history. Ford's competitive positions, cost reduction measures, and financial performance make it a strong buy

**Performance:**

- Our analysis using discounted FCF over 5 years suggested that the stock had an intrinsic value of \$26.89
- We purchased Ford at \$18.00 on October 24th, the day they announced Q3 earnings
- While Ford had a great quarter and beat expectations the stock has fallen to ~\$17.00 and appears to be stuck in a range
- The primary drivers for the decrease in stock could be attributed to:
  - Concern over CEO Alan Mulally's possible departure
  - Quality issues with Ford vehicles especially Microsoft Sync





- We strongly believe in Ford’s business model, financial position, and growth prospects
- Ford’s European division will continue to improve as they expand their presence in Asia and South America and capture more market share in North America
- Q4 earning and sales should beat analyst expectation and hopefully pull the stock out of the range

**Our Plan for Ford:**

- Given our 3 – 5 year investment time horizon, it is difficult to identify a “worst performing investment” after only one month of trading
- We continue to believe Ford is undervalued as a whole. Low valuation coupled with record sales, dividend growth, and international success point to a higher share price for Ford
- We have a stop loss order at 15% of our purchase price and will continue to monitor Ford as its stock price approaches our calculated intrinsic value

## Sector Outlooks

**Sector:** Consumer Discretionary

**Manager:** George Cerwinski

### Facts and Figures

<b>S&amp;P Weighting:</b>	12.4%	<b>P/E TTM:</b>	21.4x
<b>ROE TTM:</b>	20.5%	<b>YTD Performance:</b>	33.26%
		<b>Dividend Yield:</b>	1.37%

**Intro Description:** The Consumer discretionary sector consists of businesses that sell nonessential goods and services. These companies are most sensitive to the economic cycle and tend to outperform during boom times. There are two types of companies in the sector, manufacturing companies that produce actual goods and service companies. Its manufacturing segment includes automotive, household durable goods, textiles & apparel and leisure equipment. The services segment includes hotels, restaurants and other leisure facilities, media production and services, and consumer retailing and services.

### Trends

1. Inventories remain quite lean providing retailers with some pricing power as economic activity picks up and consumers regain confidence
2. The Federal Reserve continues to be quite accommodative, which could help to support the consumer, although the potential for reduced asset purchases has increased market volatility.
3. The job market, although still somewhat sluggish, appears to be improving at a steady rate which should help bolster consumer confidence
4. Falling energy prices, lower debt levels, an improving housing market, and strong auto sales all bode well for a strong consumer sector

**Portfolio Strategy:** We find consumer discretionary space to be a very attractive and plan to overweight this sector as we further develop our portfolio next semester. Improving unemployment, low gas prices, and a recovering housing market are all positive signs for the American consumer and will likely drive growth in this sector. We plan to explore firms in the housing and retail subsector to complement our automaker exposure next semester.



**Sector:** Consumer Staples  
**Manager:** Xin (Keira) Wang

**Facts and Figures**

<b>S&amp;P Weighting:</b>	10.19%	<b>P/E TTM:</b>	18.73x
<b>ROE TTM:</b>	24.73%	<b>YTD Performance:</b>	21.38%
		<b>Dividend Yield:</b>	2.85%

**Intro Description:** Consumer Staples are essential products such as food, beverages, tobacco and household items. All the products are satisfied the customers' basic needs, people are unable or unwilling to cut out of their budgets of consumer staples regardless of their financial situation. The continuous and constant demand for these products irrespective of the economic cycle gives the sector a defensive posture. Although this is positive during tough economic times, it can also be negative during improving economic conditions since consumers don't typically expand their spending on such items as the economy improves.

**Trend:**

1. **Economic Growth:** U.S. and worldwide economy are recovering now, and many central banks continue to firmly make effort to stimulate the economy. As Consumer Staples has the defensive posture during the economic downturn, it could impair the defensive advantage as the economy improves.
2. **High Unemployment:** Although consumer staple companies are much less exposed to changes in income, they are still impacted when consumer confidence drops or income growth declines. As U.S. unemployment stays relatively high in 2013, consumers still prefer cheaper brands, which will limit the growth of branded companies and hurt the profitability of the sector.
3. **Expansion in Emerging Markets:** Rising demand for the consumer staples products in emerging markets offers the huge opportunities for the companies. But more exposure in emerging markets could increase the risks of foreign exchange rates.
4. **Cost Reduction:** In order to surge the profitability, more and more companies are dropping the low-margin products categories, launching cost-saving and restructuring programs to improve the operation efficiency.

**Portfolio Strategy:** Since Consumer Staples sector is stable and defensive, the team decided to weigh the sector as S&P weighting at the end of next semester. The strategy of this sector is choosing steady growing companies with high financial strength, low beta, stable cash flow, large market capitalization and strong dividend yield. The S&P weight is 10.19%, in order to make sure the value of each pitch is at the neutral level, the team decided to invest total three stocks in this sector at the end of next semester, two of three were invested in this semester, which makes the current weight overweigh than the market.



**Sector:** Energy

**Manager:** Robert Shedrawy

### **Facts and Figures**

<b>S&amp;P Weighting:</b>	10.51%	<b>P/E TTM:</b>	14.19x
<b>ROE TTM:</b>	13.77%	<b>YTD Performance:</b>	18.93%
		<b>Dividend Yield:</b>	2.12%

**Intro Description:** The Energy sector consists of businesses that produce or supply energy. This sector includes companies involved in the exploration and development of oil or gas reserves, oil and gas drilling, or integrated power firms.

Performance in the sector is largely driven by the supply and demand for worldwide energy. Energy producers will do very well during times of high oil and gas prices, but will earn less when the value of energy drops. Furthermore, this sector is sensitive to political events, which historically have driven changes in the price of oil.

### **Trends**

1. Global uncertainties could threaten some supplies, although we don't believe the recent Egyptian problem will result in a disruption.
2. Developing nations will likely need more energy as they improve their infrastructures and modernize their economies.
3. Supplies could increase dramatically with a renewed commitment to exploration and technological improvements. We've already seen new discoveries and existing fields produce more oil than originally projected.
4. Conservation efforts and new technology could impact the growth in demand for energy products

**Portfolio Strategy:** We find energy space to be an attractive sector despite current decreases in oil prices. We will weigh the sector in accordance to oil price fluctuations. We believe that continued exploration efforts bode well for some industries in this sector. We plan to explore firms in the pipeline and services sectors in the upcoming semester.



**Sector:** Financials

**Manager:** Omo (Pornpong) Lueang-A-Papong

### **Facts and Figures**

<b>S&amp;P Weighting:</b>	16.10%	<b>P/E TTM:</b>	13.30x
<b>ROE TTM:</b>	8.40%	<b>YTD Performance:</b>	26.39%
		<b>Dividend Yield:</b>	1.73%

**Intro Description:** The Financial sector consists of businesses that provide financial services to commercial and retail customers. Financial services perform best in low interest rate environments. A large portion of this sector generates revenue from mortgages and loans, which gain value as interest rates drop. Furthermore, when the business cycle is in an upswing, the financial sector would benefit from additional investments. Improved economic conditions usually lead to more capital projects and increased personal investing. New projects require financing, which usually leads to a larger number of loans.

### **Trends**

1. Recent delinquent loan estimates have decreased among credit card companies, indicating improving balance sheets.
2. Businesses could increase borrowing, as they take advantage of low rates and look to spend on projects they've been postponing in light of economic and fiscal uncertainty.
3. Rising interest rates could dampen demand for mortgages, which could impact profits in certain areas of the financial sector.
4. Government intervention, such as new limits on certain fees that can be charged, has already started to affect the financial industry and could hold back performance for the foreseeable future.

**Portfolio Strategy:** We find financial sector to be a very attractive and plan to at least market weight this sector as we further develop our portfolio next semester. Improving unemployment, increasing borrowing, and a decreasing delinquent loans are all positive signs for financial institutions and will likely drive growth in this sector. We plan to explore firms in the insurance industry and real estate industry next semester.



**Sector:** Health Care  
**Manager:** Yan Zhu

**Facts and Figures**

<b>S&amp;P Weighting:</b>	13.01%	<b>P/E TTM:</b>	18.33x
<b>ROE TTM:</b>	18.39%	<b>YTD Performance:</b>	32.97%
		<b>Dividend Yield:</b>	1.7%

**Intro Description:** Health care stocks are stocks relating to medical and healthcare goods or services. The healthcare sector includes pharmaceuticals, hospital management firms, health maintenance organizations (HMOs), biotechnology and a variety of medical products. The sector’s five-year growth now stands at 13%. Stocks in the healthcare sector are often considered to be defensive because the products and services are essential. Even during economic downturns, people will still require medical aid and medicine to overcome illness. Having a consistent demand for goods and services makes this sector less sensitive to business cycle fluctuations.

**Trends:**

1. Sector is health with demand returning, better growth and emerging market.
2. Opportunities and Long Term profits in managed-care industry due to Affordable Care Act.
3. Big Pharmaceutical firms will probably continue to rummage biotechnology.
4. The increasing number of the aging population and the baby boomers stimulate the demand of health care services and related products.
5. Health-care spending improves in developed world, but at a slow pace; European demand situation remains bleak, economic recovery is very slow; Pharmaceutical and device companies are expanding business to emerging market, in some cases emerging markets contribute nearly a quarter of their total sales.

**Portfolio Strategy:** WE plan to overweight this sector as we further develop our portfolio next semester due to its robust performance. The sector’s five-year growth now stands at 13% and continue to defy expectations which gain around 20%. The increasing demand from aging population, baby boomers and emerging markets, negative impacts and opportunities arose by Affordable Care Act, the recovered economy and the lowered unemployed level convince us the better performance in future. We plan to explore firms in traditional Pharmaceutical, health care products and health care facilities industry next semester.



**Sector:** Industrials

**Manager:** Jonathan Coombes

**Facts and Figures**

<b>S&amp;P Weighting:</b>	10.87%	<b>P/E TTM:</b>	17.78x
<b>ROE TTM:</b>	17.54%	<b>YTD Performance:</b>	29.94%
		<b>Dividend Yield:</b>	1.95%

**Intro Description:** The three main areas within the sector are Capital Goods, Commercial and Professional Services, and Transportation. The Industrials sector makes up 10.63% of the S&P 500, and historically moves very closely in-line with the S&P 500 index as a whole. Two of the most important drivers of performance for industrials are building construction (residential, commercial, and industrial real estate), and demand for manufactured products.

**Trends:**

1. While lending standards remain relatively tight, they are gradually loosening. Increased credit availability should help to increase capital expenditure and drive sector growth.
2. Recent fiscal austerity in many key countries has had a negative impact on economic activity and demand for industrial goods. Increasingly, countries are considering undoing some of these policies.
3. Corporate balance sheets are carrying high levels of cash compared to historical levels. Available cash may be used for investment in equipment to drive growth.

**Portfolio Strategy:** We believe that industrials is currently an attractive area for investment with potential for growth. We plan to overweight this sector due to the increasing potential for capital expenditure by firms on the supply side, and improving economic conditions and reduced fiscal austerity on the demand side. Inventories in the manufacturing area are relatively low overall, which makes it more likely that production will be expanded to meet demand. The recent slowing of growth in the Chinese economy appears to be the biggest threat to growth in this sector.



**Sector:** Technology  
**Manager:** Murali Kuchipudi

**Facts and Figures**

<b>S&amp;P Weighting:</b>	17.88%	<b>P/E TTM:</b>	16.97x
<b>ROE TTM:</b>	20.78%	<b>YTD Performance:</b>	18.92%
		<b>Dividend Yield:</b>	1.62%

**Intro Description:** Technology sector consists of the following sub-sectors: software and services, hardware and equipment, and semiconductors and semiconductor equipment manufacturers. Software and services is broken down further into Internet Software, IT Services, and Software. Hardware and equipment is broken down into Communications Equipment, Computers, Electronic Equipment, and Office Equipment. Semiconductors are a standalone sub-group.

**Trends:**

1. According to the IDC, smartphones are projected to grow at 27% CAGR through 2015. Additionally, mobile data traffic is projected to grow 18-fold between 2011 and 2016. Many areas of IT are and will be benefiting from this explosive growth in smartphones and other mobile devices including: smartphone manufacturers, mobile payment processing, internet services, mobile chip makers, and internet gaming, to name a few.
2. Tablet growth is projected to continue (24% projected CAGR through 2016), while PC sales are expected to be flat or down slightly. This has completely changed the game for “old school” PC makers and semiconductor companies. Dell, Hewlett-Packard, and Intel are just a few of the companies feeling the pain from this trend. On the other hand, companies like Apple, Qualcomm, and Samsung are benefitting tremendously. Tablets are also gaining popularity in the work place. Companies and IT organizations have to reassess security models to accommodate user choice
3. The amount of data companies generate is growing at an exponential rate as most companies’ business processes have become computerized. Additionally, the growth of the internet and e-commerce has increased the need to record data. The IDC projects the amount of data storage capacity shipped to grow 48.1% through 2015.
4. Cloud computing is a broad technology trend that continues to evolve and change rapidly.
5. Over the next few years, enterprise cloud strategies will be impacted by hybrid cloud computing, cloud brokerage, expanded delivery models, cloud-centric design and formalized cloud decision models. Cloud computing is also expected to increase the need for data storage.
6. Next generation analytics will expand beyond measuring and describing the past to predict what is likely to happen. Moreover, advanced analytics will increasingly be used as input into tactical and strategic decisions. These types of decisions typically require collaboration among key stakeholders and decision makers. Embedding social and collaboration capabilities in advanced analytic applications will capture best practices. Companies offering analytical software and services will benefit.

**Portfolio Strategy:** We wanted to invest in companies that have strong exposure to Smart phone and cloud supply chain. Inventory upgrades haven’t started in full place. So we want to market weight this sector.





**Sector:** Basic Materials

**Manager:** Robert Shedrawy

**Facts and Figures**

<b>S&amp;P Weighting:</b>	3.51%	<b>P/E TTM:</b>	18.8
<b>ROE TTM:</b>	14.80%	<b>YTD Performance:</b>	17.0
		<b>Dividend Yield:</b>	2.55

**Intro Description:** accounts for companies involved with the discovery, development and processing of raw materials. The basic materials sector includes the mining and refining of metals, chemical producers and forestry products. The basic materials sector is sensitive to changes in the business cycle. Because the sector supplies materials for construction, it depends on a strong economy. This sector is also sensitive to supply and demand fluctuations because the price of raw materials, such as gold or other metals, is largely demand driven.

**Trends:**

1. Global central banks are now largely in easing mode, which should help to support economic activity and the materials sector.
2. Global central banks are now largely in easing mode, which should help to support economic activity and the materials sector.
3. Chinese demand for processed commodities might be slowing as technological advances and a build-out of production facilities allow the country to produce more of its own materials. China recently transitioned from a net importer to a net exporter of steel.
4. Wage costs are rising in the materials sector as we've seen skilled labor shortages in certain segments of the market.

**Portfolio Strategy:** As low commodities prices and excess supply continue along with a slow recovery in construction will likely put pressure on the sector. We have determined to underweight this sector based on struggling financials throughout and will likely not increase our position in this sector barring any macroeconomic improvements.



**Sector:** Telecommunications Services  
**Manager:** Murali Kuchipudi

**Facts and Figures**

<b>S&amp;P Weighting:</b>	2.43%	<b>P/E TTM:</b>	21.51x
<b>ROE TTM:</b>	3.38%	<b>YTD Performance:</b>	7.60%
		<b>Dividend Yield:</b>	4.66%

**Intro Description:** The Telecommunications Services sector contains companies that provide communications services primarily through a fixed-line, cellular, wireless, high bandwidth and/or fiber optic cable network. The sector is divided into two sub-industry indices, Wireless Telecommunication and Wire-line Telecommunication. Wireless Telecommunications accounts for over 90% of the sector and consists of all Wireless providers, including prepaid and postpaid.

**Trends:**

1. The Wireless Telecommunications Carriers industry is well positioned for future growth. Over the five years to 2018, the number of wireless subscribers is expected to continue increasing. As a result, revenue is projected to grow at an average annual rate of 6.6% over the next five years.
2. When interest rates start to rise, the telecom sector could suffer.
3. In contrast to the technology sector, companies in the telecom sector have a lot of debt on their balance sheets, so we continue to view the group with caution as interest rates continue to rise.
4. Wireless demand appears to be increasing as more communication and media devices move to the wireless arena, although some of that movement is likely to take away from fixed-line revenue.
5. The higher dividends typically paid by telecom companies are increasingly attracting for investors tired of paltry fixed-income yields. But the yield advantage these companies have over the market appears to be diminishing.
6. Net profit margins are declining for the telecom sector as competition squeezes margins.
7. Capital expenditures in the telecom space are rising as companies look to improve and expand their networks, which could be a burden on profitability in the near future.
8. The telecom sector has the highest debt-to-equity ratio of any nonfinancial sector. That could hurt the group in this time of tight credit.

**Portfolio Strategy:** The strategy for this fund is to invest in low beta, high dividend yielding, large market capitalization value stocks to anchor the portfolio. These safe, income generating companies will be well diversified, both in services and geography, and will have the necessary network infrastructure to adapt to new technologies in the industry.



**Sector:** Utilities

**Manager:** George Cerwinski

**Facts and Figures**

<b>S&amp;P Weighting:</b>	3.11%	<b>P/E TTM:</b>	15.96x
<b>ROE TTM:</b>	7.33%	<b>YTD Performance:</b>	10.63%
		<b>Dividend Yield:</b>	3.97%

**Intro Description:** The Utilities Sector includes five industries: Diversified Utilities, Electric Utilities, Foreign Utilities, Gas Utilities, and Water Utilities. The US electric power industry, market cap of which is 31% of the Utilities Sector's, comprises investor-owned, cooperative, municipal, state, and federal utilities.

**Trends:**

1. Rising interest rates and an improving economy will cause investors to shy away from the safe haven utilities sector and look for higher yields and more risk elsewhere in the markets
2. Aging infrastructure and environmental concerns over the use of coal and nuclear power are driving capital investment among utilities. Many firms are shifting toward natural gas fired plants to take advantage of low prices and the supply glut
3. Low ROEs are expected to continue as firms work to update infrastructure and improve environmental impact, these capital expenditures will likely impact growth going forward

**Portfolio Strategy:** We plan to underweight utilities as rising interest rates and high capital expenditures will likely put pressure on the sector. However, we still find the yields attractive and will continue to look at companies with solid financial strength that have demonstrated consistent earnings and dividend growth.

