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| UConn Graduate Student Managed Fund |
| Fall 2015 Report |
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Dear Foundation and Investment Board Members,

We would like to thank you for giving us the opportunity to participate in the 2015-2016 Student Managed Fund. It has been a wonderful and learning experience for each manager involved in the program and has allowed each of us to explore financial markets and build our portfolio under the guidance of Professor Ghosh and Professor Rakotomavo. We are thankful that each of you has volunteered your time in the classroom as well as at SMF events to provide us with an in-depth educational experience that will set us apart from our peers and instill us with valuable knowledge necessary to succeed in our post-MBA careers.

SMF has provided us with a platform to do in depth analysis on various investment vehicles. Additionally, the program has exposed many of us to valuable tools such as Morningstar Direct, Value Line Investment Survey and Bloomberg for the very first time. The guidelines, goals and constraints set up in the prospectus helped us learn how to direct our investment philosophy and process in order to fulfill the needs of external constituencies. In order to ensure that the guidelines were followed, we built a process whereby each manager must be able to convince the group about their analysis and support the argument that their recommendation was a sound investment. With managers from different backgrounds and expertise levels, this led to a stimulating discussion that ensured all ideas were fully vetted before any action was taken.

Please enjoy the information in this report. Our intent was to shed light on our thought process, team dynamics, and logic in making our decisions. It is our hope that you find it interesting and compelling. We look forward to monitoring and continuing our progress throughout winter break and next semester.

Sincerely,

Alex Sadowski, Lead Manager

Akhilesh Kumar, Portfolio Manager

Akhil Sood

Chris Norris

Eddie Laclaustra

Jason Harris

Jifeng Hu

Lingfan Sun

Neel Munot

Yun Xie

**EXECUTIVE SUMMARY**

**Benchmark and Style:**

* The S&P 500 is the fund’s benchmark. Accordingly the fund is structured as a mid- to large-cap value portfolio. However we do consider small cap while keeping in mind their liquidity and downside risk.
* Although the fund is allowed to invest up to 20% of its value in fixed income, we made the decision not to invest in the asset class as we are in a period of historically low interest rates. It is our belief that the Fed will increase rates in the near future, which would lead to depreciation in a bond portfolio’s value.

**Philosophy and Strategy:**

* We consider our investment approach to be that of value investing. We sought investments in companies with solid and defendable business models, strong balance sheets, and current stock prices that were below their intrinsic value.
* We employed a bottom-up investment approach, relying on fundamental analysis of individual securities as opposed to emphasis on economic and market cycles.

**Economic and Market View:**

* We believe that the U.S. economy and market is in a mid-expansionary cycle.
* Some pertinent macroeconomic factors such as relative dollar strength to foreign currencies, probable interest rates hikes, over-supply effects on oil prices, slowdown of the Chinese economy and historically high U.S. employment rates played a role in our investment decisions.

**Process:**

* Each of the ten managers was assigned an S&P sector to research in order to establish an overall view of the market.
* We used discounted cash flow and dividend growth model analyses in order to establish individual security’s intrinsic value relative to their current market price.
* Each manager has pitched at least twice this semester, and will pitch at least four times before the end of this academic year.
* Each pitch is done with a thorough analysis presented to the other fund managers, coupled with a detailed one page report highlighting financials, relative valuations and riskiness of the companies.
* To reach the prospectus outlined 70% threshold approval, seven out of ten members must vote yes in order to invest in the recommended security.

**INVESTMENT PHILOSOPHY AND STYLE**

We consider the primary mandate to be value investors, to look for stocks that we believe the market is currently pricing too low (i.e., below their true intrinsic value). To determine each security's intrinsic value, we applied a discounted cash flow analysis and when appropriate the dividend growth model. We generally look for stocks trading at more than 15% below their intrinsic value.

We employed a bottom-up approach when selecting individual securities for our portfolio, choosing to focus on companies with solid fundamentals and business models rather than emphasizing economic and market cycles. It is also important that each company we invest in displays strong corporate governance and an independent board in order to avoid principal agent problems. This being said, we did not entirely ignore macroeconomic factors when selecting securities and each individual manager was responsible for following trends within each of the ten S&P sectors.

Our focus was on mid- and large-cap stocks as we viewed them as safer and more liquid investments. Additionally, we tend to focus on companies that are late in their business lifecycle (i.e., “value” companies) as opposed to early stage companies (i.e., “growth” companies). Oftentimes high growth companies are overvalued by the market, as indicated by high P/E multiples, and harder to analyze through fundamental analysis. We generally look for companies that have recurring revenue, consistent growth, strong balance sheet, long track record of profitability, strong management and a compelling story of value and/or competitive advantage. We also adhere to the UConn Foundation’s mandate that we invest in socially responsible companies, which we measure through available CSR scores through Bloomberg.

Our goal per the SMF mandate is to outperform the S&P 500 over five years; however, our performance is measured over the nine month academic calendar. As a group we are cognizant that our investment horizon is beyond this academic year, focusing primarily on the quality of our analysis and the stories of companies we choose to invest in to sustain quality earnings.

**INVESTMENT STRATEGY**

We are an actively managed fund looking to select individual securities to beat the broader market. Our bottom-up investing approach focuses on fundamental analysis to identify solid investments regardless of sector or market cycles. Our primary focus is on mid- to large-cap companies with strong business models that identify customers and profitably addressing their needs and differentiated strategies. We seek to take advantage of market irrationality and short-term market mispricing to purchase securities we believe are undervalued based on our estimates of their intrinsic value. Through this strategy, our goal was to beat the S&P 500 index—seeking to generate positive alpha.

At the start of the fall semester we had approximately $1.86M in the S&P 500 ETF. Our goal was to invest in 40 securities over the course of the academic year, or approximately $46k to $50k per investment. In order to avoid having to liquidate holdings for new investments during the spring semester, we set a goal of investing in 20 securities this fall (approximately 50% invested). To date, we have invested in 17 securities and are approximately 46% invested.

The Student Managed Fund is permitted to put up to 20% of the portfolio into fixed income. We chose not to invest in this asset class due to historically low interest rates and the belief that the Fed will raise interest rates in the near future, leading to a negative effect on bond portfolio valuations. Opportunities may exist in the event that certain fixed income instruments see tightening yield spreads; however, such opportunities are difficult to identify and it is our belief that placing such bets would assume too much risk within the framework of our mandate.

**RISK MANAGEMENT**

**Unsystematic Risk:**

Unsystematic risk is the type of uncertainty that comes with the company or industry invested in and can be reduced through diversification. We instituted that each manager pitch at least one stock in the sector they initially researched. As such, we avoided our portfolio being over weighted on historically high growing but riskier sectors such as Information Technology or Financials. To date, we have invested in all of 10 S&P 500 sectors, with highest weight of 23.47% in the Consumer Discretionary sector.

**Systematic Risk:**

Systematic risk is the measure of stock volatility which cannot be diminished or reduced through diversification. Our methodology to control the systematic risk is to invest in the company of which the business model is understandable, historical performance is sustainable and beta level is acceptable. We tended to avoid the company which is too focused by the entire market, because usually the market will react very strongly to such firm’s performance. For example, Amazon’s share price has risen more than two times this year and its PE ratio has reached over 900. Although all of us agreed that Amazon will continually grow in a dramatic manner, 8 out of 10 managers voted no for this company because its volatility and risk it would add to our portfolio.

**INVESTMENT PROCESS**

**Training and Development:**

Before we began with our stock pitches, Professors Ghosh and Rakotomavo organized a variety of workshops and open discussions concerning the methodology of pitching stocks and tools that can be leveraged – such as Bloomberg, Value Line Investment Survey, S&P NetAdvantage and Morningstar Direct. FNCE 5408 (Valuation of Financial Assets) is a mandatory class for all graduate SMF managers, taught by Professor Ghosh and supplemented by Professor Rakotomavo and IAB member Chris Wilkos.

**Channels of Communication:**

The team regularly held weekly meetings in conference room 404 in the GBLC—either two times a week for two hours on Tuesday and Thursday or one time a week on Thursdays. The purpose of these meetings was to pitch individual stocks, vote on stocks that were pitched, insight sharing, task allocation and agenda setting. Professors Ghosh and Rakotomavo regularly attended these meetings to share their insight and help establish an investment process.

**Stock Pitching:**

To date we have held four stock pitching rounds, each of which had five managers pitching an individual security. Each manager was required to recommend one stock of their choice regardless of sector and one stock that pertained to their assigned S&P sector. Each stock pitching round was broken into four sections: 1) The portfolio manager who is going to present his or her stock recommendation must send a one page stock pitch report to everyone 24 hours before presentation; 2) During the meeting, stock manager must conduct presentation includes but not limited to key statistics, company profile, industry overlook, investment theory, investment risk, investor conference call transcript takeaways, relative valuation, financial performance analysis and valuation; 3) Following the presentation, a Q&A session took place which usually lasted for 5 to 20 mins; 4) Voting was conducted one week after the presentation to make sure each manager have sufficient time to understand and do the research. To approve a stock for the portfolio we agreed upon 70% approval level, which means 7 out of 10 portfolio managers has to vote ‘yes’ in order for the stock to be selected.

**SECTOR ALLOCATION**

Our goal is to establish 35 to 40 positions representing all sectors by the end of the academic year. Initially each manager was assigned a sector and he presented sector analysis and outlook for his assigned sector. Although our initial stock pitches had no sector constraints, we continuously monitored the sector allocation compared to S&P 500 sector weightage so we could have a balanced portfolio. Furthermore, we temporarily stopped pitching stocks after our initial pitches in order to evaluate our weightages versus the S&P 500. In order to promote diversification in our portfolio, we decided to set sector constraints during each manager’s second pitch, requiring them to choose an undervalued company in their respective sector.

Our top three sectors by weight are Consumer Discretionary, Consumer Staples and Financials. Furthermore, our bottom three sectors by weight are Telecommunication Services, Energy and Materials. We will continue to search for undervalued companies in non-represented or underrepresented sectors as we move forward to ensure we have a diversified portfolio.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **S&P 500 Sector Weights** | **Current Portfolio Weights** | **Over/Underweight** |
| **Consumer Discretionary** | 13.20% | 23.47% | 10.27% |
| **Consumer Staples** | 9.70% | 11.88% | 2.18% |
| **Financials** | 16.20% | 11.79% | -4.41% |
| **Industrials** | 10.20% | 11.64% | 1.44% |
| **Health Care** | 14.60% | 11.60% | -3.00% |
| **Utilities** | 2.90% | 5.98% | 3.08% |
| **Information Technology** | 20.80% | 5.96% | -14.84% |
| **Telecommunication Services** | 2.40% | 5.92% | 3.52% |
| **Energy** | 7.10% | 5.88% | -1.22% |
| **Materials** | 2.90% | 5.88% | 2.98% |

**EQUITY PORTFOLIO AND ALLOCATION**

As fund managers, the benchmark that we are being measured against is the SPDR S&P 500 ETF (Ticker: SPY). By shaping a well-diversified portfolio focused on a mix of growth and value stocks we intend to maximize our returns. Below is a snapshot of our current portfolio. Please note that all portfolio analysis is based on the position on December 1, 2015 at the end of the trading day.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Industry** | **Company** | **Date Purchased** | **Shares Held** | **Current Price** | **Portfolio Weight** | **Current Position Value** |
| **Consumer Discretionary** | **23.5%** | **201,182** |
| Leisure Products | Polaris | 29-Oct-15 | 450 | 105.73 | 5.9% | 47,601 |
| Media & Entertainment  | Disney | 29-Oct-15 | 435 | 119.42 | 5.8% | 50,195 |
| Household Durables | Toll Brothers | 29-Oct-15 | 1400 | 37.10 | 5.9% | 53,284 |
| Specialty Retail | CarMax | 6-Nov-15 | 875 | 56.63 | 5.9% | 50,103 |
| **Consumer Staples** | **11.9%** | **101,809** |
| Food & Staples Retailing | CVS Health | 17-Nov-15 | 535 | 91.56 | 5.9% | 51,066 |
| Tobacco | Reynolds American  | 19-Nov-15 | 1100 | 47.03 | 6.0% | 50,743 |
| **Energy** | **5.9%** | **53,406** |
| Oil, Gas & Consumable Fuels | Marathon Petroleum  | 19-Nov-15 | 900 | 56.41 | 5.9% | 53,406 |
| **Financials** | **11.8%** | **104,577** |
| Consumer Finance | Capital One | 18-Nov-15 | 650 | 78.82 | 5.9% | 51,883 |
| Real Estate Investment Trusts | AvalonBay  | 19-Nov-15 | 285 | 181.50 | 5.9% | 52,694 |
| **Health Care** | **11.6%** | **98,423** |
| Biotechnology | Gilead Science | 6-Nov-15 | 460 | 106.36 | 5.8% | 48,691 |
| Health Care Equip & Supply | Medtronic | 11-Nov-15 | 650 | 76.56 | 5.8% | 49,732 |
| **Industrials** | **11.6%** | **98,452** |
| Aerospace & Defense | UTX | 29-Oct-15 | 500 | 98.09 | 5.8% | 48,350 |
| Air Freight & Logistics | UPS | 6-Nov-15 | 480 | 103.59 | 5.8% | 50102.4 |
| **Information Technology** | **6.0%** | **51,630** |
| Tech Hard, Storage & Per. | Apple Inc. | 18-Nov-15 | 440 | 117.75 | 6.0% | 51,630 |
| **Materials** | **5.9%** | **50,989** |
| Construction Materials | Martin Marietta  | 18-Nov-15 | 320 | 159.92 | 5.9% | 50,989 |
| **Telecommunication Services** | **5.9%** | **50,655** |
| Diversified Telecomm Services | AT&T | 19-Nov-15 | 1500 | 33.46 | 5.9% | 50,655 |
| **Utilities** | **6.0%** | **58,652** |
| Electric Utilities | ITC Holding  | 19-Nov-15 | 1,550.0 | 33.30 | 6.0% | 58,652 |

Below table summarize, key important ratios for our holdings along with the average for our total invested portfolio.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Weightage** | **Dividend Yield** |  **(P/E)** |  **(P/CF)** | **Beta** | **EV/EBITDA** | **Profit Margin** | **ROA** | **EV/Sales** |
| **Total** | 100.00 | 1.91 | 16.30 | 12.29 | 0.96 | 11.12 | 9.10 | 4.85 | 2.07 |
| **Apple Inc.** | 6.01 | 1.72 | 12.79 | 8.38 | 1.10 | 6.25 | 22.85 | 20.45 | 2.21 |
| **AT&T Inc.** | 5.84 | 5.60 | 13.58 | 5.61 | 0.74 | 10.37 | 3.78 | 1.53 | 2.36 |
| **AvalonBay Inc.** | 6.02 | 2.69 | 35.20 | 23.84 | 0.59 | 27.09 | 40.16 | 4.47 | 17.04 |
| **Capital One Corp** | 5.95 | 1.90 | 10.79 | 4.06 | 1.15 | 8.91 | 16.77 | 1.31 | 3.47 |
| **CarMax Inc.** | 5.82 |  | 19.66 |  | 1.27 | 18.22 | 4.23 | 4.76 | 1.44 |
| **CVS Health Corp** | 5.87 | 1.48 | 20.75 | 12.95 | 0.93 | 11.68 | 3.39 | 6.10 | 0.86 |
| **Gilead Sciences Inc.** | 5.76 | 0.80 | 9.84 | 8.65 | 1.09 | 6.97 | 53.78 | 42.56 | 4.87 |
| **ITC Holdings Corp** | 6.06 | 2.07 | 19.55 | 9.92 | 0.57 | 13.33 | 23.94 | 3.54 | 9.09 |
| **Marathon Petroleum**  | 6.11 | 1.95 | 10.20 | 8.72 | 1.31 | 5.22 | 4.88 | 11.20 | 0.51 |
| **Martin Marietta**  | 5.97 | 0.99 | 36.25 | 21.64 | 1.06 | 16.34 | 7.59 | 3.65 | 3.36 |
| **Medtronic Plc** | 5.76 | 1.79 | 24.93 | 16.46 | 1.05 | 22.09 | 11.28 | 3.69 | 5.40 |
| **Polaris Industries Inc.** | 5.51 | 2.01 | 14.95 | 11.41 | 0.88 | 7.66 | 9.82 | 22.23 | 1.44 |
| **Reynolds American** | 5.97 | 2.91 | 15.23 | 162.79 | 0.72 | 12.24 | 32.00 | 9.04 | 8.37 |
| **Toll Brothers Inc.** | 6.15 |  | 18.83 | 41.34 | 0.87 | 21.69 | 8.51 | 4.10 | 2.35 |
| **United Parcel Service** | 5.80 | 2.80 | 20.36 | 11.83 | 0.89 | 12.09 | 6.81 | 10.59 | 1.75 |
| **United Technologies**  | 5.61 | 2.64 | 13.63 | 13.50 | 1.08 | 9.04 | 9.41 | 6.31 | 1.70 |
| **Walt Disney Co.** | 5.80 | 1.15 | 22.33 | 17.86 | 1.06 | 13.37 | 15.98 | 9.73 | 3.96 |

Below are the key ratios for the portfolio compared to S&P 500. As evident from below table most of the ratio for SMF portfolio is very close to S&P 500. Our dividend yield is 1.91 compared to 2.09 for S&P 500, further Beta for our portfolio is 0.96, compared to 1 for S&P 500.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **SMF Portfolio** | **S&P 500** | **Difference** |
| **Dividend Yield** | 1.91 | 2.09 | -0.18 |
| **Price to Earning** | 16.30 | 18.66 | -2.36 |
| **Price to Cash flow** | 12.29 | 10.90 | 1.39 |
| **EV/Sales** | 2.07 | 2.22 | -0.15 |
| **EV/EBITDA** | 11.12 | 12.68 | -1.56 |
| **Profit Margin** | 9.10 | 8.32 | 0.78 |
| **Return on Assets** | 4.85 | 2.72 | 2.13 |
| **Beta** | 0.96 | 1.00 | -0.04 |

**INVESTED PORTFOLIO**

Below table gives the induvial return of each stock on standalone basis and also as compared to S&P 500. As on December 1, 2015 worst performing stock in our portfolio was Polaris ( unrealized loss of –ve 5.00%) and best performing sock in our portfolio was ITC Holding ( unrealized gain of 14.7%).

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Buy Date** | **Company** | **Buy Price** | **CP** | **Gain Loss** | **S&P 500** | **S&P 500 Gain Loss** | **+/- Compared to Benchmark** |
| 29-Oct-15 | Polaris | 111.29 | 105.78 | -5.0% | 2089.41 | 0.63% | -5.6% |
| UTX | 99.24 | 96.70 | -2.6% | 2089.41 | 0.63% | -3.2% |
| Disney | 114.34 | 115.39 | 0.9% | 2,083.58 | 0.91% | 0.0% |
| Toll Brothers | 36.21 | 38.06 | 5.1% | 2,089.17 | 0.64% | 4.5% |
| 6-Nov-15 | UPS | 103.95 | 104.38 | 0.4% | 2,089.17 | 0.64% | -0.2% |
| Gilead  | 107.59 | 105.85 | -1.6% | 2,083.58 | 0.91% | -2.5% |
| CarMax | 57.24 | 57.26 | 0.0% | 2,083.58 | 0.91% | -0.9% |
| 11-Nov-15 | Medtronic | 76.40 | 76.51 | 0.1% | 2,089.17 | 0.64% | -0.5% |
| 17-Nov-15 | CVS Health | 94.67 | 95.45 | 0.8% | 2,089.17 | 0.64% | 0.2% |
| 18-Nov-15 | Apple Inc. | 115.75 | 117.34 | 1.4% | 2,099.20 | 0.16% | 1.2% |
| Martin Marietta  | 157.00 | 159.34 | 1.5% | 2,075.00 | 1.33% | 0.2% |
| Capital One | 77.06 | 79.82 | 3.6% | 2,099.20 | 0.16% | 3.4% |
| 20-Nov-15 | AT&T | 33.8 | 33.77 | 0.0% | 2,099.20 | 0.16% | -0.1% |
| AvalonBay Comm.  | 178.0 | 184.89 | 3.9% | 2,089.17 | 0.64% | 3.3% |
| ITC Holding  | 33.0 | 37.84 | 14.7% | 2089.41 | 0.63% | 14.1% |
| Marathon Petro | 55.8 | 59.34 | 6.3% | 2089.41 | 0.63% | 5.7% |
| Reynolds American  | 46.3 | 46.13 | -0.3% | 2,050.44 | 2.55% | -2.8% |

Below is the graphical representation of individual stock returns.

Our first investment was made on October 29, 2015. From the first investment till December 1, 2015, our invested portfolio has generated return of 1.54% compared to 0.88% for S&P 500.



Below is the performance summary of our invested portfolio. As evident from the table SMF invested portfolio has given superior returns compared to S&P 500. Further for SMF portfolio, Risk / Return ratios as Sharpe Ratio, Jensen Alpha and Information Ratio are in a very respectable range.

|  |  |  |
| --- | --- | --- |
| **Portfolio Statistics** | **SMF Invested Portfolio** | **S&P 500** |
| **› Return** |   |   |
| Total Return | 1.54 | 0.88 |
| Mean Return (Annualized) | 28.73 | 16.21 |
| Mean Excess Return (Annualized) | 10.78 |   |
| **› Risk** |   |   |
| Standard Deviation (Annualized) | 12.28 | 12.18 |
| Downside Risk (Annualized) | 8.48 | 7.90 |
| Tracking Error (Annualized) | 4.04 |   |
| **› Risk/Return** |   |   |
| Sharpe Ratio | 1.60 | 0.92 |
| Jensen Alpha | 8.98 |   |
| Information Ratio | 1.88 |   |

**Total Portfolio Snapshot:**

|  |  |  |
| --- | --- | --- |
|  | **Sep 22, 2015** | **December 1, 2015** |
| ETF | $1,860,328.77 | $1,146,099 |
| Equity | - | $869,774 |
| Cash | 327 | $8,067 |
| **Total** | **$1,860,655.77** | **$2,023,940** |
| **Return**  | **8.78%** |

Below is the performance summary of our invested portfolio. As evident from the table SMF invested portfolio has given superior returns compared to S&P 500. Further for SMP portfolio, Risk / Return ratio as Sharpe Ratio, Jensen Alpha and Information Ratio are in a very respectable range.

|  |  |  |
| --- | --- | --- |
| **Portfolio Statistics** | **SMF Portfolio** | **S&P 500** |
| **› Return** |  |  |
| Total Return | 8.78 | 8.69 |
| **› Risk** |  |  |
| Standard Deviation (Annualized) | 12.85 | 14.13 |
| Downside Risk (Annualized) | 8.80 | 9.59 |
| Skewness | -0.16 | -0.07 |
| Tracking Error (Annualized) | 2.24 |  |
| **› Risk/Return** |  |  |
| Sharpe Ratio | 4.07 | 3.96 |
| Jensen Alpha | 1.83 |  |
| Information Ratio | -1.07 |  |

To date, the invested portfolio has outperformed the S&P 500. Our invested portfolio has returned 1.54% compared to 0.88% for S&P 500. Furthermore, our total portfolio has returned 8.78% compared to 8.69% for S&P 500.

To date, we have been able to invest 45.9% of initial ETF portfolio given to us. Also at this point of time we are invested in all the 10 S&P 500 sectors. Current portfolio beta is 0.96 and P/E ratio is 16.30 compared to S&P 500 P/E ratio of 18.66. Since each manager is required to make at least two investment pitches per semester, we purposefully aimed to be about 50% invested in order to avoid having to liquidate holdings second semester—doing so would be against our established value investor approach.

**ECONOMIC OUTLOOK**

Global growth is forecasted at 3.3 percent in 2015 and 3.8 percent in 2016, with uneven prospects across the main countries and regions. Growth in emerging market economies is softening, reflecting an adjustment to diminished medium-term growth expectations and lower revenues from commodity exports, as well as country-specific factors. The outlook for advanced economies is showing signs of improvement, owing to the boost to disposable incomes from lower oil prices, continued support from accommodative monetary policy stances, and more moderate fiscal adjustment. The distribution of risks to near-term global growth has become more balanced. The decline in oil prices could boost activity more than expected. Geopolitical tensions continue to pose threats, and risks of disruptive shifts in asset prices remain relevant. In some advanced economies, protracted low inflation or deflation also pose risks to activity.

During the global financial crisis and in the years that followed, the principal global shocks - the 2009 subprime and Lehman Brothers crisis and the 2011-12 euro area crisis — had similar effects on all regions, albeit to varying degrees. But the forces that are now shaping the global outlook —most notably declining oil and commodity prices—are more redistributive in nature, benefiting some regions and countries while hurting others. Growth divergences among the major economies, and the resulting interest rate and currency adjustments, are also having varying effects across regions. These forces are shaping up the outlook for the future:

* Recent sharp declines in oil (and to a lesser extent, commodity) prices, although a net positive for the global economy and for oil importing regions, are weighing on the commodity exporting countries of Latin America, the Middle East, North Africa and sub Saharan Africa.
* The diverging trajectories of the major economies— robust growth in the United States, the weaker recoveries progressing in the euro area and Japan, and slowing growth in China—also have varying implications across regions and countries, boosting those with strong trade links with the United States, but hurting those more tightly linked with the other major economies.
* The strengthening of the U.S. dollar and the weakening of the euro and yen are also having a redistributive effect. Most obviously, they are a welcome boost to the tepid recoveries in the euro area and Japan and are a headwind to the U.S. recovery. But they are also generating tensions between financial stability and competitiveness in regions and countries that have seen rising dollar denominated indebtedness in recent years.

Domestically for the United States growth remains positive. The preponderance of economic data support the case that the U.S. economy is in the middle of what could turn out to be the longest expansion on record. The three longest expansions to date have all occurred since 1960. They lasted between eight to ten years, longer than any prior U.S. expansion. It is not a coincidence that expansions have been longer during the recent years and recessions less frequent and much shorter. Monetary and fiscal policies have been used more actively to influence economic growth since World War II and it’s worked. The last recession ended in June 2009. Almost six and a half years later, the usual measures of the cyclical timing clock are clustered around the mid-cycle position. The index of leading indicators points to continued moderate growth going into 2016. Growth is slower over the past year following a sharp acceleration in 2013 and 2014. The deceleration this year mainly reflects the drag from lower oil prices on the energy patch and the strong dollar on exports. Together, these effects have been disproportionately harmful to the manufacturing sector, where factory production growth has slowed from about a 4% pace when energy was booming to just about a 2% pace over the last year. Export growth has shown a comparable deceleration over the same time frame. Leading indicators suggest an upturn for 2016 rather than more downside because the positive impact from these factors is building steam while the drag effects dissipate.

Over time the yield curve spread (difference between the ten‐year Treasury note yield and the overnight federal funds rate set by the Fed) has generally been considered the single most important indicator for predicting recessions and tracking the level of monetary policy accommodation. The yield curve spread is currently over 200 basis points. That is an extremely accommodative and implies monetary policy is still in an early expansion phase position. Mid-cycle positioning for the yield curve is in the 100 to 150 basis point range. This is an important reason for expecting several more years of expansion. Every recession in the past 50 years has been preceded by an inverted yield curve after the Federal Reserve raised the short‐term rate above the ten‐year yield. Monetary policy is one of the main drivers of the business cycle and currently it is on cruise control. A few rate hikes over the next year are unlikely to put the brakes on. In fact, the last thing the Fed wants is to put the brakes on. That is because the Fed generally stays accommodative to support the economy until inflation becomes a problem. One reason this is such a long expansion is the low level of inflation, the lowest in over a half century. In fact, the Fed is in the unusual position of wanting more inflation which will power wage growth as well.

When the Fed is accommodative, the use of leverage or debt becomes more prevalent. In fact, one reason expansions turn into recessions is the excessive use of debt to keep growth going. But currently leverage in the private sector is still normal. While credit growth has normalized, households are in good shape to borrow. Financial obligations ratio for the household sector compiled by the Fed looks at all recurring payments to service debt obligations plus other regular payments like rents. It reached an all‐time high just ahead of the financial crisis and has plummeted to levels last seen about 35 years ago. Consumers have a lot of room to expand as wage gains, job growth, low unemployment and easing credit conditions support big‐ticket purchases. Consumption accounts for about 70% of U.S. GDP. Low oil prices and a strong dollar are major tailwinds for consumers to continue spending. The housing cycle in terms of new housing units authorized is showing signs of early expansion because it has still not recovered from the 2008 financial crisis. Its mid-cycle peak is years away. Millennials are just starting to buy houses and move into apartments on a grander scale. Consumer confidence is also high suggesting general consensus of improved economic conditions.

Therefore, the U.S. economy is particularly believed to be in its mid-cycle phase and equities are expected to outperform, albeit at a slower pace and with slightly more volatility than in recent years. We looked at each sector specifically to further judge the economic impact and have a more detailed understanding.

**SECTOR ANALYSIS**

**Consumer Discretionary:**

The Consumer Discretionary makes up 12.97% of the S&P 500. The major industry groups in this sector are Automobiles, Media, Textiles, Apparel & Luxury Goods, Internet & Catalog Retail and Hotels, Restaurants & Leisure.

Automobile: Fundamental outlook for the automobile manufacturer’s sub-industry for the next 12 months is positive. In 2015 and 2016, U.S. automotive demand trending higher year-over-year, following a record number of vehicle recalls in 2014. Global demand is expected to rise in both years. Europe has pressured General Motors and Ford in the troubled region, but the companies have shown progress, and expected to see higher industry sales volume there after years of declines. Russia and parts of South America still look likely to be challenged areas, with declines, and the strong dollar is hurting profit and sales translation.

Media & entertainment: Fundamental outlook for media and entertainment sub-industry is neutral, against a backdrop of a gradual improvement in consumer discretionary spending. While traditional formats (DVDs, CDs) and distribution channels have likely reached saturation, continued evolution of newer channels for digital delivery of content to consumers -- including online/mobile streaming, electronic sell-through (EST) and video on demand (VOD), as well as a proliferation of streaming video outlets. DVD sell-through market buffeted by secular headwinds (versus gains in Blu-ray), with rentals pressured by a demise of several brick-and-mortar stores.

Textiles & Apparel: Fundamental outlook for the Textiles & Apparel: sub-industry is positive. Companies with strong brands to leverage quality, newness and innovation in their product offerings to further stimulate consumer demand in 2015. Also geographic diversification to benefit global Textiles & Apparel companies. With consumer spending gradually improving amid lower gasoline prices, consumers seeking out value when making discretionary purchases, and stretching their budgets when the merchandise is right. As such, Textiles & Apparel brands and retailers offering fashion newness and technical innovation in their products as having the best chance of capturing sales and gaining market shares.

Internet & Catalog Retail: Fundamental outlook for the Internet retail sub-industry for the next 12 months is positive. While the collection of state taxes from online retailers and increased marketing expenses pose some concerns, shipping costs is expected benefit from lower gasoline prices, and favorable growth prospects as consumers increasingly enjoy the convenience and value that online retail provides. Forrester Research projects that US e-commerce sales will increase from a projected $262 billion in 2013 to $370 billion in 2017, a compound annual growth rate (CAGR) of 9.0%. Significant growth in this category has been, and will continue to be, driven by several factors. From a macroeconomic viewpoint, global outlook for consumer spending on such discretionary items as entertainment subscriptions or online travel-related bookings for hotels and air tickets should remain relatively strong in the foreseeable future.

Hotels, Restaurants: Fundamental outlook for the restaurants & hotels sub-industry is positive. Sector is projected to have low single digit same-store sales growth in 2015. Consumers have been cautious, and have been trading down or dining out less often, in particular during the weekdays. So it is projected that casual dining restaurants will have slower traffic, while fast food and fast-casual dining restaurants will be less affected. Full-service restaurant segment will have same-store sales growth of lower single-digits for the year.

**Current Positions: PII, DIS, TOL, KMX**

**Information Technology:**

The IT services industry is a component of the information technology sector, which comprised 20.2% of the S&P 500 and 19.8% of the S&P 1500, as of September 11, 2015. From a stock price perspective, the 18.2% increase in 2014 for the information technology sector outperformed the 11.4% rise in the S&P 500. From a profit perspective (as of September 14, 2015), the information technology sector is anticipated to generate 3.3% profit growth in 2015 and 10.6% in 2016; both estimates exceed those for the broader market. The IT Services Industry ought to outperform the broader market averages over the coming six to 12 months. Over the 10-year period ended 2014, the sector’s 11.7% CAGR exceeded the S&P 500 growth of 5.0%. Over the 10-year period, information technology was the leading sector, followed by health care (8.9%) and consumer discretionary (8.7%).

**Current Position: AAPL**

**Health Care:**

Health care sector has been performing strong for past few years as compared to S&P 500. Sector’s year to date return is 5.64%, higher than that of S&P 500 which is 3.23%, while for last 3 years and last 5 years, sector’s return is 23.12% and 20.25% respectively, as compared to 16.41% and 14.44% for S&P 500. The fundamental outlook for the health care equipment sub-industry for the next 12 months is neutral. 2015 revenues is expected to rise in constant currency at a mid- to upper single digit pace, aided by new products, expansion into emerging markets, and, in some cases, acquisitions. Longer-term fundamentals is positive, because of including increasing global demand for quality health care, aging populations and rising R&D outlays, leading to a steady flow of new diagnostic and therapeutic products.

Besides, led by the pharmaceuticals industry, the health care sector has been a consistent place for investors to look for dividends. The sector’s 39% payout ratio at the end of the first quarter of 2015 provides ample opportunities for health care companies to continue to make payments and, indeed, raise them.

**Current Positions: GILD, MDT**

**Energy:**

The energy sector makes up 7.9% of the S&P 500 and 7.5% of the S&P 1500, as of June 2015. There are two main industry groups in this sector: energy equipment & services (19%) and oil, gas & consumable fuels (81%), and in general, the broader outlook for this sector is negative. The crude oil prices experienced a sudden and dramatic decline, which began in late 2014, and recently it briefly fell below $40 per barrel. Most analysts believe that the crude oil market will continue to be lower for longer. Aside from crude oil, the pricing outlook for both natural gas and natural gas liquids (NGLs) also likely remain weak. But demand for natural gas appears to be rising, as is demand for the key hydrocarbons that are embedded in the NGL stream (such as ethane and propane). The revenue stream depends on the willingness of its upstream customers to continue to spend on oil and gas projects. And in the international aspect, the expectation is positive. But within the North America, analysts predict a great likelihood of cuts. In addition, since valuations have decreased for many individual companies, we expect further industry consolidation to continue.

**Current Position: MPC**

**Industrial:**

Industrials sector has always been performing either at par or under the S&P 500. From a stock-price perspective in 2014, the 7.5% increase for the industrials sector underperformed the 11.4% increase in the S&P 500. One year % change in the industrials sector has been a negative 3.1% compared to a positive approximately 1.00% for the S&P 500. There are three main industry groups in this sector: capital goods (i.e., aerospace & defense, building products, industrial machinery), commercial & professional services (i.e., commercial printing, data processing services, office services & supplies), and transportation (i.e., airlines, air freight & logistics, trucking, railroads). The NI margin and EPS growth have boosted strong numbers for this sector in recent times, however, these numbers are still below the S&P’s performance. From the valuation perspective, the sector’s forward PE is expected to drop to 16.1x compared to the S&P 1500’s forward PE of 18.0x – valuing this sector at a discount. Factors affecting this sector include instability in global economies and economic growth in the US, growth in e-commerce and military spending, demand for commercial aerospace and oil prices.

**Current Positions: UTX, UPS**

**Utilities:**

This sector contains providers of electricity, natural gas, water, and other utilities services. The sector makes up nearly 3% of the market with a value of $1.03 Trillion. The sector includes 5 industries: 1) Electric utilities (53.6%); 2) Multi-utilities (35.5%); 3) Gas utilities (7.0%); 4) Independent power & renewable electricity producers (3.0%); 5) Water utilities (1.0%). The steady growth in residential demand has proven that the Utilities sector can be recession resistant. Being less volatile than the market, the sector outperformed the S&P 1500 from 2007-2009, and underperformed from 2010-2013. The steady cash flows and high dividends give investor the incentive to buy this sector. On August 3, 2015, the EPA released the Clean Power Plan. The plan calls for a 30% reduction of carbon emissions from the American power plants by the year 2030. In the long run, utilities will benefit from the CPP as long as they invest in new power plants. Investments and the purchase of emission credits will increase their rate base or their recoverable expense. As base rates rise, so will earnings per share.

However, these businesses are heavily infrastructure dependent and often take on large amounts of debt to expand and maintain their capital intensive systems. In those cases, companies in this sector are extremely sensitive to the movement of interest rates. All recent communications from the Fed seem to indicate an increase of rates is imminent before the end of the year, thus ending the near decade long vacation from more expensive debt. This has many investors moving out of the sector. Utilities are often seen as defensive securities, whose high dividend payouts make them attractive in a down economy. An improving economy will cause investors to put their money in higher growth stocks than the utilities sector can offer. Though utilities are largely tied to the housing sector, which has rebounded nicely since 2008, anticipate this sector to underperform the market should the Fed raise rates and economic growth accelerate.

**Current Position: ITC**

**Materials:**

The materials sector makes up 3.1% of the S&P 500. Its sub-sectors are chemicals (69%), metals and mining (14%), containers and packaging (9%), paper and forest products (4.8%), and construction materials (3.3%). From 2014, the 4.7% price appreciation of the materials sector lagged the 11.4% rise in the S&P 500. Revenue growth is expected to be flat in 3015 with 1-2% growth in 2016. EBITDA margin expansion is expected to be in line with the S&P 500 with net income margins continuing to lag the index. 5 and 10 year earning growths have also lagged the S&P 500. Since the third quarter of 2014, the sector was valued above its historical forward P/E ratio, though the sector is valued in line with the overall market.

The materials sector has been down in large part due to sustained low commodity prices. Additionally, the sector has been hampered by slower growth in developing economies (particularly China) which typically have greater demand for basic materials. As many material companies have globalized, a stronger dollar could hurt results for companies exporting processed materials from the US. A positive economic outlook in the US creates opportunities for some sub-sectors. Improving US consumer confidence and spending will drive growth in e-commerce packaging. A continuing strengthening of the housing market will boost construction material producers who are focused primarily in the US.

**Current Position: MLM**

**Consumer Staples**:

The consumer staples sector made up 9.7% of the S&P 500 and 9.1% of the S&P 1500, as of mid-August. The sector is comprised of 12 sub-industries. The three main industry groups that these sub-industries fall into are food & staples retailing, food, beverage & tobacco, and household & personal products. Year to date, as of Nov.30, 2015, the consumer staples sector had a positive return of 1.23%, greater than the S&P 500 index’s return of 1.04%. From the balance sheet analysis, ROE of this sector continues to be maintained well above that of the broad S&P 1500 index at 11.1% as of the first quarter of 2015, mainly due to higher asset turnover performance within the sector. Consumer staples companies had showed improving interest coverage, implying that the sector had a better fiscal stability. Looking into P/E ratio, the sector is valued at a premium compared with the S&P 500, at its 15.8x average since 2009. Overall, the consumer staples sector appears to be strong.

Several factors are benefiting this sector. US GDP growth is forecasted to be 2.4% for 2015, greater than that of 2.2% in 2014. The recovery of the economic will likely generate more demand of products in this sector. In addition, the drop in oil prices will result in more consumers’ disposable income and pushes consumers to be more apt to purchase full price items, rather than searching for discounts. Consumer staples retailers have aggressively cut costs and are attempting to create more perceived value for consumers, which could support sales. And an improving environment may also allow consumer staples companies to firm up current pricing or raise prices. On the other hand, the risk factors should not be overlooked. The growth of low-cost, emerging-market production continues to accelerate the competition. This could shrink pricing power in the sector by reducing margins and earnings. Many central banks are now firmly in easing mode in an effort to stimulate the economy, which could hurt the more defensive sectors, such as consumer staples.

**Current Position: CVS, RAI**

**Financials:**

The financial sector represents 16.5% of our benchmark index, the S&P 500. Year to date, as of 11/30/15, the sector had a slightly negative return of -0.61% while the index gained 1.52%. There are 21 sub-industries included in the sector with diversified banks making up the largest portion in terms of market value at 30%. Moving forward the sector is expected to grow much more in line with the market, lending to a market weight recommendation. With a forward P/E of 16.0x the sector is trading at a premium vs. its average since 2009 of 15.1x. However, this is still a discount over the index as a whole. A positive indicator for the sector is the improving consumer spending and confidence, in particular boosting the consumer financials sub sector. While consumer confidence has been on a downward trend in recent months, according to OECD data, consumer spending is still expected to go up over our investment horizon. Also the largely expected interest rate increases will be a net positive for the sector, as the highest weighted industries like insurance will be able to earn higher spreads.

**Current Position: COF, AVB**

**Telecommunications:**

As of June 12, 2015, the telecommunication services sector makes up 2.2% of the S&P 500 and 2.0% of the S&P 1500. This sector is broken into three sub-industries: Integrated Telecommunications Services (94.1%), Alternative Carriers (5.1%) and Wireless Telecom Providers (0.9%)

In 2014, the telecommunications sector saw a 1.5% price-depreciation, lagging behind the 11.4% rise in the S&P 500 index. For 2015, this sector is once again underperforming the S&P 500, which has seen a 1.5% price-appreciation year-to-date, with a 3.7% price-depreciation. The telecommunications sector is both highly capital intensive and regulated. Capital intensity is expected to moderate in 2016, after steep increases over the past five years, and will likely be between 14% to 16% by the end of 2016. However, this sector will likely remain the most levered sector within the S&P 500. The telecommunications sector is also subject to increased regulation from the FCC. In December 2014, the FCC increased rural broadband speeds under CAF. The FCC now requires companies receiving Connect America funding for fixed broadband to serve consumers with speeds of at least 10 Mbps for downloads and 1 Mbps for uploads. That is an increase reflecting marketplace and technological changes that have occurred since the FCC set its previous requirement of 4 Mbps/1 Mbps speeds in 2011. A key premise of FCC rules is that Internet service providers (ISPs), such as AT&T, Verizon, and Comcast, must treat all Internet traffic equally and cannot prioritize the traffic of certain preferred customers. Simply stated, Internet providers cannot play favorites—giving certain customers faster connectivity (presumably for a fee), while slowing the traffic of those that refuse to pay fees. This prevents the ISPs from controlling the Internet by blocking out competitors and by demanding fees to provide fast access to certain websites or applications.

Since 2012, P/E multiples have fallen, reflecting the greater uncertainty and challenges within the telecommunication services sector. When looking at a relatively low or no growth industry earnings growth trajectory in the coming years, P/E multiples appear to be in a range between 12x and 14x on a forward 12-month basis.

**Current Position: T**

**INDIVIDUAL POSITIONS**

**United Parcel Service Inc. (NYSE: UPS)**

We purchased 480 shares of United Parcel Service Inc. at an average price of $103.95 per share on October 29, 2015.

United Parcel Service, Inc. is the world’s largest integrated air and ground package delivery carrier. Also provides specialized transportation and logistics services. Service is offered throughout the U.S. and in over 220 other countries. Domestic package operations accounted for 62% of ’14 revenues; international (22%); supply chain & freight (16%).

Outlook for the air freight and logistics industry for the next 12 months is positive. Fundamentals in domestic shipping are likely to strengthen and the valuations of many logistics companies are likely to expand. We see improving volume and yield trends on expanding shipping demand and improved pricing over the coming year. According to data from the U.S. Board of Transport Statistics, total cargo rose 5.2% in 2014 - international up 6.9% and domestic up 3.4%. YTD May 2015, total cargo rose 5.0%, with international up 6.2% and domestic up 3.6% & with the holiday season still remaining. Demand for international shipping is believed to be to be driven by export activity out of Asia and developing economies throughout the world. Growth in e-commerce & increase in disposable income will fuel this industry.

UPS is the giant among global parcel shipment companies having assembled an integrated global shipping network that's unlikely to be matched. Despite its extensive unionization and asset intensity, UPS produces returns on invested capital about double its cost of capital and margins well above its competitors' due to the firm's leading package density and outstanding operational efficiency. UPS has turned to health care markets and developing nations for growth. Even existing operations have revenue expansion potential via pricing power and operational efficiency via low oil prices, because UPS operates within a somewhat rational oligopoly market. UPS earns its wide economic moat from efficient scale, cost advantage, and the network effect. Extensive express, ground, and freight networks demand a huge quantity of trucks, trailers, terminals, sorting equipment, IT systems, and skilled labor. Replicating these assets in the absence of sufficient package flow would be costly. As evidenced by DHL's worthy effort, such a project would require at least a decade of effort.

Risks include slower than expected economic recovery, periods of tremendous volume productivity and confusion similar to previous two holiday seasons.

 As of December 1, 2015 we have an unrealized gain of 0.4% on United Parcel Service Inc.

**Apple Inc. (NASDAQ: AAPL)**

We purchased 440 shares of Apple Inc. at an average price of $115.75 per share on November 18, 2015.

Apple Inc. is one of the world’s largest makers of PCs and peripheral & consumer products, such as the iPod digital music player, the iPad tablet, the iPhone smartphone, and the ‘‘Apple Watch,’’ for sale primarily to the business, creative, education, government, and consumer markets. It also sells operating systems, utilities, languages, developer tools, and database software.

Outlook for the S&P Technology Hardware, Storage & Peripherals sub-industry for the next 12 months is positive. PC sales have begun to stabilize and see less pronounced pressures related to the cannibalization on lower priced tablet devices. Also hardware vendors will continue their efforts to take costs out of their infrastructures as they strive for profitability. The growing popularity of robust mobile computing devices stimulates data traffic to be handled by servers, creating another spur to the industry. Healthy growth for data storage hardware market is seen in the next 12 months driven by content digitization, growing popularity of social networking websites, longer record retention for compliance with government regulations and the increasing prevalence of data mining and related analytics. We foresee growing demand for Internet-based computing solutions because they offer companies opportunities to reduce costs and improve customer service.

The “Buy” opinion primarily reflects AAPL's compelling valuation, favorable view on leasing programs by carriers/AAPL and positive outlook on potential products offerings in 2016 (i.e. new iPhones and TV streaming). AAPL's significant market position in key areas and high customer satisfaction enable Apple Inc. to enjoy a premium. Strong balance sheet and excess FCF will be employed for dividends and stock repurchases, as well as small bolt-on acquisitions. We foresee iPhone growth, coming from both attracting new customers to iOS (mostly in emerging markets, although we still see U.S. growth as well) and retaining Apple's existing premium iPhone customers, where we think the company's competitive advantage will play an increasingly important role.

Investment risks include rising competition on multiple fronts, constant need to innovate on hardware and software fronts, and currency fluctuation.

 As of December 1, we have an unrealized gain of 1.4% on Apple Inc.

**Medtronic (NYSE: MDT)**

We purchased 650 shares of Medtronic at an average price of $76.40 per share on Nov 11, 2015.

Medtronic is an Irish medical device company headquartered in Dublin, Ireland. The company was founded in 1949 in northeast Minneapolis, Minnesota, USA. Medtronic is the world's largest standalone medical technology development company. The company has six segments: Cardiac and Vascular Group, Services and solution group, Diabetes Group, Minimally Invasive Therapies Group and Restorative Therapies Group. The composed of six main business units develop and manufacture devices and therapies treat more than 30 chronic diseases, including heart failure, Parkinson's disease, urinary incontinence, Down's syndrome, obesity, chronic pain, spinal disorders, and diabetes. Products includes: pacemakers, cardiac resynchronization therapy devices, gastrointestinal diagnostics, etc. In June 2014, Medtronic announced its acquisition of Covidien, PLC of Ireland for $50 billion, making it the largest ever medical technology acquisition.

The combination of Medtronic and Covidien positioned Medtronic a clear industry leader and set the stage for Medtronic to lead the transformation of healthcare. Eight equity investment analyst upgraded following the announcement, and by deal closure the market cap increased by 32 billion. Medtronic expected to result of minimum $850 million in cost synergies by the end of FY 18. Besides, the lower tax rate in Ireland provides MDT with a competitive advantage on future deals.

Financially, Medtronic FY15 revenue grew by 6 percent on a comparable, constant currency basis, which was at the upper end of mid-single digit baseline goal, and more than a 2 percentage point improvement from FY14. Following the Covidien acquisition, Medtronic have increased the percentage of our cash flow that is accessible. In June 2015, Medtronic announced to increase dividend for 38 consecutive years at a compounded annual growth rate of 18 percent.

Looking ahead, Medtronic has an opportunity to truly meet the universal needs of healthcare – improving clinical outcomes, expanding access, and optimizing cost and efficiency – in a way that no other company can. The industry-leading products, clinical and economic expertise, global footprint, and financial strength position Medtronic to be the preferred partner for physicians, hospital systems, patients, payers, and governments around the world.

As of Dec 1, 2015, we have an unrealized gain of 0.1% on Medtronic.

**Marathon Petroleum Corporation (NYSE: MPC)**

We purchased 900 shares of Marathon Petroleum Corporation at an average price of $55.8 per share on November 19, 2015.

Marathon Petroleum is the nation's fourth largest refiner, with a crude oil refining capacity of 1.7 million barrels daily in its seven refinery systems. Its operations consist of three segments: Refining & Marketing, Speedway, and Pipeline Transportation. It operates 2,746 Speedway stations in 22 states and sells Marathon branded gasoline at 5,455 independent stations in 19 states. Also has interests in 8,300 miles of pipelines and in ethanol manufacturing and owns 73.6% of MPLX LP.

The fundamental outlook for the oil & gas refining & marketing (R&M) sub-industry for the next 12 months is positive, YTD through June 30, the R&M index has risen 16.3% versus a 0.6% gain in the S&P 1500 Composite Index. The increased domestic crude oil production helps to cut reliance on imported crude oil, and also excess industry supply weighs on pricing, which improves a refiner's cost of crude oil purchases. In addition, rising production of oil sands production from Canada, along with improved pipeline and rail capacity, should enable an increased supply of heavy oil making its way to the key Gulf Coast refining complex in the U.S.

Companies that refine petroleum tend to perform well during periods of low oil prices as lower costs aid earnings. And Berkshire Hathaway raised its stake in refiner Phillips 66 a few months ago, improving the confidence of investors for this sub-industry. Marathon Petroleum reported a strong quarter, with earnings growth in all three of its segments, and a series of successful acquisitions nearly double its Speedway retail segment, and transforms it into primarily a Gulf Coast refiner (62% of capacity in the region), which leaves it a better position, because greater amounts of discount crude will become available on the Gulf Coast with the startup of new pipeline capacity. In addition, Marathon is investing to expand its midstream and retail businesses in an effort to diversify its earnings stream away from the more volatile refining business, and we believe that’s a good strategy for long-term development.

However, Marathon mainly benefits from the domestic crude discounts; its risks depend on movements in the prices of crude oil and gasoline or diesel. Supply interruptions or increased demand may drive up oil prices, and demand destruction or economic slow-downs may also depress refined product prices. In addition, with greater reliance on the export market, Marathon may be also exposed to the threat of construction of over-sea refiners.

As of December 1, 2015, we have an unrealized gain of 6.3%% on Marathon Petroleum Corporation.

**CarMax Inc. (NYSE: KMX)**

We purchased 875 shares of CarMax, lnc., at an average price of $57.24 per share, on November 6, 2015.

CarMax, Inc. is the largest U.S. retailer of used cars. As of April 1, 2015, CarMax owned and operated 146 used car superstores. It also sells new vehicles at locations under franchise agreements with four new car manufacturers. The company provides financial services to customers through CarMax Auto Finance (CAF). Its strategy is to overcome important sources of customer dissatisfaction with traditional auto retailers, while maximizing operating efficiencies.

The automotive retail industry is highly fragmented. While CarMax is the largest used auto retailer, it still represented only about 2% of the total late model used units sold. During the past few years, Internet marketing has taken on great significance for the used vehicle and vehicle financing markets. The outlook for this industry is positive. Many new and restyled vehicles, combined with updated in-vehicle technology and greater fuel efficiency, as well as more vehicles coming off leases, should also drive new vehicle sales.

Automotive Retail has a #2 industry ranking in Value Line, with a great potential under the current market situation. CarMax has increased revenue and profitability at a remarkable rate and has a significantly higher operating margin compared with its competitors. In addition, CarMax stock is near the bottom of its 12-month trading range, but due to the better-than expected showing in the August quarter, it has a great appreciation potential. Also, its share repurchase program shows the confidence of the board, and this company is most probably undervalued.

In terms of risks, rising investment in new facilities and ongoing share repurchases will likely limit capital available in other purposes, and also increase its debt ratio. Based on the EPS, CarMax recently traded at a premium to the average of automobile retailers, and the demand for and pricing of used vehicles could be weaker than analysts expect as well.

As of December 1, 2015, we have an unrealized gain of 0.04% on CarMax Inc.

**Capital One Financial (NYSE: COF)**

We purchased 650 shares of COF an average price of $77.06 per share on November 18, 2015.

Capital One Financial Corporation operates as a diversified financial services company. The company focuses primarily on consumer and commercial lending and deposit origination. Following the 2012 acquisition of the U.S. ING Direct business, Capital One became the sixth largest depository institution and a leading direct bank in the U.S. As of September 30, 2015, Capital One had $213 billion of loans, with about 76% consumer (39% of total loans were domestic credit card receivables, 4% international credit card receivables, 19% auto loans, 12% home loans and 3% retail banking loans) and the remaining 24% commercial (about half real estate).

Capital One offers its products throughout the United States. It also offers its products outside of the United States principally through Capital One Bank (Europe) plc, an indirect subsidiary of COBNA organized and located in the United Kingdom (the U.K. Bank), and through a branch of COBNA in Canada. The company's U.K. Bank has authority to accept deposits and provide credit card and installment loans. Its branch of COBNA in Canada has the authority to provide credit card loans.

As a result of bold acquisitions and organic expansion, Capital One has evolved from a monoline credit card company to a diversified holding company offering a broad spectrum of financial products and services to consumers and businesses. Capital One can be generally divided into three segments--credit cards, consumer banking, and commercial banking--all of which have been supplemented by acquisition and subsequently grown organically. However, credit cards still constitutes the largest percentage of its net income. In the past, analyst were impressed by the consumer and commercial lending growth as improvement in the overall economy took place in 2014. More recently, it is expected that credit card business will serve as the catalyst for balance sheet growth, which should help stabilize net interest margins as higher-yielding assets are added to the loan portfolio. While the expansion of its automotive and commercial lending businesses will continue its solid growth during the remainder of 2015, the positive macroeconomic factors in the U.S. with low unemployment and solid GDP growth will lead to a stronger consumer balance sheet and increase their willingness to spend and consume. This will be positive for consumer lenders like Capital One. In the past, Capital One's strategy has been defined by the bank's large and bold risks with shareholder capital through potentially risky acquisitions in an effort to transform itself into a full-service bank. The most recent example is Capital One's intention to acquire $8.5 billion in loans related to health-care equipment and providers from General Electric Capital as the latter company exits the business. Management continues to be focused on building shareholder value by growing diverse businesses into a unified bank that serves its customers well, maintains strong expense controls, and produces resilient and attractive risk-adjusted returns.

As of December 1, 2015, we have an unrealized gain of 3.6% on COF.

**Gilead Sciences, Inc. (NASDAQ: GILD)**

We purchased 460 shares of GILD at an average price of $107.59 per share on November 6, 2015.

Gilead Sciences (GILD) primary areas of focus include human immunodeficiency virus (HIV); liver diseases, such as chronic hepatitis C virus (HCV) infection and chronic hepatitis B virus (HBV) infection; oncology and inflammation; and serious cardiovascular and respiratory conditions. It has operations in approximately 30 countries worldwide. In the liver diseases area, the company received approval from the U.S. Food and Drug Administration (FDA) and the European Commission for Harvoni, in December 2014, the first once-daily single tablet regimen for the treatment of HCV genotype 1 infection in adults. Harvoni combines the NS5A inhibitor ledipasvir with the nucleotide analog polymerase inhibitor sofosbuvir, which was approved under the tradename Sovaldi, in 2013.

Gilead's focus on infectious disease has paid off in spades. With a small salesforce, inexpensive manufacturing, and selective research and development, it generates stellar profit margins, and the firm's pipeline is extending its reach into other high-margin markets like hepatitis C and hematological oncology. With the approval of hepatitis C drug Sovaldi in late 2013, Gilead's competitive advantages have strengthened, moving it into wide-moat territory. Gilead's tenofovir molecule-- in Viread, Truvada, and all single-tablet regimens-- forms the heart of the firm's $10 billion HIV franchise. Its newest single-tablet regimens, Complera and Stribild, are seeing rapid uptake and strong reimbursement. Such regimens offer patients convenience and affordability, as they are less likely to miss doses and develop drug resistance, and they only need to make one copayment. Gilead will see new competitive threats in HIV; Glaxo could introduce a Truvada/Tivicay single tablet regimen once Truvada patents begin to expire in 2018, and generic versions of Atripla should be available beyond 2021. However, Complera and Stribild will have a strong grasp on the market by this time, resetting the firm's HIV patent cliff into the 2020s. Gilead's pipeline drug TAF appears to have bone and renal safety advantages over tenofovir, and the first TAF combination regimen is poised to reach the market by the end of 2015.Management is diversifying with acquisitions, including the $11 billion Pharmasset deal and key hepatitis C drug Sovaldi. While AbbVie launched its all-oral regimen in late 2014 and Merck is set to launch a competitive regimen in early 2016, Gilead's regimens set a high bar. Sovaldi and Harvoni (a combination of Sovaldi and ledipasvir launched in October 2014) saw $12.4 billion in sales in 2014. While negotiated discounts have rapidly increased, the number of patients seeking therapy has also increased, Gilead will see $19 billion in hepatitis C sales in 2015, or 80% of the global market.

As of December 1, 2015, we have an unrealized loss of 1.6% on GILD.

**United Technologies Corporation (NYSE: UTX)**

We purchased 500 shares of United Technologies Corporation at an average price of $99.24 per share on October 29, 2015.

United Technologies Corp. operates in five business segments: Pratt & Whitney (revenues of $14.5 billion in ’14) makes and services commercial and military aircraft engines; Otis ($12.9 billion) the world’s largest manufacturer and servicer of elevators and escalators; UTC Climate ($16.8 billion) makes heating, ventilating, and air-conditioning (HVAC) equipment; Sikorsky ($7.5 billion) makes helicopters (now sold to Lockheed); UTC Aerospace ($14.2 billion) produces aerospace and industrial products.

There is a positive outlook for the commercial aerospace and neutral outlook on defense for the next 12 months. Increases in commercial air traffic, driven by recovering global economic trends, will help drive strong commercial aerospace results. Trade association IATA estimates that global passenger air traffic grew 5.9% in 2014 after growing 5.2% for 2013 and sees growth of 7.0% in 2015. This continued solid demand for new commercial jets, fueled by growth in the developing markets and a need to replace aging, less fuel-efficient aircraft in developed markets.

Each of United Technologies' businesses manufactures highly-engineered equipment, with product innovation, durability, and reliability serving as key differentiating factors against competitors. The development of a new aircraft engine, for example, can take the better part of 20 years, and the institutional memory preserved through several decades of operating history and technological expertise can provide a competitive edge when creating next generation technology. The value inherent in United Technologies' intangible assets-–its active and historical patent portfolios, long-term customer relationships, and collaboration assets shared by joint ventures, springs from the strength of United Technologies' engineering expertise, a core competency supported by average yearly spend of nearly 4% of its consolidated sales on research and development. In addition, customer-funded R&D can average an amount equal to about 3-4% of sales. New product development powers growth of the installed base, which we view as the physical representation of United Technologies' wide economic moat. Global reach in each of United Technologies' four operating segments translates into scale-based cost advantages in sourcing, manufacturing, distribution, and aftermarket service. In addition, customers invest significant amounts of capital in order to install and maintain the vital equipment and systems sold by United Technologies. Unplanned downtime in both building and aerospace systems can be incredibly costly, or even catastrophic when considering the consequences of elevator or aircraft engine failure. In either case, the motivation to protect an installed base of equipment translates into a high degree of customer switching costs. Nearly 44% of United Technologies' consolidated revenue comes from aftermarket maintenance and repair services, which we view as evidence of sticky relationships sustained by customer reliance on the original equipment manufacturer.

As of December 1, 2015, we have an unrealized loss of 2.6% on UTX.

**AT&T, Inc. (NYSE: T)**

We purchased 1,500 shares of AT&T Inc. at an average price of $33.80 per share on November 19, 2015.

AT&T is the second-largest U.S. wireless carrier, serving more than 100 million customers. The firm is also provides local fixed-line services, including voice, data and television services, in 21 states. AT&T also provides phone and data services, such as data transport, to larger businesses nationwide. The firm recently acquired DirecTV, adding 20 million U.S. satellite television customers and a presence in Latin America. AT&T also recently closed two acquisitions in Mexico, adding 8.6 million wireless customers in the country.

Our fundamental outlook for the integrated telecommunication services (wireline) sub-industry for the next 12 months is neutral. We expect revenue pressure to remain, but think broadband growth and cost savings will yield modest free cash flow growth to support dividends. We have a positive opinion on select, high dividend paying companies within the sector. New versions of smartphones continue to drive wireless customer growth for the larger carriers. With more existing customers upgrading to high-end subsidized devices, we expect healthy wireless revenue growth, but also operating margin pressures over the next twelve months. In wireline, we expect continued access line weakness, but stable broadband subscriber gains. Competitive threats from cable and satellite providers should weigh on pricing and subscriber growth. However, we see continued cost cutting, merger synergies, and business market improvements supporting free cash flow. We expect telecom providers to continue to invest in high-demand fiber-based services to support broadband growth, with a focus on improving both data speeds and coverage. The government is phasing in regulatory changes to universal service funding to spur broadband availability, which we see as modestly negative for rural carriers. After dividend reductions by several mid-sized telecom companies in recent years, we believe dividend payout ratios for most are at levels that can support current attractive dividends.

AT&T's competitive advantages primarily stem from its position in the wireless industry, in our view. Verizon Wireless and AT&T dominate the industry, with about 60% of the market between their retail and wholesale businesses. The strongest evidence of AT&T's moat in the wireless business is its ability over the past several years to take market share and invest heavily in its network while generally improving margins and generating solid cash flow. Even with the resurgence of T-Mobile recently, AT&T and Verizon Wireless have taken all of the growth in the postpaid market and then some since the end of 2007. At the same time, AT&T's wireless EBITDA margin has expanded from the mid-30s to around 40%, despite the cost of subsidizing smartphones. Outside of Verizon Wireless, no one else in the industry comes close to that level of profitability. We expect the scale that AT&T and Verizon Wireless enjoy will allow these firms to continue spending far more aggressively on networks, marketing, additional wireless spectrum, and customer service than anyone else in the industry.

As of December 1, 2015, we have an unrealized gain of 0.03% on T.

**Polaris Industries Inc. (NYSE: PII)**

We purchased 450 shares of Polaris Industries Inc. at an average price of $111.29 per share on October 29, 2015.

Polaris Industries manufactures off-road vehicles for recreational and utility use. Vehicles include motorcycle, snowmobiles, and side-by-side vehicles. The company is present in the U.S., Canada, Mexico, Western Europe, and Australia. Polaris provides replacement parts and accessories for all products and sells through a network of independent distributors and dealers. Unemployment has steadily been decreasing since 2009 and now sits at 5.1%. Additionally, U.S. home prices have rebounded from the recession. Both are good pieces of news for the leisure product industry. When the workforce is employed, there are more discretionary funds available for recreation. Following suit, when home values rise, homeowners feel more comfortable spending cash. The industry as a whole has a large potential in developing countries. Low gasoline prices also make these vehicles more affordable to operate. Lastly, baby boomers will continue to be drawn to Polaris Vehicle activities.

Polaris is deeply rooted in the ORV’s snowmobile markets and also has a presence in motorcycles manufacturing. There are only a handful of companies that are involved in these markets. Polaris and Artic Cat are the only companies that are heavily involved in both ORV and Snowmobiles. Most other Polaris’s competitors only focus on one market, for example, Harley-Davidson is the world’s largest motorcycle manufacturer. Polaris is very well diversified across markets. Additionally, there is very low threat of new entrants to the industry. This is due to the high capital requirements for R&D and manufacturing of products. Polaris has a strong brand identity specific to product appeal and because it can only be challenged by a handful of players, you can expect consistent growth. Lastly, Polaris has been acquiring its suppliers over recent years and has firm control over supply chain and dealer inventories. It can be argued that these products appeal to a niche market only in certain geographic locations with open-wilderness easily accessible. Additionally, the recreational products rely heavily on disposal income from healthy economies. Therefore it is vulnerable to down markets. Additionally, because Polaris is present in so many sub-industries, there is a risk that it could be spread its resources too thin.

Polaris is well positioned for substantial growth for the next 3-5 years. The company has been bolstering expansion efforts in Europe, which will also diversify of risk. Currently, the stock is experiencing a selloff based on slightly lower reforecast earnings for 4Q15 and recall of 53,000 RZR units. That being said, we still like a Polaris for its revenue, net operating cash flow, and debt to equity ratio numbers. Based on our calculation, in line with several Wall Street analysts, Polaris is severely undervalued at its current 52-week low. Look forward to big gains once the market realizes the company’s true market value.

As of December 1, 2015, we have an unrealized loss of 5.0%

**ITC Holdings Corp. (NYSE: ITC)**

We purchased 1,550 shares of ITC Holdings Corp. at an average price of $32.98 per share on November 19, 2015.

ITC Holdings Corp is the nation’s largest independent electric transmission company. The company is based in Novi, Michigan. ITC’s value proposition is its investments to improve grid reliability, increase market access, and lower the total cost of delivered energy. The company operates through four subsidiaries in MI, IA, MN, IL, MO, KS, and OK. The peak load exceeds 26,000 megawatts along 15,000 circuit miles of transmission line. The Federal Energy Regulatory Commission regulates the transmission industry and their policy decisions can have indirect impacts on ITC’s Return on Equity. ITC is more exposed than others in the industry because 100% of its rate base is FERC-regulated transmission.

The Environmental Protection Agency mandates a reduction in carbon emissions from power plants of 30% from 2005 levels by the year 2030. To retrofit their infrastructure, many utilities have taken advantage of low interest rates. Adoption of smart grid technology has lowered costs and improved the reliability of delivered power. Additionally, the rebound in the U.S. housing market has driven utility demand higher. The Electric Power Transmission industry is at the mature stage of its lifecycle, usually serving as an income stocks with high and reliable dividends. Significant growth in the industry is expected because growing demand in outpacing the delivery and production capabilities in the U.S.

FERC may look to cut ROE for the Industry in certain regions. Customers in the Midwest, where ITC operates, filed complaints that argued that allowed ROE was too generous. If the FERC cuts rates, ITC has said that every 10 bps drop in allowed ROE would cut earnings by $2.7 million. To prepare for this change, ITC set aside a $0.06 per share reserve in the possibility that a mandated refund was ruled. However, these rulings are not anticipated until 2016 or 2017. The ROA over the past 5 years suggests the high operating returns relative to ITC’s peers are unsustainable. The company may be overly investing its business with debt finance. The market prices ITC at a high P/B than its peer median.

Since the ROE regulation may change from the FERC’s decision, ITC is shifting its capital plans to focus more on contractual transmission projects. It currently has two projects in the pipeline. The first is the Lake Erie Connector, which will bring power back and forth from Canada to the U.S. The second, is a project shared with NRG Energy and York Capital Management to bail out the Puerto Rico Electric Power Authority with $3.5B. PREPA is about to default on $700M in loans and the new capital would allow the utility to modernize and upgrade. It is estimated that PREPA is owed $1.75B in surge charge. Additionally, the company last year had announced a repurchase program of $150 million common stock shares. However, ITC’s high gross and pre-tax margins indicate a differentiated product portfolio and good cost control.

As of December 1, 2015, we have an unrealized gain of 14.7%.

**Walt Disney Co. (NYSE: DIS)**

We purchased 435 shares of Walt Disney Company at an average price of $114.34 per share on October 29, 2015.

Disney is a leading media conglomerate with key operations in theme parks, television, film, and merchandise licensing. Theme parks and Resort segment includes parks in the U.S., Europe, and Hong Kong as well as a cruise line. Another park is scheduled to open in China in 2016. Their media networks include ABC, ESPN, The Disney Channel, and ABC Family. Studio films are made under the Disney, Pixar, Marvel, and LucasFilm brands. Consumer products include merchandise licensing, books, video games, and retail stores

Disney is the premier brand in entertainment. Their strategy as a content creator rather than content delivery should help them withstand changes to media delivery over the next few years. ESPN stands to be hit the hardest by switch to a-la-carte media consumption and Disney has already begun cost-cutting measures to prepare for possible lower revenues. Acquisitions of Marvel and the Star Wars franchise has created a strong pipeline of films for the next five years, with benefits also to the theme parks, television content, and consumer products segments.

As consumer confidence continues to increase, there should be growing demand for the Disney’s content, especially with the first new Star Wars movie in ten years. Disney is well positioned to remain leader in industry and trade at premium multiples. Recent price drop creates opportunity for near-term return as well as long term.

The stock saw another drop on Nov 27, when the company confirmed that ESPN subscribers dropped by 3% in the last year. This was substantially the same news that caused a larger sell-off over the summer and does not affect our investment thesis.

As of December 1, 2015, we have an unrealized gain of 0.9% on DIS.

**Martin Marietta Materials Inc. (NYSE: MLM)**

We purchased 320 shares of Martin Marietta Materials, Inc. at an average price of $157 per share on November 18, 2015.

Martin Marietta Materials, Inc. is the second largest U.S. producer of aggregates for the construction industry, including highway, infrastructure, commercial, and residential applications. The company also produces some specialty products, accounting for 12% of revenues, while the aggregate business accounts for 88%. Its largest markets include California, Texas, Florida, Colorado, Georgia, and Iowa. 44% of aggregates were used in highway and public infrastructure projects.

The construction industry has entered a gradual recovery that should continue over the next several years. This includes the private residential housing market and public infrastructure projects. In 2014, construction spending rose 5.6% and in the first 8 months of 2015, spending was again up 9.8%. The House of Representatives recently passed a new transportation funding bill covering the next three years and it is expected to be finalized by the end of the year. The need to improve public infrastructure, especially highways, will provide steady demand for aggregates.

Martin Marietta Materials is well positioned to benefit from the housing market recovery while more stable government projects provide steady growth. They are well protected from new entrants to the market since it is very hard to open new quarries due to zoning and environmental regulations. They also have larger exposures to the higher growth markets in the South and West of the U.S. Their management has deployed capital well in recent years, selling off less desirable businesses and acquiring new ones to access better markets.

Martin Marietta Materials’ P/E ratio is significantly lower than their major competitor despite higher growth in recent years. While their margins are lower, recent acquisitions should help improve that. Risks include the highly cyclical nature of the construction market, fuel and energy costs, and politics endangering public funding of infrastructure projects.

As of December 1, 2015, we have an unrealized gain of 1.5% on MLM.

**CVS Health Corp. (NYSE: CVS)**

We purchased 535 shares of CVS Health Corp. at an average price of $94.668 per share on Nov.17, 2015.

CVS Health is uniquely positioned to provide access to care that’s most convenient for each patient with its unmatched breadth of assets and channel-agnostic approach. The company is a market leader in retail pharmacy, pharmacy benefits management, specialty pharmacy, and retail medical clinics—and very well positioned in an era of consumer-directed health care. CVS Health has captured one third of total U.S. prescription growth since 2008. Through its 7,800 retail pharmacies, more than 900 walk-in medical clinics, a leading pharmacy benefits manager with more than 65 million plan members, and expanding specialty pharmacy services, CVS enables people, businesses, and communities to manage health in more effective ways.

The U.S. healthcare landscape is currently undergoing its most transformative change in decades, due in large part to the implementation of the Affordable Care Act (ACA). More than 30 million Americans are expected to gain healthcare coverage by 2018, with enrollment expansion occurring primarily through Medicare, Medicaid, and the public exchanges. Health care consumers are taking on greater responsibility for choosing their own plans and controlling costs. The “retailization” of healthcare and ACA will benefit CVS, whose strategy is offering high-quality healthcare services to customers with the affordable cost. we believe CVS, as the retail drugstore, is better positioned to take market share from non-traditional competitors. And we expect that prescription volumes will have a significantly increase in 2015 as tens of million people are expected to eventually gain healthcare coverage due to implementation of the ACA.

Furthermore, the company is growing in a stable rate and is generating more free cash flow. The company increased 21% in cash from operations since 2010, and increased 48% in free cash flow in 2014. Focusing on the shareholder value, the company increased the dividend payout ratio from 14% to 24% since 2010. In addition, shareholders are expected to receive more than $7 billion through dividends and share repurchases in 2015. From the operating view, the company continues to expand its footprint in existing markets as well as by entering new markets such as Seattle. It opened or acquired 184 new stores in 2014, and opened 400 retail stores since 2010. In addition, the affirmation acknowledges that the acquisition of the Target pharmacy and clinic business provides CVS with an earnings growth opportunity, increasing CVS's presence in important new markets including Seattle, Denver, Portland, and Salt Lake City.

Risk factors include the adverse impact from the Walgreens’ acquisition of Ride Aid and the possibility of pharmacy benefit management (PBM) client loss and/or the failure to win new PBM business.

As of December 1, 2015, we have an unrealized gain of 0.8% on CVS.

**Reynolds American Inc. (NYSE: RAI)**

We purchased 1100 shares of Reynolds American Inc. at an average price of $46.25 per share on Nov. 20, 2015.

Reynolds American, Inc. is an American tobacco company and is the second-largest tobacco company in the US. Its holdings include R. J. Reynolds Tobacco Company, American Snuff Company (formerly Conwood Company), Santa Fe Natural Tobacco Company and Niconovum AB. Reynolds American's subsidiaries manufacture and market a variety of tobacco products, including cigarettes (Newport, Camel, Pall Mall, Kent, Doral, Misty, Capri and Natural American Spirit brands) and moist snuff (Grizzly and Kodiak brands). In 2010, Reynolds American's operating companies sold about 28% of all cigarettes sold in the U.S. In July 2014, Reynolds American announced the purchase of Lorillard Tobacco Company in a deal valued at $27 billion.

Our fundamental outlook or the tobacco sub-industry for the next 12 months is positive, since the industry has favorable pricing trends, healthy free cash flow growth and is in a relatively benign litigation environment. Year to date through August 21st, the S&P Tobacco Index increased 7.4%, versus an 4.0% decline for the S&P 1500 Index. In 2014, the Tobacco Index rose 8.5%, compared to the S&P 1500's 10.9% gain.

The overall financial performance of this company is quite strong. Revenue is expected to rise 25% in 2015, reflecting net benefits from the acquisition of Lorillard in June 2015. Operating (EBITDA) margins will likely widen in 2015 to about 44%, up from 38% in 2014, on an improved product mix following the completion of the acquisition of Lorillard. EPS is estimated of $2.00 in 2015, up 17% from operating EPS of $1.71 in 2014. Japan Tobacco has agreed to purchase the rights to one of Reynolds' cigarette brands. In addition, several factors will have a positive impact on the company’s performance. First, RAI is selling the international rights to its Natural American Spirit name and associated trademarks to Japan Tobacco Group for $5 billion in cash. The deal, which does not include the rights to the U.S. market, allows Reynolds to retain its share of domestic revenue. The funds received from the transaction will probably go toward paying off debt and/or buying back stock, which will relieve the company's debt burden. S&P has recently given the company a positive credit rating outlook. Second, a federal assessment that forced cigarette manufacturers to make annual payments of approximately $1 billion to farmers has ended. Altria, Reynolds American, and Lorillard mostly paid the payments. The expiration of the payment will estimate to provide a 10% boost to Reynolds' 2016 earnings. Third, a signing of a technology sharing term sheet between R.J. Reynolds and British American Tobacco provides a framework for collaboration and mutual cross licensing of vapor product technologies through 2022. Fourth, higher disposable incomes due to lower gas prices and e-cigarette customers that have moved back to combustibles will at least benefit the traditional cigarettes industry in the short term.

There are also several risk factors. Increasing regulation and taxation could have an adverse effect on the results of operations, cash flows and financial position. RAI’s operating subsidiaries are subject to significant limitations on advertising and marketing of tobacco products, which could harm the value of their existing brands and their ability to launch new brands.

As of December 1, 2015, we have an unrealized loss of 0.3% on RAI.

**Toll Brothers, Inc. (NYSE: TOL)**

We purchased 1,400 shares of Toll Brothers Inc. at an average price of $32.21 per share on October 29, 2015.

Toll Brothers, Inc. is a builder of upscale single-family detached homes, townhouses, and condominiums located primarily on land it has developed. The company operates in 19 states and in 50 markets focused heavily in the North East and only recently developing a strong presence in the West Coast with a strategic acquisition of another builder. Sold 5,397 single-family and attached homes in fiscal 2014 that range in price from approximately $200,000 to $2,000,000. Company provides financing in conjunction with several mortgage banking companies.

Our outlook for the Real Estate industry is good. There’s a continuing recovery in this industry from the crisis but luxury homes have been behind the overall pace. Revenues have increased annually through 2013, with macroeconomic factors suggesting the trend to continue. Large inventory of existing houses being on the market with more competitive pricing will continue to slump returns in the short-term. However, a continued increase in consumer confidence, softening lending standards and overall economic growth will benefit builders greatly. A consumer taste shift into renting versus buying will be the greatest risk moving forward however TOL has developed some assets to take advantage of this.

Mortgages for purchases are recovering, new home sales while not at post crisis peak are strong, employment figures are good and wages are due for a bump. Most all economic factors point to a continued strong recovery in the industry. Trepidation over interest rates should be subdued for now as mortgages, despite likelihood of increase, are still at all-time lows. The company in 2014 made a strategic acquisition to expand operations in the west coast, 5,200 home sites.

On average Toll homes are $300,000 more expensive than the mean of the top 5 builders, definitively placing it in another market. The company assuredly has cost savings and business model advantages over its true competitors in scale, coverage and brand awareness. While the lower priced builders have experienced dramatic revenue growth since the crash this luxury market has yet to see comparable growth. As the market continues to recover we expect luxury home sales to do very well with this company being a large benefactor. Lastly, the company’s expansion into renting with its expanding City Living and Apartment Living brands should help capitalize in the growing market trend of renting vs buying.

As of December 1, 2015, we have an unrealized gain of 5.1% on TOL.

**AvalonBay Communities, Inc. (NYSE: AVB)**

We purchased 285 shares of AvalonBay Communities Inc. at an average price of $177.95 per share on November 20, 2015.

The company is a real estate investment trust (REIT) focusing on the management, development, redevelopment and acquiring of high-quality apartment complexes. The communities and luxury properties are located in 11 states and the District of Columbia. As of Sept 30, 2015, AvalonBay had an interest in 282 communities with a total of 82,527 units, including 27 communities under construction, and eight communities under reconstruction. The company also has development rights already established that could add 10,000 units to the portfolio, half of which is in the Metro NY area a historically strong real estate market.

REITs have been reporting average occupancy figures in excess of 95% for the first half of 2015. Despite an expanding supply of new development, rental rates are on track to improve 5% in the year thanks to the high occupancy. New development will continue to be strong thus heightening competition however, macroeconomic factors like the historically low unemployment rate suggest the development pace is sustainable by the market.

The buy opinion for AvalonBay is based on their strong balance sheet relative to competitors, confidence in management and positive outlook for industry. Essentially, investing in AVB is a play to take advantage of the change consumer preferences from buying to renting in the US. If this trend proves to be ongoing then AVB will be uniquely situated to benefit in that environment. Their Capital structure allows them to be more flexible in the short-term than competitors, which is favorable given the unknowns in the capital markets.

As of December 1, 2015, we have an unrealized gain of 3.9% on AVB.