FATALPHA
VALUE INVESTING

info@fatalpha.com fatalpha.com

By
Sophocles
Sophocleous, CFA

INSIDE CURRENT ISSUE

Apologies for the delay in sending out this month's letter. My goals is to always get it out in the first week of the month, however I've been extremely busy on a number of items. One of these directly affects you, my readers. This is the revamp of the website. Special thanks to FatAlpha follower Christina for her amazing website design feedback. Check it out at www.fatalpha.com. It is still being updated but you will find that it has changed significantly. Comments and suggestions are welcome. There is much more information on the strategy and statistics that are of interest. In addition, I've added a new blog section where I tend to provide updates throughout the month. Posts will include interest articles that I'm reading, brief comments on some of the stocks I'm looking it, as well as some of the trades that you see here in the monthlies (eg. see my trade on XRX: http://goo.gl/xkyU2Q). I invite you to engage in conversation on any of the posts via the comment section that is available under each post.

I've also been busy with other work items such as meetings, new tools to help assist me, and a lot of research. Many don't realize how much work goes on behind the scenes. For example, when the market was recently closed for a holiday my wife asked me what I was going to do with my day off. I replied I was going to work. She didn't realized how much preparation is needed. So I further replied to my wife, who is a high school teacher, "Before you go to class to teach, don't you prepare, don't you have any work to do before you teach that class?"

Before I discuss performance, note that I have changed the benchmark for the S&P 500. Until now, I used the SPX Index from Bloomberg and then the ^GSPC from Yahoo Finance as the S&P 500 benchmark. I have changed this to the SPY which is the S&P 500 ETF. This is a better comparison, as the SPY is something an investor can buy as a passive portfolio vs the active value investing strategy I run. In the benchmark calculation, I now assume reinvestment of after tax dividends.

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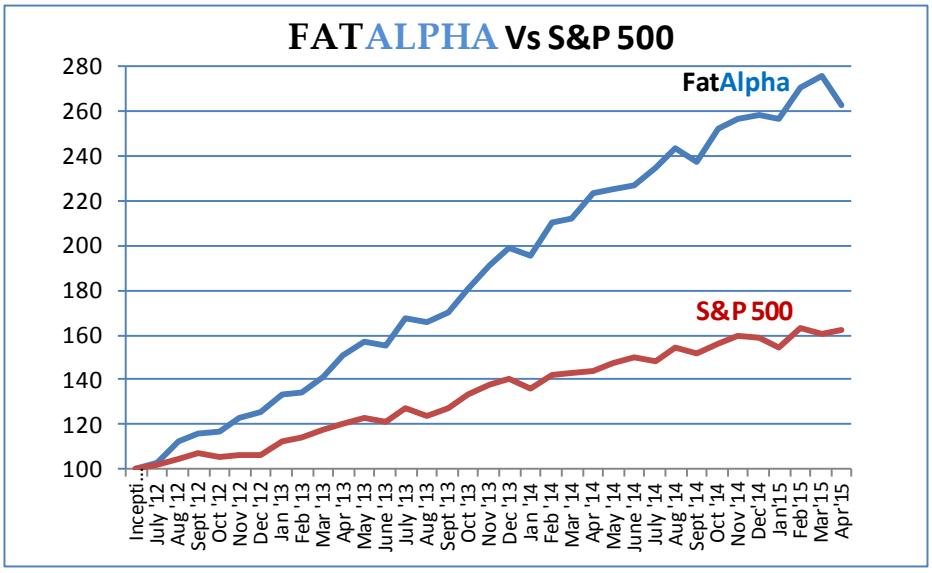
Performance

MONTHLY PERFORMANCE								
Yr/Mo	2015		2014		2013		2012	
	FatAlpha	S&P 500	FatAlpha	S&P 500	FatAlpha	S&P 500	FatAlpha	S&P 500
January	**-0.83%**	-2.51%	**-1.76%**	-3.09%	**6.45%**	5.72%		
February	**5.49%**	5.62%	**7.64%**	4.55%	**0.71%**	1.28%		
March	**1.84%**	-2.01%	**0.91%**	0.39%	**5.35%**	3.34%		
April	**-4.80%**	1.35%	**5.08%**	1.06%	**6.47%**	2.29%		
May			**0.97%**	2.32%	**4.19%**	2.36%		
June			**0.83%**	1.58%	**-0.73%**	-1.85%		
July			**3.17%**	-0.95%	**7.45%**	5.60%	**2.89%**	2.37%
August			**3.67%**	3.95%	**-1.00%**	-3.00%	**9.12%**	2.51%
September			**-2.39%**	-1.84%	**2.78%**	2.66%	**3.03%**	1.99%
October			**6.21%**	2.74%	**6.26%**	5.05%	**0.66%**	-1.36%
November			**1.78%**	2.75%	**5.50%**	2.96%	**5.58%**	0.57%
December			**0.86%**	-0.80%	**4.34%**	2.04%	**1.79%**	0.18%
Year	**1.42%**	2.26%	**29.95%**	13.08%	**59.01%**	31.97%	**25.14%**	6.36%
FatAlpha beat S&P 500 27 out of 34 times								

S&P DOWN MONTHS		
Month	FatAlpha	S&P 500
Oct-12	**0.66%**	-1.98%
Jun-13	**-0.73%**	-1.50%
Aug-13	**-1.00%**	-3.13%
Jan-14	**-1.76%**	-3.56%
Jul-14	**3.17%**	-1.51%
Sep-14	**-2.39%**	-1.55%
Dec-14	**0.86%**	-0.80%
Jan-15	**-0.83%**	-2.51%
Mar-15	**1.84%**	-2.01%
Average	**-0.02%**	-2.06%
Median	**-0.73%**	-1.98%
FatAlpha beat S&P 500 8 out 9 times		



SINCE INCEPTION:	FatAlpha	162.3%	Vs	S&P 500	62.3%

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Earnings Insights:
http://www.factset.com/websitefiles/PDFs/earningsinsight/earningsinsight_5.8.15

An interesting article on cleaning up your contacts.
http://www.wsj.com/articles/clean-up-your-messy-android-and-iphone-contacts-without-going-mad-1429637144

A broker that charges no fees….
https://robinhood.com/

Pick from the Ira Sohn Conference:
http://www.zerohedge.com/news/2015-05-04/ira-sohn-conference-picks-and-pans-summary

Something to think about. China's export boom a fraud?
http://qz.com/70683/surprise-chinas-export-boom-might-be-a-fraud/

Michael Lewis on the flash crash. Good questions.
http://www.bloombergview.com/articles/2015-04-24/michael-lewis-has-questions-about-flash-crash

Your smartphone keeping you awake?
http://www.businessinsider.com/smartphone-impact-brain-body-sleep-2015-2

This MinFin thinks banks should be taxed more. Hmmm….
http://www.bloomberg.com/news/articles/2015-05-01/sweden-s-finance-minister-says-banks-should-be-taxed-more

Buffett's No. 1 Fan:
http://money.cnn.com/2015/05/02/investing/berkshire-hathaway-50-anniversary-shopping/index.html?iid=HP_LN

The Chinese stock that only goes up….
http://qz.com/396072/meet-the-chinese-stock-that-only-ever-goes-up/

The $9 computer
http://www.businessinsider.com/chip-worlds-cheapest-computer-at-9-2015-5?utm_content=15089967&utm_medium=social&utm_source=twitter

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Trades

Date: **April 27th & 30th, 2015**
Ticker: AAPL
Name: Apple
Transaction: Sold
Price: $132.76 & $125.15
Size: Reduced position

Note:
Company posted great numbers but the highlight was iphone sales in China. Not much heard on the watch which is no surprise. It's still too early for it to have any impact on total sales. Firstly, it's the first version and so we can expect significant improvements going forward. Secondly, its battery last 1 day which I find to be a disappointment. Batteries deteriorate over time. Anyone want to charge their watch twice a day after owning it for a year or two…? Ipad sales weren't good but that makes sense. I don't own one as I get the job done with my iphone 5 which has a smaller screen. So with the new iphone 6 plus, I can't imagine how a buyer can justify buying both an ipad and an iphone 6… Personally my only surprise was apple's market share of the computer market. I expected more. The mac is now at about 6% compared to 4% a few years back. Considering what a wonderful ecosystem it is, my belief was a shift to more apple products with emphasis on the mac. Apple has done an overall good job with the related devices (eg. routers, etc). The problem which will resurface is the reliance on the phone. The company is trying hard with other projects (eg. the watch, Apple Pay, potential electric car, etc) but until something emerges this reliance will be an overhang. The stock sold off post earnings. I took some profit a day before and a few days later when the stock closed under the 50 ma. AAPL is now the smallest position in the portfolio. As a reminder, the main reason for its purchase was due to the high % holding in the SPY which has been replaced over time. It currently ranks outside of my growth value range. On a break, I will be selling the remaining position.

Date: **April 9th & 27th, 2015**
Ticker: CBI
Name: Chicago Bridge & Iron
Transaction: Bought
Price: $49.25 & $49.33
Size: New position

Note:
This global engineering and construction company was brought to my attention by my value growth model. We join Warren Buffett and David Einhorn as shareholders with Einhorn's entry at $43 versus our $49. There are a number of issues that have pushed this stock to its current price:

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1. The Shaw acquisition raised questions regarding accounting and reporting methods. A piece of research by an unknown entity called Prescience Point helped fuel the rumors. It's been a long time since the February 2013 acquisition, and the stock has further been looked at by large investors as noted. Considering the time past and investors involved, I don't consider these accusations as valid.
2. In 2014 concerns emerged over a cash outflow due to "Contracts in Progress". This is not uncommon in the construction business. The company believes they are entitled to a payment from the Georgia Nuclear Project. This is still unresolved.
3. The decline in oil prices. The CEO said in a conference call that less than 5% of the business is exposed to upstream end markets. Furthermore its backlog is broken down into 50% power, 30% natural gas, 5% gas processing, 5% refining and 10% petrochemicals.

In the most recent earnings, sales were up 7% while operating profit rose 50% as operating margin improved from 5.5% to 7.8%. The company reiterated its $5.55-6.05 EPS guidance on revenues of $14.4-15.2bn. Sore spot was the negative operating cash flow, although the company projects it will close the year 500-600m as it makes up for it in the second half of the year. Also noteworthy is the company's plan to reduce share count by 10% by the end of 2016 – basically taking out the Shaw acquisition shares issued.

Date: **April 21st & 27th, 2015**
Ticker: AVT
Name: Avnet
Transaction: Bought
Price: $45.01 & $43.69
Size: New position

Note:
The technology distributor group has several members that present value. Arrow Electronics (a competitor) is already part of the portfolio and so only a small position was initiated in AVT. Along with ARW, these two control 60% of the market in North America and Europe. I initiated half the position before earnings and the rest following earnings. I was satisfied with the results which showed growth in both sales and operating profit. The market punished the stock due to guidance that was below expectations. Another member of the group which looks interesting is Insight (NSIT) – a prior holding. FYI, NSIT stock has performed well following dips below the 200ma.

Date: **April 27th, 2015**
Ticker: DTV
Name: DirecTV
Transaction: Sold
Price: $90.22
Size: Exit position

Note:

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Telecom groups have lost the net neutrality fight. With the CMCSA/TWC merger withdrawn and T/DTV merger appearing more at risk I exited the position. T's new bond success to fund the merger has helped push DTV to the 90s. I took opportunity to cash in. A deal failure will see DTV back at 80 or perhaps even worse which could set up a value growth play. Following my sale competitor (Netflix and Cogent) have come in demanding conditions on the merger…

Date: **April 14th & 22nd & 24th & 27th, 2015**
Ticker: TRN
Name: Trinity Industries
Transaction: Sold, Bought, Bought, Sold
Price: $35.46, $34.10, $28.87, $28.08
Size: Net reduction in position

Note:
PLEASE READ THIS NOTE WITH THE LETTER COMMENTARY TO GET THE FULL PICTURE. On the 14th, I reduced the position by taking some profit in TRN. My thinking on that day: "Stock stalled despite broader market move. This was likely due to supply from October that may have been selling on the return of price to current levels. In other words, scared longs from October are taking opportunity to exit. The position remains one of the top 3 in the portfolio. Technical catalyst of 200-ma is right above and may refresh interest in the stock on a break higher." On the 22nd I increased the position by allocating 1% of the NAV to TRN on a -6% move following this Bloomberg article: http://goo.gl/HVTJeC. On the 24th I bought some more on the sell-off following management confirmation that they were co-operating with the authorities with an investigation on the Federal Highway Administration. After the market closed, Wall Street Journal published an article that demand for railway cars (which is big business for TRN) was falling off a cliff. (See: http://goo.gl/8OgKbH) So while the DoJ investigation resulted in emotional selling, this new piece of news was an additional and much more important headwind. Hence I reduced the position on the following business day.

Date: **April 21ST, 2015**
Ticker: ADM
Name: Archer Daniels Midland
Transaction: Bought
Price: $48.03
Size: New position

Note:
ADM is one of the world's largest processors of corn, wheat, oilseeds, cocoa, as well as a manufacturer of value-added food (i.e. flout, biodiesel, corn sweeteners, etc) and feed ingredients. The stock is a value play opportunity that presented itself most probably due to expected drop is sales on strong dollar and weak corn processing business. And despite missing revenue expectations, earnings surprised as operating profit rose 12%. The company has returned cash to shareholders via dividends and share buybacks.

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Date: **April 13th & 16th, 2015**
Ticker: AXL
Name: American Axle
Transaction: Sold
Price: $25.41 & $24.73
Size: Exit position

Note:
AXL has lost its momentum and has moved away from value. Have been watch to exit on weakness. The stock has not be able to keep up recently with the market and so was further reduced on the 13th. I sold remaining position in AXL as the stock broke below the 50ma on heavy volume for no apparent reason. On the 16th it continued to drop when a small relief move would have been the norm.

Date: **April 14th, 2015**
Ticker: SANM
Name: Sanmina
Transaction: Bought
Price: $23.63
Size: Increased position

Note:
I took the opportunity to increase the position follow a 5% pullback which occurred due to a downgrade by a broker. I have found that while downgrades negatively affect a stock, a value play (pending no change in fundamentals) usually rebounds.

Date: **April 10th, 2015**

Ticker: JBL
Name: Jabil Circuit
Transaction: Bought
Price: $23.89
Size: New Position

Note:
According to the company, "Jabil is an electronic product solutions company providing comprehensive electronics design and manufacturing product management services to global electronics and technology companies." To the average investor, the most important piece of information is that JBL manufactures the phone casings for the iPhone 6 and 6 plus. As of the last fiscal year, Apple was 18% of revenue. With the success of the new iPhone, this is an indirect play on Apple with a value angle. With its recent stock performance this ranks as value momentum and value. We returns and growth just shy of my model criteria, it almost ranks as a

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value growth play. Hence I'm pretty excited this stock could do very well for the portfolio. Guidance for the fiscal year looks good with sales of $17.5-18.5 bn and EPS of $1.85-2.15

Date: **April 9th, 2015**
Ticker: TEX
Name: Terex
Transaction: Bought
Price: $26.51
Size: New Position

Note:
The company is a manufacturer of construction equipment, heavy-duty utility vehicles, cranes and aerial work platforms (AWP). The position was kept small because of the expected decline in the AWP business which became actual result at the end of April. However even adjusting for the lower EPS, it still appears in my value model output. Management expects to improve its margins and generate 600m in adjusted EBITDA in 2015.

Commentary (Continued from page 1)

This is a better benchmark which as a result will be a better judge of the FatAlpha strategy. (It should be note that this change resulted in a slight increase in the return of the benchmark both historically and this month). Regarding April's performance, the portfolio experienced the perfect storm. Earnings season was the worst for FatAlpha since I've started running this strategy in 2012. Either good or bad, the market found a reason sell. It was a miss in either sales or EPS or both, it as a change in guidance, it was the strong dollar (where exactly was the surprise here?), it was oil, etc, etc, etc. According to FactSet, the blended earnings growth is 0.1%, the lowest since the third quarter of 2012! Furthermore, "This week marks the first time since January in which earnings for the first quarter reflect a year-over-year increase." As a result, during April, the portfolio was down -4.80% vs 1.35% for the S&P benchmark. Therefore the 2015 return has been reduced to 1.42% vs 2.26% for the S&P.

The main reason for the poor performance was the drop in the portfolio's two largest positions: Trinity Industries (TRN) and Sanmina (SANM) which together were about 14% of the NAV. TRN (which has been reduced and is no longer the largest position – See "Trades" Section) lost -24% while SANM dropped -16% for the month. Sanmina reported both higher sales and operating profit but missed Wall Street expectations. Furthermore guidance was stated below what the street estimated. There are some related industry concerns, however the stock still remains cheap. It was unfortunate that I increased the position a few days earlier on a decline following a downgrade by a broker. This resulted in a bigger negative impact. With hindsight some ammunition could have been held back. On Trinity, the story is a lot more complicated. After I took some profit last month, the stock sold off following a Bloomberg article regarding rumours of a Department of Justice investigation into an investigation into the Federal Highway Administration for favourable treatment of Trinity regarding its guardrail product. Once this rumour was confirmed and that TRN was co-operating with the DoJ, the stock further sold off. This was announced at the conference call after a monster positive earnings release. So instead of a rally, it fell

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further. As noted under "Trades" I bought more on this. The way I see it is that this whole issue has been exaggerated. Firstly, the company's guardrail business is absolutely tiny compared to the rest of the business. Specifically the guardrail product is under the construction products group. The ENTIRE constructions products group makes less than 7% of revenues. So is it worth the company's time? I don't think so. One could argue that Trinity could have compensated the Federal Highway Administration into supporting them so that they ensure they don't get hit with the 700-800m ruling that was appealed (see previous monthly letters). That amount is still less than 1 year's operating profit. Would Trinity management engage in illegal activities even for this amount? Again I don't think so. It is still manageable. Much larger companies (think banks) with much better connections and much more at risk didn't try paying off the government. So if we assume that Trinity did nothing, then the DoJ has no case. They can't really to tell the Federal Highway Administration that their view of the guardrail is wrong. Hence I think this issue has been exaggerated.

To make matters worse, the WSJ reported that demand for railway cars has declined (see "Trades" section). If the investigation is not an issue, then this is. A fellow investor and FatAlpha follower noted to me that perhaps the drop was not due to the investigation but due to the decline in car demand due to the slowdown in the oil industry. Thanks Kevin for the view! Kevin could be right and the DoJ investigation is a coincidence or more likely it is the combination of the two that has result in this heavy selling. Following the WSJ article I reduced the position in order to better manage the risk. So while the investigation is an exaggeration, this news is negative fundamentally. On the bright side, there is a great deal of discussion and commotion regarding safety and the upgrade of railcars. If this plays out then they will need replacement which will be a huge positive for TRN.

With a concentrated portfolio you always run the risk of having such volatility pop into the returns from time to time, but only with a concentrated portfolio can you truly outperform. As Warren Buffett correctly put it "Diversification is protection against ignorance. It makes little sense if you know what you are doing." I have been bless with a phenomenal performance so far. But all investment strategies run into speed bumps. This is one of them and I wouldn't be surprised if there were more. It's natural in the financial markets. Good discipline dictates that we stick to a solid strategy and patience will pay us.

Taking a step back and looking at the market, I can to stress that I am a bit worried. The valuations look extended and the activity I've seen is getting quite emotional. Huge volatility in both value and growth stocks. Look at TWTR and LNKD moves. Growth investors in particular should worry as the market is starting to punish these stocks. If earnings continue to disappoint these stocks will be hit the hardest. From a technical perspective it appears that we could be running out of steam. The chart below (scroll down) shows the pit session S&P continuous futures contract on a weekly basis. If we look at the rotations taking place we see there are overlapping rotations which get closer and closer. A strong trending market pushes higher and higher. This is not the case as shown. So fundamentals and technical are not looking attractive. Having said that, we need more evidence. The bull still needs to show some excess on the highs. An excess with a selling in tail is still nowhere to be seen, and I believe we will see one before this market turns over. So I remain net long but keep all of this at the back of my head.

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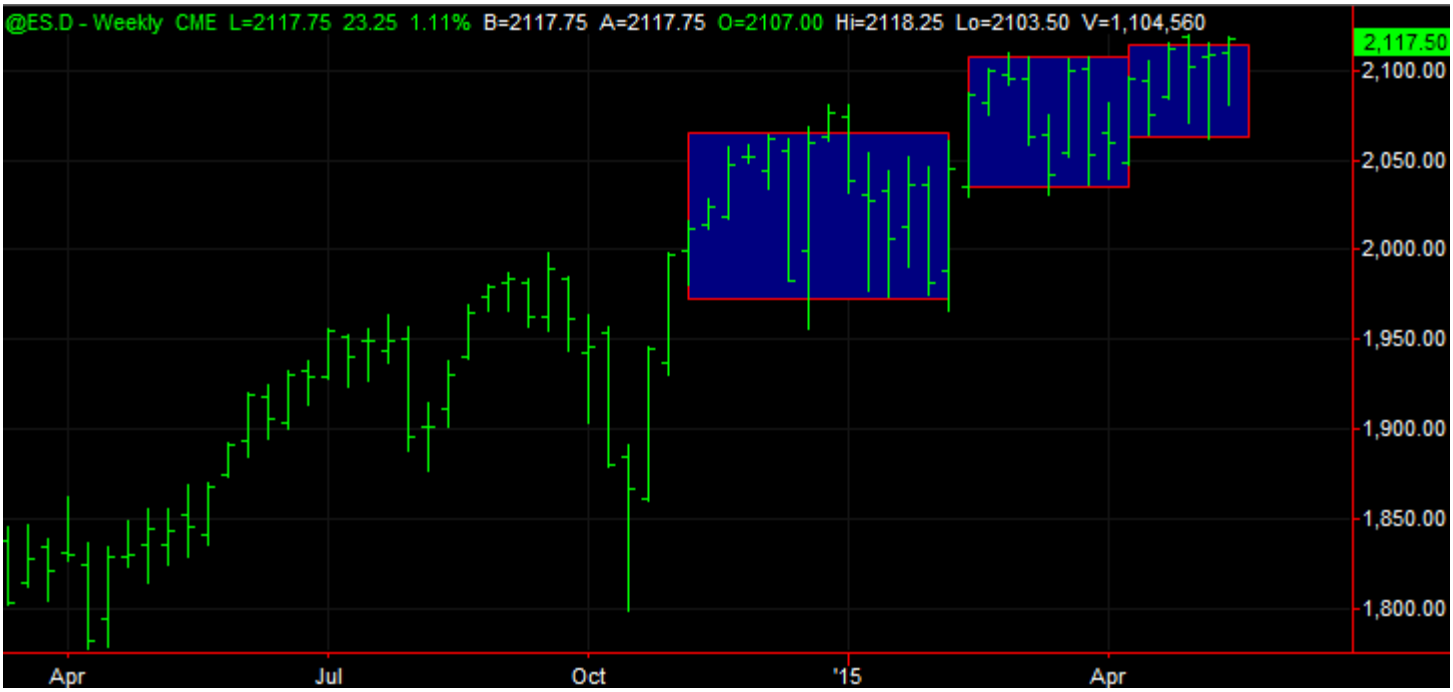

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