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VALUE INVESTING

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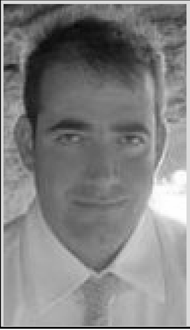

By
Sophocles
Sophocleous, CFA

INSIDE CURRENT ISSUE

"What do you call a stock that's down 90%?

... A stock that was down 80% and then got cut in half.

- David Einhorn

Over the past month I've received some encouraging feedback from readers. Some have told me that they enjoyed receiving this letter, while others thanked me as they copied some of my trades and profited. I'm grateful and in return decided to make a major overhaul to the newsletter. I think you will enjoy the new format which includes some additional sections.

My commentary will be found here on the front page with my real money strategy performance on page 2. A review will be found on page 3. This review may be of a book I read, a website I saw, a newsletter I read or any other source which I believe may be helpful to my readers. Items of interest will be found on page 4 under "Check This Out!". This page will obviously contain practically anything. The computer from the movie "2001 Space Odyssey" (IMDB link: http://goo.gl/tC6G) inspired the title "Hal 9000 Investing" to the section on page 5. Here I will present a model or screen, and may also run the screen for your convenience. This does not mean that I recommend the output or that I have checked the integrity of the data. This will be up to you to investigate further should you so desire. Page 6 will have a contributor article or some type of similar article where a fellow practitioner(s) discuss almost any topic. In this issue my good friend and brilliant economist Richard Segal has provided a piece on Greece. The final section will list my trades for the past month.

After an excellent 2014, the portfolio continued to perform well in January with a -0.8% drop versus a -3.1% for the S&P 500. The best performers for the month included Alaska Air (up 14%), Apple (up 11%

(Continued on page 11)

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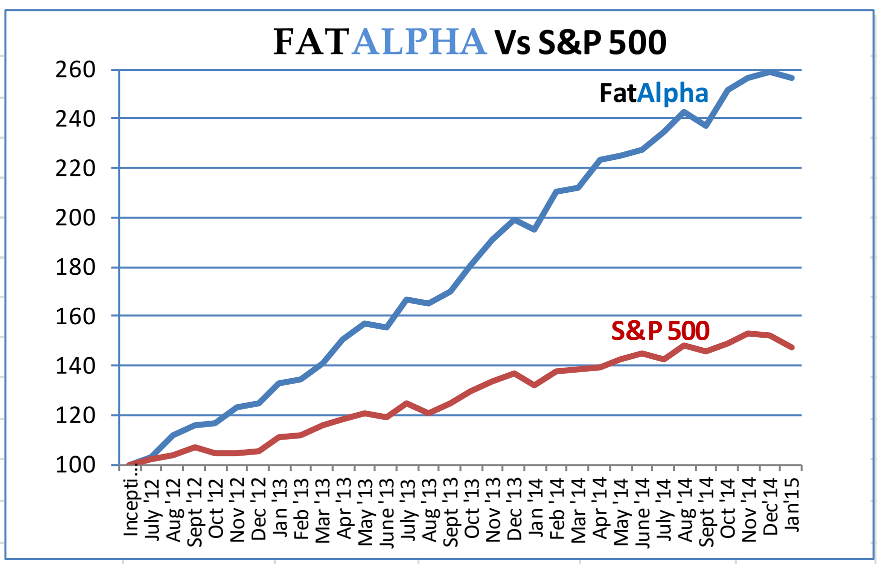
Performance

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%**	-3.10%	**-1.76%**	-3.56%	**6.45%**	5.04%		
February			**7.64%**	4.31%	**0.71%**	1.11%		
March			**0.91%**	0.69%	**5.35%**	3.60%		
April			**5.08%**	0.62%	**6.47%**	1.81%		
May			**0.97%**	2.10%	**4.19%**	2.08%		
June			**0.83%**	1.91%	**-0.73%**	-1.50%		
July			**3.17%**	-1.51%	**7.45%**	4.95%	**2.89%**	2.13%
August			**3.67%**	3.77%	**-1.00%**	-3.13%	**9.12%**	1.98%
September			**-2.39%**	-1.55%	**2.78%**	2.97%	**3.03%**	2.42%
October			**6.21%**	2.32%	**6.26%**	4.46%	**0.66%**	-1.98%
November			**1.78%**	2.45%	**5.50%**	2.80%	**5.58%**	0.28%
December			**0.86%**	-0.42%	**4.34%**	2.36%	**1.79%**	0.71%
Year	**-0.83%**	-3.10%	**29.95%**	11.39%	**59.01%**	29.60%	**25.14%**	5.60%
FatAlpha beat S&P 500 24 out of 31 times								

BEAR MONTHS PERFORMANCE		
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%**	-0.42%
Jan-15	**-0.83%**	-3.10%
Average	**-0.25%**	-2.09%
Median	**-0.78%**	-1.77%
FatAlpha beat S&P 500 7 out 8 times		



SINCE INCEPTION:	**FatAlpha**	156.4%	Vs	**S&P 500**	47.7%

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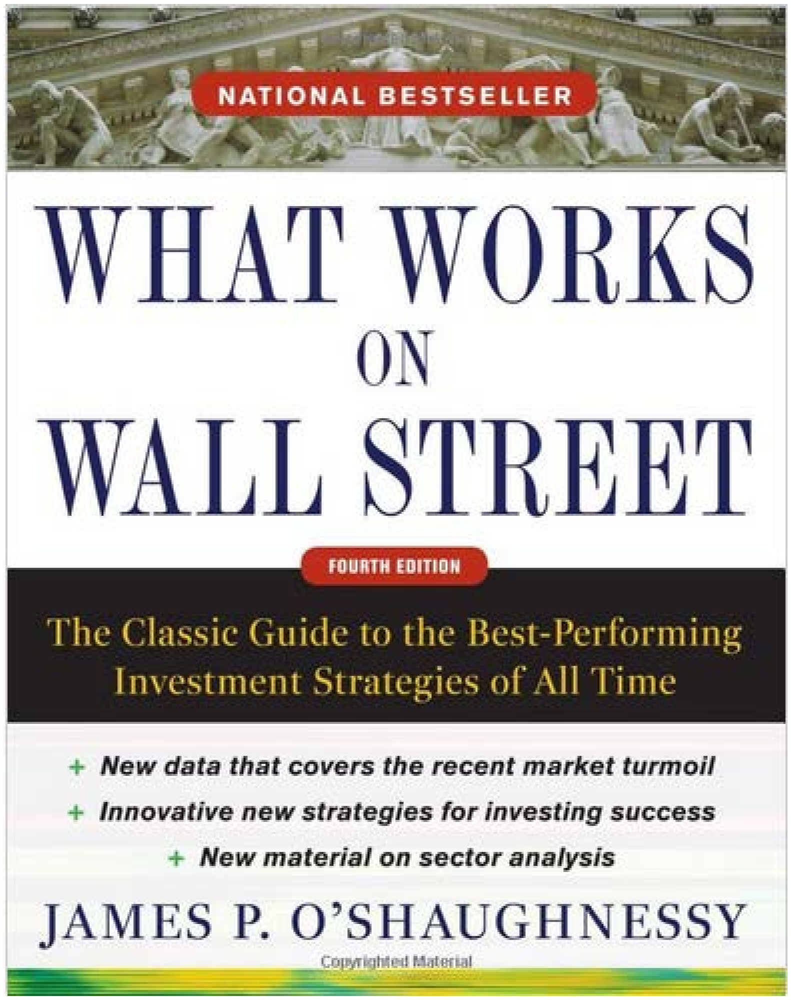
Reviews

I've decided to begin this new 'Review' section with a review of the book that inspired me and was the trigger or turning point to begin forming my strategy. This book is non-other than "What Works on Wall Street" by James O'Shaughnessy.



The beauty of the book is its presentation of data and strategies. What works and what doesn't based on the backtested results. There is no vague opinion or some secret indicator. The author thoroughly backtests single factors but also combines factors into strategies which he also backtests. With performance data going back to 1926 backtests are done on: P/E, P/Bk, P/S, EV/EBITDA, as well as profit margins, returns, momentum, growth, debt and accounting ratios. He then shows combinations of multifactor strategies and how a single composite factor can be formed to improve the returns relative to a single value ratio such as price to books.

The analysis and methodology are very thorough as he takes into account various potential biases (eg. survivorship bias) and other data problems. These are discussed in the very first chapter, right before he starts digging into to the data.

The author has used this research to manage money professionally for the Royal Bank of Canada, Bear Sterns and currently O'Shaughnessy Asset Management with around $7 billion under management. So not only does he talk the talk but also walk the walk. It is my understanding that O'Shaughnessy combines strategies so as to find stocks that are not only cheap but also have financial strength and earnings quality. There is a great deal of information on the internet that readers can check out. My disagreement with O'Shaughnessy approach is his sole quantitative focus. Unlike the author I believe there is a place for qualitative old-fashioned bottoms-up fundamental research.

Currently in its fourth edition, and with 720 pages of content, the book is a steal at under $30 at Amazon.com and I wholeheartedly recommend it.

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Check This Out!

Free Book:

Professor Pablo Fernandex of the IESE Business School of the University of Navarra published a book entitled "Valuation and Common Sense". This book is in its fourth edition and is available for free. I have not read the book but it's free and the content looks interesting. According to the author "The book explains the nuances of different valuation methods and provides the reader with the tools for analyzing and valuing any business, no matter how complex. The book uses 202 figures, 336 tables, 160 examples and 900 comments from readers to help the reader absorb these concepts."

The book's 39 chapters have to be downloaded individually. These can be accessed via the table of contents which can be found in either of the below links. The first link takes you to the professor's university page where you can find all the tables and figures used in the book

http://web.iese.edu/PabloFernandez/Book_VaCS/valuation%20CaCS.html

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2209089

Shake Shack IPO:

Some rough facts about this burger joint:

- $65 million total assets prior to the offering. 63 total current stores, comprised of: 31 domestic company-operated Shacks; 5 domestic licensed Shacks; and 27 international licensed Shacks.
- Strategy: "The company continues to expand slowly and plans to open 10 new outlets in the U.S. every year with a goal of reaching 450 in the long term."
- Expansion will mean lower margins as Manhattan Shacks have an operating margin of 31% versus 21% for non-Manhattan Shacks.
- CEO Garutti and Founder Danny Meyer discuss the IPO and plans on Bloomberg. See video: http://goo.gl/ZF0DBq
- With a market cap of around $1.5b, and LTM Sales of around $107m, the stock trades at 15x sales.
- Sales growth quarter-on-quarter was 15%, year-on-year was 40%, but same store sales was up 1.2%.

Looks expensive to me. My advice to the excited: Stay away.

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Hal 9000 Investing

$$Z(v) = \frac{1}{\sqrt{\pi}} \int_{-\infty}^{\infty} \frac{e^{-t^2}dt}{t-iv} = i\int_0^{\infty} e^{-vt-t^2/4}dt \qquad \int_{-\infty}^{\infty} e^{-x^2}dx = \left[\int_{-\infty}^{\infty} e^{-x^2}dx \int_{-\infty}^{\infty} e^{-y^2}dy\right]^{1/2} = \left[\int_0^{2\pi}\int_0^{\infty} e^{-r^2} r\,dr\,d\theta\right]^{1/2} = \left[\pi\int_0^{\infty} e^{-u}du\right]^{1/2} = \sqrt{\pi}$$

In this article, I will briefly present the Piotroski F-Score and show the output from screening the Russell 3000. Joseph Piotroski received a B.S. in accounting from my alma mater, the University of Illinois in 1989. He worked as a senior tax associate at the firm Coopers & Lybrand before receiving an MBA from Indiana University in 1994, and a Ph.D. in accounting from the University of Michigan in 1999. He taught at the University of Chicago and is currently at Stanford. Piotroski is known for a paper he wrote in 2000 entitled "Value Investing: The Use of Historical Financial Statement Information to Separate Winners from Losers."

In the paper, Piotroski presented a model which outperformed the market. He calculated a score with a maximum of 9 points based on 9 questions he asked from each company. The highest returns came from companies that were among the cheapest 20% of stocks based on Price to book and that had a score of 8 or 9. This model returned 23% over the backtest period. The nine questions are:

1) Is net income positive? (1 point if positive).
2) Is operating cash flow positive? (1 point if positive).
3) Net income growth > Total asset growth (1 point if true)
4) Operating cash flow > Net income (1pt if true).
5) Total asset growth > Total liabilities growth (1pt if true)
6) Current ratio is higher this year vs last year. (1pt if true).
7) Shares outstanding decrease (1pt if true).
8) Gross margin is higher this year vs last year. (1pt if true).
9) Sales growth > Asset growth (1pt if true).

To see the entire paper please go to the FatAlpha website, click on Articles and scroll down to "Priceless Academic Papers". On February 5th, I ran a screen of the cheapest 20% in the Russell 3000 based on price to book and which had a Piotroski F-Score of 8 or 9. The result from this run are the following stocks: ACCO, BCOR, CHK, CPE, LRN, NFX, OC, OMG, PEIX, TEX, TRK.

ACCO is actually a holding in my portfolio.

Please note once again that the results from this or any other screens are not recommendations and I have not checked the integrity of the data or the inputs. This page is meant to provide some food for thought.

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Contributor Article

Greece: What's a Hellenic Republic to Do?

Sovereign and corporate balance sheet advisors are normally somewhat between discreet and secretive, partly so as not to draw too much attention to a client that may be struggling, but also because they don't perceive it as appropriate to provide personal opinions about topics such as debt relief or to hog the limelight, in contrast with the proverbial corporate finance rainmaker. This we feel described Lazard and its approach to running spreadsheets and interference on behalf of countries such as Argentina and Cote d'Ivoire, among others. However, once the spotlight on its renewed Greek advisory contract became too much, its leading figures were forced to open up about strategy and tactics, past and present.

Naturally, it's the objective of a financial advisor to provide the best advice for his client, but if the tactics prove too successful in the short run, they might prove unsuccessful in the long run, by delaying market access when this would be helpful towards fuelling a nascent recovery. On the other hand, it has become quite clear that having been thrust under the spotlight, Lazard will be publicly pushing for more debt relief for Greece than would otherwise have been the case. In addition, it is worth noting that the measure of a good advisor is its ability to work equally as well with political masters across the spectrum, and in the Greek example, this should not go unnoticed.

It is widely acknowledged that the current public debt stock equivalent to about 170% of GDP is unsustainable, and although the examples of Portugal and Italy suggest that ratios above 120% of GDP need not be disastrous to funding or growth prospects (five year government bond yields being around 1.5%) – the IMF projects Greek government debt around that level by 2020 – there remains the open question of how this country will get there. Moreover, the IMF readily admits that the 'fiscal adjustment' to date 'has been extraordinary by any international comparison.'

As a result, it is conceivable that the IMF will push the EU to agree to debt relief on the Greek public debt stock, but let's not forget that bondholders have already agreed to significant haircuts, and there are a variety of ways to reaching other debt reduction goals, beyond simply reducing the nominal amount of principle owed. A face saving technique would be to lower the annual coupon payments and stretch out the maturities, and this would be more politically amenable to creditor countries as well.

A principal write-down coupled with the type of 'GDP warrants' already attached to rescheduled private debts, and actually a concept which is decades old, would be a fair compromise in theory, but in practice it will be a fine line between future Greek governments paying a fair extra amount and public opinion in one country or another believing it has under- or over-paid. In addition, this type of renegotiation would take many months, if not years, perhaps stretching beyond Syriza's initial mandate.

In any case, its politicians will have to tone down the rhetoric if they wish to convince the wealthier creditor nations of the desirability of any kind of debt reduction, because after all Greece remains an upper income country, and the hard-line strategy could quickly backfire as regards an international public opinion which for now remains quite supportive.

Richard Segal
Economist
Jefferies

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Trades

Date: **January 21st & 28th, 2015**
Ticker: UFS
Name: Domtar
Transaction: Sold & Bought
Price: $39.22 & 37.25
Size: No change planned (temporarily halved)

Note:
The stock had a one-day jump for no apparent reason. I found no news through the official channels or the social networks so I decided to sell the position and re-enter on a retrace. This is not the type of trade I do frequently, and is actually quite rare for me. This stock has had some volatility since I've been watching it and came to the conclusion that this was just another one of those days. As the average volume is about $2.5m a day then the movements can be influenced by any institutional activity. So I decided to sell the entire position at $39.22 on the 21st and on the 28th I got back in.

Date: **January 27th, 2015**
Ticker: SANM
Name: Sanmina
Transaction: Bought
Price: $21.55
Size: Added a small amount to position

Note:
Company posted great numbers for the quarter with sales, operating profits and eps all up in the double digits. The market did not like the outlook figures which will be down sequentially, however year-on-year they still represent growth. An exaggerated sell off occurred which represented an opportunity to add a small amount of shares to the position.

Date: **January 26th, 2015**
Ticker: ANTM (ex-WLP)
Name: Anthem (ex-Wellpoint)
Transaction: Sold
Price: $138.70
Size: Reduce Position

Note:

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Anthem (aka Wellpoint) has been my largest position (excluding the periodic holding of SPY) for a long time now. As fears of health care doom and gloom faded away, the market recognized value and pushed this stock to new highs. The result has been a push that is moving away from value. On this I sold half the position and will be further reducing.

Date: **January 16th, 2015**
Ticker: ONVO 17JAN15P 3.0
Name: Organovo Holdings
Transaction: Expired
Price: $0
Size: Exit Position

Note:
The options expired worthless. It was a tiny position which was initiated as the short borrow rate was extremely high. This turned out to be a mistake as the time value was costly. While I made a profit on the August puts in 2014, had I put on a synthetic short the end result would have been different. This stock caught my attention at around $9. It is currently $6 so the direction was spot on but the execution failed. And while this company has never made money, made huge claims and has only shown minimal success there still is a following.

Date: **January 8th, 2015**

Ticker: TRN
Name: Trinity Industries
Transaction: Bought
Price: $27.14
Size: New Position

Note:
Trinity Industries is involved in rail (railcars and parts), railcar leasing and management, construction products (highway safety products, and lightweight and natural aggregate), inland barge (manufacturer of barges used to transport cargoes on U.S inland waterways), and energy equipment (wind towers). The company has been growing at double digits with operating margins in the high teens, and its backlog of railcar units is at an all time high of 51k units. The stock has dropped due to two factors: 1) the drop in oil prices which could hurt demand for railcars, and 2) a $175m jury ruling against it for not consulting with the Federal Highway Administration (FHWA) about changes to its guardrail product. The company has appealed but according Trinity's Q3 results, the damages may balloon to $702m plus attorney fees, costs and interest if they lose. It should be noted that the lawsuit was initiated by a former competitor while the FHWA continues to approve the product and validated the change in question years ago. So it looks like there is a good chance Trinity wins. Even if the ruling goes against the company, it has over half a billion in cash with capacity to raise debt if needed (current debt/ebitda is 2.5x). The larger risk of a loss is a drag on both the story and the stock as further damages are awarded. I suspect there is a good chance of a rebound and an exit from this stock before all the above is played out.

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Date: **January 7th, 2015**

Ticker: AXL
Name: American Axle
Transaction: Bought
Price: $22.74
Size: New Position

Note:
This stock has been on the move with one of the best six month performances in the market. In addition it is among the cheapest 10% of all stocks in the Russell 3000, so we have momentum with value. Recent results have been great with sales rising 16% and operating profit 26% in last quarter. FCF for the last twelve months is at its highest levels in years. It has a high dependence on GM as 60-70% of revenue is generated via sales to GM. However, according to Morningstar, GM has one of its best quality and design car models in decades. Sales are up at GM in the last six quarters and auto industry in the U.S. finished 2014 strong, with automakers reporting Monday that December sales increased 10.9% year over year to 1.5 million.

Date: **January 5th, 2015**

Ticker: VOYA
Name: VOYA Financial
Transaction: Bought
Price: $40.91
Size: New Position

Note:
The company is a spin-off from ING which offers retirement (58% of operating earnings before taxes), insurance (25%) and investment (17%) solutions to around 13 million individual and institutional clients via over 220,000 points of distribution. It is the 2nd largest provider of defined contribution retirement plans in the US based on number of plans and is in the top five in both life insurance and medical stop loss coverage. ING still holds a stake which has been constantly reduced over time as the company has been buying back stock.

Date: **January 5th, 2015**
Ticker: AAPL
Name: Apple
Transaction: Bought
Price: $106.52
Size: New Position

Note:

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Apple is a consistent double digit income statement grower. There aren't many companies that have been able to grow at Apple's rate. In this elite group we find that Apple is one of the cheapest. The story here is growth at a reasonable price. The 6 plus appears to be a huge success as it has appeared in the hands of friends worldwide, including small Cyprus. Another for the purchase is the relatively high amount of SPY in the portfolio due to sale of positions. It makes more sense to hold AAPL rather than SPY as it is a superior holding relative to the average S&P stock. Plus the S&P is unlikely to move without its largest holding.

Date: **January 5th, 2015**
Ticker: COF
Name: Capital One
Transaction: Sold
Price: $80.85
Size: Reduced Position

Note:
Capital One has been reduced because of the addition of VOYA (another financial services company). This has been done so as to keep the allocation to financial services lower (around 12% vs 10% in December). The other two positions in financial services is VOYA (retirement, investment management, insurance) and WRB (insurance).

Date: **January 2nd, 2015**
Ticker: CTB
Name: Cooper Tire & Rubber
Transaction: Bought
Price: $34.63
Size: Added to Position

Note:
Increased size of position as initial position established was lower than planned.

Date: **January 2nd, 2015 & January 5th, 2015**
Ticker: NSIT
Name: Insight Enterprises
Transaction: Sold
Price: $25.04 & $24.84
Size: Exit Position

Note:

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I began exiting the position in December as it has moved out of value. Sold the remaining position this month.

Commentary (Continued from page 1)

since the early month purchase), and the short position in Keurig Green Mountain (GMCR) which dropped another 7% for a second month in a row. GMCR is the only short position in the portfolio at the moment but I expect that I will be adding additional shorts this year. GMCR is a good example of how selective shorts can help enhance returns even a bull market. The worst performers included ACCO (-12%), COF (-11% but is any bank stock doing well these days…), HPQ (-10%) and SANM (-10% which I added to on the exaggerated move down).

2015 started with another down month for January. This brought out the bears last year who quoted the January Barometer which predicted a down year. This year, not only do we have the January Barometer against us, but also the "Super Bowl Market Predictor". This states that if a team from the old American Football League wins (as the Patriots did on February 1st), the market will fall that year. And apparently it's got an 81% success rate (http://goo.gl/t6NirD). On the other hand we are in the third year of a presidential cycle. This indicator would suggest that the market will close up. Now what does this mean for us? The truth? Nothing at all. It's all history and play with numbers. Sure it's fun to know and I enjoy following these predictors, but we don't invest based on spurious correlations. We invest based on research, opportunity and risk.

Now please go back and read the opening quote from David Einhorn. So simple but yet ignored. Investors look at a market that is down and think it can't fall any further. They try to bottom pick. This has been seen repeatedly in stocks but also in broader markets (eg. Europe, Greece, Emerging Market, etc) and asset classes (eg. bonds, commodities, currencies, etc). People feel comfortable with what they now and that is closer to home. This may work if you live in the U.S. and you decided to buy some shares in your health care provider that happens to be a multi-billion dollar market cap company in the S&P 500. But if you live in almost any other country then the result can be shocking. How do shareholders in Greece feel after the recent devastating drop? Or how about those bailed in banks in Cyprus that saw their shareholders wiped out? So my advice is to ignore the past and study the current situation and valuation. Furthermore risk is critical to evaluating the asset allocation. Just because you may feel strongly about an investment doesn't mean you go all in with your portfolio. But it's not just individuals who act recklessly, it's also funds as some poor investors found out after the move in the Swiss franc wiped out $800m in investor money (see: http://goo.gl/OQZrLx)

Kipling had an article entitled 30 smart ways to invest $1,000 (see: http://goo.gl/TyFBKm). One example was to build a high yield ETF portfolio via buying the HYG, PFF, and VNQ. Personally, I have recommended to friends who want to start investing in a small way to look at some indexing choices. However, I would like to warn investors that they need to take note of the costs involved. For example, if you put on the Kipling trade and use a $9.99 broker then it will cost you almost 3% in commissions just to buy! Then you may incur annual account fees. For example, my broker charges $10 a month minus monthly commissions, which means that if you just buy and hold then you may end up with 12% in account fees a year with a $1,000 account! So the size of the portfolio is important. And it works both ways. If a fund is too big then due to size the investable universe shrinks. This means fewer opportunities and thus again lower returns. If feel that investing is exciting then be prepared for loses. This is serious stuff and "good investing" is a lot less fun than it looks on Bloomberg and CNBC.

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