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Intrinsic Value Wealth Report

Editor: Dr. Paul M. Wendee

INSIDE THIS ISSUE:

INDICES

(Close as of 10/31/17)

DJIA	23377.24
S&P 500	2575.26
NASDAQ	6727.67
10-YR TREAS	2.374%
GOLD	$1,267.00

Our Proprietary Award-Winning* Stock-Picking Model, *The Cassandra Stock Selection Model*, Was Established In 1994.

The Cassandra Model's Multi-Factor Score (MFS)

The Cassandra Stock Selection Model that I developed in 1994 is a quantitative model. It has a twenty-three year history of performance and an excellent track record. It is a quantitative model algorithm that incorporates both human and computer input; and number crunching analysis. The proprietary algorithm that I developed for the Cassandra model looks at the health and financial strength of a company; assesses the growth prospects for the company; and tries to ensure that one is paying a reasonable price for the company. It could be considered a "growth at a reasonable price" model (a term believed to have been coined by legendary investor Peter Lynch).

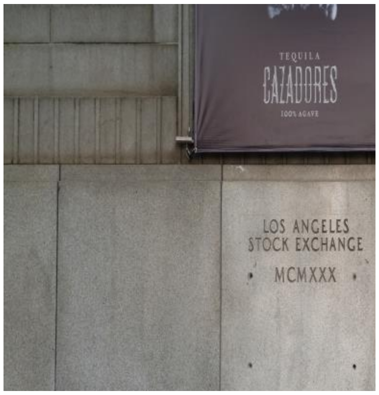
The core component of the Cassandra model is the **Multi-Factor Score (MFS)**, which is generated by the model. Stocks that have a MFS of 0% to 40% are considered "Buy" candidates; stocks with a MFS of 40% to 60% are in the "Hold" range; and stocks that have a MFS of 60% to 100% should be looked at as possible "Sale" candidates (or a reduction in the proportion that the stock represents in the portfolio). For more background on the Cassandra Stock Selection Model, please see the article entitled: The Cassandra Model: "Quant Lite", which was posted on May 28, 2017 in the online version of the Intrinsic Value Wealth Report (IVWealthReport.com).

Economic and Investment Review

The U.S. economy, as measured by Gross Domestic Product (GDP), grew at a seasonally inflation-adjusted rate of 3.0% in the third quarter due to rising stock prices; increasing business and consumer confidence and spending; and a higher level of exports. So far, the economy is in its ninth year of what has been a very slow growth cycle, growing at only a 2.2% per year average growth rate. There is much hope that the economy is finally picking up steam.

Business investment has been picking up, with an 8.6% increase in spending on equipment in the third quarter. Consumers increased their spending 8.3% on durable goods in the third quarter. However, wage growth has remained stubbornly low. Reflecting an improving global economic environment, Eurozone growth, while slowing somewhat, still registered a respectable 2.4% growth in GDP in the third quarter. There has been stronger consumer, business, and investor optimism, which have all increased since the election. Businesses in particular have been encouraged by the Trump Administration's pursuing a rollback in regulations; an overhaul of the tax code; and other pro-business policy changes.

It is still too early to tell if the strong third quarter results represent a trend, or just a short-term aberration. In its nine years of expansion, the U.S. economy has had many false starts. In a recent poll of economists (continued on back page)



Above, the now empty headquarters building of the Los Angeles Stock Exchange and the Pacific Stock Exchange on Spring Street in Los Angeles. It served as the headquarters from 1931 to 1986. The Pacific Stock Exchange was later moved to San Francisco.

Focus List

The Cassandra Stock Selection Model ***Focus List*** spreadsheet and notes can be found in the **Supplemental Materials** section of this newsletter.

Cassandra Stock Selection Model Candidate List

The Cassandra Stock Selection Model spreadsheet and notes can be found in the **Supplemental Materials** section of this newsletter.

A good way to think about this spreadsheet is that it is a list of pre-screened and ranked stocks that are in raw data form and can be "mined" by the user of the research.

Stock Market Valuation

Our estimates of the market valuations for two stock market indices, the Dow Jones Industrial Average (DJIA) and the Standard & Poor's 500 (S&P 500), can be found in the **Supplemental Materials** section.

Stock Highlight: Penske Automotive Group (PAG)

Penske Automotive Group, Inc. (PAG) is the second largest retail automotive dealer in the U.S. It operates 355 franchises worldwide (164 of the franchises are located in the U.S., with most of the other franchises located in the U.K.).

Our estimate of the fair value (intrinsic value) of this stock is $57 per share. Given the current price of $46.32 (as of 10/6/17), the stock is currently undervalued about 19% by our estimate. The company's fundamentals look attractive. The P/E ratio of 11 is below its 5-year average P/E ratio of 12.5. The company has had a strong 5-year growth in earnings and sales of 15.8% and 12.6%, respectively. Further moderate to strong growth is expected. While it is a narrow margin business, 5-year ROE has grown 17.8%. Its current ROE is 19.5%.

In the third quarter, Penske Automotive Group reported an increase in revenues of 7.2% to $5.5 billion; and an increase in earnings from continuing operations of 6.8% to $1.10 per share. These were unexpectedly good results, as the company had not been expecting results this good due to fallout to their business from hurricane damage and business interruption in several key states.

Penske Automotive Group has been growing through acquisitions and franchise expansion. PAG has acquired CarSense in the U.S. and CarShop in the U.K. Both of these companies, which sell used cars, have helped PAG expand further into the used car market. With much of its business coming from the U.K., the company remains vulnerable to foreign exchange rates.

The Retail Automotive Industry has appealing long-term appreciation potential. The industry is composed of two parts: (1) dealerships; and (2) automotive replacement parts and services. The dealership part of the industry is significantly affected by macroeconomic trends, and as such will rise and fall with the economy. The steady, but slow, growth in the economy has benefited the dealership part of the industry in the last few years. The strong growth experienced by the dealership part of the industry has started leveling off, though, making the near-term prospects somewhat uncertain. The entire industry has also benefited on a short-term basis from the demand for replacement vehicles and repair and maintenance on vehicles resulting from the recent hurricanes (which also hurt their businesses due to business disruptions). The industry tends to be a stable and profitable business with a diversified stream of revenues (new and used auto sales, auto financing, parts, and service). As the industry continues to grow through acquisitions and expansion, the strong companies within the industry can be expected to grow over the long-haul.

With Penske Automotive Group's leading position in the industry and strong financials, we like this company for the long-haul. The 2.55% dividend yield is attractive as well and should cushion some of the downside that might be experienced in this stock if the markets decline. We have assigned this company a very attractive Multi-Factor Score (MFS) of 36.0%.

Original Report October 6, 2017; Revised Report October 31, 2017

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Convertible Securities

"Because of the convertibility feature, these 'hybrid' securities reflect movements in both stock prices and interest rates."

Convertible securities include financial instruments such as convertible bonds, convertible preferred stocks, and warrants. Convertible securities can be converted into common stock at the holder's option. Because of the convertibility feature, these "hybrid" securities reflect movements in both stock prices and interest rates. To learn more about convertible securities, there are many excellent articles and books on the subject. One reference that we have found particularly helpful is: Knecht, L. and McCowin, M. (1989). Valuing Convertible Securities. In Fabozzi, F. (Ed), Advances & Innovations in the Bond and Mortgage Markets (pp. 97-116). Chicago: Probus. Periodically, we choose a convertible security to highlight in this newsletter. The stocks underlying the convertibles we review are ranked by the Cassandra Model in the same manner as other stocks in our Cassandra Stock Selection Model Candidate List. You can find our highlighted convertible securities in the Supplemental Materials.

The Wealth Creation Pyramid

The Wealth Creation Pyramid is designed to show some of the major categories for building wealth. It is the result of many years of study of the wealth building process; experience working with clients who have built considerable wealth; and my own personal experience building wealth.

Newsletter subscribers should consult *The Wealth Creation Pyramid* as one of many useful investment tools while considering their investment plans. *The Wealth Creation Pyramid* can be found in the **Supplemental Materials** section of the newsletter.

Financial Planning Tip of the Month: The Six Essential Concepts of Investing

"They are more than just simple rules – they are critical concepts which will determine the success or failure of an enterprise."

As an academic and practitioner in the field of enterprise value analysis and creation, I have studied extensively the methods used and philosophies that successful investors have to select their investments. In a field of endeavor such as this, I find it useful – critical actually – to synthesize the methods and philosophies of successful investors into a few broad concepts. I have been an investor since I was thirteen years old and have been a professional investment banker, securities analyst, and investment portfolio manager for thirty-six years – so I have been at this endeavor of discovering the successful investment strategies for quite some time. I have boiled all of this down into what I call *The Six Essential Concepts of Investing*. I will introduce these concepts in this issue of the Intrinsic Value Wealth Report. We will explore each of the six concepts in future issues of the newsletter. Whether you are an investor, or an entrepreneur creating an enterprise - and whether your enterprise is large or small, private or publicly traded - you should always consider the following six concepts:

1. Does the enterprise have very large market opportunities;

(Continued on next page)

Alternative Investments

Alternative Investments can provide very attractive returns, but also generally carry a much higher level of risk. Accordingly, they are placed higher on *The Intrinsic Value Wealth Creation Pyramid (TM)*. There are many different asset classes that are considered Alternative Investments. The following are some of the more common Alternative Investment asset classes:

Alternative Investment Asset Classes

- Real Estate
- Oil and Gas
- Private Equity

Potential Benefits of Alternative Investments

- May reduce the overall volatility of your investment portfolio
- May provide greater investment returns
- May provide greater diversification
- May provide greater investment flexibility

Please see *Book #4 – The Intrinsic Value Wealth Creation Pyramid* for a listing of some Alternative Investment sponsors. Also included in this listing are some other considerations that one should make before investing in these types of investments.

Announcements

The next meeting of the San Diego Chapter of **Private Capital Networks/ArchAngels** is scheduled for November 28, 2017 from 2 pm to 5 pm at the offices of Mintz Levin in San Diego. **Private Capital Networks/ArchAngels** is a group of angel investors that review earlier stage companies in which to make a possible investment. Dr. Wendee is the co-founder of the San Diego chapter.

Dr. Wendee will be attending **The National Due Diligence Alliance (TNDDA)** meeting in Florida in November to review Alternative Investments.

Dr. Wendee will be speaking at the San Diego Chapter of the **American Association of Individual Investors (AAII)** on January 13, 2018. The subject of his talk will be *quantitative investing*.

The Six Essential Concepts of Investing

(Continued from previous page)

2. Does the enterprise have an unfair competitive advantage;
3. Does the enterprise have a business model that can take the large market opportunity and the unfair competitive advantage and make it all work;
4. Does the enterprise have a management team that can make the business model work;
5. If you are investing in an enterprise (as opposed to being an entrepreneur creating the enterprise), can you acquire the enterprise at a price (or valuation) that compensates you for the investment risk you are taking; and
6. Whether you are the investor or entrepreneur, you must keep in mind that "luck" plays a significant role in the success of any enterprise. There are ways to account for and control the "luck" factor, but you must first recognize that luck (good and bad) is a factor.

The six concepts are broad, but embody most of what successful investors and entrepreneurs consider when embarking on or investing in an enterprise. They are more than just simple rules – they are critical concepts which will determine the success or failure of an enterprise. Each one will be explored in upcoming issues of this newsletter.

Supplemental Materials

The Intrinsic Value Wealth Report is published in two parts: (1) the main newsletter; and (2) a supplemental materials section. *The Intrinsic Value Wealth Report* is packed with useful investment information for investors. Because there is so much content in the newsletter, we publish it in two parts comprised of several PDF files to make it easier to access the material.

Be sure to review all of the supplemental material, as a great deal of the useful information in this newsletter is found in the **Supplemental Materials** section of this newsletter. You can find these materials at the Supplemental Materials link or by signing into IVWealthReport.com.

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Economic and Investment Review (continued from page 1)

conducted by the Federal Reserve Bank of Philadelphia, the forecasters expect growth of 2.1% in 2017, and lowered their outlook for growth in the U.S. economy to 2.4% in 2018, 2.2% in 2019, and 2.0% in 2020. All of these targets are far below the 3% growth rate in the third quarter, indicating non-sustainability of the third quarter trend. Inflation picked up somewhat this past summer, but still remains below the Fed's 2% target. The Fed is expected to leave rates unchanged at its November meeting, but to have one more rate hike before year end.

On a longer term basis, there are several trends which have been a drag on the economy; and which don't appear to be improving anytime soon. The first is U.S. worker productivity, which has been sluggish for more than a decade. Slow productivity growth can prevent wages from rising and can slow economic growth. The second disturbing trend is the labor force participation rate, which is currently around 63%, having declined from above 67% in early 2000. A low labor force participation rate holds the economy back from achieving its full potential. Going forward, two further trends pose long term concerns. The first is a sharp increase in lending to the most highly leverage companies, not just in the U.S., but worldwide. Such lending has risen by more than half this year. The risk of such excessive lending can be seen in the recent Toys "R" Us, Inc. bankruptcy filing. Toys "R" Us, Inc. had been significantly leveraged. The second major trend posing a possible risk to the economy is the unwinding of the Fed's $4.2 trillion bond portfolio, which was bought to stabilize the economy after the 2008 financial crisis. Finally, the U.S. savings rate fell to a 10-year low of 3.1%, down from 6.3% two years ago. This might partially reflect unusual spending due to recovery efforts from damages sustained from Hurricanes Harvey and Irma. But, it could also be due to a *wealth effect* resulting from low unemployment and rising housing and stock prices. Low savings rates can persist for long periods of time; but have been associated in the past with financial bubbles that collapsed. And it is important to note that due to in large part to the low wage growth, consumer incomes have not risen sufficiently to sustain solid economic growth.

The markets are, in our opinion, very overvalued. The stock market is up significantly for the year, placing too much of a premium on the economy's improvements. Accordingly, in this overvalued market we would recommend caution in making new investments. We believe it is important to maintain a long-term view toward investing. This means that you should continue building your investment portfolios; but keep in mind that because of the market's overvaluation, the market overall is not in a bargain state. As always, use the Cassandra Model to select individual securities that do offer growth and value opportunities in this market.