November and December 2017

Volume 6, Issue 11/12

Intrinsic Value Wealth Report

Editor: Dr. Paul M. Wendee

INSIDE THIS ISSUE:

INDICES

(Close as of 12/15/17)

DJIA	24651.74
S&P 500	2675.81
NASDAQ	6936.58
10-YR TREAS	2.353%
GOLD	$1,254.30

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

A Tale of Two Companies

In the October 2017 issue of the Intrinsic Value Wealth Report, I introduced *The Cassandra Stock Selection Model*. The core component of the Cassandra Model is the **Multi-Factor Score (MFS).** 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 a possible "Sale" candidate. One of the key features of the MFS is its ability to monitor stocks on an ongoing basis. The same factors that are used to pick stocks initially are monitored to help us decide when to sell the stocks.

Here is how the MFS works in the monitoring phase. If the health and growth factors remain constant, and the price goes up, the MFS will increase to the *hold* and *sell* ranges. If the price remains constant, and the fundamentals of the company deteriorate, the MFS will also increase into the *hold* and *sell* ranges. The MFS will also change if all of the factors are changing together (i.e., price, health and financial strength, and growth prospects).

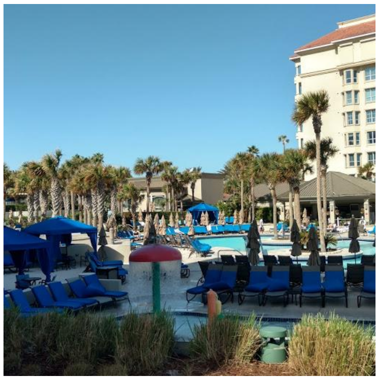
I have constructed a data table using two case studies, Apple, Inc. and General Electric Company, to illustrate how this actually works in practice. Please click the link, A Tale of Two Companies, to access the table.

Economic and Investment Review

Recent economic reports and data suggest that the U.S. economy may finally be getting on a solid footing. The U.S. economy, as measured by Gross Domestic Product (GDP), grew at a seasonally inflation-adjusted rate of 3.3% 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 in a sustained manner.

Business investment has been picking up, with an 8.6% increase in spending on equipment in the third quarter. After-tax corporate profits, without inventory valuation and capital consumption adjustments, rose 4.9% in the third quarter, which was 10% higher than in the third quarter of last year. Corporate profits had fallen 2% in the second quarter of this year. Consumers increased their spending 8.3% on durable goods in the third quarter; and consumer spending has shown growth in other areas. The latest jobs report showed that hiring remained steady, which has driven the unemployment rate down to 4.1% for two months in a row to a 17-year low. However, wage growth (continued on back page)

Focus List



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

Above, Dr. Wendee attended The National Due Diligence Alliance (TNDDA) investment banking conference, which was held November 10-12, 2017 on Amelia Island, FL. This is a conference held several times throughout the year for investment bankers and registered investment advisers to learn about new opportunities in the Alternative Investment asset classes.

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: Viacom, Inc. (VIAB)

Viacom, Inc. (VIAB) owns a valuable portfolio of cable networks and other assets. Its six flagship brands are BET; Comedy Central; MTV; Nickelodeon; Nick, Jr.; and Paramount Pictures.

Our estimate of the fair value (intrinsic value) of this stock is $53 per share. Given the current price of $26.15 (as of 11/17/17), the stock is currently undervalued about 51% by our estimate. The company's fundamentals look attractive. The P/E ratio of 5.6 is below its 5-year average P/E ratio of 12.8. While its 5-year growth in earnings (EPS diluted continuing) has been a paltry 1.4% and its sales growth has been in negative territory at 0.9%, its more recent 1-year growth of 29.4% in earnings (EPS diluted continuing) and 6.2% in sales growth show promise. Viacom's current margins are healthy at 14.1% for its net profit margin and 21.0% for its operating profit margin. The 5-year average ROE is 43.5%. Its current ROE is 36.3%.

Viacom's quarterly revenue increased 2.88% year-over-year to $3.3 billion in the fourth quarter. Earnings per share increased from $0.63 to $1.68 on a year-over-year basis. Sumner Redstone controls 79.8% of the Class A shares (which is effectively held by Redstone's daughter, Shari) through National Amusements, Inc. Mario Gabelli controls 10.2% of the Class A shares.

The company is in the midst of a restructuring plan and appears to be moving forward in its recovery efforts. The former CEO of Viacom's International Media Networks, Robert Bakish, took over full control of the company's global entertainment operations last October. His recovery plan is centered on placing more of a focus on Viacom's six flagship brands. This has resulted in the improved financial results shown in the past year.

The traditional media model is being challenged by the newer forms of entertainment delivery. Netflix in particular has been a major disrupter in the Entertainment Industry. Netflix has spent an estimated $1 billion dollars in each of the last two years on original content; and plans to spend an additional $8 billion in 2018. Amazon, Apple, Disney, and Google plan large expenditures in 2018 as well. The industry is in the midst of a wave of mergers and acquisitions, which may benefit the current industry participants. The industry must adapt to the changing tastes of a younger demographic, which can be difficult to do. As the industry faces the challenges of a changing environment from many directions, companies within the industry must adapt; or they will be replaced by companies that offer more contemporary offerings and solutions.

Viacom is a bit of a turnaround play. While it has a strong franchise, it is in the midst of a restructuring plan – which does appear to be working though. The traditional media model is being challenged by the newer forms of entertainment delivery. Viacom must be able to adapt to this changing environment, as do all of the traditional media companies. With Viacom's leading position in the industry and strengthening financials, we like this company for the long-haul. The 3.06% dividend yield is attractive as well. We have assigned this company a very attractive Multi-Factor Score (MFS) of 35.0%. We believe these shares offer significant upside potential.

"The 3.06% dividend yield is attractive…We have assigned this company a very attractive Multi-Factor Score (MFS) of 35.0%."

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 –*Large Market Opportunities*

"…you need to have very large markets to get truly blockbuster investment results. Some people call these "monster markets.""

In the October 2017 issue of the Intrinsic Value Wealth Report, we introduced **The Six Essential Concepts of Investing**. The six essential concepts that we seek to understand and use in our search for extraordinary investment opportunities are as follows: (1) A Large Market Opportunity; (2) An Unfair Competitive Advantage; (3) A Business Model That Can Make The Extraordinary Investment Opportunity Work; (4) The Right People (Management); (5) The Right Price (Valuation); and (6) The Recognition That *Luck* Plays a Significant Role. Each of the six essential concepts will be discussed in this column in this and future editions of the newsletter. In this issue, we discuss the concept of large market opportunities.

Simply stated, large market opportunities refer to the notion that you need to have very large markets to get truly blockbuster investment results. Some people call these "monster markets." Large market opportunities often lead to investment returns that yield ten times (10X), twenty times (20X), fifty times (50X), or even more return on investment. Lifestyle investments (investments such as hair salons, grocery stores, and gas stations) that

(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.

The Six Essential Concepts of Investing

(Continued from previous page)

characterize many "mom and pop" operations won't do when you are looking for extraordinary investment opportunities. You need investments that will eventually gain millions or billions of customers – enterprises such as Starbucks, Facebook, and Apple Computer. Apple Computer is a good example of an enterprise that has a monster market. Apple Computer was started in 1976 by Steve Jobs and Steve Wozniak in Jobs' garage. Apple Computer now has a nearly $1 trillion dollar market valuation. That is a monster market!

Paul M. Wendee & Associates, LLC, the Intrinsic Value Wealth Report, and the Value Driver Institute have undertaken a collaborative *future forecasting* research project to identify potential extraordinary investment opportunities. Forecasting for the future has its roots during the 1960s and 1970s at research institutions such as the RAND Corporation, a well-known think tank. Our collaborative research project is using many of the same forecasting tools and techniques that have been developed at the RAND Corporation and other research institutions that have been studying the future for more than five decades.

Announcements

The next meeting of the San Diego Chapter of **Private Capital Networks/ArchAngels** is scheduled for January 30, 2018 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 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*.

Dr. Wendee visited **The Institute for the Future** on November 20, 2017. The IFTF was co-founded in 1968 by RAND Corporation researcher Olaf Helmer to study the future and "…provide practical foresight for a world undergoing rapid change." Dr. Helmer is also the creator of the *Delphi Method* of research.

Dr. Wendee was recently named a **Research Fellow** at the Center for Global Business and Information Technology Research at the University of Phoenix.

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)

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 expected overhaul of the tax code; and other pro-business and pro-growth policy changes.

While we are greatly encouraged by the recent economic news, it is still a bit early to tell if the strong second and 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 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 3.3% 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. Accordingly, the Fed raised interest rates at its December meeting for the third time this year, and the fifth time in the last two years. The Fed also signaled that it would likely stay on a similar course of gradual interest rate increases in 2018, reflecting their optimism for the economy. The latest Fed hike seems to be an effort to simply keep the economy from overheating as it continues to expand.

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. Another concerning trend is the 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. Finally, the U.S. savings rate fell to a 10-year low of 3.1% in the third quarter, down from 6.3% two years ago. It now stands at 3.2%.

In this overvalued market use caution in making new investments. Continue building your investment portfolios using the Cassandra Model to select individual securities that offer growth and value opportunities.