# 2016 GURU PORTFOLIO PERFORMANCE REPORT

REVIEW AND ANALYSIS OF VALIDEA'S GURU-BASED MODEL PORTFOLIOS

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## 2016 MARKET OVERVIEW

We can call 2016 the year of "contrarian surprises".

The market had one of the worst starts to the year ever. By mid-February, the S&P 500 had fallen over 10% and the Russell 2000 was down nearly 16%. These losses were on top of what was a lackluster and very narrow market in 2015, where most of the gains came from a handful of large growth stocks. The fall in commodity prices, particularly oil, was dramatic and WTI crude fell below $30 a barrel (for context the price was $107 a barrel in June of 2014). GDP growth in the fourth quarter of 2015 and in the first quarter of 2016 was anemic at best, and corporate earnings were in the middle of an "earnings recession". The Federal Reserve, which had expected to raise rates throughout 2016, was on hold as growth looked as though it was stalling. Defensive sectors, including utilities, telecom and consumer staples were performing best, and fund flows were moving out of riskier asset classes and into lower risk positions.

The lower for longer, slow growth mantra, which had largely dominated the market discussion in 2014 and 2015, seemed to be correct and gaining strength. But from the middle of February to late June, the market recovered all of the losses from earlier in the year as economic indicators, including growth in in the U.S. job market, stabilized.

At the end of the second quarter, the global economy seemed to be at risk from Brexit. Almost no expert, economist, academic, poll or betting agency was predicting a "yes" vote on Brexit. Immediately following the Brexit vote, global markets fell sharply, but as the market digested the actual economic impact of Britain leaving the European Union and the time it would take (i.e. years) to fully implement the move toward independence, the market quickly reversed and within 8 trading days of the vote most markets, including the S&P and Russell, had recouped all of their losses.

During the third quarter, markets moved slightly higher and investors' attention was focused on the U.S. Presidential race. Just like with Brexit, very few pundits predicted a Donald Trump victory, and most thought the market would decline significantly if Trump were to pull out a win. Well, guess what -- since Trump's victory the exact opposite of what most were predicting has taken place and there has been a massive rotation in the market and change in leadership from large growth companies to smaller value names.

Why the rotation into these types of stocks? The primary reason is the market is expecting higher economic growth, a result of many of President-Elect Trump's pro-business policies. Third quarter U.S. GDP growth came in at 3.5%, so the growth may have already been increasing, but the market expects the policies of a Republican administration to lead to further increases. In addition, interest rates have moved higher and the market is expecting increasing rates, and higher inflation, in the future. Gradually increasing rates, slightly higher inflation and better overall growth has historically been beneficial to smaller stocks.

Everything that wasn't working well earlier in the year -- energy, financials, cyclicals, value stocks, small caps -- is what powered the market higher into year end. This bodes well for many of the stocks we hold in our portfolios. Any investor that tried to invest based on the headlines would have likely been caught flatfooted as the market changed very quickly and in very unexpected ways. So 2016 was certainly the year of "contrarian surprises", but the real winners were those who took a long term, disciplined approach with their investment portfolios and stood their ground even during times of uncertainty.

After a long stretch of relative underperformance, Validea's value-models saw a return to their outperforming ways. By the end of the year, some of our deepest value strategies were up anywhere from 2-4 times the market. Generally we believe that value stocks and strategies are set up for continued strong performance over the next few years as they revert after multiple years of trailing growth stocks.

**Continue reading to see some of the performance highlights from 2016. (Returns are without dividends and most of the portfolio performance in this report refers to Validea's 10-stock monthly rebalanced portfolios.)**

## NOTABLE 2016 VALUE STRATEGIES

**The Price-to-Sales Strategy based on Ken Fisher's *Super Stocks***

The chart on the following page shows how massive the performance of the Fisher model was in 2016. A $100,000 in the model would have been worth over $142,000 at the end of the year. As the chart shows, a large portion of those returns came in the second half of the year as value stocks and cyclical stocks began to emerge from their long slumber.

Validea's Fisher model is a value strategy that rewards stocks with low P/S ratios, long-term profit growth, strong free cash flow and consistent profit margins. The model was constructed using the approach Fisher outlined in his book, "Super Stocks". A key criteria used in the approach is the Price-to-Sale ratio (PSR), which Fisher helped popularized as a value metric. Fisher argued that sales (vs. earnings) were more stable and offered a better gauge of a company's business, and so the Price-to-Sales measure was preferred. For non-cyclical business, Fisher wanted a PSR below 0.75 to 1.5.

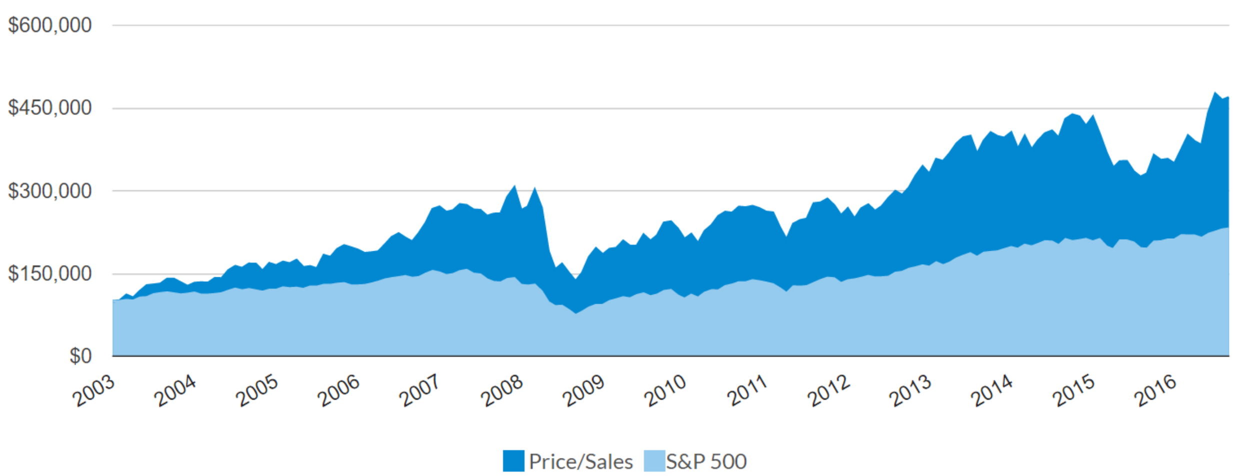
Below are some of the holdings in the portfolio throughout the year that had the biggest impact, both on the positive and negative side. During the year, the portfolio was positive on over 60% of all holdings, meaning 6 out of 10 positions appreciated in value from the buy price. Big winners included John. B. Sanfilippo & Son and Thor Industries.

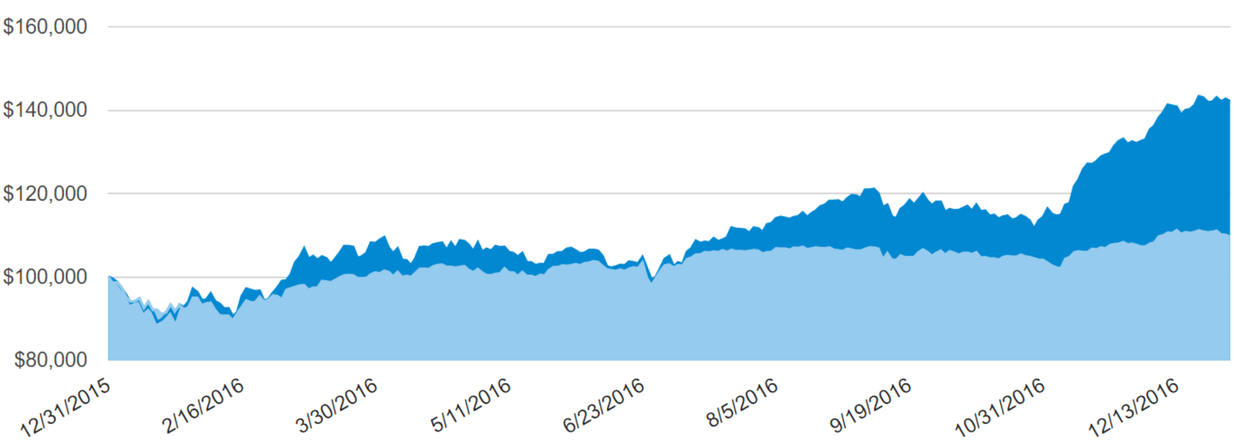
Below the table of portfolio holdings you will see two charts. The first chart shows the portfolios long term performance vs. the S&P 500, while the second shows the performance for 2016. Each chart simulates a $100,000 investment in both the model portfolio and the S&P 500.

## Price-Sales Investor Best and Worst Performers for the Year

| TICKER | COMPANY | DATE ADDED | DATE REMOVED | START PRICE | END PRICE | RETURN |
|---|---|---|---|---|---|---|
| JBSS | JOHN B. SANFILIPPO & SON, INC. | 8/26/2016 | 11/18/2016 | $49.48 | $66.99 | ^ 35.39% |
| THO | THOR INDUSTRIES, INC. | 12/18/2015 | 7/29/2016 | $55.08 | $76.54 | ^ 38.96% |
| SKX | SKECHERS USA INC | 4/8/2016 | 5/6/2016 | $26.70 | $31.43 | ^ 17.72% |
| RHI | ROBERT HALF INTERNATIONAL INC. | 3/11/2016 | Open | $42.62 | $48.61 | ^ 14.05% |
| THO | THOR INDUSTRIES, INC. | 12/18/2015 | 7/29/2016 | $55.08 | $76.54 | ^ 38.96% |
| VLO | VALERO ENERGY CORPORATION | 6/3/2016 | 11/18/2016 | $55.15 | $63.39 | ^ 14.94% |
| PWR | QUANTA SERVICES INC | 7/2/2015 | 3/11/2016 | $28.55 | $22.56 | v -20.98% |
| CALM | CAL-MAINE FOODS INC | 3/11/2016 | 10/21/2016 | $51.41 | $37.05 | v -27.93% |

## Price-Sales Investor Since Inception and 2016 Performance Charts



**The Contrarian Investor based on David Dreman's *Contrarian Investment Strategies***

The Contrarian Investor model, which was inspired by the approach outlined by David Dreman in his book, *Contrarian Investment Strategies*, is one of our deepest value models. The strategy first looks for stocks with low price/earnings, price/book, price/dividend, and/or price/cash flow ratios, and then, to separate stocks that had been beaten down because of investor overreaction from those that were outright dogs, he applied a number of other fundamental tests, looking, for example, for a high current ratio, high return on equity, high pre-tax profit margins, and a low debt/equity ratio.

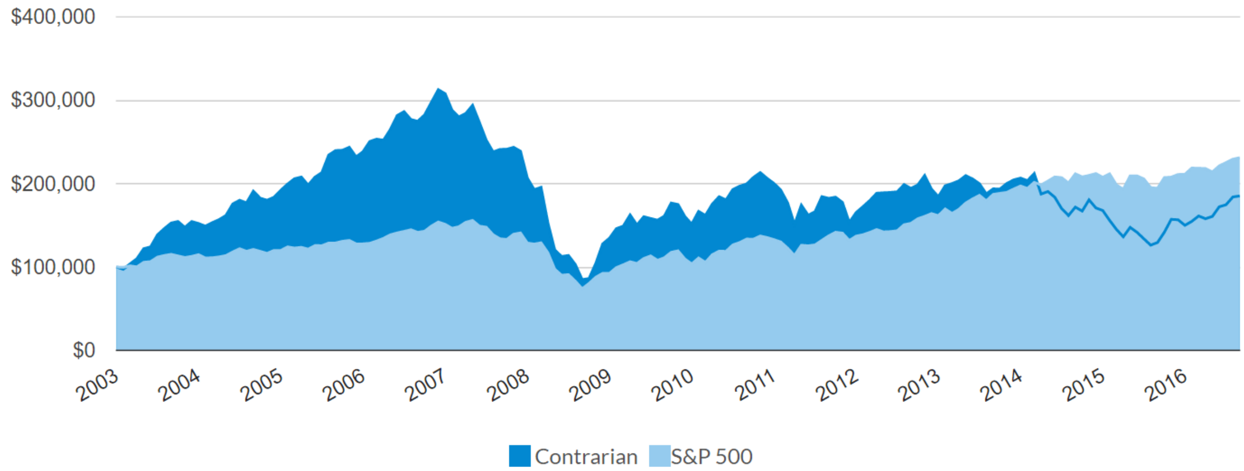
From 2003-2007, the Dreman model was one of our very best performers. Since the financial crisis, however, it's lagged the market and in some cases by a wide margin. However, 2016 could have been a turning point for the portfolio. For the full year, the 10-stock strategy produced a return of 30.5% compared to the S&P 500's return of 9.5%. The returns for this model came early, and as the year went on the portfolio continued to build on its lead over the market. This portfolio is not for the faint of heart, and after a rough 2014 and 2015, the past year helps us realize that even good value strategies are risky and can fall out of favor for multiple years, and so if you are going to invest in such an approach you need to take a very long term view.

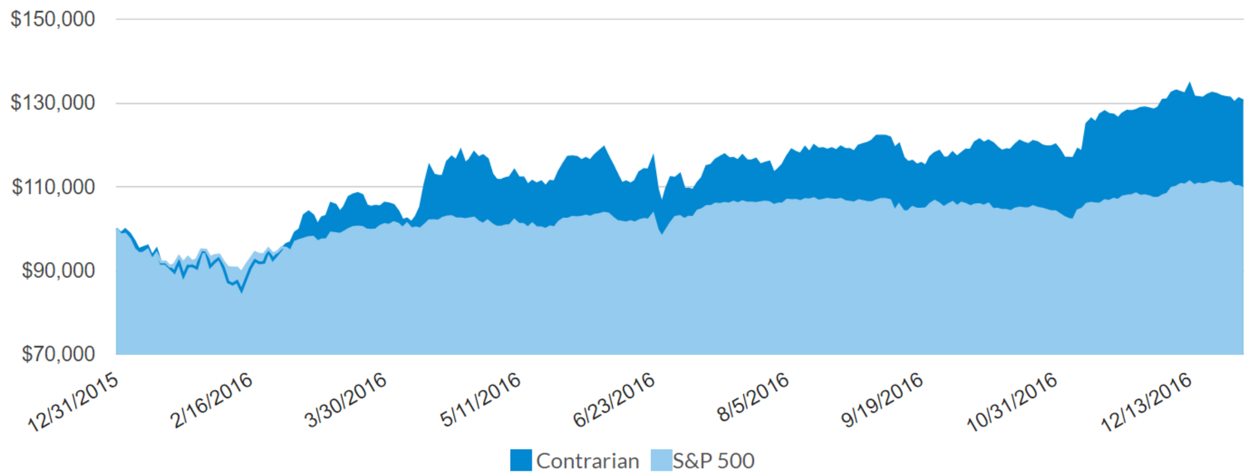
One interesting observation about the Contrarian approach is that it tends to be the model with the highest number of holdings in non-U.S. stocks. The performance of many international markets have lagged that of the U.S. over the last few years, another contributing factor to the hard times felt by the Contrarian investor model. However, there will be periods when International stocks perform much better and we expect this portfolio to be well-positioned in that type of market environment.

**<u>Contrarian Investor Best and Worst Performers for the Year</u>**

| TICKER | COMPANY | DATE ADDED | DATE REMOVED | START PRICE | END PRICE | RETURN |
|---|---|---|---|---|---|---|
| NAVI | NAVIENT CORP | 1/15/2016 | 5/6/2016 | $9.00 | $13.12 | ^ 45.78% |
| UNM | UNUM GROUP | 2/12/2016 | 5/6/2016 | $25.14 | $33.66 | ^ 33.89% |
| MTU | MITSUBISHI UFJ FINANCIAL GROUP INC (ADR) | 2/12/2016 | 9/23/2016 | $4.11 | $5.40 | ^ 31.39% |
| ASX | ADVANCED SEMICONDUCTOR ENGINEERING (ADR) | 5/6/2016 | 6/3/2016 | $4.66 | $5.71 | ^ 22.53% |
| TKC | TURKCELL ILETISIM HIZMETLERI A.S. (ADR) | 5/6/2016 | 11/18/2016 | $9.20 | $7.19 | v -21.85% |

## Contrarian Investor Since Inception and 2016 Performance Charts




**The Value Investor Model based on Ben Graham's *Intelligent Investor***

The Graham approach is based on the oldest strategy of all those that inspired our guru-based models, drawing on the stock-picking advice Graham laid out in his 1949 classic *The Intelligent Investor*. Similar to the Dreman model, the Graham deep value approach had a few difficult years in 2014 and 2015, as the chart below shows, but bounced back nicely in 2016. For the full year 2016, the Graham portfolio put up a return of 20.5%.

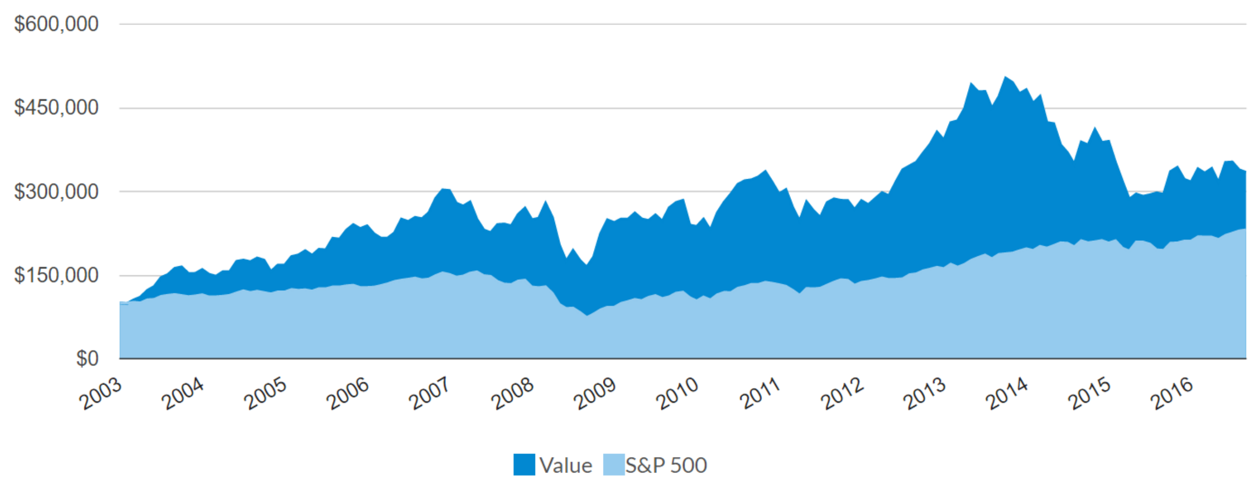
The Graham model reflects the conservative approach that Graham -- called the "Father of Value Investing" -- used. Having lived first through his own family's financial woes and then through the Great Depression, Graham focused as much on preserving capital as he did on generating big gains. He thus used some rigorous balance sheet tests to assess a business in which he was looking to invest. For example, the Graham-based model requires that a company have a current ratio (that is, current assets/current liabilities) of at least 2.0, a sign of strong liquidity. It also requires that a firm's long-term debt be no greater than the value of its net current assets.

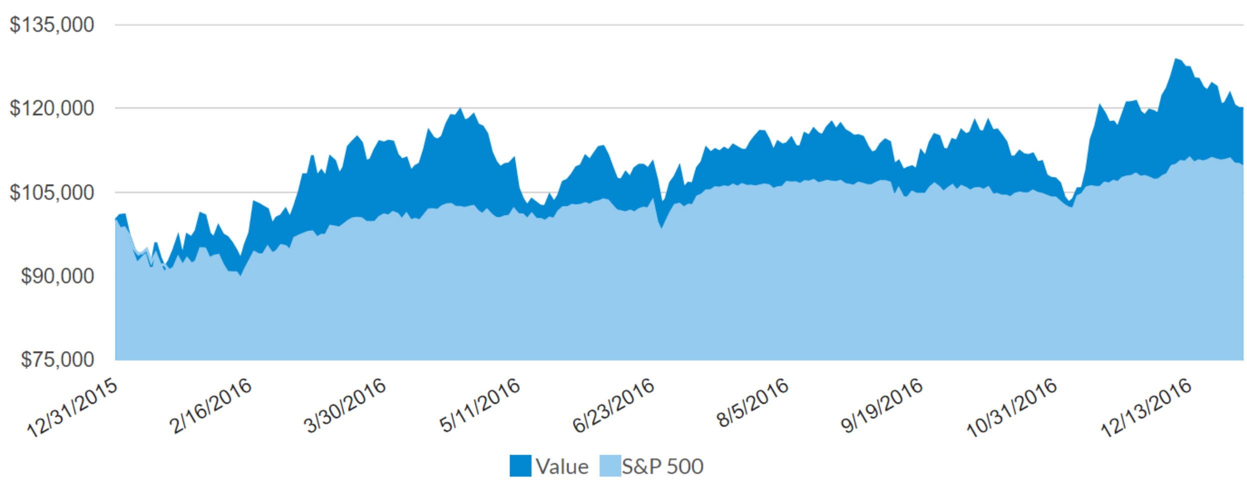
Those requirements helped the Graham approach find financially stable companies during the financial crisis, allowing it to minimize losses in what was a dreadful year for stocks.

## Value Investor Best and Worst Performers for the Year

| TICKER | COMPANY | DATE ADDED | DATE REMOVED | START PRICE | END PRICE | RETURN |
|---|---|---|---|---|---|---|
| FOSL | FOSSIL GROUP INC | 1/15/2016 | 3/11/2016 | $30.55 | $49.73 | ^ 62.78% |
| SSL | SASOL LIMITED (ADR) | 1/15/2016 | 3/11/2016 | $22.82 | $31.16 | ^ 36.55% |
| HP | HELMERICH & PAYNE, INC. | 8/26/2016 | 12/16/2016 | $62.43 | $78.70 | ^ 26.06% |
| TECD | TECH DATA CORP | 8/26/2016 | 9/23/2016 | $72.63 | $87.31 | ^ 20.21% |
| MYGN | MYRIAD GENETICS, INC. | 12/16/2016 | Open | $18.80 | $15.70 | v -16.49% |
| BKE | BUCKLE INC | 7/29/2016 | Open | $27.39 | $20.35 | v -25.70% |

## Value Investor Since Inception and 2016 Performance Charts



# NOTABLE 2016 GROWTH STRATEGIES

**The Small Cap Growth Investor Approached based on The Motley Fool**

The small cap growth strategy, which is based on a rigorous stock screen developed by the Motley Fool, continues to deliver outstanding results, year in and year out. The strategy is the best performer of all our portfolios since 2003, and it also tends to be the most consistent performer, generating positive yearly returns more than any other of our portfolios.

The Fool strategy is based on the approach that Fool co-creators Tom and David Gardner laid out in the *Motley Fool Investment Guide: How the Fools Beat Wall Street's Wise Men and How You Can Too*. The Fool-based approach centers on finding the stocks of small, fast-growing companies that have solid fundamentals. Healthy profit margins, low debt, strong cash flows, and good research and development budgets are all important to the strategy, which also uses the P/E-to-Growth ratio to help avoid fast-growing but overpriced stocks.

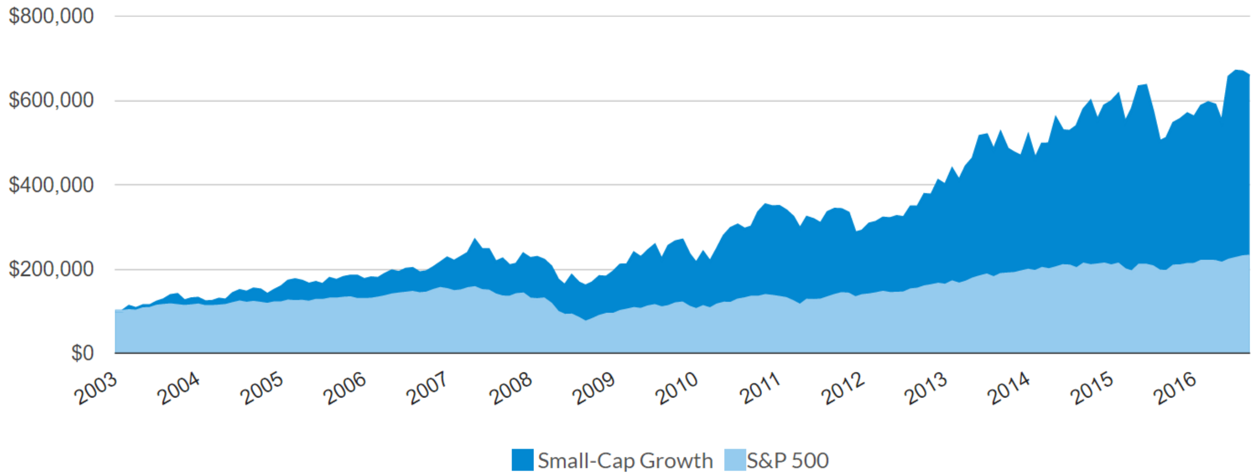
One of the additional criteria this model looks at is relative strength. Looking for stocks with strong price momentum has proven to be a long term winning strategy in academic circles, and along with value, weighting stocks by momentum has shown to be one of the factors influencing stock returns. Looking for stocks with high momentum could also be one of the factors that has helped this model, as it allows it to identify stocks in a strong uptrend while at the same time getting out of stocks, quickly, that have lost momentum.

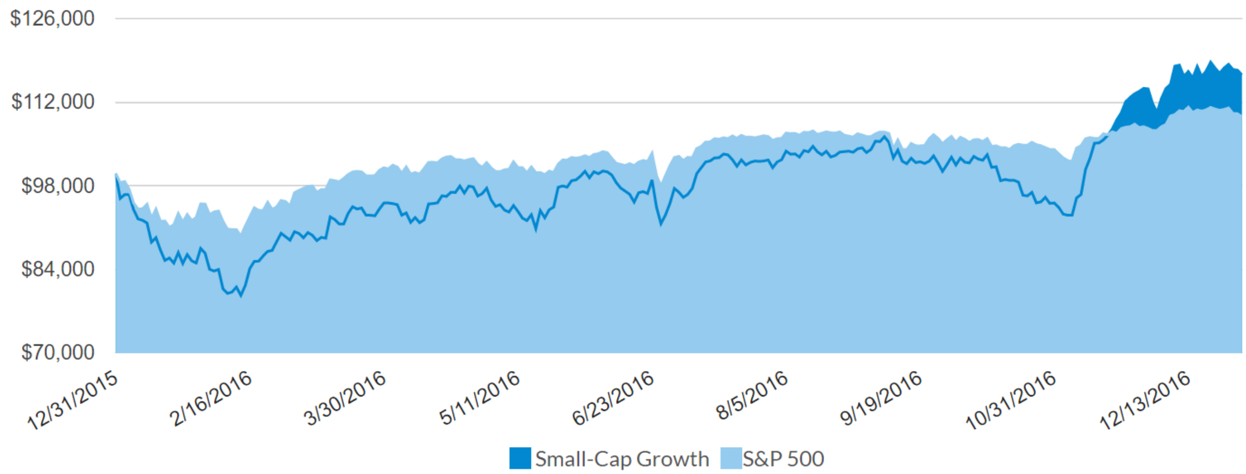
Since the portfolio's inception, the model has returned over 500% compared to the market's return of around 125%. For 2016, the portfolio returned 16.6% compared to 9.5% for the S&P. The one thing that should be noted is that the portfolio mostly trailed the market during the year, which is not a big surprise given that value stocks outperformed growth names in 2016, but in the fourth quarter the portfolio got on track and was able to finish the year ahead of the market. Overall, the portfolio has beaten the market in all but two of the last fourteen years.

**<u>Small Cap Growth Investor Best and Worst Performers for the Year</u>**

| TICKER | COMPANY | DATE ADDED | DATE REMOVED | START PRICE | END PRICE | RETURN |
|---|---|---|---|---|---|---|
| HIIQ | HEALTH INSURANCE INNOVATIONS INC | 11/18/2016 | 12/16/2016 | $9.80 | $13.20 | ^ 34.69% |
| BUSE | FIRST BUSEY CORPORATION | 10/21/2016 | 12/16/2016 | $22.74 | $29.72 | ^ 30.69% |
| PDFS | PDF SOLUTIONS, INC. | 10/21/2016 | 12/16/2016 | $18.99 | $23.59 | ^ 24.22% |
| HQY | HEALTHEQUITY INC | 10/21/2016 | 12/16/2016 | $35.63 | $40.98 | ^ 15.02% |
| LMAT | LEMAITRE VASCULAR INC | 9/23/2016 | 12/16/2016 | $20.19 | $22.99 | ^ 13.87% |
| EFSC | ENTERPRISE FINANCIAL SERVICES CORP | 10/23/2015 | 4/8/2016 | $29.71 | $25.50 | v -14.17% |
| BANC | BANC OF CALIFORNIA INC | 8/26/2016 | 9/23/2016 | $21.98 | $18.25 | v -16.97% |

## Small Cap Growth Investor Since Inception and 2016 Performance Charts



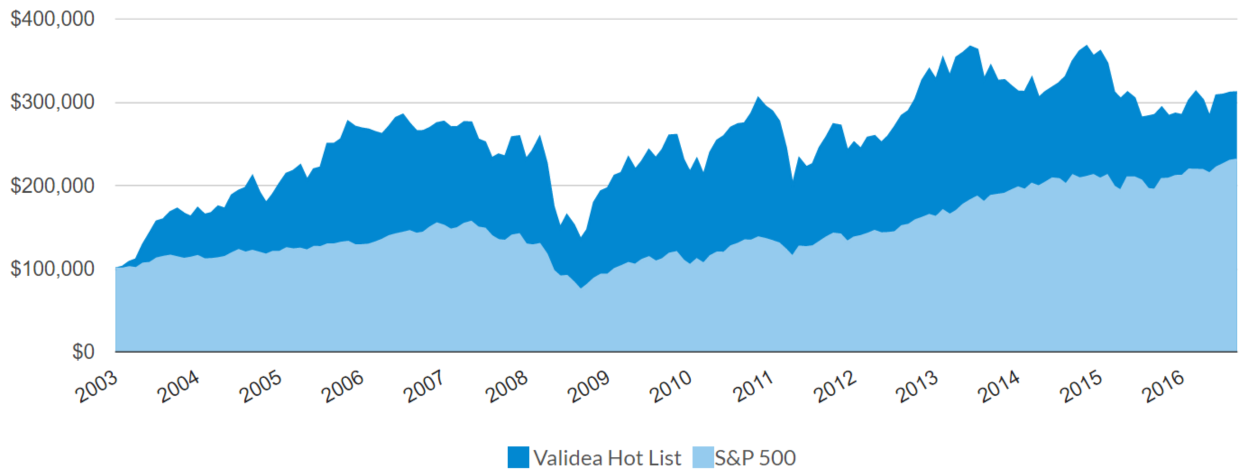

## 2016 CONSENSUS STRATEGIES

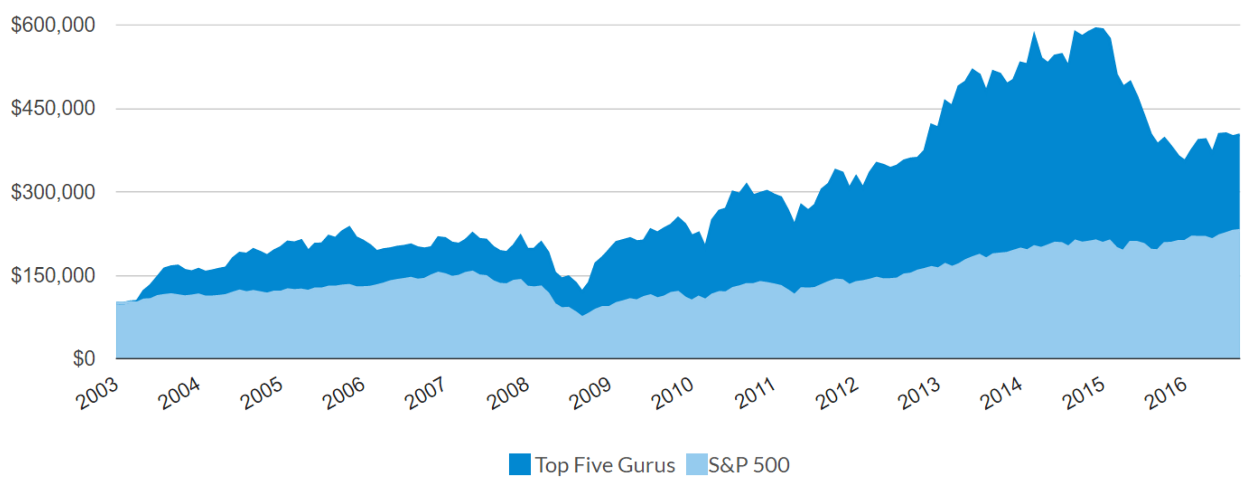
### The Validea Hot List & Top Five Guru Portfolios

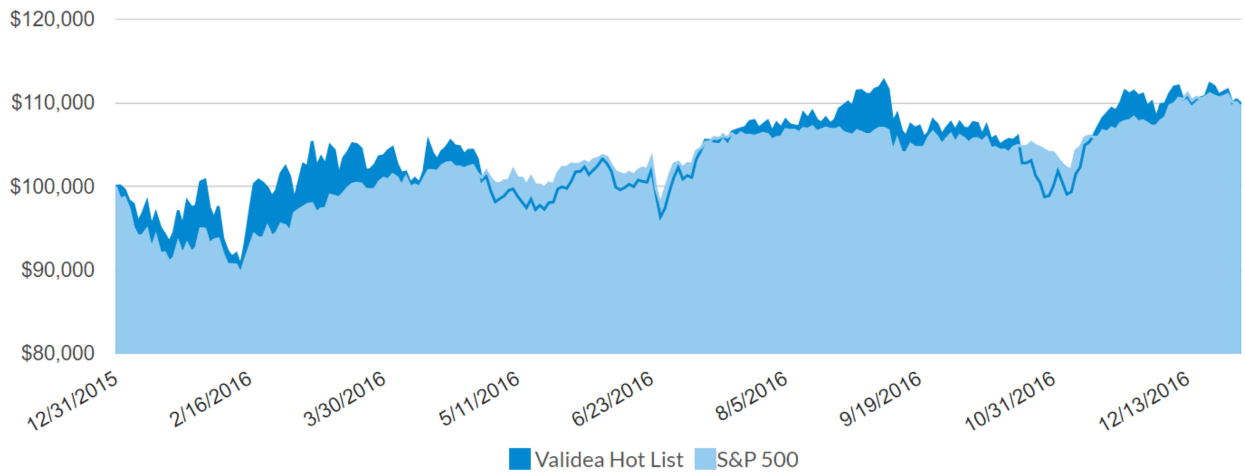
The Validea Hot List and Top Five Guru Portfolios had average to subpar years. For the full year, the Hot List returned just slightly more than the market while the Top Five Gurus Portfolio trailed the market by a wide margin. Actually, the Top Five Guru Portfolio was our worst performer out of all of our models during the year. However, both strategies maintain a large lead over the market since their inception. The Hot List Portfolio has returned around 200% since inception while the Top Five has done even better, with around a 300% return. While both of these portfolios are far ahead of the market over the long term, the underperformance of the Top Five Gurus portfolio highlights the variability any one of our strategies can have over short periods of time and in any given year.

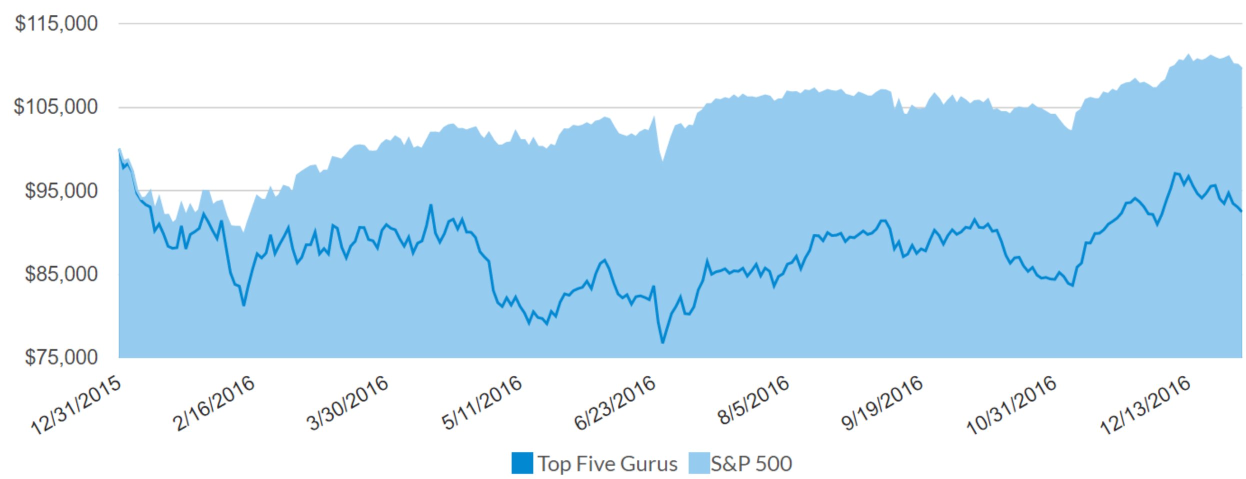
The Validea Hot List and Top Five Guru Portfolios are consensus strategies. By that, we mean they are strategic blends of multiple models. The Hot List portfolio holds stocks that obtain high scores from multiple guru approaches as the same time, while the Top Five holds the top two stocks across five different models. Our goal with both approaches is to limit the strategy specific risk that a standalone guru model, like value or growth method may be susceptible to, but as the performance shows, even a blended model can fall out of favor. This is why it's very important to any investor who is using our system to understand that in the short run our strategies are risky. But over long periods of time, if you follow one or many of our portfolios with discipline and a commitment, you can put the odds of outperforming in your favor.

**Validea Hot List and Top Five Gurus Portfolio Since Inception and 2016 Performance Charts**






**To view the 2016 model portfolio results, as well as the full historical record of all of Validea's strategies, please click here to view our model portfolios.**