



**new Constructs**<sup>TM</sup>  
Tools for Better Investment Performance

# Debunking Wall Street Myths

**Important Disclosure Information is contained on the last page of this report.  
The recipient of this report is directed to read these disclosures.**

# Agenda

- I. Today's Capital Markets
- II. Where Markets Went Awry
- III. How To Be A Successful Investor
- IV. Opportunities
- V. Appendix

[Hyperlinks](#) in this presentation enable you to download free reports and more info.

# Part I

## Context For Today's Capital Markets

## Question:

How has the Market Changed over the years?

### Shorter Holding Periods for Stocks

- Until mid-1960' s average holding period was seven years
- Today, average holding period is less than one year and annual portfolio turnover is more than 100%<sup>1</sup>

### Major Reactions to Quarterly Earnings

- Stock prices make large moves in response to earnings surprises
- Suggests that long-term cash flows are less important

### Amateur Individual Investors - Growth Market

- Schwab, TD Waterhouse, Scottrade
- Day trading

### Media - Growth Market

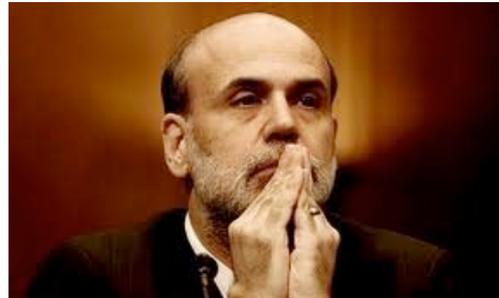
- TV: Mad Money, CNBC Squawk Box, and Squawk on the Street
- Print: Wall Street Journal, Investors Business Daily, local newspapers
- Web: Motley Fool, TheStreet.Com, CBS MarketWatch

<sup>1</sup>Rappaport, Alfred. "The Economics of Short-Term Performance Obsession." *Financial Analysts Journal*, vol. 61, no. 3 (May/June): 65-79.

## Questions:

- What is “Reg FD”?
- What was the purpose of the Global Research Settlement?
- What is a 10-k?
- What are “footnotes”?
- What is a gold rush?

# Who are these people: Entertainment or serious business?

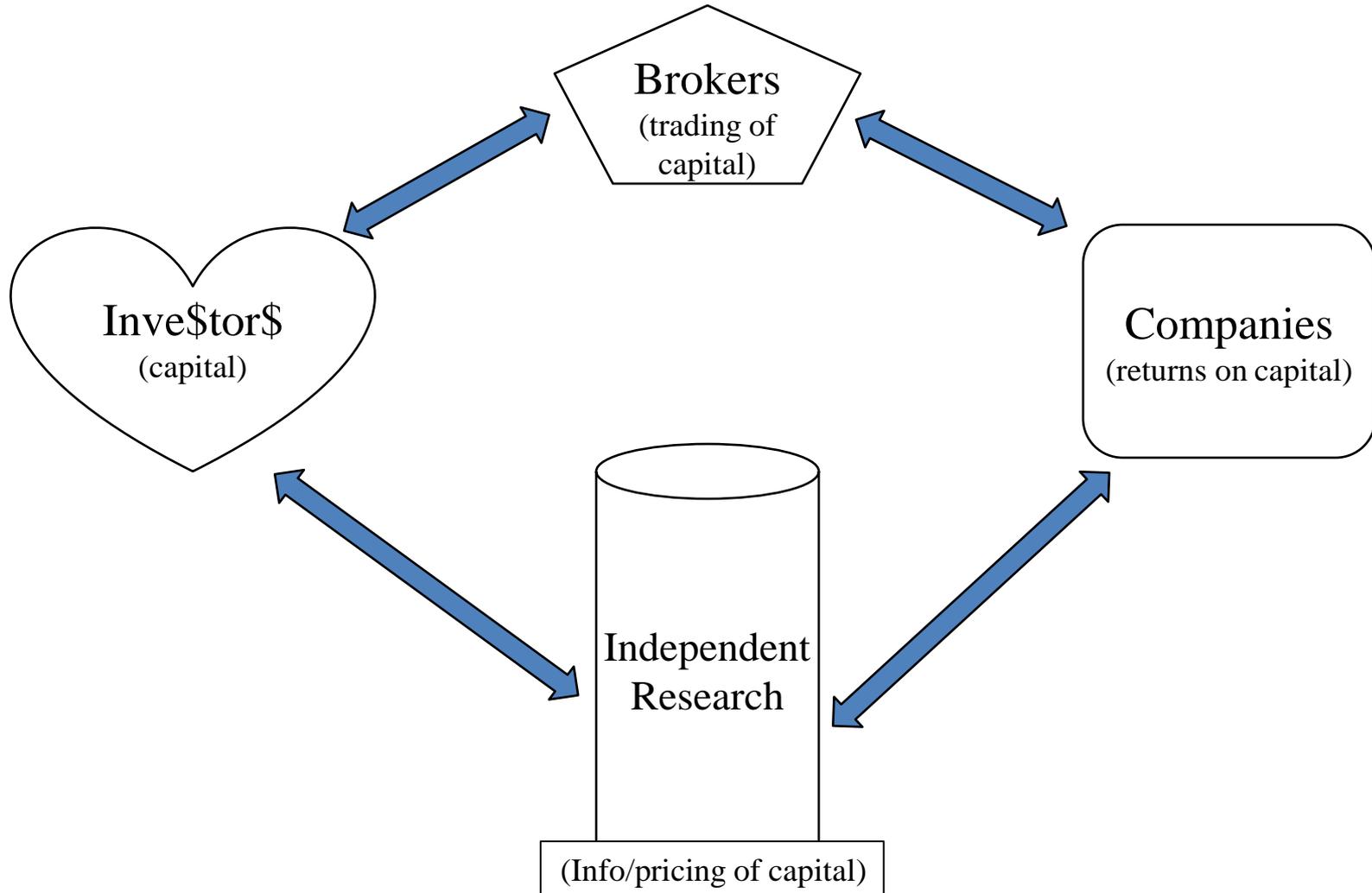


# Part II

## Where Markets Went Awry

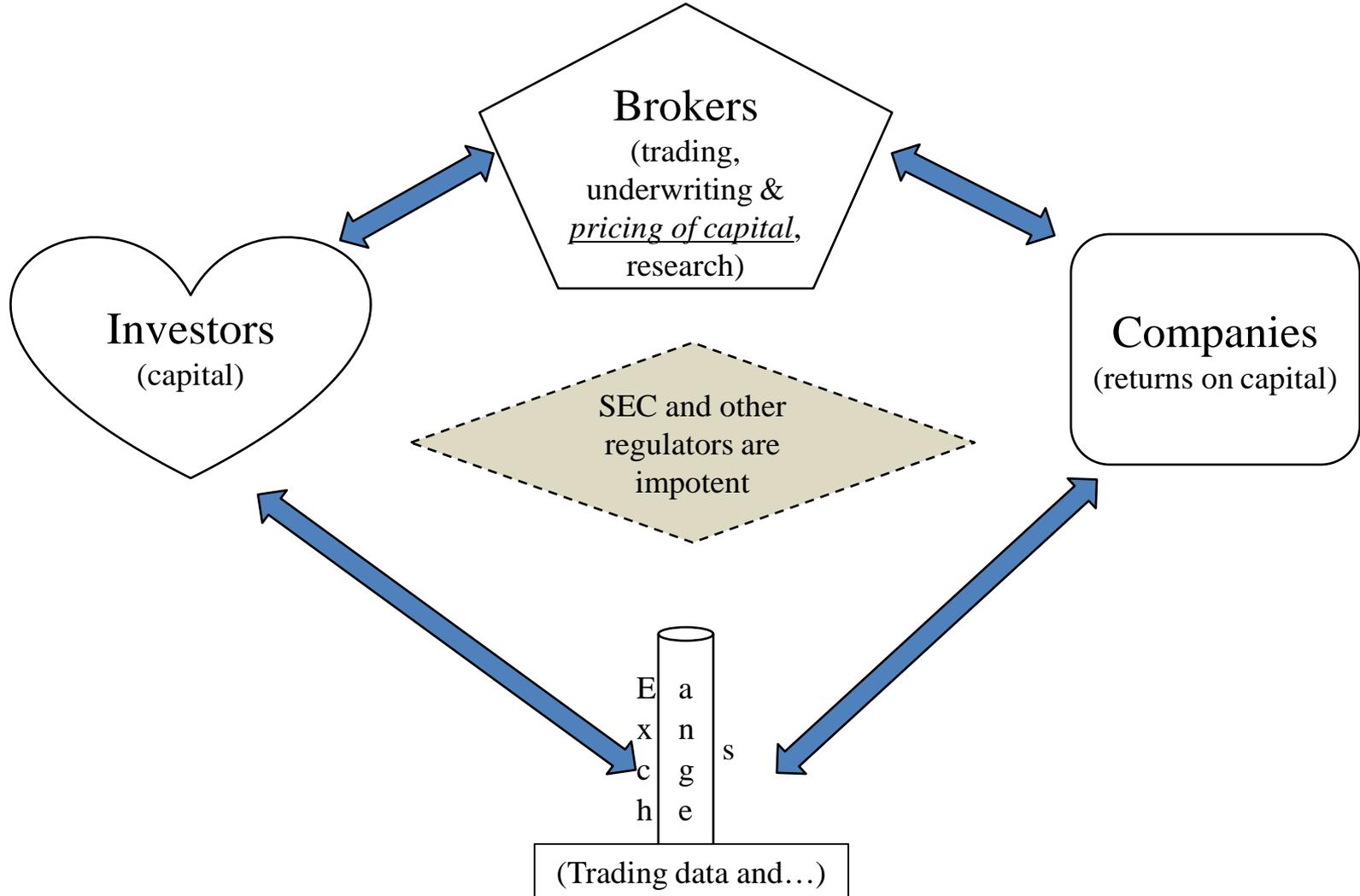
# Capital Markets Eco-System In Theory

Independence Is Key to Integrity of Information

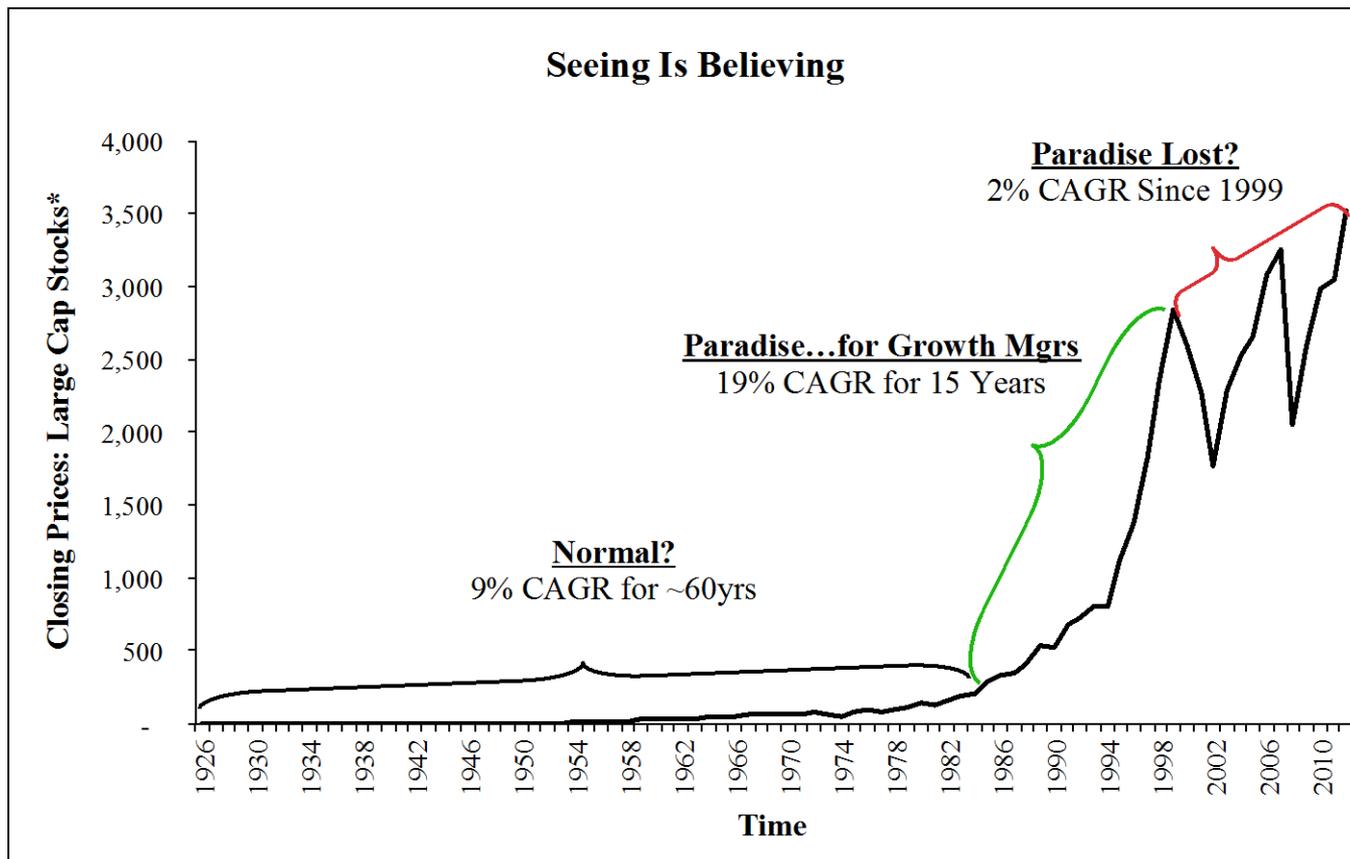


# Capital Markets Eco-System In Reality

## Dearth Of Independence Where It Matters Most



# Extraordinary Market Growth Impact On Investor Expectations



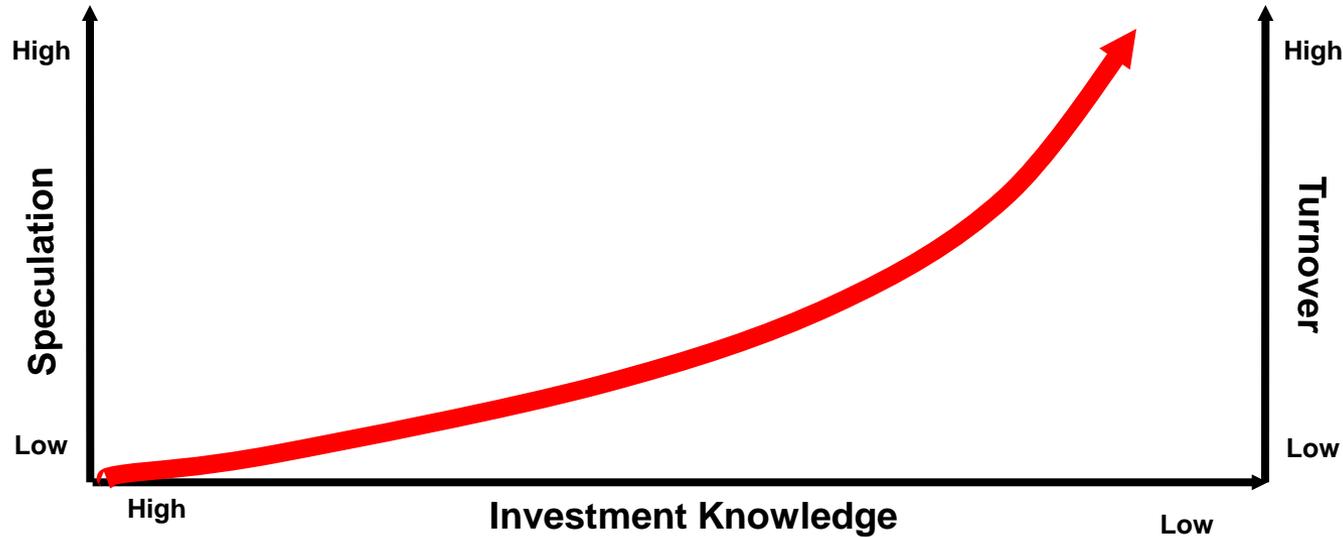
Source: Novo Capital Management, LLC and Ibbotson

Ibbotson, 2008 Ibbotson Stocks, Bonds, Bills and Inflation Valuation Yearbook, (Chicago: Morning Star, 2008), 228-229

•Large Cap Stocks” as defined by Ibbotson are the best comparison for the S&P 500, which did not exist as it does today in 1926.

# Noise Trumps Knowledge & Skews Valuations

## People Who Know Less Tend to Trade More



### Percentage Breakdown of Institutional Investor Categories

Quasi-Indexers	61%
Transients	31%
<u>Dedicated</u>	<u>8%</u>
Total	100%

### Institutional Investor Categories Definitions

1. Quasi-indexers - low turnover and small stakes
2. Transients - high turnover and small stakes
3. Dedicated - low turnover and large stakes

Source: Brian Bushee, "Identifying and Attracting the 'Right' Investors: Evidence on the Behavior of Institutional Investors," Journal of Applied Corporate Finance, Vol. 16, 4, Fall 2004, 28-35

# Part III

## How To Succeed

## How To Succeed

1. Know your competition
2. Choose who you want to be
3. Execute a sound strategy

# Who are these people?

Your competition



## Choose Who You Want To Be

Speculator

“If you are a speculator, your decision to buy or sell is based on what you believe about the near-term direction of price.”  
- Ben Graham

“...speculation is the activity of forecasting the psychology of the market.”  
- John Maynard Keynes

Vs.

Investor

“If you are an investor, your decision to buy and sell is based on the underlying economics of the stock you own.”  
- Ben Graham

“Investing is an activity of forecasting the yield on assets over the life of the asset...”  
- John Maynard Keynes

# Execute

## Only 3 Ways to Beat the Market

Better Data - difficult and expensive to obtain

- Gathering and analyzing data from the Notes to the Financial Statements provides a competitive advantage.

Better Analysis - not just your neighbor, one must out-think the entire market

- Better data means better models.
- Better models provide better analysis.

Better Discipline - stick to your guns, don't follow the herd.

- Long and short strategy is built on specific, quantifiable thresholds derived from a model we can trust.
- Our models do all the number crunching to supply our human capital with superior information and decision-making capabilities.

## Recognize Limitations of Traditional Research

Core Problem: GAAP is exploitable.

Only Solution: Read the Footnotes and MD&A.

<b>Traditional P&amp;L</b>	<b><u>Economic P&amp;L</u></b>
Revenues	Revenues
- operating expenses	- operating expenses
	- <b>Hidden Incomes/Charges</b>
= pretax earnings	= pretax earnings
- taxes	- taxes
= Reported Profit	= Profit
	- <b>capital charge/hidden liabilities and assets</b>
	= Economic Profit

## Reasons You Can't Trust Reported Numbers

### Buried in Footnotes and MD&A

- Hidden Expenses/Income
- Unrecorded Goodwill
- Impairments
- Unconsolidated Subsidiaries
- Minority Interests
- Unrealized Gains/Losses
- Changes in Accounting Rules
- Derivatives Exposure
- Customer Concentration
- FASB 159
- Employee Stock Options
- Option Valuation Assumptions
- Operating Leases
- Loan Loss/LIFO Reserves
- Pension Assumptions
- Excess Cash
- Pension Over/Under Funding
- Auditor's Opinions
- Carrying Value vs Fair Value
- Mid-year acquisitions

*[Here](#) is our detailed report on all adjustments*

## Discover the Economics

### Measuring Key Results

- **NOPAT** ➡ core operating earnings after-tax
- **Invested Capital** ➡ all cash invested in the business
- **WACC** ➡ rent management must pay for use of capital

Return on Invested Capital = NOPAT/Invested Capital

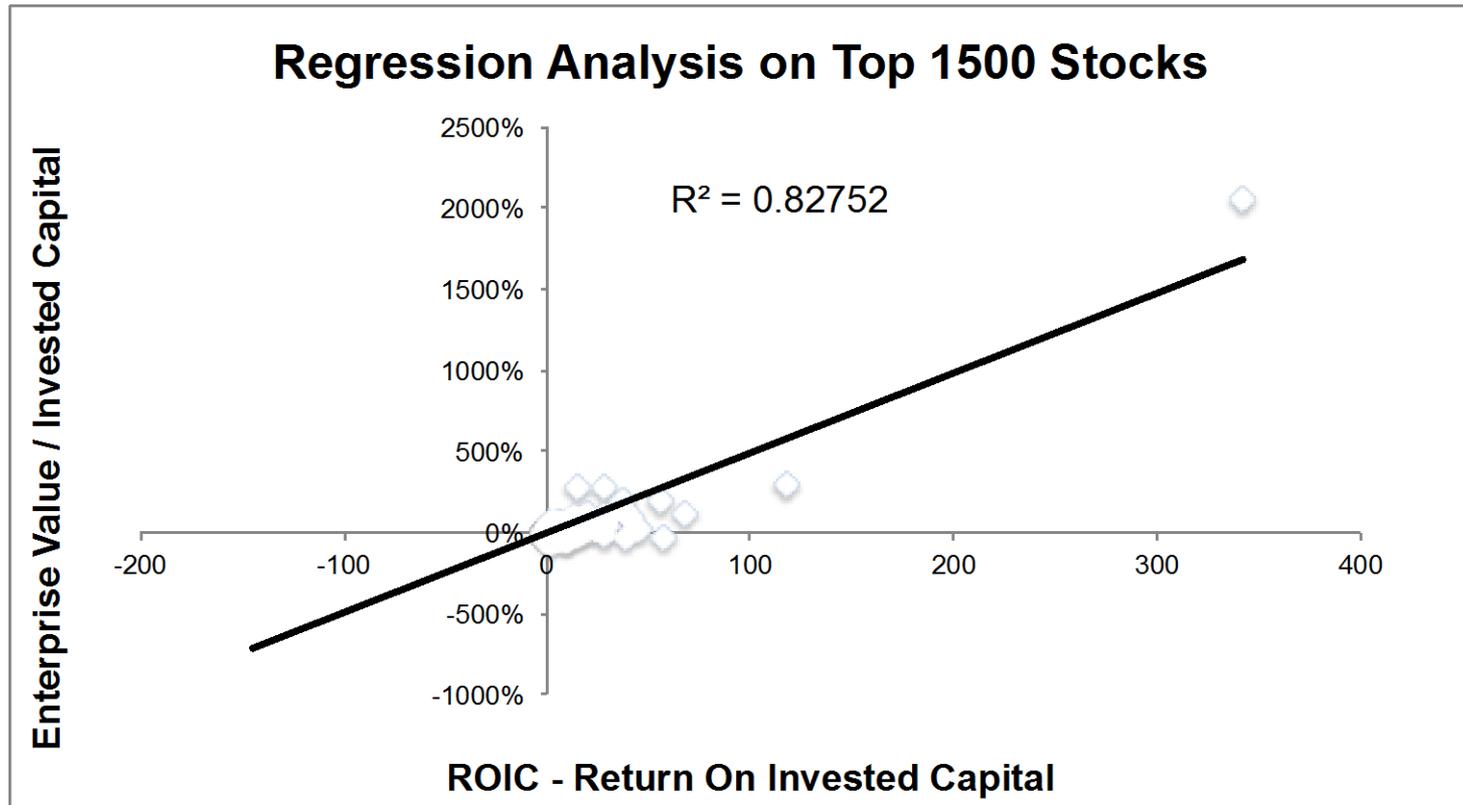
Economic Profit = (ROIC – WACC) \* Invested Capital

Free Cash Flow = NOPAT – change in Invested Capital

**Economic Profit Margin = ROIC - WACC**

# Why Do Cash Economics Matter

Market Assigns Value to Where It Gets the Most in Return

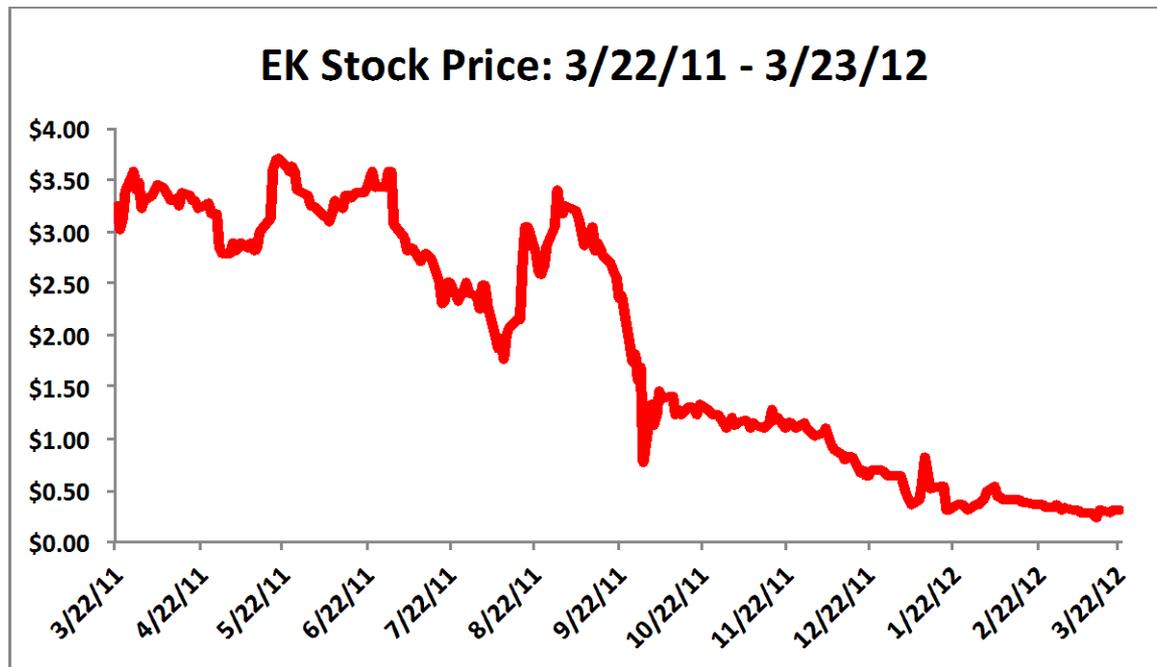


# Danger Zone

## Sell Call: Eastman Kodak (EKDKQ.PK) on 3/21/2011

### 2010 10-K Revealed Funny Pension Attg

1. Underfunded by \$2.6bn or 3x the market cap at the time
2. 2.2% of revs from pension, abnormally high return on plan asset assumption 8.7%
3. Valuation implied 10% CAGR in NOPAT for 11 years
4. Down 90% while S&P500 was down ~3%, no longer under coverage



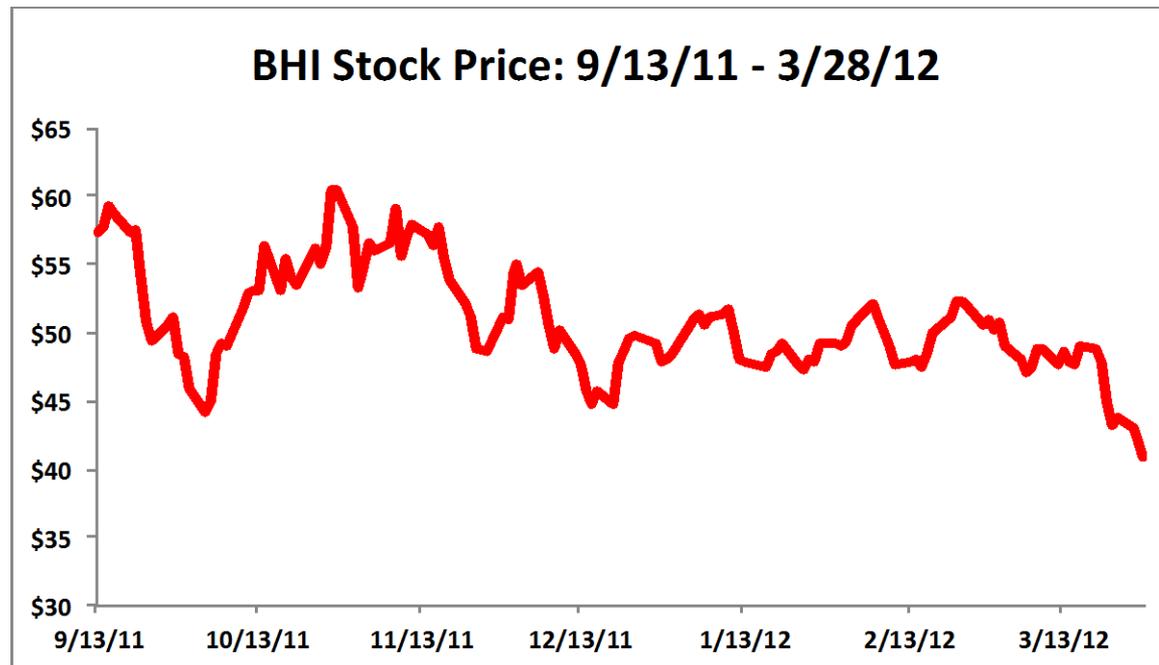
\*This graph was created based on information collected and analyzed by New Constructs, LLC. New Constructs regularly gathers information from over 3,000 companies' 10Ks, including the Notes to the Financial Statements and MD&A.

## Danger Zone

### Sell Call: Baker Hughes (BHI) on 9/13/2011

#### 2010 10-K – Acquisition Accounting Overstated EPS and Margins

1. Economics of BJ Services deal were bad: accounting creates “[hi/lo fallacy](#)”
2. [Economic earnings](#) diverged from reported earnings. Stock follows economics.
3. Valuation implied 20% CAGR in NOPAT for 12 years
4. Down 30% while S&P500 was up ~20%, Neutral rated as of 3/21/12



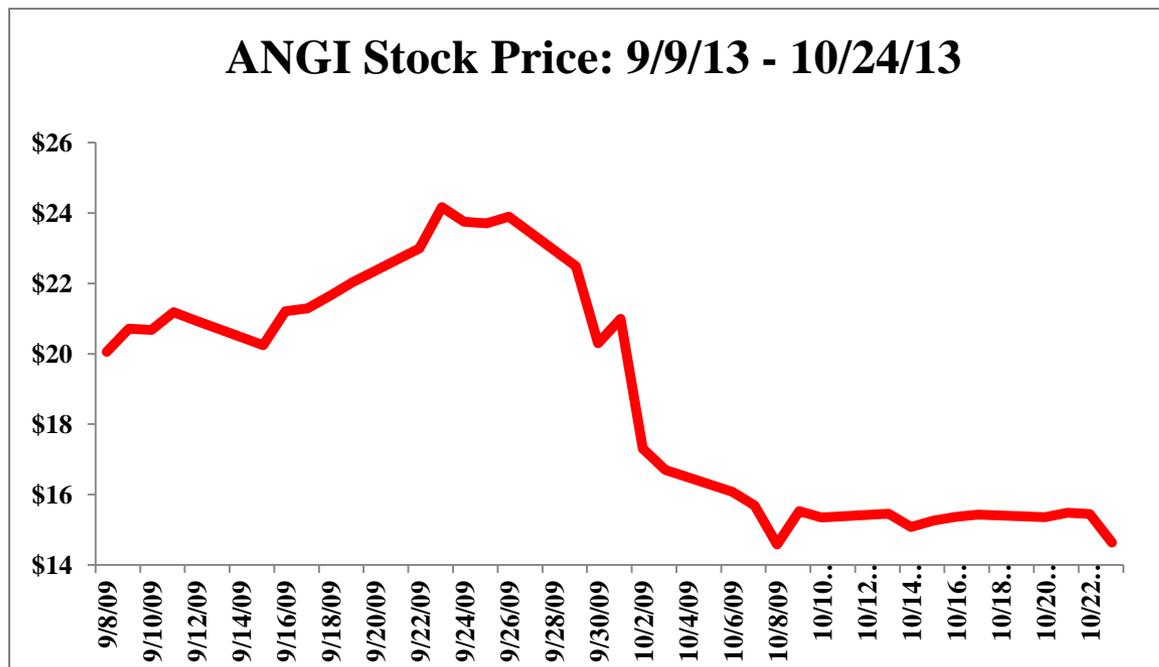
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# Danger Zone

## Sell Call: Angie's List (ANGI) on 9/09/13

### Charging Customers for Paid Reviews

1. 18 Years of Operation and Still No Profit
2. 5 Million Unique Visitors per Month vs 25 Million for Yelp
3. Valuation implied 25% CAGR in Revenues for 15 years
4. Down 27% while S&P was down 5%, still recommending sell



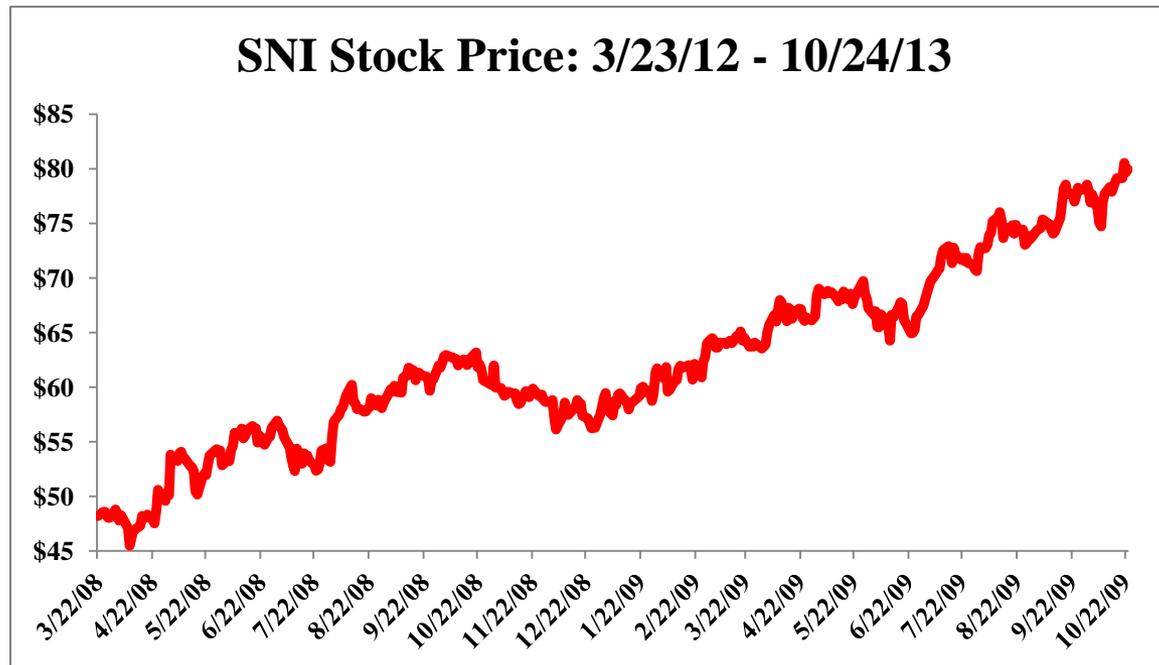
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# Long Ideas

## Buy Call: Scripps Networks (SNI) on 3/27/2012

### Superior Economic Earnings

1. Economic earnings higher than GAAP net income
2. Valuation implied no future growth in profit (NOPAT)
3. Up 66% while S&P500 was up ~13%, still recommending buy



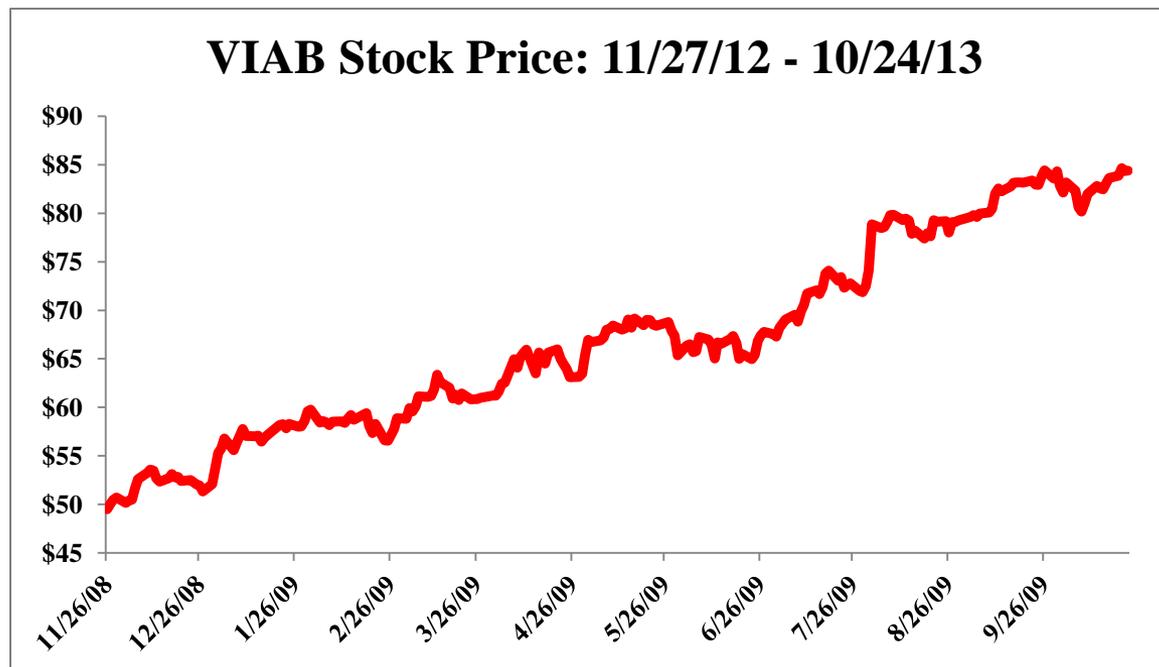
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## Long Ideas

### Buy Call: Viacom (VIAB) on 11/27/2012

#### Market Focused on Wrong Numbers

1. Revenue decline masks big increase in profits
2. Higher ROIC reflects intelligent change in business mix
3. Valuation implied permanent 25% decline in profit (NOPAT)
4. Up 70% while S&P500 was up ~25%, still recommending buy



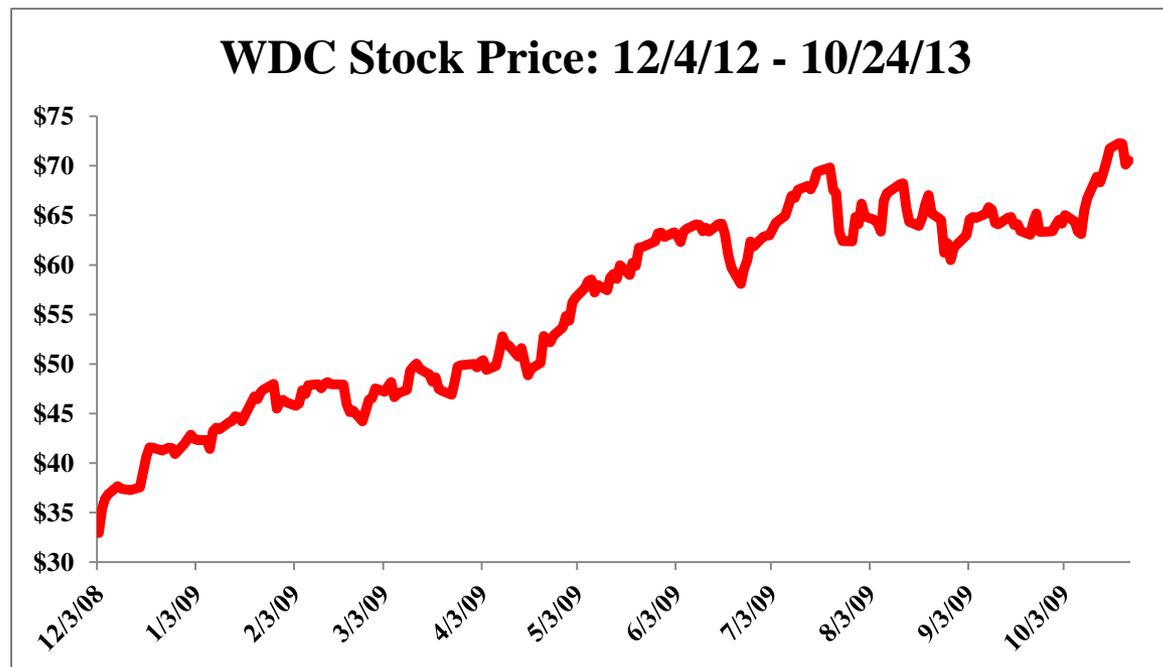
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## Long Ideas

### Buy Call: Western Digital (WDC) on 12/4/2012

#### Misunderstood Business and Valuation

1. The cloud is good for storage, power grid analogy
2. ROIC is 40%
3. Valuation implied permanent 70% decline in profit (NOPAT)
4. Up 114% while S&P500 was up ~25%, still recommending



\*This graph was created based on information collected and analyzed by New Constructs, LLC. New Constructs regularly gathers information from over 3,000 companies' 10Ks, including the Notes to the Financial Statements and MD&A.

# Part IV

# Opportunities

# Internships and Employment

“Learn Stocks the Right Way” – Richard Hunt Columbia Business School 2014, winner of Pershing Square Stock Picking Contest for 2013

- Looking for financial journalists
- Email [recruiting@newconstructs.com](mailto:recruiting@newconstructs.com)

## Brief Summary of opportunity:

- > publish articles in high profile media outlets: Forbes, [MarketWatch.com](http://MarketWatch.com), [CNBC](http://CNBC.com), [Wall Street Journal](http://WallStreetJournal.com)
- > frontline experience working with successful author
- > in-depth education on writing and investing

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Use Same Research As Top Industry Professionals

- Free full-access credentials
- Utilize ratings, models and screening tools
- For coursework or personal use
- Email ‘subscriptions@newconstructs.com’ and request access

# Part V Appendix

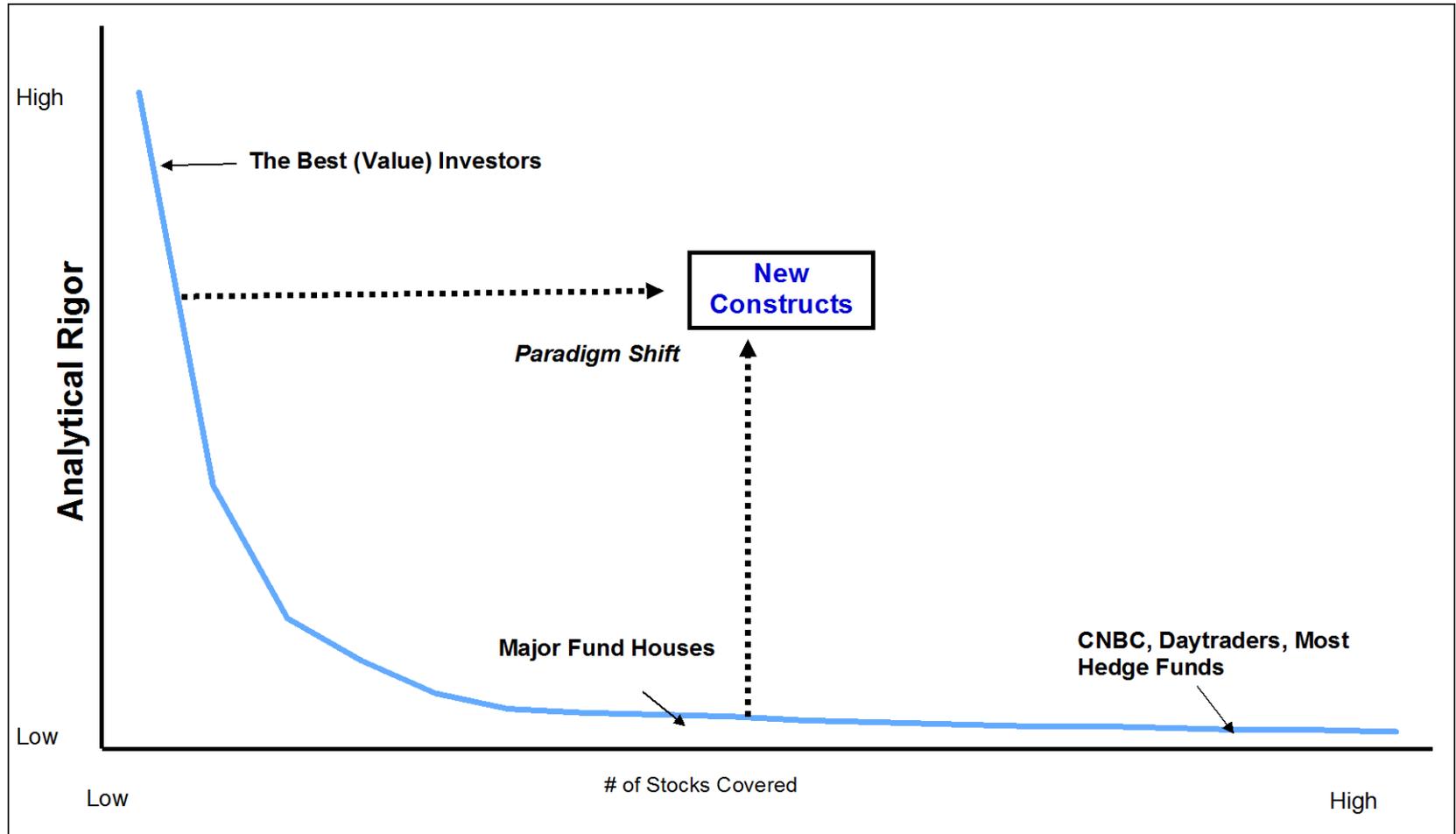
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## Independent Proprietary Research & Diligence

- Founded July 2002
- Top-rated stock-picking by [Barron's](#)
- Deep, financial fundamental focus
- Patented research platform covers 3000 stocks & 7400+ funds
- Untapped source of alpha
- Footnotes expertise is a competitive advantage
- Integrated ratings for stocks, ETFs and mutual funds

# Deep Fundamental Research on 60,000 10-Ks

## Best Insights on 3000+ U.S. Stocks



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