PRIVATE PORTFOLIO

IMA

MANAGEMENT

A disciplined, process-driven, value investment firm that provides a private portfolio management *service* tailored to individual and institutional clients tired of in-the-box, cookie-cutter, buy-and-hope investment products.

Our goal is to help the rich, and the aspiring rich, become richer while sleeping well at night.

ABOUT IMA

PRIVATE PORTFOLIO IMA MANAGEMENT

Key Management

Michael L. Conn, CFA, is President and Founder of IMA. Mr. Conn earned his B.A. from the University of Colorado at Boulder and his M.B.A. from the Harvard University Graduate School of Business Administration. Michael has more than 40 years of investment experience.

Prior to Investment Management Associates, Mr. Conn was a vice-president and a portfolio manager for Founders Capital Management and Founders Mutual Depositor Corporation. Earlier in his career Michael was a securities analyst was with Financial Programs, Inc. and Wellington Management Company.

Key Management

Vitaliy N. Katsenelson, CFA, is Chief Investment Officer. He joined IMA in 1997. Mr. Katsenelson received both his bachelor of science and master of science degrees in finance from the University of Colorado at Denver.

He is the author of two books, and his articles have appeared in *Barron's, The Financial Times,* and *BusinessWeek,* among others. Vitaliy has been a guest on CNBC, Fox Business, BNN and Yahoo! Finance.

He also writes a monthly column for *Institutional Investor* magazine and speaks to investor organizations in the U.S. and abroad. Vitaliy has close to 20 years of investment experience and has taught a graduate investment class at the University of Colorado at Denver.

We Are Different

- Our ***Active Value*** investment approach is crafted specifically for today's treacherous sideways markets.
- We don't voluntarily lock ourselves into the style, size, or geographic boxes. Investing today is difficult enough without self-imposed, baseless restrictions.
- We patiently seek out stocks of any size and any growth profile in any country (where the law is on investor's side) that meet our stringent Quality, Valuation and Growth criteria — these stocks just have to be significantly, if not ridiculously, undervalued.
- If we cannot find stocks that meet our rigorous criteria in the US or internationally, we will not just buy second-rate stocks, we will simply hold more cash. We cannot time the market, but we can value individual stocks.

We Are Different

- **Our clients are our partners**, and they are treated as such with complete transparency, honesty, and with direct access to our decision makers. In a quarterly letter we walk our clients through every buy and sell decision in their accounts.

- **We eat our own cooking.** Our portfolio managers and their families own the same stocks as our clients.

- We have **no institutional pressure to do dumb things**: We will not own a stock just because our competitors do (common practice in the mutual fund world). We will not hug benchmarks – we are not going to buy the best-looking horrible stock just to have exposure to an industry that is in an index.

Our Size Is Our Competitive Advantage

- We can stay fast and nimble – no bureaucracy, no investment decisions made by a slow committee.

- Our unique exposure in the investing community has allowed us to develop a **large global network of professional investors.** We share investment ideas with our network, and they in turn help us find new opportunities and provide feedback on our existing holdings. Our own VALUEx Vail conference helps us to grow this network every year.

- Our apprentice program allows us to increase the scope and depth of our stock research. We employ a handful of highly qualified, bright and hungry for knowledge interns from universities to assist with financial models and stock research.

We Offer a Service, Not a Product

- **New accounts will not be automatically invested in stocks** held by existing clients. Only stocks that still have a significant margin of safety will be bought.

- Clients' **unique circumstances and wishes are taken into consideration**. Some clients ask to avoid tobacco or defense stocks. Others want to take capital gains and losses for tax reasons.

- We provide complete transparency: the client can see each position and cost basis in our quarterly report provided by IMA, or daily on the custodian's website.

- **Decision makers are a phone call away.** Clients pick up the phone and call us if they have questions or concerns or just to say thank you. **Good luck reaching your mutual fund manager**.

- Unlike mutual funds, hedge funds, or ETFs, **each of our portfolios is crafted for the individual client**. Each client owns their cost basis, and they don't pay taxes for gains enjoyed by previous investors (a common problem with mutual funds).

Process, Process, Process…

- Process is not just another word for us, it is at the core of how we invest. We have a very rigorous process for every phase of investing (including the discovery, analysis, maintenance, and sell phases). **Process keeps us rational and unemotional when the world around us is not.**

More on this in a few slides…

The underlying principles of sound investment should not alter from decade to decade, but the application of these principles must be adapted to significant changes in the financial mechanisms and climate. - Ben Graham

ACTIVE VALUE INVESTING

MAKING MONEY IN THIS MARKET AND THIS ECONOMY

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Three Ways to Achieve Superior Long-Term Returns

1. **Informational advantage** – unless you are analyzing microcaps, "better information" usually means insider information and will land you in jail.

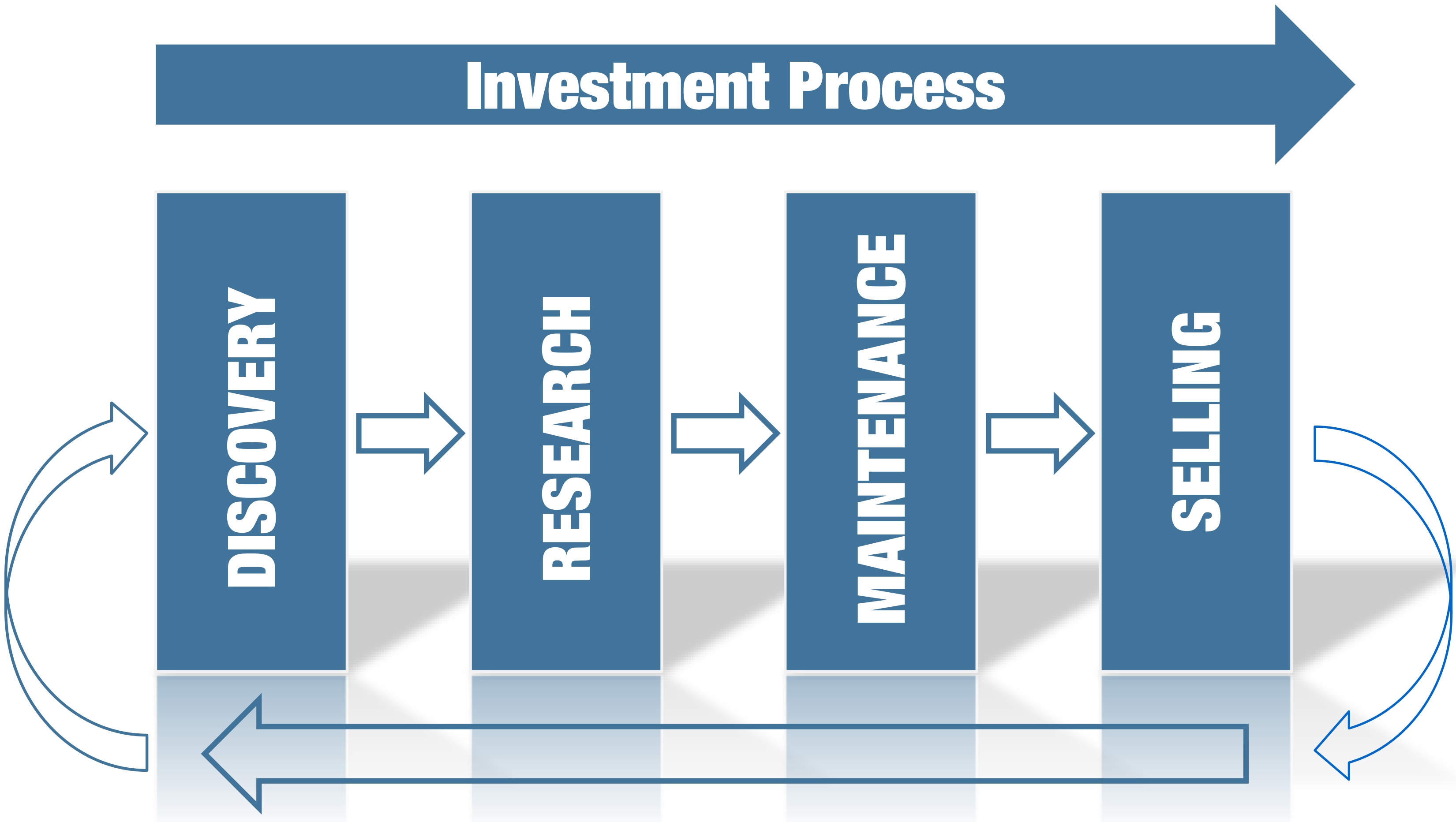
2. **Analytical advantage** – being able to analyze information better, you can build better models.

3. **Behavioral advantage** – be more rational than average market participants

See Russell J. Fuller, "Behavioral Finance and Sources of Alpha"

THE INVESTMENT PROCESS SHOULD INCORPORATE BOTH ANALYTICAL AND BEHAVIORAL ASPECTS

Pillars of the Investment Process



Process

- **Screens**: 52-week lows, insider buying, magic formula (high return on capital + low P/E), etc…

- **Watch lists** – Often when we do analysis we find companies we like but that are too expensive (no margin of safety). We determine what price valuation we want to own them at, put them on a watch list, and wait. We actively seek to identify great businesses, value them, and put them on our watch list. We perform analysis when things are going well, which makes us psychologically better prepared to buy when things go bad – and it is just a matter of time before they do.

- **Steal**: We study the holdings of other value and growth investors we respect. (Growth investors usually spend more time focusing on quality and growth of the business. A quality and growth business that temporarily stumbles will meet our value [margin of safety] criteria.)

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Process

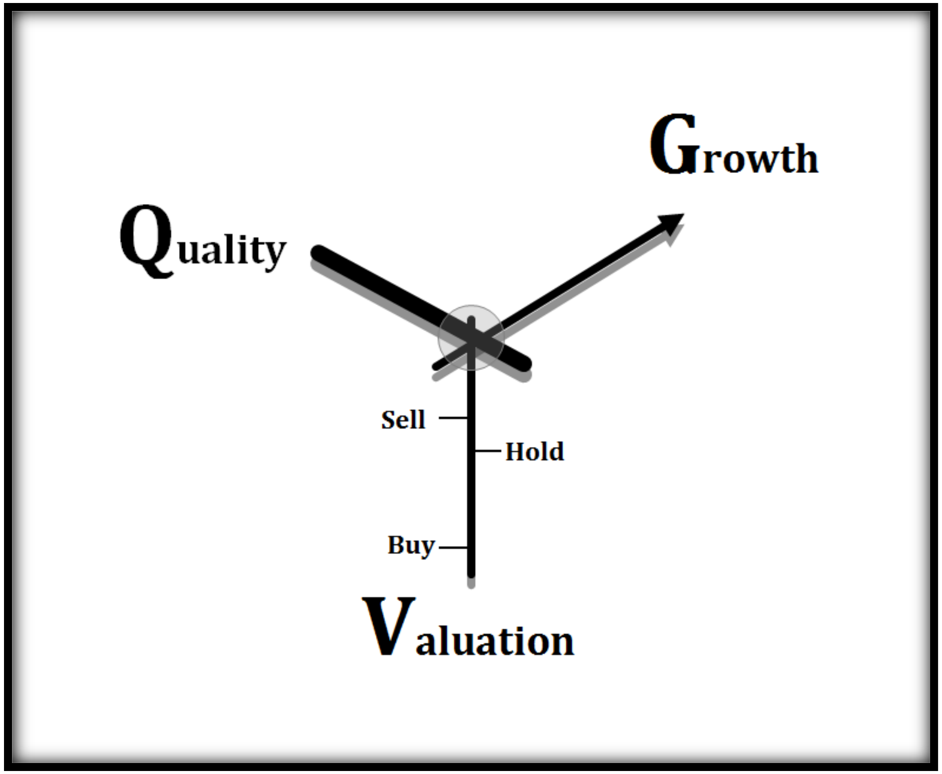
- **Map the market and the world:** Follow ETFs of various industries and countries. For instance, if a utility ETF declines, we look at utility stocks for opportunities.

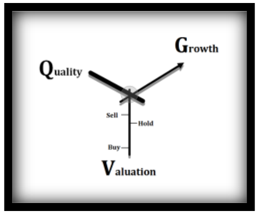
- **Network**: We talk to a few dozen value investors on a constant basis. Sharing goes both ways.

- **Read, read, read…** the writings of the members of Value Investor Club, SumZero, blogs, newsletters, Twitter (wonderful if you "follow" the right people).

- **Attend conferences:** We have found attending conference so useful that we created our own VALUEx Vail conference.

Process

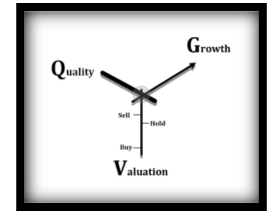




Quality

- Sustainable Competitive Advantages – a deep moat around a business
- Predictable Earnings – propelled by recurring revenues
- High Return on Capital – far exceeding the cost of capital; scorecard for value creation
- Significant Free Cash Flows – lessens reliance on external financing; source of dividends; share buybacks; usually a great business with high return on capital
- Management – We want honest, competent, long-term-oriented management, not just good at running the business but also good capital allocators.
- Strong Balance Sheets – lean towards companies that underutilize debt
- Free cash flows + High return on capital = Internal financing of growth = Little debt

RESEARCH



Growth

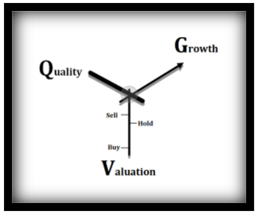
Earnings Growth + Dividends = Growth

This dimension doesn't just encapsulate earnings and free cash flow growth, it also measures dividends. Dividends are important for two reasons:

- **Quantitative** – historically, over 100-plus years, ½ of stocks returns came from dividends. In sideways markets, dividends constitute a larger (over 90%) portion of total return.
- **Qualitative** – is as important; creates another fixed cost (not unlike a rent expense) for a company, thus management has to be more frugal. Also limits management's ability to do stupid things with cash flows..

> In theory there is no difference between theory and practice. But in practice there is.
> - Yogi Berra / Jan L.A. van de Senpscheut

RESEARCH

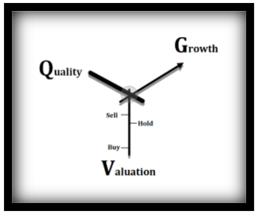


Valuation

- We want to buy a company at a significant discount to its fair value – this is a given. Increase the margin of safety in sideways markets. Instead of looking for 70 cents on the dollar, look for 40-50 cents.

- No model is perfect; all have limitations. We look at several valuation models: sum of parts, absolute P/E, relative P/E, replacement cost, discounted cash flow (this one is very important, as it puts us in the shoes of an investor, not a speculator).

- **In the sideways market environment, declining P/E is your enemy** and relative valuation models are dangerous and should be used with caution. Absolute valuation models should carry more weight.



QVG All Together

The Quality, Valuation, Growth framework is important for these reasons:

- **Systematizes analytical process** – to some degree it serves as a checklist.
- **Helps us to understand what is an ideal company**.
- **Paramount in understanding where we should and should not compromise**. Ideally, we want to own companies that ace all QVG dimensions; and though once in a blue moon we'll get an opportunity to own a few of those stocks, it is unlikely that we'll ever get the chance to have a portfolio of them. It is important to know what compromises we are willing to make within and between QVG dimensions. It also helps us to walk away from stocks if we decide we are making too many compromises.

Process

- Knowledge is cumulative, and thus as you own/follow you will learn a lot more about businesses. **We don't just follow stocks the stocks we own, we follow their competitors as well**.

- One caveat to the "knowledge is cumulative" argument: it is only cumulative if you can remember and recall. Recalling becomes difficult, because our memory gets overloaded with data. We (like everyone else) look at hundreds of companies, listen to hundreds of conference calls, read hundreds of Ks and Qs, etc. To help us recall, we write down our thesis, take notes of conversations we have with management, record our thoughts from conference calls, etc. (We are big fans of Evernote software.)

- Constantly try to debunk your thesis; look for the "other side" arguments.

> You can observe a lot just by watching.
> - Yogi Berra

Process

The sell process is as important as the buy process but usually more psychologically difficult. **In sideways markets, "buy and hold" is not dead, but it's in a coma waiting for the next secular bull market**. Selling should be kicked into higher gear. There are three reasons why you should sell an investment:

> I made my money by selling too soon.
> - Bernard Baruch

1. **It made you money.** Difficult, because you feel a sense of loyalty – after all, it made you money, you feel vested in the company, got to know the management, listened to countless presentations and conference calls, etc. The best way to deal with this attachment is to set a target valuation/price at the time you buy the stock. At that point you are more rational about what the company is worth.

Process

When the facts change, I change my mind. What do you do?
- John Maynard Keynes

2. **Things changed.** This is even more important and more psychologically difficult. To maintain rationality when it comes to selling, do a detailed write-up at the time of purchase as to why you are buying a stock – spell out your assumptions. When things go bad – and they will – revisit your assumptions and ask yourself a question: if I did not own this stock, would I buy it, knowing what I now know?

3. **Better opportunities.** Stocks in your portfolio should compete with other stocks (and other asset classes). If we see a better opportunity (especially in a similar industry) with lower risk / higher reward, we sell and buy something else. To ease psychological pain, quantify risk and reward for the existing position and new position.

Pain Arbitrage, Diversification, Focus

Pain arbitrage – have a longer time horizon than the competition. Hedge funds have time horizons of months, mutual funds of a few quarters. Opportunities are often presented when a stock is expected to do nothing for a few quarters or years. This is the only free lunch.

Diversification – in theory it sounds great, but it often leads to over-diversification: too many stocks breed indifference. It's a balance between owning too few, where you can't recover from a few stocks blowing up, and too many, so that you grow indifferent. We find that a **20- to 30-stock portfolio strikes the right balance – every decision matters, but we can recover from being wrong on a few stocks**.

Focus – paraphrasing Steve Jobs, *it is not about the companies we choose to analyze, it is about the ones we choose not to analyze.* There is only so much time in the day; you cannot be an expert in everything.

Be Opportunistic - Do nothing if there is nothing to buy. Wait for unique opportunities

SIDEWAYS MARKETS

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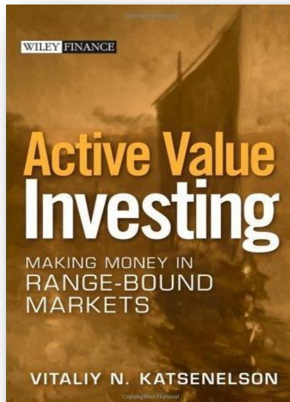
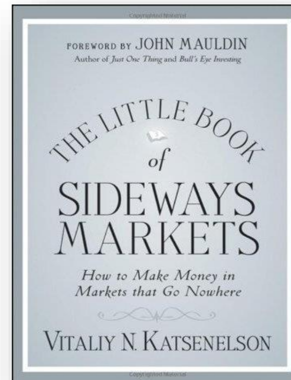
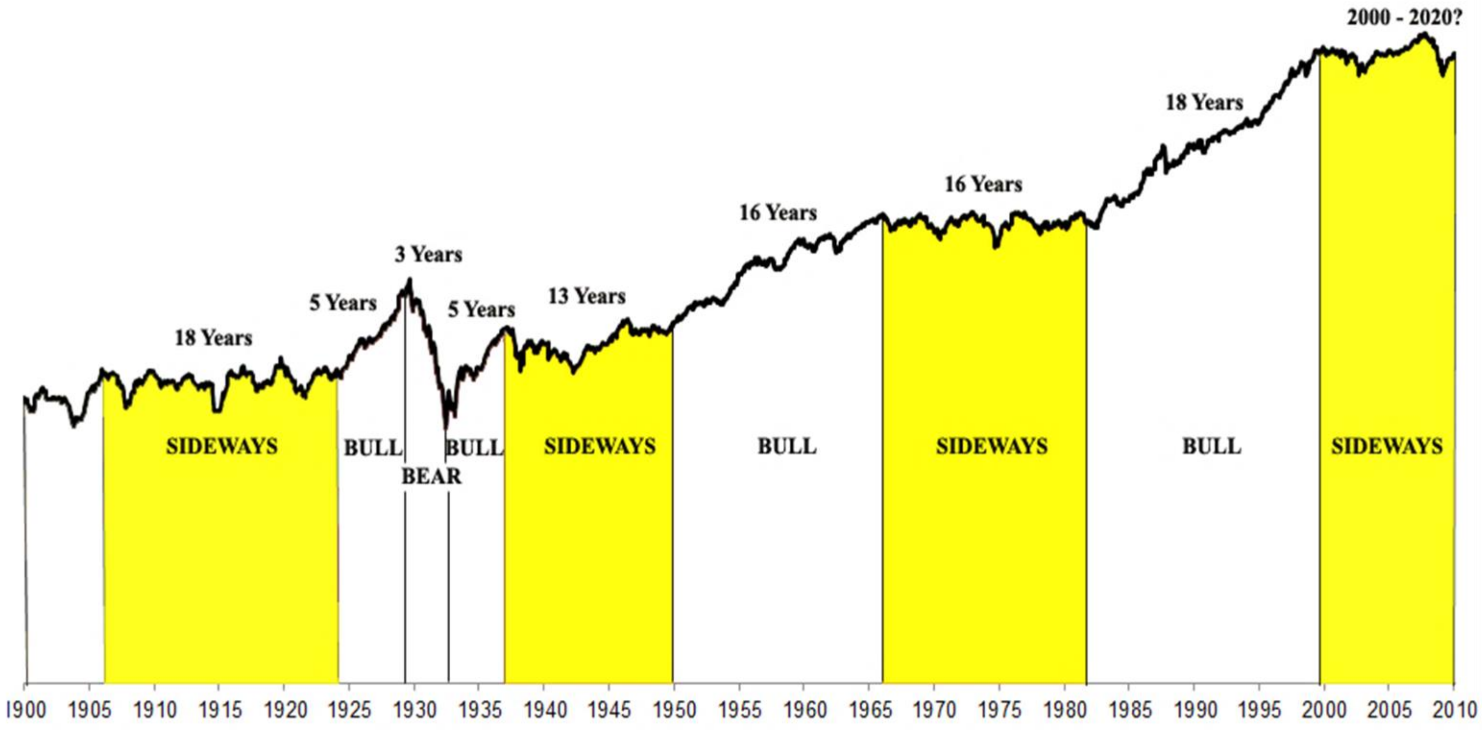
Our Sideways Markets
Thesis Is Laid Out in These Books by our CIO:





Translated into Six Languages

Dow Jones Industrial Average a 100+ Years



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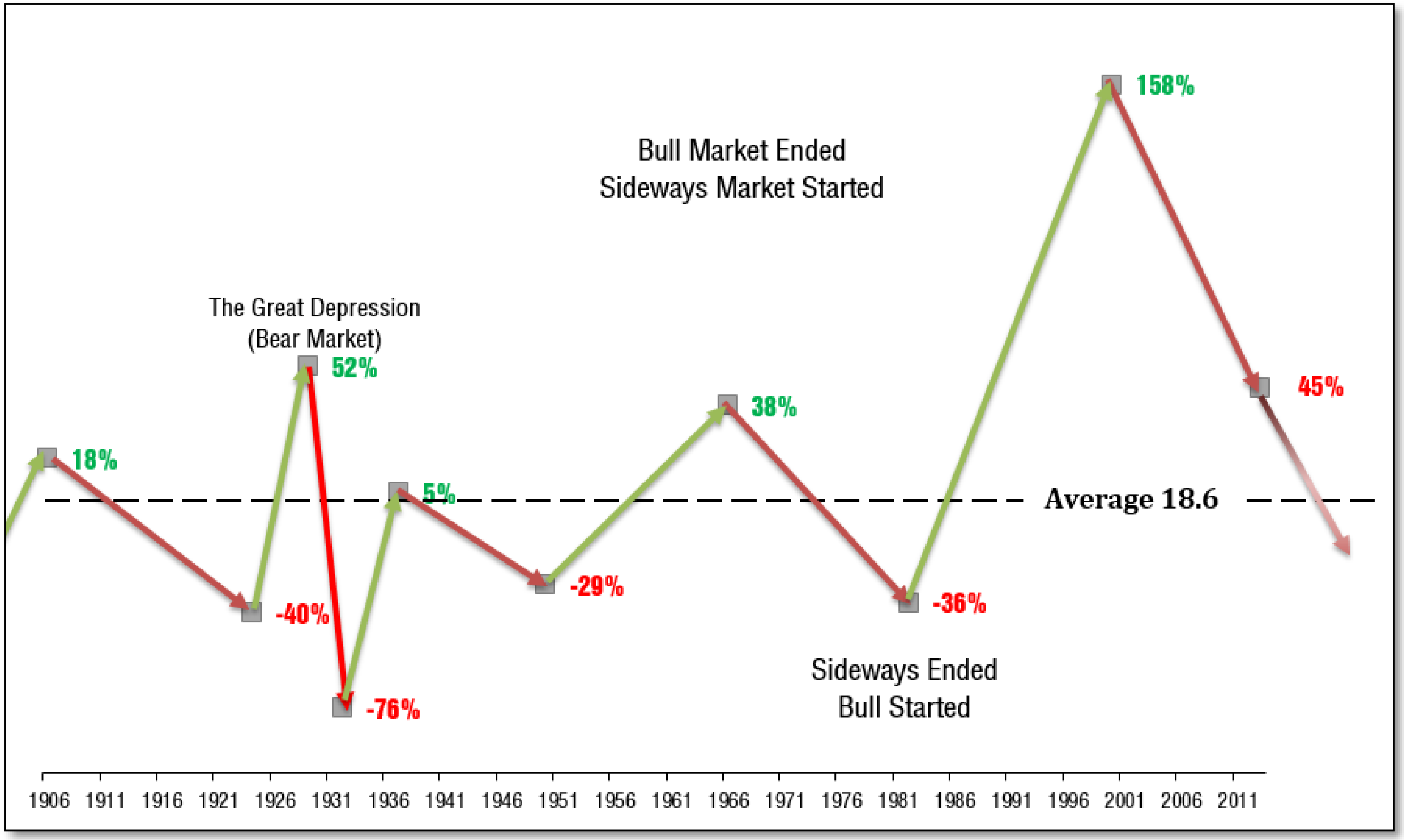
Market Cycles 101: P/E and E

	E	P/E	Start at P/E	End at P/E	Returns
Bull Markets	↑	↑	Low	High	Adding 2 positives = great returns
Sideways Markets	↑	↓	High	Low	Net-net earnings growth is cancelled out by P/E decline = a lot of volatility and no returns
Bear Markets	↓	↓	High	Low	Adding 2 negatives = horrible returns

P/E is a Pendulum That Swings Above and Below Average



10 Year Trailing P/E for S&P 500

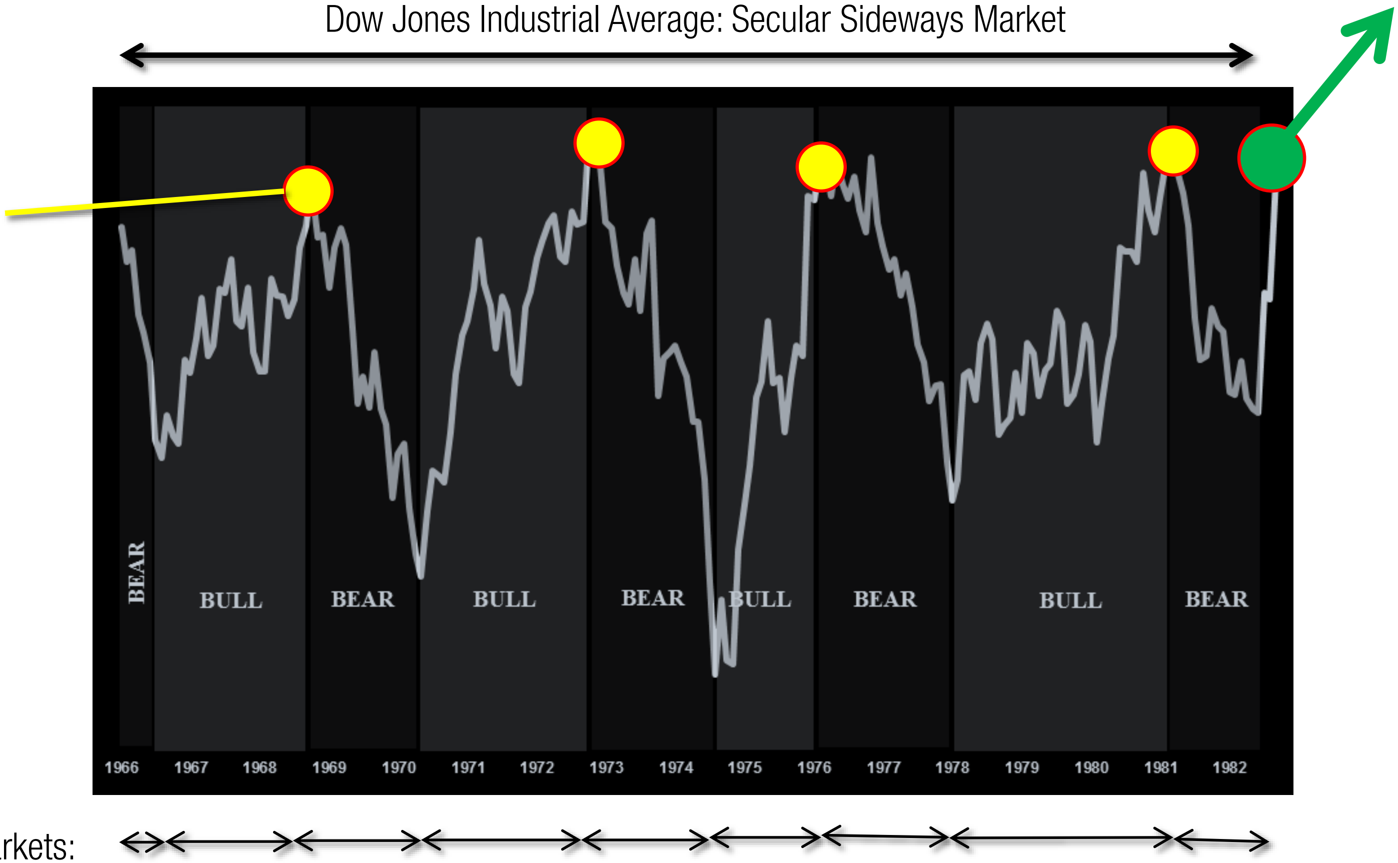
Welcome to Sideways Markets

- Over the last 100+ years, nearly every long-lasting bull market was followed by a sideways market, not a bear market (1929 was the only exception).
- Earnings and GDP growth was not much different between sideways and bull markets.
- Sideways markets start at high valuations and end at below-average valuations (usually spend half the time at below-average valuations).
- Past sideways markets lasted 13-18 years.
- The US entered into a sideways market in 2000, which followed the 1982-2000 bull market that ended at the highest valuation ever! Current sideways market will likely last longer then ones in the past.
- Today, 14 years into this sideways market, stock market valuation is 40-60% above historical average. Historically, sideways markets started (not ended) at these levels. We are still in the sideways market.
- A long-lasting sideways market is full of short-term bull and bear markets (US market had 2 cyclical bull and 2 cyclical bear markets since 2000). See next two slides.
- Buy and hold (hope) or index investors did not do well in past sideways markets.
- Sideways markets require a different investment approach.

1966-1982 Secular Sideways Market

Dow Jones Industrial Average: Secular Sideways Market

Cyclical
head fakes



Cyclical Markets:

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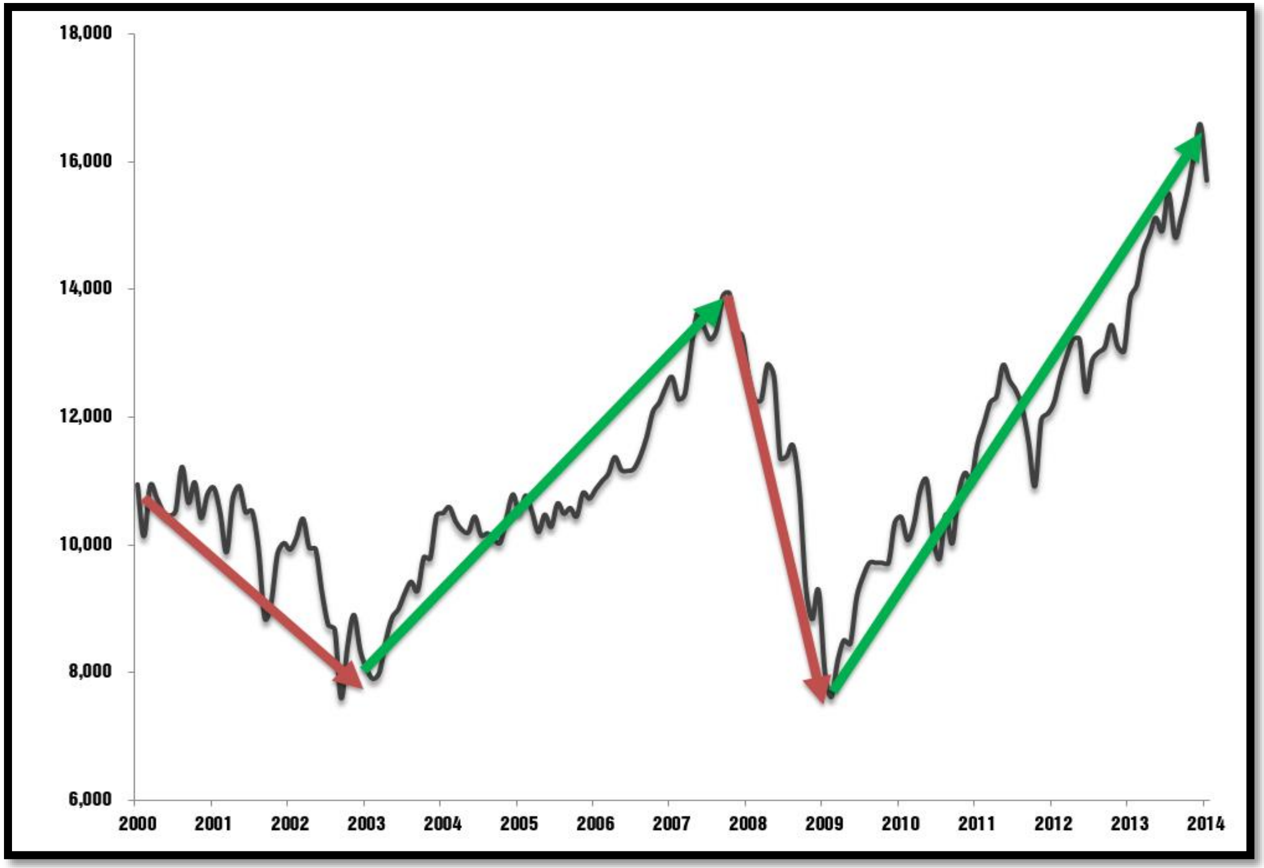
2000 – 20?? Secular Sideways Market

Dow Jones Industrial Average



Summary of Sideways Market Adjustments

- Be a buy and sell investor. Buy and hold is in a coma. Time (price) stocks through a strict buy and sell process. Buy when undervalued, sell when fairly valued. (Yes, it's this simple!)

- Time stocks, not the market: market timing is very difficult. In the short run, emotions are in the driver's seat.

- Don't buy for the sake of being invested. Don't lose money by making marginal decisions. In the absence of good stocks to buy, be in cash. The opportunity cost of cash is not as high now as in a secular bull market.

- Increase your margin of safety: fewer (better) stocks will be in your portfolio.

- Favor dividend-paying stocks. Dividends were over 90% of the return in previous sideways markets. (Warning: dividends are *part* of the analytical equation, not the whole equation.)

- Look overseas – increases returns without increasing risk.

Thank You!

More information about Investment Management Associates, Inc. can be found at www.imausa.com

To read Vitaliy's articles or subscribe to his free emails, go to www.ContrarianEdge.com

You will find our ADV Part 2 and our brochure at http://bit.ly/infoima