



# ARGUS

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We are pleased to provide a valuable source of independent research to assist you in today's rapidly changing market place.

This report will familiarize you with Argus Research in order to facilitate your use of our service.

**Argus has been providing quality independent equity research for 70 years. In 1934, Harold Dorsey, a prominent economist, saw a need for independent research on Wall Street and established Argus Research in order to provide basic, fundamental investment research for institutions and brokerage firms. Mr. Dorsey's founding principles of quality, independence, ethics and customer service have stood the test of time. Over the years, they have evolved to become a set of standards to which we are dedicated.**

QUALITY  
RESEARCH

As a leading provider of independent research, the quality of our final product is critical to our success. We have a number of systems and procedures designed to ensure that our products — primarily our opinions — are generated through high-quality techniques. In this report, which we publish quarterly, we seek to quantify the quality of our research.

Quality control starts with the people we hire. We seek experienced individuals with strong backgrounds either in financial analysis or the industries they will analyze. The average Wall Street financial analysis experience on our staff is 11 years; the average tenure at Argus Research is 7 years. More than two-thirds of our analysts have advanced degrees; one-half have earned or are pursuing the Chartered Financial Analyst designation.

Once they are on board, Argus analysts go through a training program to learn the Argus system for analyzing stocks. This system, developed over the 70 years we have been in business, employs a top-down, fundamental framework to generate specific equity recommendations. The system, which includes rigorous analysis into a company's management, its industry, growth prospects, financial condition, risks and valuation, is similar to the methodology stressed in the CFA program. Of course, training at Argus Research is ongoing. We sponsor our analysts in the CFA program, and in other continuing education endeavors.

The hierarchy at Argus Research is flat, by design. Our front line is comprised of our relationship managers and our investment analysts — not junior analysts or customer support — to better serve the client base when they call with specific questions. The analysts in turn report directly to the Director of Research, so as to ensure a seamless transfer of information in our top-down investment-decision process. The analysts have advanced research tools at their disposal to maximize their efficiency. At the same time, we encourage them to spend the energy and time to get to know the managers, customers, competitors and suppliers of the companies they cover. Our analysts meet with managers at their headquarters, at our headquarters and in the field.

We continue to learn from the conflict-of-interest controversy, and, as we are strong believers in the idea of continuous improvement, have instituted a number of new “best practice” policies to further ensure that our analysts and our ratings are independent. Our operating principle, as it has always been, is that Argus employees must always put our clients’ interests first. And our business model remains the most important step we take to protect our clients’ interests. As an independent research company, we do not participate in the investment banking or brokerage businesses, and we do not provide consulting services to the companies we cover, so our research conclusions are not compromised by alternative objectives or pressures. In the interest of fair disclosure, we are affiliated with two other Argus companies, Vickers Stock Research and Argus Investors Counsel, which is a Registered Investment Advisor with the U.S. Securities and Exchange Commission and submits detailed information to the government about the principals and owners of our firm. We do believe that there can be a balance between the principle of placing our clients’ interests first and allowing members of our staff, including our analysts, to own the stocks that we follow. We have had strict policies in place for decades that prohibit all employees from buying or selling specific stocks within five days of an analysts’ rating or estimate change. Individual analysts also are prohibited from investing counter to their recommendations. Further, when analysts appear in the media, they must follow disclosure guidelines related to stocks they or their families own. Viewers or readers can request free detailed reports on the securities mentioned by our analysts in the media by contacting our marketing department.

Each of our recommendations must have a clear, reasonable and adequate basis. Every rating starts with the individual analyst’s application of our six-point system. On a weekly basis, the Director of Research holds a research meeting at which the analysts discuss the specific stocks they are considering upgrading or downgrading. Their ideas are presented to the entire group of analysts for comment and debate. Afterward, the analyst meets with the Director of Research or other Investment Policy Committee member for a final decision (our Investment Policy Committee includes Director of Economic Research Richard Yamarone, Associate Director of Research Jim Kelleher, CFA, and Director of Market Strategy David Ritter). At the same time we encourage our analysts to fully understand the companies under coverage, we discourage them from becoming too close. Material gifts from companies under coverage to analysts are prohibited. Our analysts are also prohibited from submitting the conclusions from their research reports to the companies for review. Obviously, our analysts are unable to offer coverage of companies in exchange for investment banking business because we don’t compete in the investment banking business. Finally, when we drop coverage of a company, our policy calls for rating the shares as a SELL, and continuing to provide published analysis on the company for a period of 90 days.

Our simple, clear and effective rating system communicates to our clients our opinions about the securities we cover. We use three ratings – BUY, HOLD and SELL. For a stock to make the BUY list, the analyst must expect its risk-adjusted returns to outpace the market over the next 12 months. HOLDs are expected to perform in line with the market, and SELLS are expected to underperform. Each month, in the first Weekly Staff Report of the month, we publish a table that displays our distribution of ratings. Distributions by industry are published each month in the Investment Portfolio Guide. Information on each of our ratings, including the date established and the price, is available on our Master List.

Each of the quality control measures contributes to the overall quality assurance of the Argus Research product. Our 70 years of operation — through Depressions, recessions, bear markets and bulls — is another tangible measure of the quality of our research.

Our recommendations - BUY, HOLD and SELL - reflect the judgment of an analyst about a company's prospects as an investment in terms of value, expected growth and risks.

Argus Research does not bring companies public, advise companies on mergers and acquisitions, broker trades, make markets in stocks or manage money. Our independence allows us to make critical judgments about companies that we might not be so free to make were we competing for a firm's underwriting business. Because we're not a broker/dealer, we don't have "inventory" of a stock that we have to move with a tainted recommendation.

We have developed a six-point system for analyzing the stocks in our Universe of Coverage. We believe that this system, combined with our independence, gives us an edge as we develop our ideas, forecasts and ratings.

➤ The system, a blend of top-down and bottom-up analysis, begins with **Industry Analysis**. Our first step is to formulate a forecast for the economy and interest rates, then we collaborate with the Industry Analysts to determine which industries are expected to perform well over the next one-to-two years. Within the industry, an Analyst will determine a specific company's competitive position and its prospects.

✳ **Growth Analysis** is the second step in the process. Looking forward, we forecast growth in sales, earnings (operating and/or GAAP), dividends and cash flow for each company by studying growth in individual product lines, in margins, in the industry and in the economy. Looking backward, we smooth a company's historical growth rates in numerous metrics, including balance sheet items, and analyze them versus the company's peers and the market. In our analyses, we comment about the "quality" of a company's earnings.

✳ **Financial Strength Analysis** is the third step. We determine a Financial Strength rating for each company in our Universe of coverage. To assess financial strength, we conduct an elaborate ratio analysis, moving beyond the financial statements and into the footnotes of a company's publicly available documents to fully address obligations and opportunities.

✳ The fourth step is a qualitative **Management Assessment**. In short, our analysts need to know management in order to make a recommendation on a stock. To get to know management, they attend meetings and presentations with senior managers, travel to corporate facilities and participate in conference calls.

✳ **Risk Analysis** is the fifth step. We consider risk from both a qualitative and quantitative standpoint. On a qualitative basis, we review each company in the context of Harvard Professor Michael Porter's Five Forces model to determine potential threats. On a quantitative basis, we analyze proprietary data from our sister company, Vickers Stock Research, regarding institutional and insider ownership trends. We conduct a regression analysis to determine the correlation of a company's stock returns with the market's returns, and we determine the predictability of the relationship. We also measure the volatility of key financial statistics such as sales and earnings growth, and margins. Finally, we determine a fundamental floor for every stock in our universe through our

✳ **Valuation Analysis** is the final step. Over the years, we have developed a multi-pronged model to help with valuation. In a first step, we compare a company against its peers on metrics such as P/E and Price/Sales ratios, and dividend yields. Second, we analyze stock price activity in terms of annual sales, cash flow, dividends, book value, earnings, and earnings relative to the S&P 500. We determine normal ratio "ranges" for these various parameters, and then adjust the ranges going forward based on trends in a company's growth and profitability. We apply the adjusted ranges to our key sales, earnings and cash flow forecasts to arrive at a normal trading range. Once the range has been determined, we use two-stage and three-stage dividend discount modeling to arrive at a target price, which we estimate can be achieved over a 12-month period.

A company in the Argus Universe can be designated a SELL for not passing any of the steps. Most often, stocks rated SELL are either fully valued, face extraordinary risks, or are in an industry that is expected to underperform the broad market.

## MODEL PORTFOLIOS

Argus offers a vast array of products on a daily, weekly, monthly and quarterly basis. Of these products, some of the most popular are the Model Portfolios. Since 1997, Argus has maintained model portfolios meant to provide portfolio managers with the tools to manage funds for their individual clients. Originally encompassing five investment styles, the broker-based model portfolios have grown to six: Equity Income, Growth & Income, Blue Chip, Aggressive Growth, Mid-Cap Growth and New Era. These portfolios enable brokers and account reps to manage investment holdings across a spectrum of clients, from retired, conservative investors requiring income to salaried recent college grads who can afford to take long-term risks and have no portfolio-income requirements.

The genus “model portfolio” occupies its own niche in the realm of investment management. A model portfolio is neither an index, such as the S&P 500, nor is it an actively managed mutual fund. Indexes, typically the benchmarks against which model portfolios are compared, are an inexact measurement device. Index performance, whether size- (S&P 500) or equal-weighted (DJIA), does not reflect any transaction costs, even though component stocks cycle in and out regularly (S&P 500) or infrequently (DJIA). Moreover, bid-ask spreads are not a factor in measuring index performance, as they are in actively buying and selling stocks. Finally, execution effects, such as large-block trades in small-float stocks, are not measured in index performance. Unlike a mutual fund, the Argus Model Portfolios are not adjusted on a real-time basis, except in exceptional cases.

Yet if the model portfolios appear to offer execution and transaction costs exceeding those of indexes, and if they lack the daily monitoring capability of actively managed mutual funds, they also offer some strong positives.

Compared to indexes, the hypothetical Model Portfolios are actively managed, and draw on the resources of the Argus Research staff. Component Indexes are merely “dumb” investment vehicles; as S&P index fund holders can testify, they mirror broad market trends, a fact that hurt their performance during 2000 and 2001.

Compared to actively managed funds, the models can offer a tax-advantaged vehicle that is not reliant on the conflicted research that is published by sell-side brokers. With mutual funds, the daily monitoring function frequently leads to high levels of churn, as managers chase performance in volatile markets; this can create capital gains consequences even when performance is negative. More significantly, mutual fund portfolio managers often rely for investment advice on the sell-side divisions of the major brokerages, which furnish investment research for free in hopes of generating brokerage commissions. As has been repeatedly documented, the sell-side divisions of the major brokerages are entangled with their investment banking arms, leading to concerns about the independence and validity of that research. Argus Model Portfolio managers rely exclusively on analysis provided by the investment analysts at Argus, which does not trade for its own account or engage in investment banking, and which has been a source of independent research since 1934.

As for managing the Models, we apply a consistent, rigorous process month after month. Each month, the model portfolio managers lead a staff meeting with the research analysts to discern their best ideas. Then, the managers, armed with performance and benchmark data, along with portfolio metrics, meet with the Director of Research and with other senior Argus portfolio experts to review, plot and execute strategy. Our programming department has written a software tool that draws on our proprietary research database and allows us to perform scenario analyses. The BUY/HOLD/SELL decisions are typically reached after the close of trading, and the changes to the portfolio, along with the rationale, are distributed to the clients via the Research Notes service the next morning.

Performance statistics are maintained by an independent, third-party data provider. We publish the performance information quarterly.

The hypothetical Model Portfolios are designed to be used in conjunction with other Argus Research Portfolio reports, including the Investment Portfolio Guide, which offers Asset Allocation models, and the Fixed Income Strategy Report, which lists specific income-oriented investments for portfolio consideration.