



THE ADVISOR

DARDEN CAPITAL MANAGEMENT

Darden Graduate School of Business Administration

The University of Virginia - Charlottesville, VA

FALL 2012

Darden Capital Management

Leadership

Taylor Heaps D'13, Chief Investment Officer
Taylor Henry D'13, Chief Operating Officer
Teddy Lamade D'13, Director of Research, Editor-in-Chief

Senior Portfolio Managers

Liz Webber D'13, Cavalier Fund
Jack Bannister & Taylor Burroughs D'13, Darden Fund
Chris Lavine D'13, Jefferson Fund
John Gladden D'13, Monticello Fund
Jay Scherer D'13, Rotunda Fund

Contents

- 3 - A Letter from the Chief Investment Officer
- 4 - Fund Performance
- 5 - DCM First Half Recap
- 9 - DCM Speaker Series
- 11 - Darden Attends Next Generation Investing Event
- 12 - University of Virginia 2012 Investing Conference
- 15 - DCM Launches Inaugural Darden at Virginia Challenge
- 16 - DCM Participates in UNC Alpha Challenge
- 17 - Women in Investing Conference
- 18 - Stock Pitch Competition Highlights
- 19 - Stock Pitch Winner . . . Petsmart (PETM)
- 22 - Darden Capital Management Reading List
- 26 - Market Thoughts

Darden Capital Management is a student-run organization whose purpose is preparing its membership for careers in investment management and research as well as other functions within the financial markets.

In 1990, The Darden Foundation recognized that the best preparation for careers in these industries is hands-on investment management experience. Accordingly, the Trustees earmarked \$250,000 from the Foundation's overall endowment for active management by Darden students.

Today, Darden Capital Management's assets under management have grown to over \$7,000,000 held in five funds, making it one of the largest programs of its kind. The Cavalier, Darden, Jefferson, Monticello and Rotunda funds are managed independently and provide the opportunity for Darden students to develop skills in investment analysis and portfolio management.

Darden alumni and other investment professionals are encouraged to consider first year students for internships and second year students for full-time positions within the space. For more information, please contact [Jack Oakes D'89](#), Director of Darden's Career Development Center, at 434-924-7686.

Cavalier Fund

Liz Webber, Senior PM
Andy Hall
Matt Schultz
Julie Young

Monticello Fund

John Gladden, Senior PM
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Roddy Tilt
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Darden Fund

Jack Bannister, Senior PM
Taylor Burroughs, Senior PM
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John Ingram

Rotunda Fund

Jay Scherer, Senior PM
Jay Beekman
Jason Pan
Agnese Roberts

Jefferson Fund

Chris Lavine, Senior PM
Amanda Buckland
Mike Kovars
Kevin Lam

A Letter from the Chief Investment Officer

Taylor Heaps D'13, Chief Investment Officer

With the first semester behind us, Darden Capital Management also closed the books on a successful first semester amid considerable challenges in the market. I am extremely pleased with the progress we have made towards raising the profile of the DCM program and the investing focused students that are a product of the hands-on investing experience.

Since taking over the fund in April, the five DCM funds have been challenged by an investing climate that has been driven by macro headlines. The debt situation in Europe, a potential hard landing in China, and US presidential election has demanded the markets attention. However, we have fared relatively well in this environment. Overall, we finished 2012 just 15 bps shy of our blended benchmark after taking a very defensive position heading into the summer.

From a purely academic standpoint, I believe that this environment provides an excellent experience for the members of DCM. While we predominantly use a bottoms up approach when making investments, the large market swings based on macro events has led us to often begin with a top-down theme to generate ideas. It has forced the fund managers to become very well rounded and flexible.

DCM continues to refine and improve upon the foundation that previous portfolio managers left. Arguably most notably, DCM hosted the first inaugural Darden Value Investing Conference, which coincided with the 2012 UVA Investing Conference. We have also made significant efforts to engage the First-Years in the weekly meetings and encourage them to act as the idea generation arm of each fund by presenting ideas at every meeting.

Looking to the future of DCM, I am extremely pleased at the efforts spearheaded by Dean Bruner, Prof. Eades, and Prof. Allayannis to create a Center for Asset Management. There has always been a strong connection between asset management and the academic community. The creation of a dedicated center at Darden will serve to bolster the resources committed to investment management at Darden and increase the influence that Darden has on the investing community at large.

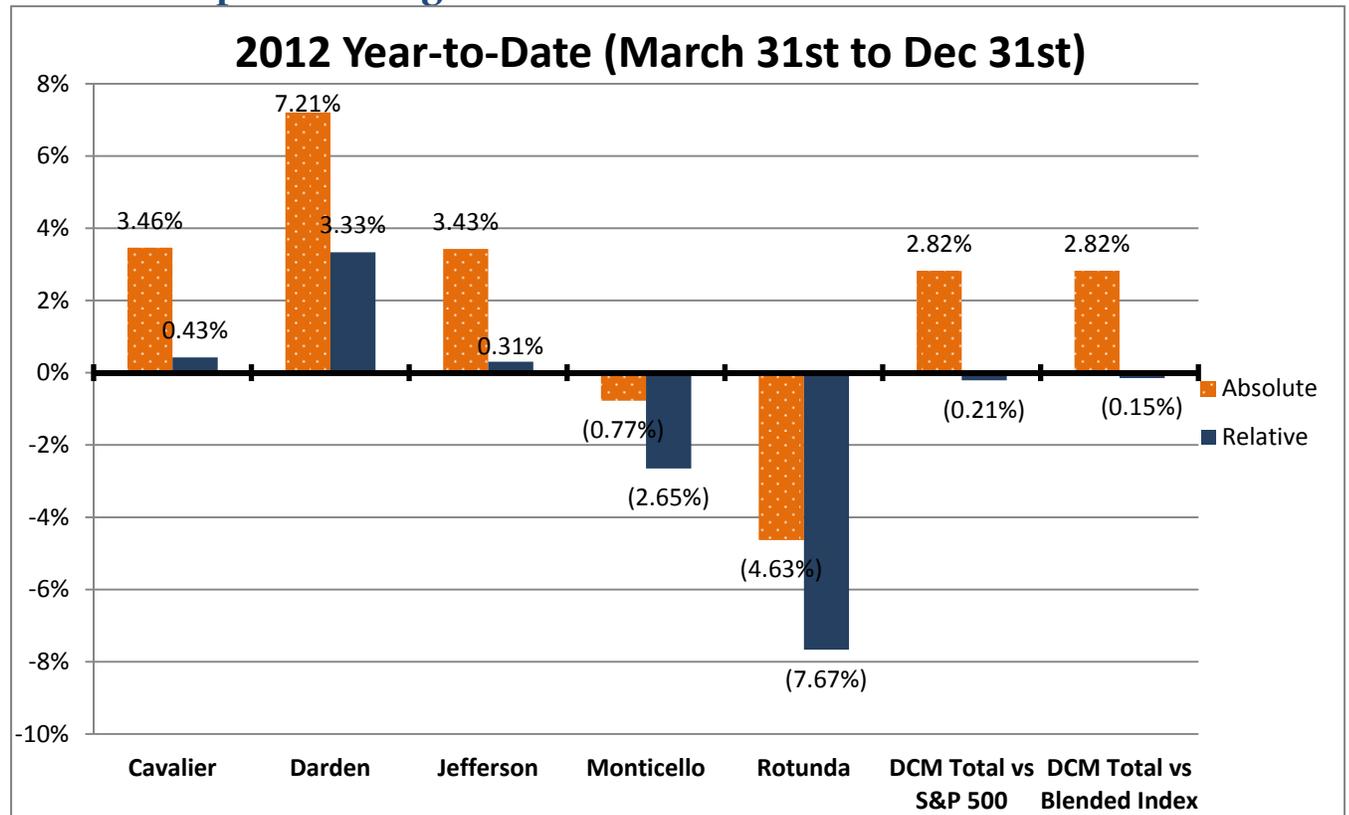
As always, the opportunity to be a part of Darden Capital Management has been an incredible experience thus far. I speak on behalf of my fellow classmates and fund managers when I say that we are honored to be participants in the program and are truly grateful for the trust placed in us as stewards of the Darden Foundation.

Sincerely,

Taylor

Fund Performance

Darden Capital Management



Darden Capital Management Monthly Report

Dec-2012 Month End

Absolute & Relative Returns

	Cavalier	Darden	Jefferson	Monticello	Rotunda	DCM Total	DCM Total
<i>Fund Benchmark</i>	<i>S&P 500</i>	<i>S&P 600</i>	<i>Russell 1000</i>	<i>MSCI World</i>	<i>S&P 500</i>	<i>S&P 500</i>	<i>Blended Index</i>
Month-to-date Return							
Absolute Total Return	(0.24%)	2.85%	(0.39%)	1.87%	2.01%	1.19%	1.19%
Stock Price Return	(0.67%)	1.85%	(0.80%)	1.57%	1.61%	0.63%	0.63%
Dividends & Interest	0.43%	1.00%	0.41%	0.30%	0.40%	0.56%	0.56%
Relative Total Return vs Benchmark	(1.15%)	(0.45%)	(1.43%)	0.12%	1.10%	0.28%	(0.57%)
Benchmark Total Return (US\$)	0.91%	3.30%	1.04%	1.75%	0.91%	0.91%	1.76%
Year-to-date Return (since Mar-2012)							
Absolute Total Return	3.46%	7.21%	3.43%	(0.77%)	(4.63%)	2.82%	2.82%
Stock Price Return	0.58%	4.97%	1.16%	(2.65%)	(6.15%)	0.60%	0.60%
Dividends & Interest	2.53%	1.88%	1.92%	1.48%	1.17%	1.87%	1.87%
Relative Total Return vs Benchmark	0.43%	3.33%	0.31%	(2.76%)	(7.67%)	(0.21%)	(0.17%)
Benchmark Total Return (US\$)	3.03%	3.87%	3.12%	1.98%	3.03%	3.03%	2.99%

DCM First Half Fund Recap

Cavalier Fund

Julie Young D'13, Portfolio Manager

The Cavalier Fund serves as a long/short equity hedge fund that focuses primarily on domestic equities including small, mid-and large capitalization companies. Our goal is to produce positive alpha with low volatility by purchasing great businesses at reasonable prices and shorting flawed businesses at overvalued prices. The Cavalier Fund was very satisfied with the portfolio during the first half of the year. We inherited a fully invested portfolio from the former managers and used the two months leading up to the summer to sell any high beta names or companies that we did not have full conviction in prior to starting our internships. Throughout the summer our cash position increased as stops were triggered, causing us to slightly underperform our benchmark. Upon returning to school in late August, we quickly got to work to find quality ideas to invest in to reduce our cash percentage. For the first half of the year, we heard 16 pitches and purchased eight long stocks and entered three short positions.

One big initiative for us has been to find short ideas to comply with our mandate as a Long/Short portfolio and to mitigate the negative effects of a downturn in the market. Our goal as portfolio managers is to enter pair trades by finding short ideas that pair with existing positions in the portfolio or that are pitched with a long idea as two new trades for the portfolio. Additionally, we have followed the advice of our predecessors that the best short ideas are once large, prominent companies that are now in declining industries with failing business models. We have continued to search for these “melting icebergs.” Most of our best performing stocks year-to-date have been short-term trades, enabling us to meet our price targets and sell or cover within a few weeks of entering the position. Our focus continues to be on increasing our short exposure and reviewing our existing names to ensure the thesis is still valid and exit the position when the target is reached or there is a better investment idea presented.

Darden Fund

Taylor Burroughs D'13, Co-Senior Portfolio Manager

The Darden fund, which specializes in small / mid-cap companies with a market capitalization of \$3 billion or less, posted strong returns in 2012. Our fund has exceeded our benchmark indices of the Russell 2000 and S&P 500 by over 300bps. We continue to believe the small cap equity space presents compelling investment opportunities and are strategically positioned to capitalize on several catalysts we think offer the potential for additional outsized fund performance.

Throughout the global financial crisis a groupthink mentality for investors seemed to prevail; seek the safety of large cap dividend paying stocks. This risk aversion phenomenon, which at times transcended all risk assets for the relative safety of USD denominated fixed income products, created and continues to foster an environment attractive for the small cap space for those willing to identify and exploit inefficiencies between market and intrinsic value. We believe this bottoms-up value approach coupled with patient capital has been and will continue to be a key aspect of our fund's alpha generation.

Also of note, record amounts of cash on large corporate balance sheets, an attractive financing environment and a lack of organic growth opportunities should lead to resurgence in M&A activity. By investing in several 'best in class' niche-market players we believe takeover potential is real and not reflected in current valuations. Additionally, these companies enjoy strong cash flow and in some cases dividend or share buyback policies. In these instances, the Darden fund has found stocks that provide persuasive investment cases with takeover potential and/or getting 'paid to wait.' GLNG and HSH are two currently held prime examples of this philosophy.

Financial leverage and the impact of dramatically higher rates is something that requires extra care in the small cap space and is a regular part of our vetting process. This fear of over leverage and the tendency for many of the names in the space to be less diversified in revenue streams led us to pare some positions, most interestingly a long term winner for us MTW, and is something we will continue to monitor going forward.

On balance, we view the opportunities within our investable universe to be wide-ranging and not germane to specific macro or sector calls which have never been a core competency of our fund. We have always believed the old adage those who live by the macro crystal ball will end up eating shattered glass. The small size of these companies and lack of sell-side analyst coverage mean an already inefficient financial market can be even less so. This is good for us and we will continue to spend the remainder of our days as stewards of DCM capital dedicated to exploiting these opportunities.

Jefferson Fund

Chris Lavine D'13, Senior Portfolio Manager

The Jefferson Fund is the GARP Strategy (Growth at a Reasonable Pace) within DCM. We took over a portfolio filled with best-of-breed names that fit within that mandate. These names performed well for the previous managers last year and helped us outperform over the summer as we kept the majority of the portfolio intact. The

names performed so well, in fact, that the valuations looked stretched and we proactively trimmed positions such as Hain Celestial and Under Armour.

The Fund has been under-positioned in healthcare, energy and financials so we plan to continue our research effort to find high quality names in those spaces. Specifically, we are avoiding areas of healthcare where we are not be able to add much value such as pharma/biotech companies, and instead found an interesting play in the group purchasing space that lowers costs and increases revenues for healthcare providers. Within energy we are looking for lower risk exploration & production companies, focusing on cash flow positive names with a history of growing production and reserves. Lastly, we began looking into non-bank financials that are less vulnerable to regulatory risk, such as the aircraft leasing and niche insurance companies.

Monticello Fund

Roddy Tilt D'13, Portfolio Manager

The Monticello Fund is our international fund and focuses on investing in a blend of companies that have global operations or are domiciled overseas. Since coming back from our summer internships we have seen unprecedented moves out of the Federal Reserve with the announcement of QE3, which has kept real yields negative to 2032 maturities. The Monticello Fund positioned the fund defensively going into year-end due to uncertainty around the election, potential deteriorating US economic conditions with the oncoming fiscal cliff, persistent negative news out of Europe, and slower growth in Emerging Markets. Since the financial crisis of 2008, central banks have boosted the markets with unprecedented quantitative easing and Operation Twist but structural problems remain around excessive indebtedness, inadequate policy response, growing inequalities, and rising inflation risk. The lack of transparency out of Washington has led to a slump in overall business activity and an unwillingness of companies to put cash to work. This explains our tepid approach to constructing the portfolio for year-end and into 2013. On the positive sign, housing is likely to contribute to GDP in 2013, which will mark the first time that it will be additive to GDP since the 2008 financial crisis. With mortgage rates near historic lows, homebuilders are increasingly optimistic following four years of record lows in construction.

Our US economic outlook is somewhat negative and much hinges on the resolution of the debt ceiling, austerity, and pro-growth measures. We believe that the US GDP growth will grow in the 0 to 2 percent range in 2013, but could see contraction if the fiscal cliff does not get resolved. Europe will continue to be a drag on the global economy with GDP growth of -1 to 1 percent, although we believe that there are

interesting opportunities in Europe on a selective basis. Finally, while Emerging Market growth seems to be slowing, we expect it to outpace Developed Market growth with GDP growth near 5 percent. Given relatively stronger Emerging Market growth, we are looking to build out our exposure to South America and Asia. Given much political uncertainty, we are favoring a defensive portfolio going into 2013 with reputable value companies that generate solid cash flow. That said, we are looking to round out our defensive portfolio with growth companies, especially in Emerging Markets.

Rotunda Fund

Jay Scherer D'13, Senior Portfolio Manager

The Rotunda Fund integrates sustainability research with fundamental analysis to select investments that are likely to outperform the market due to the improved long-term financial performance and lower risk features that accompany sustainable practices. Over the past several months the Rotunda fund team has worked vigorously to re-balance the portfolio sector weightings with names that the team believes provide fundamental value and also adhere to the fund's core sustainability thesis. This exercise included divesting several names that were deemed "unsustainable" or no longer attractive holdings and adding a number of new positions. Following a significant cash drag in the summer months that resulted in relative underperformance, the team has remained cognizant of unutilized capital and strives to remain nearly fully invested while keeping only minimal cash balances for opportunistic investments. Following this aforementioned restructuring, the portfolio has recovered nicely and performs more consistently with the market.

While we feel the fund is much more appropriately balanced with industry exposures and risks, we continue to look for high-quality sustainable names that we can add to the portfolio. We have identified several positions that we will look to exit in the near future and continue to watch a handful of stocks that we believe will be attractive additions to the portfolio. The fund is not immune to market turmoil, but has recently displayed less volatility to the downside which we consider a valuable trait in an unsure investing environment. In general, we believe the fund is well positioned for future performance and look forward to the coming months.

DCM Speaker Series

Teddy Lamade D'13, Director of Research

With the Presidential election this fall, the “fiscal cliff” that loomed at year-end, and uncertainty on both the fiscal and monetary fronts, DCM made a conscious decision to focus this fall’s speaker series on areas that will help our five funds navigate the markets more effectively. By understanding the possible implications and pitfalls that these developments might bring, we felt we would be able to apply a “macro overlay” to our traditional bottoms-up fundamental analysis.

Brant Imperatore (Darden EMBA '13), co-founder and managing partner of the Cypress Group, came and spoke to DCM members on Wednesday, October 17th. The Cypress Group is a boutique consulting and research firm based in Washington, DC, with offices in Baton Rouge, Dallas, and New York. Cypress Advisory provides institutional investment and corporate managers with actionable intelligence and analysis of political processes with outcome-specific probability and immediate market relevance. Brant is intimately involved with a broad range of financial services issues including derivatives, mortgage reform, financial crisis response, accounting, insurance, tax, anti-money laundering, bank regulation, and consumer data.

In his meeting with DCM back in October, Brant focused on a variety of issues such as handicapping and scenario planning, the chances that political meandering will force us over the fiscal cliff, the market impact of politicians not reaching a deal, the future impact of Dodd-Frank, impact of carried interest and other tax provisions, and a whole other host of legislation related issues that could impact the markets. DCM members took a lot away from this meeting with Brant, especially in regards to how to view their portfolios in a more dynamic way that mixes macro, micro, and legislative variables.

Robert Burns, Vice President of Account Management at PIMCO, was the second speaker in our speaker series and travelled to Charlottesville on Thursday, October 25th. Bob’s presentation focused on three topics: (1) An introduction to PIMCO; (2) Highlights of the firm’s Top-Down Investment Process; and (3) PIMCO’s Economic Outlook.

With assets under management near \$1.8 trillion and some of the most highly regarded investment professionals in the world, PIMCO is regarded as one of the most instrumental asset managers in the world. The firm’s investment solutions include fixed income, active equities, alternatives, and asset allocation.

PIMCO's strategy focusing on a long-term orientation, both top-down and bottom-up analysis, diversified sources of return, and strong risk management, enabled PIMCO to more ably weather the credit crisis of 2009. It coined the phrase "new normal" highlighting a lower than average GDP growth rates, higher unemployment, and a period of increased instability in the markets. As a result, they have developed an outlook based around the combination of slowing real growth due to continued policy confusion and overly incremental public and private sector responses. This will lead to heightened potential for inflection points that could put the global economy on the constant brink of a double dip.

DCM was very fortunate to have a speaker like Mr. Burns visit Charlottesville and look forward to a continued relationship with PIMCO.

Darden Attends Next Generation Investing Event

Teddy Lamade D'13, Director of Research

On October 4, 2012, Darden students were attended the **Next Generation Investing Event** in Baltimore, MD. Attendees listened to a panel highlighted by **Bill Miller** (Chairman and Portfolio Manager at Legg Mason Capital Management), **Lisa Rapuano** (Founder and Portfolio Manager at Lane Five Capital Management), **Robert Smith** (Vice President and Portfolio Manager for International Equities at T. Rowe Price), and **Ken Stuzin** (Partner and Large Cap Growth Portfolio Manager at Brown Advisory) to Twelve Darden students attended this year's enlightening event.

Each speaker presented three to four equity stock pitches ranging from long distressed domestic airline stocks to opportunities in foreign technology stocks to ways to play the growing agriculture needs of a growing middle class.

The highlight of the Event was clearly **Bill Miller's** animated pitches of Bank of America, United Airlines, and Groupon. He laid out his presentation with a theme of focusing on a historical comparable analysis, with movie clip examples including one from the non-exactly Oscar worthy "Major Payne". When referring to Bank of America, Miller compared Bank of America's stock performance to the Little Engine That Could and Groupon's performance to Amazon's stock price movements in the early 2000's. **Lisa Rapuano** most notable pitch was Intralinks (IL), a technology provider for content management and collaborative solutions. The thesis was largely driven by the increased need for companies like IL due to increased regulations stemming from the Dodd Frank bill. **Robert Smith** focused on the international sector and pitched the relatively well-known stock, Baidu (essentially the "Chinese Google"). **Ken Stuzin** focused on a secular trend towards the growing in the emerging market middle class. His Mead Johnson (MJN) pitch was a play on the growing need for reliable, safe, and high quality nutritional products for young children and infants.

The Next Generation Event was a great way for current Darden students to get a glimpse of how highly successful portfolio managers analyze a variety of sectors, how they view the investing landscape, and

Darden Capital Management was very thankful for its inclusion in this very worthwhile event and certainly hopes to participate in this worthwhile conference again next year.

University of Virginia 2012 Investing Conference

Teddy Lamade D'13, Director of Research

The **Fifth Annual 20 University of Virginia Investing Conference** took place on November 15th and 16th. This year's impressive lineup included **Sheila Bair** (Former Chairman Federal Deposit Insurance Corporation), **David Rubenstein** (Co-CEO and Managing Director of the Carlyle Group), **Kyle Bass** (Managing Member of Hayman Capital Management), **Jeremy Grantham** (Co-Founder of Grantham Mayo Van Otterloo), and **Dennis Lockhart** (President and Chief Executive Officer of the Federal Reserve Bank of Atlanta).

Titled "After the Election: Realities, Opportunities, and Challenges for Investors", the speakers focused on a number of topics ranging from the role of regulation, the global outlook, the evolvment of the sovereign debt crisis, investing in a lower growth world, and panels that discussed the future of Health Care, Energy, and Financial Service industries.

Highlights addressed by speakers:

1. **Fiscal policy:** *How will the U.S. stimulate its economy and yet plot a course to reduce the overhang of government debt?*
2. **Regulatory policy:** *Major sectors of the U.S. economy have been the focus of new and possibly onerous regulations. Will the results of the election change the investment outlook in these sectors? How do the experts handicap the prospects in various industries and economic sectors?*
3. **Foreign policy:** *How will the stance of the administration affect the presence of the U.S. in international disputes in the Middle East, South Asia, East Asia, and Europe? What does this imply for investing in developed and emerging economies?*
4. **Incentives for innovation and business expansion:** *growth remains the major challenge for the U.S. economy in the medium term. Will the administration promote growth in the private sector? What does this imply for a recovery of venture capital and investing in growth stocks?*

Panel discussions:

The first focused on Health Care and consisted of: **Dr. Richard Evans** (General Manager and Co-Founder of Sector & Sovereign LLC), **Robert J. Hugin** (Chairman and CEO of Celgene Corporation), and **Dr. Jay Venkatesan** (Portfolio Manager and Managing Partner of Ayer Capital Management). The second consisted of: **Lawrence Goodman**, President of the Center for Financial Stability, **Dennis Lockhart**, President

and CEO of the Federal Reserve Bank of Atlanta, and **John B. Taylor**, Director of Stanford University's Introductory Economics Center.

Additionally, the UVIC attendees heard keynote addresses from:

- **Kurt Billick**, Founder and Chief Investment Officer of **Bocage Capital**
- **Vincent Daniel**, Managing Member of **Seawolf Capital LLC**
- **Lawrence Goodman**, President of the **Center for Financial Stability**
- **Pierre Lapeyre Jr.**, Founder & Senior Managing Director of Riverstone Holdings
- **Vincent Reinhart**, Founder & CEO of the **American Civics Exchange (ACE)**
- **John B. Taylor**, Director of Stanford's Introductory Economics Center

Despite the fact that a number of the speakers requested that their segments be off the record, the general consensus was that the United States, despite the significant challenges, will continue to be the world's economic bellwether. This being said, there was considerable concern among the speakers regarding the "fiscal cliff" and increasing partisanship in the U.S. Congress.

One thing that seemed to be a consensus view among the participants at the Conference was that we are facing a completely new environment in the U.S. As Jeremy Grantham highlighted in his speech and in his November letter, "On the Road to Zero Growth" (http://www.gmo.com/websitecontent/JG_LetterALL_11-12.pdf), "The U.S. GDP growth rate that we have become accustomed to for over a hundred years – in excess of 3% a year – is not just hiding behind temporary setbacks. It is gone forever. Yet most business people (and the Fed) assume that economic growth will recover to its old rates.

While the slower growth environment dominated many of the presentations, there were some "green shoots" that emerged from the conference and that was in the emerging markets and energy industry. Supporters of alternative investment opportunities believe that there is significant value available in China and India, while Pierre Lapeyre (**Riverstone Holdings**), presented a very optimistic for domestic energy production emanating from the fracking and natural gas deposits in the center of the United States.

Speaker interviews from the 2012 UVIC can be viewed on YouTube. Search: "UVIC 2012" or click on the links below:

Main - http://www.youtube.com/playlist?list=PLKH1z_aubPdP8espjs-XNw7pLy1-nLMYx

Kyle Bass (Hayman Capital)

http://www.youtube.com/watch?v=t7Si3XTl6zQ&list=PLKH1z_aubPdP8espjs-XNw7pLy1-nLMYx&index=1

Sheila Bair (former FDIC Head)

http://www.youtube.com/watch?v=YRZ2mXVM9BY&list=PLKH1z_aubPdP8espjs-XNw7pLy1-nLMYx&index=2

Vincent Daniel (Seawolf Capital - Partner and Director of Research)

http://www.youtube.com/watch?v=8DHzlntwqg&list=PLKH1z_aubPdP8espjs-XNw7pLy1-nLMYx&index=3

Larry Goodman (President of Center for Financial Stability)

http://www.youtube.com/watch?v=ua8lNKohypc&list=PLKH1z_aubPdP8espjs-XNw7pLy1-nLMYx&index=4

Pierre Lapeyre Jr. (Riverstone Holdings) & Kurt Billick (Bocage Capital)

http://www.youtube.com/watch?v=Z0yX4U96Jc4&list=PLKH1z_aubPdP8espjs-XNw7pLy1-nLMYx&index=5

Dennis Lockhart (President of Federal Reserve Bank of Atlanta)

http://www.youtube.com/watch?v=h8ZRw_eokn0&list=PLKH1z_aubPdP8espjs-XNw7pLy1-nLMYx&index=6

Healthcare Panel

http://www.youtube.com/watch?v=QwXtb-d1x04&list=PLKH1z_aubPdP8espJs-XNw7pLy1-nLMYx&index=7

Darden Capital Management held its **Second Annual DCM Alumni Networking Reception** during the first night of the Conference and shortly before the Thursday night football game between UVA and UNC broadcast nationally on ESPN. The event was well-attended by alumni and current DCM members. DCM looks forward to continuing this tradition and hopes you will join in 2013!

Planning for the **Sixth Annual 2012 University of Virginia Investment Conference** is already underway! We have many exciting speakers in the line-up and are excited to announce the conference theme in the coming months.

DCM Launches Inaugural Darden @ Virginia Investing Challenge

Taylor Henry D'13, COO and DVIC Founder

This fall, DCM hosted the inaugural Darden @ Virginia Investing Challenge (DVIC) immediately preceding the University of Virginia Investing Conference (UVIC). DVIC is a *MBA-wide stock pitch competition* where MBA students prepare and present an investment idea that is based on a key theme from UVIC. The mission of DVIC is to raise the awareness in the MBA and asset management communities of Darden's *commitment to the study and practice of investment management* through Darden Capital Management (DCM) and the Center for Asset Management (CAM).

The 2012 DVIC brought *eight* MBA teams together to present ideas on investing in healthcare over the next 12 months. We enjoyed hosting students from Columbia Business School, Fuqua School of Business, Goizueta Business School, NYU Stern, University of Chicago Booth School of Business, University of Notre Dame, and The Wharton School. The winning school, **The Wharton School**, took home the Grand Prize of \$3,000 for their pitch on **Accretive Health (AH)**.

With support from our 2012 sponsors, **Brown Advisory** and **Harbert Management Corporation**, DCM created the foundation for an annual event that will bring together top MBA talent, recruiting firms and DCM alum for a day of knowledge share and debate. We are excited about the opportunities that DVIC offers to our classmates and partnering firms. We look forward to growing the competition in 2013 and hope that you will join us in our efforts! If you are interested in learning more about DVIC, please reach out to Jack Bryant at BryantJ14@darden.virginia.edu.

DCM Participates in UNC Alpha Challenge

Liz Webber D'13, Senior Portfolio Manager, Cavalier Fund

Three members of DCM – Liz Webber '13, Jon Gladden '13, and Kenan Lucas '14 – represented Darden at this year's UNC Kenan-Flagler Alpha Challenge on November 9. The Alpha Challenge is the premier stock pitch competition for MBA students in the United States, garnering teams from a majority of the top business schools both domestically and abroad. This year's team is incredibly proud of the pitches it constructed and enjoyed learning from each other throughout the competition.

For this year's challenge, teams were given a list of 125 Consumer Discretionary stocks and were instructed to pitch one long and one short idea. The stocks spanned all market capitalizations, valuation strategies (i.e. growth vs. value), and subsectors, ranging from restaurants and casinos to footwear and specialty apparel. Unlike the prior year's competition, nearly 100% of the stocks were U.S. domiciled.

The Darden team decided to focus on apparel, pitching a long of Stage Stores (SSI) and short of Fifth & Pacific (FNP). Originally, the team considered several pair trades but ultimately decided on SSI and FNP because the positive tailwinds that would bolster SSI would not significantly impact the short thesis on FNP.

SSI is a department store based in small-town America and operates under several stores names: Bealls, Goodys, Palais Royal, Peebles, Stage, and Steel's. SSI targets towns with fewer than 50,000 people, and they prefer to setup shop next to a WalMart because it drives foot traffic. SSI offers name brand apparel and does not typically face much competition in these markets. With a market capitalization of \$806 million, SSI was one of the smallest names within the universe of stocks from which the team could choose.

The SSI long thesis was predicated on four factors: same store sales are rebounding off of the lows of the recession strongly, small towns have been disproportionately hurt by the economic downturn and are poised for recovery, Steel's off-price concept is underappreciated in the market, and competition is unlikely from online retailers and other department stores. The valuation for SSI backed up the team's story, as the stock was trading at \$25.62 at the time of the pitch and had a price target of \$33.50, representing nearly 31% of potential upside.

On the short side, the team pitched FNP, which designs and markets high-end apparel through four business segments: Juicy Couture, Lucky Brand, Kate Spade, and Adelington Design Group. 95% of sales come from the U.S. with the remaining 5% coming from Canada, the United Kingdom, Brazil, and Japan. While Kate Spade is a decent brand that if scaled properly could drive future growth, Juicy Couture, the company's largest brand, has been destroying value through declining sales and margin erosion for several years. Lucky Brand is a denim apparel brand, which operates in an incredibly fragmented market and offers very limited growth over the long-haul.

Finally, Adelington designs off-brand jewelry for J.C. Penny and is a niche brand, accounting for fewer than 10% of sales.

The FNP short thesis was centered on four factors: Juicy Couture is an outdated brand that no longer resonates with consumers, Kate Spade is too small to counteract the value destruction caused by Juicy Couture, management has lost all credibility due to its inability to execute its turnaround plan, and FNP's current stock price is completely unjustified. Given that the company has reduced its assets through divestitures by \$2 billion, only has \$38 million in cash on the balance sheet, and is already highly levered, the team does not believe management has the financial resources necessary to salvage Juicy Couture

Women in Investing Conference Wrap-Up

Margot Sakoian D'14

This year, the **Women in Investing (WIN)** conference was highlighted by platinum sponsors **Capital Group** and **Fidelity** as well as executive sponsors **MFS, PIMCO, BNY Mellon, Putnam, State Street, Causeway, and Wellington.**

The conference was well represented by top MBA programs beyond Darden, including **Columbia, Johnson, Tuck, Sloan, Booth, and Wharton.** It was a fantastic opportunity for students to network with peers and company representatives alike.

Heather Carrillo was the keynote speaker for the 2012 event. She is a portfolio manager for Fidelity Asset Management, which is a leading provider of investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing and other financial products and services to more than 20 million individuals, institutions and financial intermediaries. She currently manages Fidelity Export and Multinational Fund.

During the stock pitch competition portion of the event, first-years **Jess Alvarez, Lizzie Gotimer, Madeline Mayer, and Margot Sakoian** pitched **Clean Harbors (CLH).** CLH is a leader in environmental, energy and industrial services in North America. The Darden team presented four key tenets for why they believe CLH will outperform in the long-term: (1) CLH is the gold standard in the industry, (2) high barriers to entry, (3) significant growth potential in acquired new lines of business aimed at the oil and gas industries, and (4) an upside to revenues when natural disasters occur. Based on the company's key metric of EBITDA averaged with the historical P/E multiple, they recommend a buy with a price target of \$68, which has a 21% potential upside from today's price. The Darden team believes it should be a core holding in any long diversified portfolio. The pitch was well received and much different from the other companies that were presented.

Stock Pitch Competition Highlights

Jack Bannister D'13

On October 27th, Darden Capital Management (DCM) hosted the annual **First Year Stock Pitch Competition** in which six finalists, chosen from a field of thirty entrants, competed for prizes and prestige in front of a distinguished panel of judges. DCM was impressed to see such strong commitment from first year students, particularly since pitches were due during exam week.

Congratulations to all our finalists, in particular our winners:

1 st Place	Kenan Lucas D'14	PetSmart, Inc.	NASD: PETM
2 nd Place	Joseph Geissenhainer D'14	Palo Alto Networks, Inc.	NYSE: PANW
3 rd Place	John Petrofsky D'14	CF Industries Holdings, Inc.	NYSE: CF

Runner-up finalists **Charles Land D'14**, **Christopher Lawrence D'14**, and **Jonathan Payne D'14** pitched Kennametal (KMT), Churchill Downs (CHDN), and Kroger (KR), respectively. The varying sizes of companies and wide range of industries discussed left the judges with a difficult decision, but ultimately they couldn't resist PetSmart, a "shareholder's best friend." Kenan's winning stock pitch summary can be found on page 18.

Judges included **Craig Wiese D'04**, Co-Founder of Charlottesville-based **Bema Capital**, **DCM Advisor and Professor of Business Administration Yiorgos Allayannis**, and **DCM Chief Investment Officer Taylor Heaps D'13**.

The Stock Pitch Competition is the culmination of a series of DCM training seminars and the "10-K Challenge," a fast-paced stock-picking contest held in late September and won by **Jonathan Payne D'14**. The training events covered everything from how to tell the *story* of a company, to how to write a stock pitch, to how to value a company using both absolute and relative valuation techniques. DCM members **Jack Bannister D'13**, **Taylor Burroughs D'13** and **Mike Kovars D'13** hosted audiences of more than 50 people at each of the three events.

In addition to the training sessions, DCM offered competition participants the opportunity to discuss their ideas one-on-one with DCM fund managers during designated "Office Hours." These meetings were especially useful for students with good ideas but without a prior background in finance, and they also helped form friendships among the first and second year students.

Stock Pitch First Place: Petsmart (PETM)

Kenan Lucas D'14

PetSmart
NYSE: PETM

October 27

\$69.35

Target:

\$95

Company Overview

PetSmart, Inc., (the “Company,” “PetSmart”, “PETM”), is the leading specialty provider of products, services and solutions for the lifetime needs of pets in the United States, Puerto Rico and Canada. The Company offers a broad selection of products for all the life stages of pets, as well as various pet services including professional grooming, training, boarding and day camp. As of July 29, 2012, PETM operated 1,249 retail stores and had full-service veterinary hospitals in 809 of our stores.

Investment Thesis

The Pet Industry is experiencing very attractive trends, and PetSmart provides an excellent opportunity to capitalize on these trends. People are increasingly treating their pets as well as or better than their children, and are therefore willing to spend more and more money on their pets. Furthermore, PetSmart has grown impressively throughout its history, achieving positive comps, in every year since going public. In addition, Pet Hotels, of which there are only 192 today, offer a significant opportunity to capitalize on PetSmarts relationship with consumers and drive future growth. Finally, management has already begun using free cash flow to return capital to shareholders through a dividend (1.0% yield) and a share buyback plan(\$764 mm repurchased over the past three years). This shows that they will be not be overly risky with growth opportunities outside their expertise and will effectively manage free cash flow to return excess to shareholders. As a result, the dividend yield is likely to increase and share buybacks are likely to continue.

Petsmart warrants a premium valuation to the comps and am relying primarily on the DCFs for my near term price target of \$95.00 (a blend between my DCF and the Morgan Stanley DCF). In the longer term, with the potential evolution of Pet Hotels, I believe the price could easily reach \$125+.

Variant Perception

The market appears to view PetSmart as fairly valued. It is trading above its historical average PE multiple and EV/EBITDA multiple. Also, it is valued in-line with the comps. Furthermore, at 1,249 stores, it is relatively close to the target of 1,600 stores. As a result, the market views growth opportunities as somewhat limited. The market is undervaluing the opportunity of the Pet Hotels and not reflecting the possibility of increasing dividends and share buybacks.

- ***Strong Industry Trends:*** PetSmart is well positioned to take advantage of the prevailing industry trends. There is a very strong movement towards the humanization of pets. Consumers treat their pets as well as or better than their children. PetSmart has capitalized on this by offering healthy pet food and providing more services for pets. These offerings and additional services draw people into the stores and keep them coming back.
- ***Solid Growth Trends:*** PetSmart has experienced positive comparable store sales in every year since at least 1993. While PetSmart's store growth is slowing (the Company believes it can expand to 1600 stores in the U.S. in Canada relative to its current 1,249 stores), PETM is poised to capitalize on additional offerings including boarding through its Pet Hotels.
- ***Growth Opportunities in Services and PetHotels:*** Pet Hotels (194 current locations with an additional 2 expected next year) provide a significant opportunity for growth. The hotels offer services not available at typical pet boarding facilities, which cater to pet owners who treat see their pets as children. As the pet humanization trend continues Pet Hotels should see continued growth. Additional services, such as baths, nail clippings, etc. enable PETM to increase revenue per square foot.
- ***Strong Management Team:*** The current management team has been with PetSmart through the company's expansion and their results have been impressive. Based on their actions to date, I believe they will make smart and targeted investments for growth, while also utilizing free cash flow to return capital to shareholders.
- ***Healthy Dividend:*** PetSmart's dividend is currently 1%, and the company has increased its dividend in each of the last three years. It is likely that the management will continue to increase its dividend.
- ***Share Buyback Plan:*** The board has authorized share buybacks consistently for the last several years. It appears that management will continue to use a portion of free cash flow to return capital to shareholders

Risks

- ***High-end Pet Food Products go to Grocery Stores/Club/Mass:*** To the extent manufacturers start offering their products to mass retailers, PetSmart would be significantly impacted. The Company would likely have to cut price to compete with Mass, Club and Grocery, which would impact margins. I do not believe this is likely to happen. Manufacturers would also be negatively impacted and are unlikely to pursue mass retailers.
- ***Industry Competition:*** PetSmart's most direct competitor is PETCO. There are also independent pet food retailers located throughout the U.S. These retailers all try to negotiate for exclusivity with the manufacturers of new, high end pet food. These exclusivity agreements typically do not last a long time. Even so, to the extent PETCO

or independents achieved exclusivity with a new product, some sales could be pulled from PetSmart. In addition, the competition could put pressure on PetSmart through price cuts or heavy marketing.

- ***Double Dip Recession:*** To the extent the fiscal cliff, or another event, causes another recession or otherwise impairs consumer spending, PetSmart would be negatively impacted. The Company did maintain positive comps through 2008, however, there is no guarantee they would be able to do this again.
- ***Management Fails to Deliver on Existing Growth Opportunities:*** Pet Hotels are only in 194 locations currently. Consequently, this is not a proven offering. Further expansion may not be attainable.
- ***Management Invests in Risky Growth Alternatives:*** Recently, management has been conservatively investing in new stores and Pet Hotels. To the extent they pursue more risky opportunities, or opportunities that are outside of their areas of expertise, financial performance could be negatively impacted.

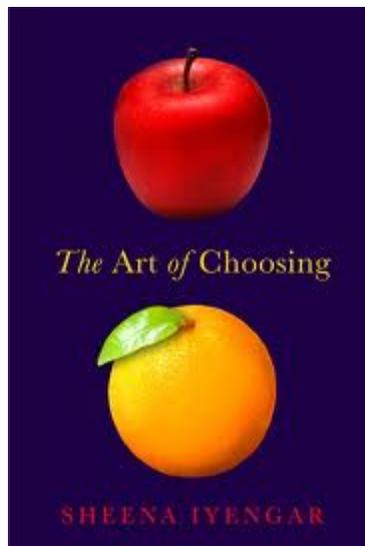
Darden Capital Management Reading List

Teddy Lamade '13, Director of Research

Sheena Iyengar, *The Art of Choosing*
(<http://sheenaiyengar.com/the-art-of-choosing/>)

In *The Art of Choosing*, Columbia University professor Sheena Iyengar, a leading expert on choice, sets herself the Herculean task of helping us become more effective choosers. She asks fascinating questions: Is the desire for choice innate or created by culture? Why do we sometimes choose against our best interests? How much control do we really have over what we choose? Ultimately, she offers unexpected and profound answers drawn from her award-winning, discipline-spanning research.

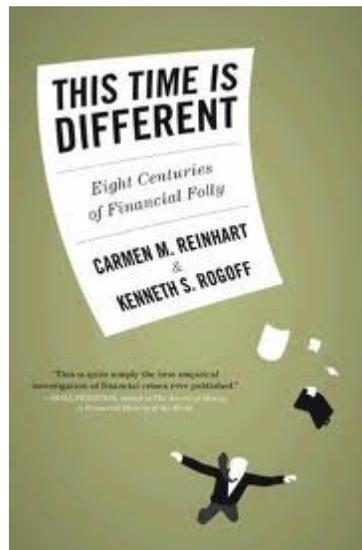
The author goes deep into the complex relationship between choice and freedom, and why one doesn't always go with the other. Too often, people crave more choices, but *The Art of Choosing* makes the argument that these same people are more often happier when their choices are somewhat limited. Too much choice can overwhelm people, leading to unpleasant experiences. In many cases, it leads to a form of decision paralysis. Whether it be shopping in a grocery store, using the television DVR at home, or selecting health plans, Iyengar pulls examples from all walks of life, allowing the reader to directly relate to the experience in some form or another.



Carmen Reinhart and Kenneth Rogoff, *This Time is Different*
(<http://www.reinhartandrogoff.com>)

"This Time is Different" maps the cyclical history of financial crisis from 1810 to 2010 for sixty-six countries representing over 90% of world GDP. "Throughout history, rich and poor countries alike have been lending, borrowing, crashing -- and recovering -- their way through an extraordinary range of financial crises. Each time, the experts have chimed, 'this time is different', claiming that the old rules of valuation no longer apply and that the new situation bears little similarity to past disasters."

It is crucial that people involved in the financial markets, and business school students in particular, have a firmer grasp on the historical cyclicity of the markets and the potential "landmines" that are out there. *This Time is Different* is a seminal book in giving readers insights into why past crisis's have occurred, but just as importantly, how they *will* happen again. Too often we get bogged down in the onslaught of information that pervades our lives in the daily news, CNBC, financial publications, and various "talking heads", but too rarely do we take a minute to reflect on how what is occurring in the present has most likely occurred in a similar form in the past. This book attempts to make those connections.



Gilmore, James H. and Joseph Pine II, The Experience Economy
(<http://www.strategichorizons.com/expEconomy.html>)

"Goods and services are no longer enough." Pine & Gilmore penned those provocative words more than a decade ago in their international best-seller, *The Experience Economy*. The book is now a classic, published in more than a dozen languages; while the ideas it espouses are embraced by readers and companies worldwide. And though the world has changed in many ways since the original book was published, the way to a customer's heart has not. In fact, the idea of staging experiences to leave a memorable- and lucrative- impression is now more relevant than ever. With an ongoing torrent of brands attacking consumers from all sides, how do you make yours stand out?

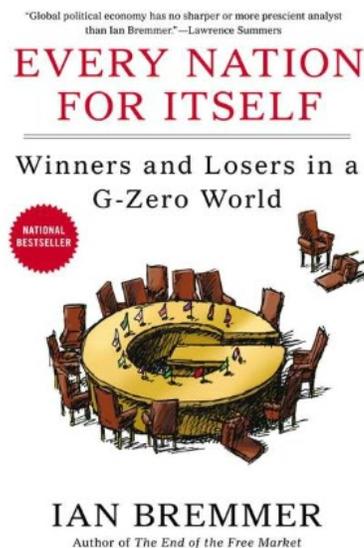
Co-author Jim Gilmore led a January term class focused on "The Experience Economy", which gave students insight into the view that we are entering the fourth phase of the American economy. Following an economy led by agriculture, then manufacturing, then services, the authors make the argument that we are currently heading into the experience phase where customer service will be at a premium. Whether it be the "staged theatre" experience at Starbucks, the family atmosphere created at Chik Fila, or the unique travel experience created by Virgin Airlines, companies that create an experience will thrive, while those who do not will fall by the wayside.



Ian Bremmer, *Every Nation for Itself*

For the first time in seven decades, there is no single power or alliance of powers ready to take on the challenges of global leadership. A generation ago, the United States, Europe, and Japan were the world's powerhouses, the free-market democracies that propelled the global economy forward. Today, they struggle just to find their footing.

Acclaimed geopolitical analyst Ian Bremmer argues that the world power structure is facing a leadership vacuum. With the unifying urgency of the financial crisis behind us, the diverse political and economic values of the G20 have produced global gridlock. In a world where so many challenges transcend borders—from the stability of the global economy and climate change to cyber-attacks, terrorism, and the security of food and water—the need for international cooperation has never been greater. A lack of global leadership will provoke uncertainty, volatility, competition, and, in some cases, open conflict. Bremmer explains the risk that the world will become a series of gated communities as power is regionalized instead of globalized. In the generation to come, negotiations on economic and trade issues are likely to be just as fraught as recent debates over nuclear nonproliferation and climate change. (<http://www.ianbremmer.com/book/every-nation-itself-winners-and-losers-g-zero-world>)



Book descriptions courtesy of Amazon.com

Market Thoughts:

Teddy Lamade D'13, Director of Research

DCM has made a conscious effort to incorporate a more macro overlay to our bottoms-up analysis and as a result, this has encouraged the five funds to better understand and include secular shifts in their security selection process. As a result, as Director of Research, I have tried to provide macro research from various sources such as KKR Macro Strategist (and UVA undergraduate alum) Henry McVey, various PIMCO portfolio managers, and Mike Lipper. In addition, to put our own “DCM spin” on the markets, I have begun a blog focused on the global markets using what we have learned during our time at Darden and through DCM.

I hope you enjoy and any suggestions/comments are strongly encouraged (lamadee13@darden.virginia.edu).

Economic Swings Uncharted Territory September 2012

Life is all about swings. No . . . not the swings we grow up on playgrounds, or the rope swings that drop us into rivers, or mood swings. I am referring to swings in human sentiment; the types of swings that shift dramatically at the drop of a hat and are the reason why the markets become irrational, both on the upside and downside.

In the past five years, we have seen dramatic swings that have caused significant bouts of volatility as the global markets make their way through the most dramatic deleveraging since the Great Depression. As a result, the labor, housing, energy, and sovereign debt markets have all been called into question. What's even more difficult to understand is how they have shifted so dramatically from one extreme to the other. One day its “doom and gloom”, the next its all “peaches and cream”. The experts and pundits have all rolled out various explanations, but their metamorphoses are hard to understand.



Don't believe me? How did the United State go from being subject to the mercy of OPEC and the oil cartel to all of a sudden becoming an energy exporter flush with natural gas and hidden oil reserves accessible by a new extraction technology known as fracking? Why do we hear one day about the possibility of a tiny European country (with a GDP equivalent to the state of Oregon) taking down the entire global economy to, days later, hearing that a solution is at hand and the euro will be preserved? Or . . . why do markets tank at the news that a tsunami has destroyed much of Japan's productive capacity only to see markets rebound as the Japanese people display their incredible resiliency and begin to rebuild? I think a large part of the reason is due to human nature. Humans overreact to negative news , but more often, respond dramatically well to the daunting challenges that surround us.

The question now is where does the "human nature" factor weigh in and what is the next pendulum to swing? It is difficult to argue against the fact that investor sentiment seems to have settled into a period of complacency as the stock market has risen close to 10% over the summer in the face of continuing troubles in Europe, a slowdown in emerging markets, stagnating U.S. data, and the pending "fiscal cliff". With so much uncertainty, I am concerned that QE3 is in large part to blame.

It is certainly a little counterintuitive to think of a rising stock market as "blameworthy", but in the longer term view, it is. A stock market that rises on increasing profits from higher productivity or organic growth or technological advancement or a whole other host of explanations that shift the spectrum of business advancement, is clearly positive. On the flip side, one that rises on increasing margins by cost cutting and is then boosted due to a perceived "Central Bank Backstop" is unsustainable. In the absence of real reform, we are seeing this phenomenon as the Federal Reserve attempts to fulfill the employment part of its mandate by attempting to alleviate the pain of the deleveraging cycle. As Henry McVey, head of KKR's Global Macro & Asset Allocation team said in his recent *Insights* report,

History suggests that governments have several options for attacking excessive debt loads. One option is to significantly raise government revenues through higher taxes; the other is to cut social benefits. However, neither seems particularly popular in a slow-growing economy and demographic environment in which a new baby-boomer turns 65 every 8 seconds. A *third* alternative, which the government is currently pursuing and is almost *always* inflationary in nature, is to hold interest rates down and do whatever it can to get nominal GDP growth above nominal interest rates in order to reduce the debt burner over time.

With Congress being incapable or unwilling to use either of the first two levers, the Federal Reserve has leaned very aggressively on the third lever and recently instituted QE3. Now it is hard to imagine that the specific process of bond buying or anticipation of bond buying that QE3 entails is directly responsible for the stock market rally. How much lower can interest rates go? Instead, I believe that with each subsequent announcement of quantitative easing and the comments from Chairman Bernanke that go along with them, we see a further combination of complacency and euphoria from

equity investors. Why you ask? Because with each QE announcement, the Fed's "support at all costs" becomes more firmly implanted.



The most concerning aspect is that even the Fed is unsure what the consequences might be. Is the Fed just pushing people into risky investments that appear safe to the untrained eye? Are we simply putting off the pain that deleveragings entail for another day or generation? What are the long term consequences of avoiding short term pain? If you read Bernanke's own words at Jackson Hole, it appears he doesn't even know.

As the Committee embarked on this path, we were guided by some general principles and some insightful academic work but--with the important exception of the Japanese case--limited historical experience. As a result, central bankers in the United States, and those in other advanced economies facing similar problems, have been in the process of learning by doing. (*Monetary Policy since the Onset of the Crisis*, Chairman Ben S. Bernanke at the Federal Reserve Bank of Kansas City Economic Symposium, Jackson Hole, Wyoming, August 31, 2012)

"Learning by doing"? With trillions of dollars and the global economy at stake, I am not sure I love this approach and fear the swing might come off its hinges.

The “A’ha!” Moment

How to think about Investing in this Globalized Economy

October 2012

I had an “A’ha!” moment last spring when I spent a few hours listening to John Griffin (Blue Ridge Capital founder and former Tiger Cub), Rick Gerson (founder of Falcon Edge Capital and Griffin’s protégé), and Michelle Kelner (portfolio strategist at Prince Street Capital) at the McIntire School of Commerce’s Spring Investing Symposium (try saying that quickly ten times). While in Old Cabell Hall at the end of the UVA lawn, I was frantically jotting down notes while trying to digest their comments. I recently reviewed my notes and noticed three highlighted quotes that applied directly to how we should be looking at the markets right now, especially business school students.

“You make the most money when things go from really bad to just bad” – Rick Gerson

“For Emerging Markets investing, you need to have direct information: visit the countries, read the local newspapers, check out local company websites, read local blogs.” – Michelle Kelner

“Be optimistic and don’t listen to the naysayers . . . the US and global economy has been through worse. Investing timidly will only lead to missed opportunities. Also, for perspective, Greece’s GDP is the equivalent of Oregon’s GDP” – John Griffin

In today’s markets, despite the apparent risks in investing globally, we cannot simply look stateside for opportunities, especially during the most uncertain and volatile times. Why? For one thing, you are closing yourself off to endless opportunities to invest in countries with better growth prospects, natural resource opportunities, liberalizing financial markets, and stronger demographics. It would be like a Virginian saying in the mid-1800’s that they would only invest in the Commonwealth despite the opportunities that the transcontinental railroad was opening up out west because of the “vast dangers” in this “uncharted territory”.



When investments “at home” stabilize and yields compress like they have in the US, investors should scour the world for investments that are “dangerous” or appear to be going badly, analyze the catalysts that would stabilize the situation, and strategically

invest in assets that will benefit from a reversion to the mean. As Gerson said, profitable ventures or investments may not even need a full recovery. With dislocations becoming more common and dramatic, even a partial recovery might suffice.

So how do you identify these opportunities? You can read all the Economist and Wall Street Journal articles you want, but that is just running with the herd. Real alpha generation comes from a much more “local” approach. As Kelner advocates, read local newspapers and blogs, peruse trade journals, and check out local company websites. The internet has given us access to these types of resources like never imagined. However, these avenues are just the beginning. To really get a true understanding for investing abroad, you have to see it with your own two eyes. It is the only way to form an original investment thesis. If you don't form this perspective, how can you really tell whether the ECB and the European Union are making progress on a solution for their debt troubles without speaking to people on the ground? How can you grasp what the slowdown in Australian mining and natural resource exploration is like without seeing it? How can you deem the Chinese real estate investment as a bubble without observing the population dynamics and current living situations?



I do not have the financial backing of a parent corporation or an endowment or a hedge fund. In fact, as a debt-burdened business school student, I am the exact opposite. However, I know that I need a glance into these local cultures, cities, and economies so I am stretching the budget a little bit more and heading over to see parts of Asia and Europe in the spring, but this is just a start.

Towards the end of the symposium, John Griffin, who was moderating the discussion, made a plea. It was almost as if he was tired of leading the discussion instead of dictating it. He commented on something that almost always goes unsaid, “Be optimistic. Don't listen to the naysayers. The US economy has been through worse”. It is a simple concept, but one that should reverberate to any young investor.

I mention a lot about history, but here it is again. Why should the satirical rhetoric towards “This Time is Different” only apply to manias and upside momentum? If it is true that this time is never different, why not adhere to the philosophy that every downturn is followed by an eventual upturn. Human nature is to be overly optimistic in good times and perpetually negative in bad times. The best investors, like Griffin and

his mentor Julian Robertson, don't listen to the naysayers. They scour the globe and invest when they have conviction, even in the darkest markets. Why should the rest of us be any different? A'ha!

Leadership in a Globalized Economy

October 2012

We are approaching a period of time that the world has never seen before. With technology speeding the process of globalization dramatically, we are essentially on the verge of a “clash of civilizations”. Countries throughout the world are opening up (or being forced to open) their borders to an unprecedented flow of capital, ideas, products, and people. Corporations can access markets once regarded as impenetrable, countries are engaging in trade that blurs channels of commerce, information exchanging between citizens is as easy as signing on to the internet. On the flip side, this hastily increased degree of communication has led to conflict: the Arab Spring, riots throughout Europe due to austerity, Occupy Wall Street vs. Tea Party movements, Chinese pirating of American products, but that is just the tip of the iceberg. The dynamic that will lead us through this rapidly changing environment is not the newest technology, or a newly integrated trade channel, or a dramatic shift in communication. The solution is much simpler and may be the first indication of where to look for investment opportunities. Leaders with a broad scope of understanding, ability to think steps ahead, and ability to reach across disciplines are needed more than ever. When these types of leaders emerge, their nations and companies will be the catalysts for a transformational global economy centered around interconnected lines of commerce.

Too often we think of leaders in “silos”, focused solely on their respective institutions. Whether this refers to corporations or governments, leaders going forward must look beyond their specified areas of interest. There is simply too much overlap between the various disciplines. For society and the global economy to sustain the progress we have seen and not retrench through tariffs, over-regulation, or restrictive business practices, leaders who are willing to move beyond their silos must emerge.



Recent events suggests that major mistakes are being made on a global level based on assumptions made on faulty data or ignorance. To name a few: (1) Assuming the Germans would just bail out the Greeks because it made the most economic sense is naïve because it ignores the countless cultural and historical underpinnings that the

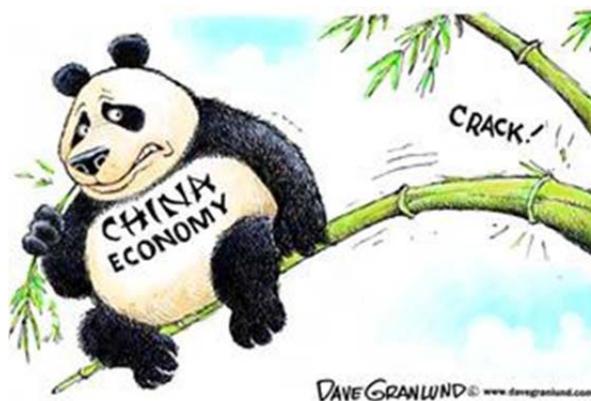
two countries have endured. It runs as deep as Greeks claiming that much of their current debts should be forgiven due to the fact that the Germans still owe them 75 billion euros worth of gold they stole during WWII and for murdering countless Greeks (Thomas, David. Festering Anger, Nazi war crimes and the 60bn pounds the Greeks believe the Germans owe them. UK Daily Mail. 11/2/2011. <http://www.dailymail.co.uk/news/article-2056400/Greece-debt-crisis-Greeks-believe-Germans-owe-60bn.html>.) (2) Expecting the Chinese consumer to quickly pick up the slack of a slowing economy and sagging export market despite a past filled with government takeovers, lack of protection for personal property, and socialist intentions. (3) Enacting the same governmental and business policy that we practice in the U.S. to the Middle East; the environment is extremely different due to religious implications and cultural rigidity. Simply believing that women should have the same rights as men is one thing, but attempting to force similar compliance on other countries is a very different story. There are countless other examples, but the key takeaway is that business and governmental decisions must incorporate a much deeper subset of considerations. Decisions that used to have one or two "implication tracks" now have three to four times that.

In just the next few months, this axiom will be tested. The United States elections are looming in November and the outcome could very well determine the path this country takes. Tax issues and a "fiscal cliff" have raised issues regarding class division, the U.S.'s role in the world, and the role that the government should play in American's lives. The country is as polarized as it has been in generations with no apparent end in sight. Americans seem to be craving for some sort of middle ground, but so long as our elected politicians require the uncompromised support of the far wings of the parties, the more difficult it will be to reach middle ground. This makes it very difficult for corporations and their leaders to make the decisions for the future of their firms. J.P. Morgan reports that 61% of American clients say the fiscal cliff is affecting their hiring plans. That is one reason why unemployment is so high. Durable goods orders plunged 13.2% in August, partly because companies are too scared to invest their cash mountains to expand production (Economist, Business and America's Fiscal Cliff: Give us a brake, Oct 6-12, 73.)

Regardless of who wins the election, I believe a shifting to the center is inevitable. The American electorate is tired of Congress inaction and business leaders need certainty. Perpetual gridlock and polarizing political conflict is not sustainable, especially when the can that's been kicked down the road has no more room to run. Despite the inaction of the past two years, I believe that this is about to change due to the action forced by the pending "fiscal cliff". If President Obama must reach across the aisle if he wants his any productivity in a second term and, despite his rhetoric in the Republican primary, Mitt Romney is a moderate Republican and his "true colors" have been showing in recent weeks. Either way, both men have to be aware of the consequences to the country and their presidencies if the aisle is not crossed. (Update: see this article from [cnbc.com](http://www.cnn.com/2012/08/14/politics/romney-obama-fiscal-cliff/) regarding other leaders who will influence the "fiscal cliff" <http://www.cnn.com/2012/08/14/politics/romney-obama-fiscal-cliff/>).

In China, the question of whether an economy of its size can be sustained under the thumb of a state-dominated structure with state-sponsored-entities driving much of the growth has not been answered. Is consumption something the Chinese citizenry ready for and, if so, what will their preferences be? Has the massive capital accumulation led to a mis/overinvestment causing a massive bubble or has it set the stages and built the infrastructure needed to become a sustainable world power? The difficult part about these considerations is that two are seemingly at odds. Investment is made out of saving, which requires consumption to be deferred. The returns to investment must be set against the disadvantage of having to wait. In more complicated economies, households must save so that entrepreneurs can invest. In most economies, people's saving is voluntary, but China has found a way of imposing the patience its high investment rate requires (Economist, Special Report - China's Economy: Prudence without a Purpose. May 26 - June 1, 8). Is this sustainable? I do not believe it is.

If China wants to build a sustainable economy and challenge the United States as the dominant global economic power, it needs leaders who promote transparency and growth from the private sector. Historically, state controlled economies can succeed as long as the economy is driven by exports, but transitioning to one that can turn inward and lean on domestic consumption can be very difficult. This is where technology and the speed of communication are game changers because if China's new leadership wants to continue China's ascent, they must realize that clamping down on citizens and this proliferation of information is nearly impossible. The Kremlin was able to clamp down on the inflow of information in the Cold War because communist leaders did not have to deal with today's "information glut". Chinese leaders do not have that same luxury.



The Middle East is a part of the world that has been supplying the rest of the world the energy needed to advance society, but for the most part, has wallowed in stagnation. There are a number of reasons for this: men such as Moammar Khadafy and Saddam Hussein ran their countries as brutal dictators, religious beliefs that often condemn the forces of capitalism are pervasive, economies tend to be overly dependent on a single commodity, vast parts of land are uninhabitable, and many nations have a history of international powers imposing their will inside their borders have made it very difficult to gain a footing in the world economy beyond being the largest exporter of oil. There is a vast, yet extremely difficult opportunity here in the untapped human capital

resource that the Middle East possesses. The problem is that it is a very explosive region with a stick of dynamite in the form of the “Israel Question” situation positioned right in the middle of it. The Arab Spring demonstrated that there is a demand for sort degree of freedom and democracy in the region. Technology like Twitter and Facebook opened up channels of communication never see before and furthered causes much faster and decisively than ever in the Middle East. The issue now is technology got the ball rolling, but leaders both in the region and internationally must now take the reins for this to be a success story and not a quagmire.



The Middle East is an incredibly difficult area to invest in, but is a region that needs to be understood because it's effects impact investing everywhere else in the world. I am incredibly concerned about the Iranian situation, both in regards to its nuclear program and to Israel. Dictator-led countries, despite the atrocities they committed, provided a counterbalance to Iranian power. Now that many of these dictators have been overthrown, Iran has emerged as the most powerful actor in the region and as long as Iranian president Ahmadinejad is in power. This will be a catalyst going forward for strategic defense companies and energy producers in safer parts of the world, but pose a major risk to major multinational corporations and markets across the globe.

Technology can only take us so far. Machines have proven to do a lot for humans to speed up the process of manufacturing, communications, and services, but they can do very little when it comes to leading. Leadership styles and methods will come into conflict if a “G-Zero World”, as Ian Bremmer describes it, emerges. Will countries agree that a global economy is the best path forward or will we see a return to hegemonic rule where nations retreat to within their borders? Only time will tell, but leaders will dictate the path and provide channels to attract capital.

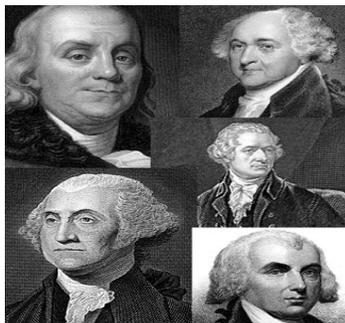
European Fallout: Unify or Splinter

Lessons from our Founding Fathers

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Many pundits have claimed in recent months that the European Union is bound to fail because the member countries will never choose a *union* over their specific *nation*. In fact, many defenders of this hypothesis believe that the E.U. was doomed from inception due to the fact that it was purely monetary and not fiscal in nature. The premise is based around the belief that human history has rarely, if ever, seen a group of individual states put aside their differences and agree to unite under a common federal government for the future prosperity of all. There are simply too many competing interests: culturally, demographically, and in regards to a nation or state's sovereign independence. It is hard to debate the significance of these challenges, but the argument that these types of challenges cannot be overcome is overblown. All you have to do is take a look back two hundred years at the formation of the United States (*specifically read "Founding Brothers" by Joseph Ellis*).

In 1790, renowned Federalist Alexander Hamilton's proposed a plan to have the federal government assume the debts that states had built up during the Revolutionary War. His goal was to shore up their balance sheets and bring the 13 states (actually 12 at the time) under the federal government umbrella. Predictably, this plan met substantial resistance from some and ardent support from others. The states that had piled up debt, but were cash strapped due to the inability to raise funds, welcomed the concept of Assumption. On the flip side, the states that had paid off the bulk of their wartime debt were opposed. For these perceived "responsible" states, Hamilton's proposal did them a perceived injustice by "compelling them, after having done their duty, to contribute to those states who have not equally done their duty" (Founding Brothers, 57). States like Virginia, which had made considerable strides to pay down their debt, felt that they had stayed the course and were now being punished for it. Why were the rules changing all of a sudden to accommodate those who failed to do so?



This was, however, not purely a financial dispute; it was in large part a power struggle. Many states felt that the power to govern themselves was under fire. The perception was that “under the guise of doing the states a favor by assuming their debts, the federal government was implicitly, even covertly, assuming sovereign authority over the economies of all of the states”. James Madison, representing the state of Virginia, said “in short, Virginia was being asked to trust its fate to the collective wisdom and virtue of the central government”. When Madison later softened on the idea of Assumption, his loyalty was questioned, “How do you feel? Is your love for the constitution so ardent that it should produce ruin to your native country?” By ‘native country’, the questioner meant Virginia (FB, 58).

To top it off, Madison, typically a calming force in politics, was also getting chastised by northern state politicians for risking the future of the republic by *not* advancing Hamilton’s legislation. If there was ever an apparent lose-lose in terms of partisan politics and is the fate of the union’s future, this was it.

This sounds eerily familiar doesn’t it? If you read those previous paragraphs again and compare the states like Virginia to Germany, the “cash-strapped states” to the PIGS (Portugal, Italy, Greece, and Spain . . . I’ve removed Ireland from the original PIIGS), and the northern state politicians to the “Monday Morning Political/Economist Quarterbacks” who are questioning every decision that does not move closer to united Europe, a clearer picture develops: maybe we have seen this before.

Hamilton’s dedication to a centralized solution to the fiscal problems facing the new government emerged out of his frustrating experience with the inadequate and hopelessly divided authority of the Confederation government in 1780’s. His goal in 1790 was to unravel, then place the United States’ tangled mess of foreign and domestic debt on firm financial footing by restoring public credit (FB, 61). Maybe Hamilton was ahead of his time or maybe his plan was not far enough removed from the country’s independence from an imperial power (England), but either way, the issue had to be dealt with. It took time and persistent negotiations both in public and behind-the-scenes, but cooler heads eventually prevailed. The Founding Fathers reached a number of compromises (such as moving the capital to Washington DC and kicking the can down the road by delaying confronting the issue of the slave trade for twenty years) that set in motion the establishment of a union while maintaining strong state rights.

Today, we see Mario Draghi and the ECB, under the presumed strict watch of the leaders of the Bundesbank, attempting to do something very similar to what Alexander Hamilton attempted to do in 1790. Draghi and company are attempting to hold together a fragile union that currently possesses very little allegiances. As evidenced by the American episode over 200 years ago, it will require leaders of substantial intelligence, foresight, and understanding to avert a possible crisis. They will need to

balance the same sort of “federalist” intentions of a stronger central government with the “republican” intentions for maintaining the power at the state (nation) level.



Is there reason to believe the European Union’s current leaders can come to a compromise much the way that America’s founding fathers did? Despite the seemingly perpetual bumbling on the part of many, I believe there is reason to believe they can, despite the protests and arguments that will inevitably continue, especially emanating from the masses. The creation of the European Union and the euro was a huge leap for the European continent. After generations of conflict and strife, the goal was to unify a continent by encouraging better relations and increasing channels of commerce. The overarching reason for the existence of the E.U. and the close parallel to the U.S. experience provide hope that leaders like Draghi and the technocrats (who have replaced corrupt officials like Berlusconi) continue to make progress and eventually bring the union together much like the American founding fathers did. The risk however is, in the words of George Washington speaking to Congress in 1778, “It is a maxim founded on the universal experience of mankind, which no nation is to be trusted father than it is bound by its interest; and no prudent statesman or politician will venture to depart from it.” Will the European Union emerge as a national union or continue to fragment into a collection of national interests bound by a common currency? The answer may determine Europe and the global economies fate for the foreseeable future.