A Note from the Chief Investment Officer: Marian Rough

At the beginning of the fall semester, we implemented a few fundamental changes to increase the already excellent quality of the Green and Gold Fund. Our faculty advisor, Dr. Andreas Rauterkus, has been a key player in making these decisions. Dr. Rauterkus and I have re-examined the core values of the Fund and have implemented them in order of greatest importance to all of our members. Our members are as diverse as the entirety of UAB, with majors all around campus in undergraduate and graduate programs. Because of this diversity, we have managed the fund to cater to all types of individuals. Dr. Rauterkus is teaching us many fundamental models when valuating equity securities. This has shown many of our underclassmen important measures when valuating securities, while refreshing our upperclassmen with previous class material. We have also participated in lessons with our Bloomberg Representative, Matt Nolfo. He has taught us in-depth functions to fully utilize our Bloomberg Terminals. Our Chief Marketing Director, Alicja Foksinska, has increased our marketing campaign across campus and worldwide though our website, LinkedIn, and Facebook page. With these changes, we are able to thoroughly educate our members about stock valuation and the Bloomberg Terminals as well as increase our organization’s esteem in the Birmingham area.

“We live in strange times," says UAB Economics professor Dr. Sarah Culver. With interest rates near zero since 2009, this has given the fund a challenge in the fixed income markets. We began the year selling off high-duration bonds not only to recognize a capital gain but also to position the fund in short term, short duration bonds. This will prepare us for when interest rates increase. In alternative markets, we are continuing to look for funds with low betas to offset the majority of our holdings. Due to record highs in the Dow and S&P 500, our equity holdings have been affected positively. In each of our sectors, we calculated the total return— including dividends for each holding— and compared this to the total return of an equivalent index. In each of the sector graphs included in this newsletter, the majority of our holdings outperformed their comparable benchmarks. From 18 September 2013 until 2 December 2013, the fund’s performance overall compounded annually was 18.31%. This reflects a value of $556,328.93 on 18 September and $575,887.24 on 2 December. We have a careful selection process when choosing holdings. Due to an increasingly knowledgeable outfit, we hold our securities in highest confidence and they have proven to outperform our earnings goals.

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Five years after the collapse of Lehmann Brothers and other Wall Street heavy hitters, the economy has yet to fully recover. As the recovery continues, we look to fiscal and monetary policy to expand and sustain the growth seen over the past several years. Currently, the economics team for the Green and Gold Fund is most concerned with Federal Open Market Committee operations, fiscal policy hindrances, and structural job market changes.

Monetary policy has been a leading driver of financial asset prices, especially in the fixed income sector. The Fed has maintained a policy of keeping interest rates low since the federal funds target rate was lowered to near-zero levels in 2008. This policy will likely be in place until at least the middle of next year as growth indicators remain weak in many parts of the economy. In an effort to spur growth, the Fed has also undertaken a quantitative easing (QE) program of $85 million in monthly asset purchases, in the form of government and mortgage-backed securities.

Ben Bernanke announced plans in September to continue this open-ended policy, likely through the end of the year—a decision that was met with rallies in stock market indices.

With inflation stable below the 2% goal and unemployment still well above pre-recession levels, at a current rate of 7.3%, we do not expect tightening of monetary policy in the short run. With a transition in Fed leadership to current vice-chair Janet Yellen, the recent nominee for the chair position, and dysfunction in Washington’s fiscal policy, the Fed is likely to keep a low interest rate in the medium-term as it tapers QE purchases. Further, with an increasingly data-driven committee, there will have to be strong improvements in the unemployment rate or an uptick in inflation before interest rate changes come to the table.

Despite avoiding a debt default in October, Congress continues to impede economic recovery with hard-money policies on both sides of the aisle. Republicans insist on decreasing domestic spending, most recently with cuts to the Supplemental Nutrition Assistance Program (food stamps), and Democrats continue to promote higher revenues, with a variety of tax increases accompanying the Affordable Care Act. These domestic spending cuts and tax increases will leave consumers with less disposable income, hurting the economy’s aggregate expenditure and economic growth. Further, political standoffs, as seen with the government shutdown and debt default scare, will continue to destabilize investor confidence and hurt financial markets. We expect the Fed to maintain dovish positions in an effort to counteract this hard money fiscal policy. More concerning is the notable trend toward part-time employment, perhaps exacerbated by the implementation of the employer mandate portion of the Affordable Care Act.

“Monetary policy has been a leading driver of financial asset prices, especially in the fixed income sector.”

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In the coming months, we will continue to analyze the effects of the Affordable Care Act’s rollout and its effects on the consumer and healthcare sectors. We are most interested in the employer and individual mandates, specifically how they will affect consumer income and business costs. The immediate question is how the mandates will affect business decisions in human resources; that is, how many small businesses will decrease their number of employees to fewer than 50, and how many full time employees will be converted to part time positions in order to avoid offering insurance coverage.

Early data suggests that this is affecting large businesses most directly, and the food service industry in particular, with corporate memos calling for more part-time positions and fewer full-time roles. We will continue to monitor the side effects of this new law as data becomes available.

With stable interest rates in the short term but fear of Fed tapering entering the markets, we are implementing a proactive investment strategy to position the Fund over the two to three-year investment horizon. Most affected by volatility in interest rates are the fixed income and emerging markets portfolios. As interest rates are the primary reason for change in bond prices, we are focusing on short term bonds to hedge our risks against longer term rates changes implemented by the Fed. The fixed income sector has implemented this strategy by increasing sector allocation to shorter duration mutual funds with differentiated strategies across corporate, government, and securitized debt.

In the alternative investments sector, we are looking to divest from the emerging markets, analyzing strategies that would produce larger gains in an environment without sustained QE and possible higher interest rates. In anticipation of the unrealized announcement of a QE taper in October, emerging markets saw capital outflow, as investors drew their money back into domestic investments. In the coming months, focus should be on decreasing allocations in emerging markets and developing updated alternative investment options.

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The banking sector has already seen interest rate hikes this year, with an increase in mortgage rates in April, largely due to fears of tightening policy at the Fed. While the banking sector can benefit from increased revenues from loans, interest rate hikes will translate to a decrease in the demand for loans, especially in longer term capital investment projects. In the consumers sector, we are more concerned with the structural job market changes rather than interest rate uncertainties. With large speculation of an increase in structural unemployment, and job growth in large part coming from part-time employment positions, consumers will have less disposable income on aggregate.

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In the coming months, we plan to continue to hedge risk against fiscal uncertainty and potential fluctuations in Fed policy by monitoring interest rate volatility, national healthcare policy, and changes in the job market.
After the sell of the struggling Tecurium Corn fund (CORN), the alternatives sector has performed well overall. Since 9/3/2013, the price of Oppenheimer Developing Markets A (ODMAX) has increased by 10.37%, the price of Och-Ziff Capital Management Group LLC (OZM) has increased by 24.52%, and the price of Permanent Portfolio (PRPFX) has increased by 0.97%. The only underperforming holding over this period has been Global X FTSE Colombia 20 ETF (GXG), which had a price decrease of 1.22%. During the same period, the total value of the sector has increased by $4,202.94, putting the sector’s total value at $48,549.82.

Since the sell of the aforementioned Tecurium Corn fund (CORN), the value of the ETF has fallen by 8.19%. To date, this move has saved the sector $562 in value.

The strategy of the alternatives sector is to lower the portfolio’s beta by investing in assets that don’t have a correlation to the rest of the portfolio’s holdings. We feel the current ETFs and open-end funds held by the sector offer the diversification needed to achieve this goal. Our short term outlook for the sector’s holdings remains positive. However, we’ve decided to closely monitor the status of Global X FTSE Colombia 20 ETF (GXG). We feel it may be necessary to take action in the near future if it continues to underperform.

The current alternatives sector has a value of $48,549.82, which makes up about 8.5% of the Green and Gold fund’s total value in assets. The target percentage for the sector is 10%. In order to meet this benchmark, a watch list of potential funds to buy has been compiled. The funds that compose the watch list are differentiated. A few notable sectors found in the funds’ allocations include: pharmaceuticals, biotechnology, energy, agriculture, water, and mergers. Ideally, we’d like to invest in areas that are currently undervalued, such as water and mergers.
Lower cotton costs, improved unemployment, consumer confidence, and a shift in the main source of revenue from whole sales to direct-to-consumer sales has led to an improvement in branded apparel gross margins, which exceeded consensus expectations. Cotton apparel imports into the U.S. are slowing as more companies continue to shift product sourcing from China in order to ease growing labor costs.

The automotive industry indicates an increase in demand for new cars as vehicles are reaching an average age of 7 to 12 years. The lower rates in automotive financing and lease deals have spurred demand for new vehicles and provided access to more potential buyers. All time high inventory levels are manageable because of the sales pace and discounted prices.

The recent sharp decline, 15% YTD in grain-related commodities, especially in corn futures, will improve food manufacturers’ margins. Corn is the main feed cost and ingredient in most packaged foods. There is a favorable crop outlook for corn following the 2012 U.S. drought.

Asian convenience stores and hypermarkets are adding more private-branded items to increase profits which could hurt margins for global U.S. brands.

U.S. Supermarkets are still feeling the impact of slow inflation and the increase in wages. Supermarkets have improved their product mix to appeal to the increase in demand for health-oriented products. Improved consumer confidence could indicate a slow increase in sales since the correlation between consumer confidence and food-at-home spending has been positive since 2008.

Outdoor and action-sports categories are expected to outpace other textile and apparel wear through 2017. Asian compacts and mid-size car segments in the U.S. are outperforming Detroit’s large trucks.

Crossovers offer better utility, fuel economy, value, and driving dynamics than large trucks.

Green coffee bean prices had a two-year decline which benefited packaged coffee product manufacturers. Producers of coffee combine a blend of Arabica and Robusta beans where prices have fallen 48% and 18% respectively since 2011.

Global protein consumption is increasing, especially in emerging markets, because of the rising urbanization, population growth and an expanding middle class. Growth opportunities in the food industry include beef, chicken, milk and pork. Specialty and natural food segments in the U.S. food industry indicate potential for growth opportunity. Whole Foods and Natural Grocers are the leading companies in this industry.
We’ve been very busy in the Fixed Income sector trying to prepare for what seems to be the inevitable—a continued increase in interest rates, which will further increase bond yields. That may sound great, but bond prices move inversely to yield, so the value of our holdings will suffer as yields rise. Just how much they will suffer is gauged with a measurement called duration. Duration is similar to time-to-maturity; however, it takes into account current pricing, coupons, optionality, and yield to provide a much more accurate measure of a bond’s sensitivity to changes in interest rates. The specific measure we use is modified duration, which is more accurate across larger shifts in rates. So, our immediate strategy is to lower the fixed income sector’s duration as low as possible in order to minimize the impact of rising rates on our holdings.

When we started in September, our sector had a modified duration of 5.78. We sold two longer duration bonds and a fund, then reinvested in funds that focus on shorter maturities. We are now down to 4.77, which is still way too high. We have two more funds with higher durations on the chopping block. A complication is that the sector started out underweight and remains underweight, so we are simultaneously looking to reinvest in less interest rate sensitive securities. Our current screener includes investment grade bond funds with a short or ultra-short term focus. We are looking at funds with a focus in corporates, governments, and taxable munis (we are tax-exempt). We are satisfied with our high yield fund (HYLD) which maxes out our allowed allocation in non-investment grade securities. We will be looking in more depth at asset backed securities in particular, but want to exercise plenty of due diligence in our selections. A blind hunt for yield in these complicated securities proved to be disastrous in 2008.

In addition to studying and following the financial press, we’ve done a couple of other things to improve our skills. Analyst Morgan MacDougall and I met with our Bloomberg representative, Matt Nolfo, to get some specific training on fixed income analysis using the Bloomberg terminals that we enjoy here at UAB. Marian Rough, our CIO, joined us for that session. She also joined me on a visit to Doucet Asset Management where we discussed fixed income strategies with Chris Doucet, CEO and Portfolio Manager, and Will Aycock, CFA, Analyst. We also sat with them at their bond desk while they analyzed securities and submitted bids.
Energy Sector: James Lucas

The Energy and Utility sector is currently screening for opportunities to deploy the Fund’s capital in securities currently undervalued by the market. Developments in recent years in the US and global energy markets have made this an interesting space to analyze and follow. As numerous sources have reported, the month of October saw the U.S. become the world’s largest producer of energy and China the world’s largest importer. As Bloomberg recently reported, horizontal drilling and hydraulic fracturing have allowed the U.S. to “tap unconventional resources at unprecedented levels.” In fact, onshore production has risen over 63% since 2007—much of this in North Dakota and Texas. However, offshore production, particularly in the Gulf of Mexico, has been sluggish as that region attempts to recover from the 2010 Deepwater Horizon disaster. Nevertheless, the U.S. government’s policy focus on reducing exposure to foreign oil has set the stage for a rebound as the Drilling and Support team at Bloomberg News noted in October. In light of this, many securities are trading at a premium value, thus making value investing in this environment quite a challenge. However, as with any industry, energy can be fragmented with many key players being overlooked.

The U.S. energy sector includes not only drilling and exploration companies, but oilfield services and pipeline transporters. Furthermore, our analysts are researching opportunities in companies focused on alternative energy sources such as biofuels, wind, and solar. In reviewing the Fund’s current equities, we believe Halliburton and Occidental Petroleum have performed admirably. However, if they have reached their full value, we will evaluate whether or not to hold these positions going forward. As an example, Schlumberger (SLB), a competitor to Halliburton, seems to meet some of our criteria for a value stock focused on the energy sector. Some current stocks we are considering include Kodiak, Valero, and Apache, which are all involved in oil drilling and exploration. Other parts of the energy sector have yet to bear any ideas, but it’s a fragmented marketplace with several opportunities that will open in the not-too-distant future. Warren Buffet’s recent purchase of Exxon Mobile demonstrates that numerous opportunities are available in the energy sector. However, with the price of a barrel of oil having a great influence on the performance of many energy stocks, we will be selective in our search and investigation of energy and utility stocks that meet our value-oriented criteria.
American banks face a challenging environment moving into 2014. The boom in mortgage origination and refinancing activities came to a screeching halt in the middle of 2013 as short-term lending rates slightly increased, leaving banks to find other sources of non-interest income. Additionally, large banks are getting hit with rising legal costs. For example, JP Morgan is expected to pay $13 billion in fines due to misleading investors about securities they purchased from the financial conglomerate. Also, Bank of America, one of our current holdings, reached an $8.5 billion settlement for selling faulty mortgage backed securities to the public. Going forward, banks will continue to build up legal reserves through quarterly reductions in net income as they expect further investigations and legal claims from disgruntled investors.

On a positive note, banks are strengthening their balance sheets by relying less on debt and more on equity capital to finance the purchase of assets. In addition, the percentage of non-performing loans to total loans dropped from 2.07% in the 2nd quarter of 2013 to 1.93% in the 3rd quarter of 2013 which reflects an increase in the quality of loans throughout the industry. Banks will continue reducing their exposure to both capital and credit risk to help prevent getting side-swiped by another economic downturn.

The low demand for loans, falling asset yields, and rising legal costs for banks has kept us looking for profitability, in other areas of the financial sector. The rest of the financial industry should continue to move with the overall market. Currently, we are looking into companies that specialize in financial technology services, asset management, and investment banking.

Our sector strategy is to maintain a target equity allocation of 8.87% and ensure diversity among our current holdings.

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**Continued from page 8: Financials Sector: Kyle Portwood**

In the second quarter of 2013, 35% of our sector consisted of equities that relied highly on mortgage service operations. The recent downturn in mortgage origination and refinancing activities prompted us to reduce the amount allocated to mortgage services by 15%. The reduction in mortgage services allowed us to decrease our diversifiable risk and exposure in the industry. Moving into 2014, we will continue to reposition the financial sector in order to enhance returns and mitigate risk.

**Industrials & Materials Sector: Andrew Clifton**

The materials and industrials sector typically move together, as they are affected by some of the same drivers. However, within the past year, they have gone in separate directions, with industrials posting positive returns and materials having negative returns. The negative return for materials is in part due to the poor performance of its metals and mining industry, which declined 20.1% in the first half of 2013. On the contrary, its largest industry, chemicals, had an 8.1% return to keep the sector in check. One industry within the materials sector that has a measure of uncertainty is housing. Along with the economy, the housing industry has been recovering since 2008; however, this recovery seems superficial. During the month of September, 49% of houses purchased were all cash deals, which were bought by institutional investors who are buying large chunks of foreclosed houses. On the surface, the market appears to be improving because houses are being bought, but less and less of these are purchased by traditional homeowners taking out a mortgage. Therefore, the housing market is recovering in the short-term, but the long-term state of its health may be misconstrued. As for Industrials, the sector outperformed the S&P index by 320 basis points last quarter. Even though the government’s sequester of the federal defense program has been in effect since March, the aerospace and defense industry continued to report positive returns. This is possibly because defense contractors sign long-term contracts and the budget cut has not caught up to them yet. However, the effect of sequester on related firms is something to be aware of for the years to come.

The main item on the docket is to purchase a security for the Materials sector. Our current allocation is 0%, compared to a 2.04% target. Since both of the securities we sold earlier this semester were in gold (Market Vector Gold Miners ETF and Sandstorm Gold LTE.), we are cautious to reinvest in metals/mining. Despite this, we are still evaluating the industry to see how it responds to global economic events. The main economy we are monitoring is China, since they import large amounts of U.S. materials for construction. An improvement in the Chinese economy could increase demand for metals such as steel, iron, and aluminum. With metals/mining in the background, we are focusing more toward chemicals. One important aspect that we are keeping an eye on is fracking. Fracking techniques produce an abundance of natural gas, which could help propel the industry. However, there is much controversy surrounding the ethics and safety of fracking, so it could potentially have adverse effects.

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Continued from page 9: Industrials & Materials Sector: Andrew

We are considering the sale of an Industrial security, as the sector is slightly overweight: Current allocation = 8.47%, target allocation = 6.19%. One security that is of particular interest is D.R. Horton Inc. (DHI), which constructs and sells single-family houses. The value of this security relies on the state of the housing market, which as mentioned earlier, is questionable. Therefore, DHI could drastically improve if the housing industry continues to recover. Or DHI, which is already operating at a loss, could take a dive even further. Overall, we are taking a conservative approach. Because of uncertainty, we are wary to make a premature decision that could ultimately have negative results.

Technology & Telecom Sector: Shane Thompson

The technology sector continues to be overwhelmed by the smartphone industry. The smartphone market has recently reached $279.9 billion in sales and companies are maintaining their focus on development for new mobile devices. Some technology companies are beginning to reach out to developing countries to offer an affordable product, such as Apple's line of 5C iPhones. A few major companies, Apple and Samsung, are starting to focus on healthcare equipment and search for the "next big thing" that will interest consumers. Mobile device investment and development will continue its growth and hold its supremacy over the sector. As a behind the scene operation, the computer hardware industry has undergone minimal growth because of an increase in market competition and a decrease in demand from consumers. Finally, IT telecommunication has become an uncertain area during this last quarter of 2013. Government budget decisions have not been released, and this is affecting telecommunication/cyber security companies that depend on government contracts for revenue. Telecommunication companies are staying optimistic and aiming for large revenue growth during 2014.
The main goal for this sector is to find stable investments while meeting the fund’s allocation rates. Additional telecommunication investments are needed to increase our allocation rate, currently .49%, to meet the target allocation of the fund, which is 1.64%.

We plan to keep stocks in the portfolio that have a strong hold in the market-place and will be needed for a long period of time, so we are not rushing to add investments to meet our target allocation rate. An idea of stable telecom service companies will be clearer once the government budget is proposed, and we will be able to tell what companies will survive in the industry. This has become an issue in this industry because our holdings gain revenue from government contracts, which have been affected by the government budget crisis. A potential sale of KEYW Holding Company could occur based on the fact that 97% of their revenue is generated by government contracts. This issue will be monitored and addressed during 2014 when a more precise evaluation of the situation can be made.

To broaden the sector’s holdings, we plan to identify companies that have a unique relationship with large market share businesses. We would look through the web of supply chains to identify these unique suppliers. We will identify investment candidates based upon a product or service they have that makes them invaluable to larger firms, which will increase the potential for growth and return from each candidate. Analyzing the companies would help to decide if they are a value stock and undervalued by the market.

Conversely, identifying stocks in emerging markets with high intrinsic value as value stocks is another potential strategy. Stock screeners, filtered by our criteria, would be used to give us a list of potential businesses to monitor and in which to invest. Even though these two processes are time consuming, we think they will give the best starting point in our value stock strategy that will ultimately benefit our sector and the fund in the long run.

A list of securities that are currently being analyzed are Avnet, Inc. (AVT), Nuance Communications, Inc. (NUAN), International Business Machines, Corp. (IBM), Arrow Electronics, Inc. (ARW), Consumer Staples SPDR (XLP), and Blackberry, Ltd. (BBRY).
The fall 2013 semester has been good to the healthcare sector with all of the companies beating the performance of the S&P 500 as well as the Healthcare Select Sector SPDR since the 26th of August, with the exception of Synergy Pharmaceuticals. The healthcare sector currently owns XLV as the core holdings, along with ABT, ABBV, SGYP, and GILD as the investment holdings.

The first task for the sector this year was to compile and accumulate information on all of the holdings since not all of the records were accounted for. Our immediate concern is Synergy Pharmaceuticals, SGYP. In addition to being the only position without a positive return in just under a year of holding it, the company has yet to produce any revenue for the past 5 years. Their cost of research and development has led to a string of negative cash flows, and their only current source of funding comes through the sale of common stock. In researching their products, they have 2 potential drugs in their pipeline making progressions in advancing to late stage clinical trials. However, UAB’s Green and Gold Fund doesn’t look for companies with long-term potential growth. It instead focuses on undervalued companies, which SGYP is not. At the next meeting, a sell presentation will be given in expectation of relinquishing our holdings in SGYP.

In addition, we have been looking into some key areas of the healthcare sector to try and find undervalued companies. In articles from YAHOO! Finance and Forbes, hospital management and generic pharmaceutical companies are a few of the main beneficiaries in response to the Patient Protection and Affordable Care Act. The hospitals benefit from more insured patients which allows them to profit by minimizing cost-covering, and the generic drug companies benefit from a big push to lower out-of-pocket medical expenses, with medications being a large portion of those costs.