2012

The Odd Quarter Research Report, First Quarter, Volume 1, Issue 1

Bryant University, Archway Investment Fund

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The Archway Investment Fund
Bryant University
1150 Douglas Pike
Smithfield, RI

The students of the Archway Investment Fund would like to thank all of the faculty, trustees, and guest speakers who make the Fund a truly unique experience.

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Investment Objective

Our goal is to achieve a risk adjusted return that is equal to or exceeds the S&P 500 benchmark. We use the Sharpe ratio to measure risk and the portfolio's risk-adjusted performance. We implement a value based, active management strategy that focuses on finding companies with fundamental indicators which are better than their industry averages. These fundamentals, ranked in importance, include: beta, price to earnings, return on equity, dividend yield, return on assets, price to book value, and price to sales.

We buy companies trading below their intrinsic value with fundamental indicators better than their industry averages. We hold companies trading below their intrinsic value that have fundamentals around their industry averages. We sell companies that fall below the fundamentals of their industry averages.

Our process for determining intrinsic value involves quantitative and qualitative analysis. We identify companies with favorable criteria such as: financial ratios, operating metrics, stock metrics, operating margins, and growth.

When we believe a stock meets these criteria, we apply qualitative analysis. This includes researching a company to identify the following: business models, company strategy, governance, market factors, global diversification, and business segment diversification.

Once this research has been conducted, and we feel a company meets our investment objective, we build financial models to calculate the intrinsic value of a company.

In an attempt to outperform the S&P 500 benchmark, we plan to investigate American Depository Receipts and invest in international companies. Additionally, we will make use of covered options for the purpose of hedging risk and generating excess return.

Archway Investment Fund

Consumer Discretionary and Staples

Evan Bekasi
Dave Peagram
Shauna Skiba

"...the Conference Board released its Consumer Confidence Report for February and needless to say it blasted economists' predictions. Economists polled were looking for 63.0 but the report showed that the Consumer Confidence Index rose to 70.8. When you consider that consumer spending makes up about two-thirds of the US GDP, this is a very bullish sign. US consumers are finally starting to come around and see that the economic recovery is taking hold and they believe there are an increasing number of opportunities..." - Seeking Alpha

General Sector Outlook

Consumer Staples

The Consumer Staples sector offers products that are considered necessities in everyday life for consumers. Due to this, the sector is considered extremely stable and is utilized in portfolios as a safety net to regulate market variations. Because of the basic and consistent need for consumer staples items, demand for staple products normally remains stable despite economic downturns or low consumer confidence. Sales of products in this sector have remained relatively constant throughout the past few years. Therefore, many companies in this sector exhibit stable and modest earnings. For this reason, investment in the Consumer Staples sector is seen as a defense mechanism for portfolios. Our overall outlook for the sector is positive. The sector spdr (XLP) YTD return is around 2.3% and it has consistently outperformed the S&P 500 over the past year. Due to the strengths of the Consumer Staples Sector, specifically its non-cyclical demand and stable performance, we believe that this sector should be overweighted. During periods where the economy is slowly improving, consumers typically do not decrease spending on the staple products, which allows the Consumer Staples Sector to continue perform well compared to other sectors.

Consumer Discretionary

The Consumer Discretionary sector depends largely on the spending decisions made by individuals, which are based on the confidence that they have in the economy. The unemployment rate is expected to stay above 8% over the next 6 months, indicating that consumer spending and discretionary income will not change drastically. Although consumer confidence showed some signs of increase, we hold a neutral outlook for the Consumer Discretionary sector as a whole. Despite this outlook, we do believe that some industries within this sector have potential opportunity and may perform well as unemployment remains high. The sector as a whole has been outperforming our benchmark over the past year and has a current YTD return of 10.69%. Since this sector has been performing well in comparison to our benchmark, we believe that this sector should be slightly overweighted. We do believe that the Consumer Discretionary Sector will continue to show potential signs of growth and continue outperforming the S&P 500.

Areas of Opportunity

Consumer Staples

The Consumer Staples Sector consists of companies that provide household goods to their customers, in many cases worldwide. Since these goods are considered necessities of life, this sector is traditionally looked at as defensive. In times when the economy sputters investors tend to rush to stable areas of the market such as staples and perhaps utilities. Now, Utilities are not part of the Staples Sector but the reasoning behind this rush to safety is similar in that the general public will still need to purchase food from companies like General Mills or perhaps shaving products from Procter and Gamble, just as they will continue to pay their electricity bills. Therefore, a key benefit of investing in Consumer Staples companies is that they tend to have very strong brand recognition both in the U.S. as well as abroad. This high brand recognition can be considered a moat by value investors such as Warren Buffett. Of course, Warren also says that the idea of growth and value stocks being separate entities is a farce because "growth is always a component of value [and] the very term value investing is redundant." However, he does prefer to invest in companies that can establish a moat, or competitive advantage, because it makes it more difficult for competitors gain market share and gives the company pricing power. For this reason, the strong brand recognition is an essential part of the value story as value investors.

Industry 1: Household Products

The Household Products sub-sector is comprised of companies that produce non-durable household products. These companies include Procter and Gamble and Colgate-Palmolive. Companies within the sub-sector tend to have a long roster of goods that appeal to a large variety of consumers. Securities in the Household Products sub-sector perform well during good economic periods and provide downside protection during downturns. Sales and earnings typically remain steady attracting risk-aware investors.

Industry 2: Food and Non-Alcoholic Beverage

The Food and Non-Alcoholic beverage retailing sub-sector is comprised of companies that specialize in drug retail, food distribution, food retail, and hypermarkets and super centers. These companies include General Mills and Kraft Foods. Similar to the Household Products sub-sector, this sector attracts the safe investors. Companies in the Food and Non-alcoholic beverage sub-sector offer reliable dividends and stock price stability.

Consumer Discretionary

We feel that during this period of high unemployment and slow economic growth, the discount retail environment will continue to have solid sales and earnings numbers. The same is true at the opposite end of the retail environment with high income individuals continuing to take advantage of low interest rates. We believe the discounters will actually outperform high-end retailers, but both will outperform the general markets.

Industry 1: Discount Retail

As consumer discretionary income may rise slightly, we would like to focus on discount apparel retail stores. We believe that consumers will continue to purchase the goods that they want while looking to do so at a discount. Stores similar to the TJX Companies will potentially benefit from consumers' cautious spending.

Industry 2: High-End Retail

Although we would like to focus on the discount apparel retail stores, it is also important to note that high-end retail stores have typically remained profitable even when consumer spending is slow. Those who shop in high-end stores, such as those making yacht purchase, etc., typically do not ease their luxury spending. Although high-end retails may not see in increase in sales during hard times, they typically do not see as much of a decrease in sales as other stores. Companies within this industry offer a typically steady stock price and we believe may offer a potential increase.

As consumers' discretionary income remains steady, we expect that consumers are continuing to focus on the goods that they need and also purchase those at a discount when possible. Household products, food and non-alcoholic beverages are items that consumers will continue purchasing regardless of the discretionary income they have. Most of these items are seen as necessities, which allows them to remain profitable during economic downturns as well as when the economy is recovering. The discount retailers and high-end retailers also seem to be well-off during these periods. As we continue to see the economy improve slowly over the next few quarters, we believe that these industries are positive opportunities for our sector.

Areas to Avoid

Consumer Staples

We feel that during times of high unemployment, consumers will focus less on items that they do not need and focus more on the essentials. We believe that consumers will look for discounts for the products that they need and avoid purchasing products that they believe are overpriced.

Industry 1: Personal Product

The Personal Product Industry has a return of -4.9% over the past year. As people's discretionary income remains relatively steady, consumers are not purchasing products such as perfumes and cosmetics. We believe that consumers are looking for cheaper products as substitutes or just not purchasing them at all because they can be relatively expensive. Until discretionary income rises, we do not see consumers purchasing these types of products.

Consumer Discretionary

Although in times of high unemployment and slow economic growth some industries within the Consumer Discretionary Sector flourish, we also believe that there are some specific industries that will decline. The Diversified Consumer Services Industry includes both necessities and services that consumers purchase as an "added-value" for their home and those that make their lives easier. Consumers will drift away from utilizing an interior designer and home-cleaning service before they stop purchasing clothing and household product. We believe that during this period, this is one industry that we should avoid.

Industry 1: Diversified Consumer Services

The Diversified Consumer Services Industry has had a return of -7.59% over the past year. We believe that this is due to consumer spending little to no money on consumer services such as interior design and residential home security. These two may also be tied to new home sales, which are remaining low due to consumer's discretionary income. Until we see an increase in discretionary income, which will lead to an increase in home sales, we believe that this industry will not show significant growth.

We further believe that consumers will drift away from the industries that they do not find vital. As consumers continue to economize, they are looking at discount stores and "do it yourself", DIY. Consumer services are usually one of the areas of spending contraction, as people look to spend money on necessities such as household products. When looking at the macro economy, we believe these two industries should be avoided during the remainder of the semester.

Current Holdings

The equities we hold in the Consumer Staples/Discretionary sector are all mid to large capitalization companies with well-known brands. The only exception to the brand recognition factor is Nordstrom, they are a clothing retailer and do not produce their own brand of clothing. We emphasize brand recognition as part of our value investment style because it creates a competitive advantage in pricing and loyalty. Warren Buffett refers to this as a moat, and encourages investors that brand recognition and loyalty is very important to consider when looking for intrinsic value in a firm. Metrics we pay close attention to when evaluating a company and its stock are PE ratios compared to industry averages, dividend yields, as well as beta compared to industry averages. Below we provide further insight into each of our sector holdings.

Consumer Staples

- **Holding 1:** General Mills
  - General Mills (ticker: GIS), with a current price of $38.49 and a beta of .18, was purchased in April of 2010 and has been around for over 100 years. This company produces cereals and other food products such as Cheerios, Betty Crocker, Pillsbury, and Nature Valley. They are considered market leaders in sales volume in virtually all of their brand categories. GIS meets our investment objective in that it continues to trade at a PE ratio of 16.41 that is lower than both its industry and S&P averages. GIS also consistently increases its dividend per share, which is currently at $1.22, as earnings grow. We believe that GIS is a mainstay in our portfolio due to its blue chip status as well as its growing emphasis on international expansion.

- **Holding 2:** Coca-Cola
  - Coca-Cola (ticker: KO), with a current price of $71.49, was first purchased by the fund in November of 2007, making it one of our longest holdings. Coke is one of the most recognizable brands, not only among soda companies, but in the entire world. KO is a market leader and has also made a push into the international markets, adding to its success. Their PE ratio of 19.36 is much lower than their competitors, and their ROE, 27.31%, and ROA, 8.91%, are much higher than average. KO has a beta of .53 which fits our investment objective in that it is less volatile than the current market. This firm carries immense intrinsic value simply through its brand recognition, its brand loyalty, and its distribution channel. Coca-Cola is the epitome of a brand investment and we believe will continue to produce superior returns for the foreseeable future.

- **Holding 3:** Altria Group
  - Altria Group (ticker: MO) is the parent company of Philip Morris, a producer of tobacco products such as Marlboro cigarettes among others and is currently trading at $30.12. Altria also produces John Middleton smokeless tobacco products, Ste. Michelle Wines, and operates a finance division known as Philip Morris Capital Corporation both in the US as well as abroad. Philip Morris has been in operation since the early 1930s, and Altria was spun off as the parent company in 2003. Although tobacco products are known to be dangerous to one's health, Marlboro and other cigarettes have some of the most brand loyal customers of any consumer product class. As per our objective statement, MO has exceptionally high Return on Equity, 75.89%, a low beta of .39, and also one of the highest dividend yields, 5.40%, in the entire consumer sector making it an attractive holding since being purchased in November, 2010.

- **Holding 4:** Proctor and Gamble
  - Procter and Gamble (ticker: PG), trading at $67.65, is a top ten Fortune 500 blue chip equity that has been part of the portfolio for over two years. PG is considered

a safety investment due to its well-known staples product line including Folgers Coffee, Gillette razors, Duracell batteries, Old Spice, Crest toothpaste, and Pampers baby diapers among others. These products ensure that the firm will maintain healthy sales volumes even during economic downturns. They continue to trade at an attractive PE ratio of 19.85, and low beta of .45, while returning a healthy and competitive dividend of $2.10 to their investors. PG has also been promoting its international expansion quite heavily as of late, further diversifying its sales base while adding to its top line.

- **Holding 5:** Nestle SA
    - Nestle SA (ticker: NSRGY) is an American Depository Receipt for the Swiss based consumer staples company. NSRGY was purchased for the portfolio on March 1 of this year and is the world's largest food and nutrition company. The product line includes Gerber baby food, Nestle Pure Life water, Poland Springs, Perrier, Cookie Crisp, Kit Kat, Coffee-Mate, Stouffer's, Beneful pet foods, Purina, Jenny Craig, Lean Cuisine, and Boost nutritional beverages. The firm's PE ratio is 19.7, which is in line with the industry average. NSRGY has a beta of .58 and its ROE is 16%. It fits our objectives through its strong brands, international exposure, and market leadership.

The chart below summarizes key comparisons between our holdings and their respective industries not including Nestle due to the fact that it was purchased recently.

Company	**Ticker**	**P/E**	**Industry Average-P/E**	**Beta**	**Industry Average-Beta**	**Div. Yield**	**Industry Average-Div. Yield**
General Mills	GIS	16.27	19.47	0.4	0.5	2.85%	2.39%
Coca-Cola	KO	12.67	17.68	0.52	0.64	2.68%	2.97%
Altria Group	MO	18.06	15.75	0.44	0.59	5.33%	2.94%
Procter and Gamble	PG	18.95	20.26	0.49	0.67	3.10%	3.59%

Consumer Discretionary

- **Holding 1:** Advanced Auto Parts
    - Advanced Auto Parts (ticker: AAP) was purchased by the portfolio on February 25, 2011 at a price of $62.63. At the time of writing this report, the current price is $86.96. AAP follows our Investment Objective consistently. The stock has a P/E ratio of 16.69 which is below the industry average of 18.53. AAP's beta of 0.68 is also below the industry average which is at 0.77. Although the dividend yield of AAP is 0.28%, which is below the industry average of 2.07%, it is still higher than its direct competitors which generally do not offer a dividend.

- **Holding 2:** Big Lots
    - Big Lots (ticker: BIG) was purchased on September 30, 2010 at a price of $33.44. Currently, BIG is trading at $45.00. Similar to AAP, BIG meets our Investment

Objective. The stock has a P/E ratio of 15.47 which is below the industry average of 17.5. The stock has a beta of 0.88 with an industry average beta of 0.63. Although BIG does not offer a dividend, its direct competitors do not either causing indirect competition creating an industry average dividend yield of 1.72%.

- **Holding 3:** McDonald's
  - McDonald's (ticker: MCD) is the longest held security in the Archway Fund and was purchased on October 25, 2005 at a price of $32.29. MCD is currently trading at $96.90. MCD meets our Investment Objective criteria with a P/E ratio of 19.04 which is below the industry average of 119.39 (Note: If you remove the outlier from the Industry Average, the new average would be 20.12). The beta of MCD is 0.5 which is also below the industry average of 0.7. MCD has a high dividend yield of 2.79% compared to the industry average of 1.58%.

- **Holding 4:** Nordstrom
  - Nordstrom (ticker: JWN) was added to the portfolio on September 29, 2011 with a purchase price of $46.65. Currently, JWN is trading at a price of $53.65. Nordstrom follows our Investment Objective with a P/E ratio of 16.77 which is below the industry average P/E ratio of 17.82. The stock has a beta of 1.18 which is also below the industry average of 1.28. JWN recently increased their dividend yield to 2.10% which is higher than the industry average of 1.54%

Company	**Ticker**	**P/E**	**Industry Average- P/E**	**Beta**	**Industry Average- Beta**	**Div. Yield**	**Industry Average- Div. Yield**
Advanced Auto Parts	AAP	16.6	18.53	0.68	0.77	0.28%	2.07%
Big Lots	BIG	15.4	17.5	0.88	0.63	0	1.72%
McDonald's	MCD	19.0	119.39	0.5	0.7	2.79%	1.58%
Nordstrom	JWN	16.7	17.82	1.18	1.28	2.10%	1.54%

Closing Remarks

Moving forward, we hope that you continue the approach we took and implement active management as well as value investing. We believe that securities with low betas and P/E and dividend ratios better than industry average are beneficial to our portfolio over the long term. When re-evaluating companies we currently hold, keep in mind that selling is more difficult than buying and it is more difficult to let go of the holdings we have had for a while. If at any time you believe a company no longer meets your investment objective or find that a company fits well with your objective, take the appropriate actions. Also, during the beginning of your time as portfolio managers take a close look at the macro economy and consider the factors in the economy that will affect your sector the most. This approach will help you identify the correct industries to invest in and which ones to avoid. Remember that every decision you make is vital to the fund and ensure that every decision relates back to the investment policy.

Archway Investment Fund

EEO Sector Report

Erik Budlong
Joey Griffiths
Parker Williams
Christopher Willson
Fan Zhou

"I've been following Chevron since I was in the fourth grade!" – Parker Williams

General Sector Outlook

Energy

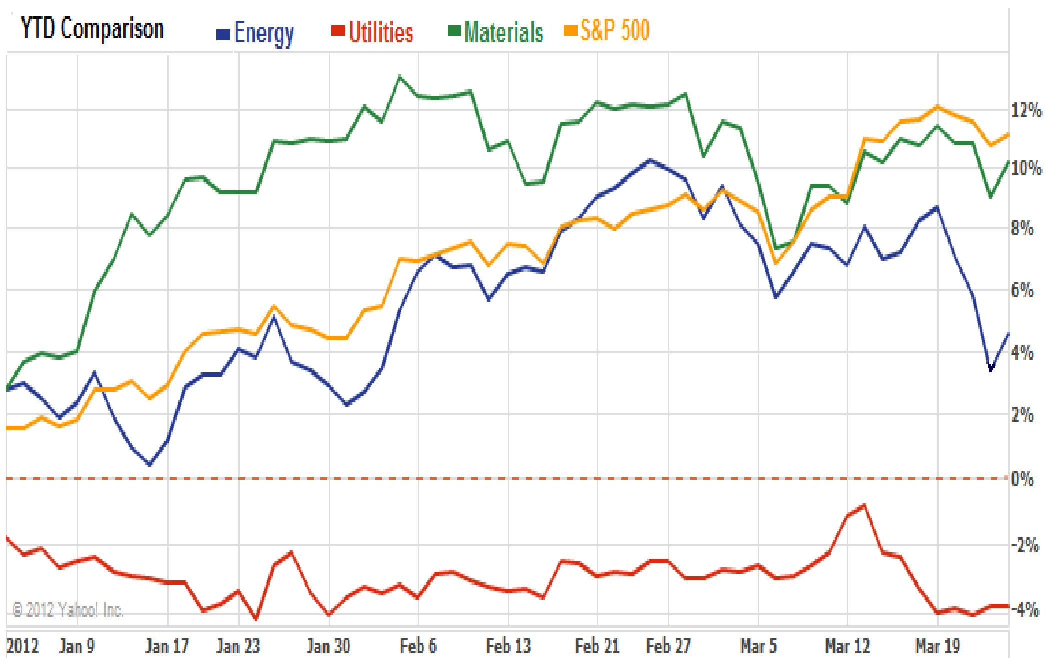
The 2012 outlook for the Energy Sector as a whole looks positive. When breaking down the energy sector, the sub-sectors all have varying outlooks. However, when comprised into one group, the overall consensus is that 2012 will be positive for this sector. Various reports from CIT Group's research studies have indicated that 85% of the companies within this sector expect to seek financing this year. With Ben Bernanke stating that interest rates will be kept close to zero until 2014, companies are viewing the upcoming years as a period in which they can borrow money at a very low cost in order to continue to grow their companies. This is not only favorable for the energy sector but also for the global economy as whole. With companies expected to borrow more money and refinance money already borrowed, it is expected that the growth of jobs will increase thus helping reduce the national unemployment rate. Other reasons for the expected increase in funds borrowed by many of the energy companies around the world are because of new green acts which may come into play this coming year. Regulation in the energy industry is very high and new regulations have been discussed where companies would have to reduce emissions by a considerable amount in order to meet new energy standards. This is a blow to the energy sector as it is expected for companies to have to invest a considerable amount of money in order to comply with this new set of standards.

Materials

The 2012 outlook for the materials sector is neutral to positive. The outlooks are varied across the sub-sectors of Gold and Silver, Copper, Coal, Industrial Metals & Minerals, Agricultural Chemicals, Special Chemicals, and Oil and Gas. Starting with gold, the increased demand from India and China will push gold prices higher. Gold will also likely climb due to the fact that real interest rates will likely remain negative for the year. Silver prices are likely to go up as well due to a weakening global financial environment, as many investors turn to the precious metal as a "safe" asset. Copper prices are predicted to remain stable for the foreseeable future, especially when China, one of the biggest copper consumers, has been cutting down its demand for copper due to slowing real estate development. Coal prices dropped dramatically at the end of 2011, and the slide is expected to continue as firms are facing decreased demand due to new EPA regulations. Many firms are now finding long term alternatives for coal. Chemicals in general are predicted to experience growth in 2012 due to the stronger recovery from the recession. Oil and gas are also expected to rise which will increase both the demand-side and the supply-side. Additionally, there is strength in demand for light vehicles and aircraft, which will further increase both demand and supply of oil and gas. However, industries such as textiles, paper and printing are not doing as well as oil and gas. Therefore, the lags in these industries are likely to offset the boom in oil and gas industry.

Utilities

The utilities sector has a neutral outlook for the next twelve months. This is true across the sub-sectors of electric utilities; multi-utilities; and independent power producers & energy traders. Minimal improvement in the power and housing markets, as well as the S&P Utilities Index being down 3.1% YTD have raised fears about the sector's profitability. Regulated operations should continue to see earnings growth in the single digits. Wholesale and industrial sales have been pressured by the economic slowdown. Since natural gas prices have been low, customers have faced lower bills and may be less inclined to conserve energy. Nevertheless, regulators are sure to be carefully scrutinizing rate increase requests. Some companies have lowered their business risks by reducing exposure to trading as well as exploration and production operations. They have used additional earnings to reduce their long term debt and boost dividends. Wholesale power operators should have declining earnings due to lower margin power contracts. Nuclear power plants should receive intense scrutiny regarding license renewals as well as new facilities being built. Companies are also being more cautious regarding entering into mergers due to the high costs of the regulatory approval process and low acceptance rate. Since the Environmental Protection Agency released new standards for coal emissions, we are expecting natural gas-fired generation to remain strong for the next few years. Additionally, some independent power producers are building solar and wind generation facilities.



Areas of Opportunity

Energy

Oil and Gas Equipment and Services:

Over the past year the Oil and gas equipment and services sub-sector decreased by roughly 5.23%. However the industry outlook for the oil and gas equipment services industry is very positive over the course of the next year. Hoover's analysts project that the oil and gas equipment services industry will grow at an average annual rate of approximately 9% over the course of the next 5 years. This growth will mostly be fueled by high commodity prices, with particular attention paid to oil and gas. Decreases in commodity prices would present a major challenge to the oil and gas equipment services industry as it will result in fewer companies needing to take advantage of these services. This industry is presented with major opportunities by the United States goal of decreasing dependency on oil from the Middle East. This would result in the need for opening public U.S. lands to drilling, and would drive demand in the industry. The industry has a strong average ROE of 8.53% and an average price earnings ratio of 33.3.

Materials

Gold:

For the foreseeable future, we see positive growth in gold mining companies. Gold already is selling at near all-time highs (~$1,700 / ounce), and we expect this to continue. There is a very strong correlation between real interest rates and the prices of gold. Historically, when real interest rates are low or negative, gold prices increase. The Federal Reserve has indicated that it plans to keep the nominal interest rate at roughly zero through 2014, and that inflation is pegged at about 2% in the near future. Real interest rates are forecasted to be negative for the next few years. We believe that this will help keep gold prices high. Other qualitative factors that we believe will help keep gold prices high are the strong demand in Asia. The Chinese government has recently stated that they believe gold will become 'the world currency' and hence has been buying large amounts of it. In India, gold is a huge part of the culture and most families commit a large portion of their income to the precious metal. With gold prices high, gold mining companies become more valuable. The rising commodity price boosts their bottom line while adding very few costs. However, one thing to watch when tracking gold or other mining companies are oil prices, as these companies use lots of heavy equipment that require immense quantities of gas.

Utilities

Water Utilities:

We expect favorable trends for water utilities over the next few years. The S&P Water Utilities Index rose 1.4% YTD and the average dividend yield is 3%. These companies should continue to be granted adequate rate increases to cover rising infrastructure costs for aging water systems. More budget-strapped municipalities should find it economically advantageous to sell their systems to private companies or establish public-private operating partnerships. New regulations related to chemicals could boost water rates along with municipal water system partnerships.

- EPA will likely require waster systems to use more advanced and costlier technology
- Water stations and lines set for reframing shale gas wells should provide new revenue
- Growth in desalination is expected to rise $6B by 2020

We believe this is a good safe haven for a long term investment. These companies have a strong dividend yield and low borrowing rates should drive capital investment.

Areas to Avoid

Energy

Oil and Gas Exploration and Production:

We project this industry to have a low growth rate as a result of volatile commodity prices and increases in environmental regulations resulting in increased costs in the industry. Additionally there has been a continual trend of decreasing oil production in the United States. This decreased oil production is resulting in a shift toward natural gas. There has also been a significant increase in the popularity of renewable energy resources which presents a major challenge to companies operating in this sub-sector. As mentioned above the price volatility in this industry creates a challenge for these firms, particularly in forecasting future earnings. While the current high price of oil has resulted in increased exploration, over all reserves in the industry continue to decline.

<u>Materials</u>

Domestic Chemical Manufacturing:

We have a neutral to negative outlook for chemical manufacturing. The chemical manufacturing industry is contingent on a strong economy where there is significant corporate spending. For 2012, we don't see an economic environment that bodes well for this industry. The American Chemistry Council expects chemical output in the U.S. to decline more so than in 2011. The fact that the Greek debt crisis is not yet solved hurts domestic chemical companies, since a large portion of their business is done in Europe. However, in emerging markets chemical usage continues to climb. If an attractive emerging market chemical manufacturing firm that is an ADR presents itself, and has many features listed in our investment objective, then it would be worth looking in to.

<u>Utilities</u>

Electric Utilities:

We expect a neutral outlook for electric utilities, as the S&P Electric Utilities Index was down 3.4% YTD. Likewise, we only see minimal improvement in the housing and power markets for the next 12 months. Earnings for wholesale power operators should decline through 2012 due to much lower margin power contracts. The nuclear crisis in Japan still has public and political concern intensified regarding the safety of nuclear power plants. This has made obtaining license extensions for existing plants difficult to obtain.

- Intense scrutiny regarding the development of new nuclear power plants
- Failed mergers make companies cautious about investing the regulatory approval process
- Difficulty in getting rate increases

We believe this a sub-sector that we should avoid for the time being. We already have some exposure to electric utilities from Duke Energy and NextEra Energy. When the regulatory environment improves in the future, we may want to revisit the idea of investing in electric utilities.

<u>Current Holdings</u>

We hold companies in the energy, materials, and utilities sectors. These companies were chosen because we believe they had fundamental indicators better than their industry averages and were trading below their intrinsic values. We believe they all have favorable financials and growth potential, as well as strong company management and business segment diversification.

<u>Energy</u>

Chevron Corporation:

- Purchased 2/25/2011 at $102.10, currently $110.03, and has almost reached its intrinsic value of $115.72
- Performance has outperformed the S&P 500 and XLE index
- The company's past exploration findings will lead to reserves and production in the near future.
- Chevron has outperformed the market in recent quarters because of commodity pricing which may prove to be non-sustainable.
- Beta of 0.95, which is below the industry average of 1.20
- P/E ratio of 8.16 and divided yield of 3.0% slightly off industry average of 12.97 and 3.63%, respectively.
- Net margin percentages and revenue growth continue to be positive

Statoil ASA ADS:

- Purchased 5/7/2010 at $21.39, currently $28.71, and has almost reached its intrinsic value of $33.56
- Performance has mimicked the volatility of the S&P 500 and XLE index
- The company has won several key contracts off of the coast of Norway and has also found new drilling deposits which should prove to be quite lucrative for investors.
- This company is international which fits what we are looking for in terms of sector diversification
- Beta of 1.36, which is above industry average of 1.20
- P/E ratio of 6.62 and divided yield of 3.40% off the industry average of 12.97 and 3.63%, respectively
- Net margin percentages and revenue growth continue to be positive

Flowserve Corporation:

- Purchased 5/8/2009 at $74.38, currently $114.94, and has reached its intrinsic value of $110.40
- Performance has underperformed the S&P 500 and XLE index
- The company has announced a 12.5% increase in quarterly dividends which is great for what we are looking for in companies.
- This company offers diversification for the energy sector as a whole because its main operations are in the creation and sale of piping, valves and other key materials needed in the oil and natural gas industry.
- The company has created high margins from secondary market sales in recent quarters.
- Beta of 1.50, which is above industry average of 1.20
- P/E ratio of 12.70 and divided yield of 1.20% slightly off the industry average of 12.97 and 3.63%
- Net margin percentages and revenue growth continue to be positive

Consol Energy Inc:

- Purchased 5/8/2009 at $24.88, currently $33.04, and is below its reevaluation price of $39
- Performance has underperformed the S&P 500 and XLE index
- The demand for coal in Asia is stripping supply which creates a very attractive margin for Consol.
- Consol may still be several quarters or years away from capitalizing on frac drilling operations in both the Utica and Marcellus Shale formations.
- Beta of 1.70, which is above industry average of 1.20
- P/E ratio of 13.50 and divided yield of 1.05% slightly higher than the industry average of 12.97 and below the dividend yield industry average of 3.63%
- Net margin percentages and revenue growth continue to be positive

Halliburton Company:

- Purchased 9/29/2011 at $30.52 and is currently trading at $34.74
- Performance has underperformed the S&P 500 and XLE index
- New products such as steam assisted gravity drainage system are expected to drive results.
- This company has high exposure to North America and is not well diversified geographically.
- Beta of 1.35 above industry average of 1.20.
- P/E ratio of 9.60 and divided yield of 1.00% slightly off the industry average of 12.97 and 3.63%, respectively
- Net margin percentages and revenue growth continue to be positive

The reason we continue to hold these companies in our portfolio is because we believe we will achieve a risk adjusted return that is equal to or exceeds the S&P 500. These companies have fundamentals around their industry averages and are trading below their intrinsic value. We continue to apply quantitative and qualitative analysis to these holdings to ensure that they are in line with our investment objective.

<u>Materials</u>

Stepan Co.:

- Purchased 11/24/2010 at $72.24, currently $84.12, has almost reached its intrinsic value of $85
- Performance has mostly outperformed the S&P 500 and XLB index
- This company declares its quarterly dividend of $0.28 is payable on 3/15/12
- This stock has reached it 52 weeks high of $91 on an intraday basis
- This company fourth quarter net income rose 55% to 13.2 million from previous period
- Beta of 1.23 slightly below industry average of 1.28
- P/E ratio of 13.2 and dividend yield of 1.3% slightly lower than the industry average of 13.9 and equal to the dividend yield industry average of 1.3%)
- Net margin percentages and revenue growth continue to be positive

Praxair Inc.:

- Purchased 5/8/2009 at $73.16, currently $109.68, has reached its intrinsic value of $85
- Performance has outperformed the S&P 500 and XLB index
- This company's total sales rose roughly 10% for the year 2011
- This company has large international operation and serves a diverse range of customers, it helps the company maintain revenue and seek new opportunities
- This company's good cash reserves proved flexibility in future expansions
- Beta of 0.95, which is below industry average of 1.36
- P/E ratio of 20.1 above industry average of 15.9, and dividend yield of 1.9% below industry average of 2.3%, respectively.
- Net margin percentages and revenue growth continue to be positive

The reason we continue to hold these companies in our portfolio is because we believe we will achieve a risk adjusted return that is equal to or exceeds the S&P 500. These two companies have fundamentals around their industry average. We continue to apply quantitative and qualitative analysis to these holdings to ensure that they are in line with our investment objectives.

Utilities

NextEra Energy:

- Purchased 3/2/2011 at $56.20, currently $59.75, and has almost reached its intrinsic value of $61
- Performance has mimicked the volatility of the S&P 500 and XLU index
- Management employs a low-cost generation fleet with many wind and nuclear facilities
- Its emissions are so low that carbon cap regulation would boost the firm's renewable investments
- Beta of 0.52 below industry average of 0.67 and EPS of 4.59 better than industry average of 2.31
- P/E ratio of 13.07 and divided yield of 4.01% slightly off the industry average of 12.13 and 5.2%, respectively.
- Net margin percentages and revenue growth continue to be positive

Duke Energy:

- Purchased 2/9/12 at $21.45 and is currently trading at $21.03
- Performance has beaten the S&P500 and XLU index
- Widely diversified assets and attractive dividend provide downside protection
- Management proactively addresses environmental risk through investment in cleaner technology
- Regulated utilities provide solid earnings and rate base growth offers significant growth potential
- Beta of 0.34 below industry average of 0.66, while P/E ratio of 16.41 higher than 12.09 average
- EPS growth of 28% much higher than industry over age of -4.24%
- Dividend yield of 4.76%, which is just under industry average of 5.79%
- Better than industry average for Price to Book, Debt to Equity, and Net Margin.

The reason we continue to hold these companies in our portfolio is because we believe we will achieve a risk adjusted return that is equal to or exceeds the S&P 500. These companies have fundamentals around their industry averages and are trading below their intrinsic value. We continue to apply quantitative and qualitative analysis to these holdings to ensure that they are in line with our investment objective.

Closing Remarks

Going forward, we hope to continue holding a diverse set of stocks within each of our sectors. This includes companies with different types of exposure. Additionally, we hope to own at least one ADR in each of our sectors so that we can have some international diversification. We believe that companies with fundamental indicators (beta, P/E, ROE, Dividend Yield) better than their industry averages will offer the best return on investment. Please be sure to stay knowledgeable of current trends by staying in tune with news related to our sectors.

Archway Investment Fund

Financial Sector

Matthew Minese
Nicholas Testa
Alex Wong

"Our plate is full. We have a lot to do building our company organically and that is our key focus."- Jamie Dimon

General Sector Outlook

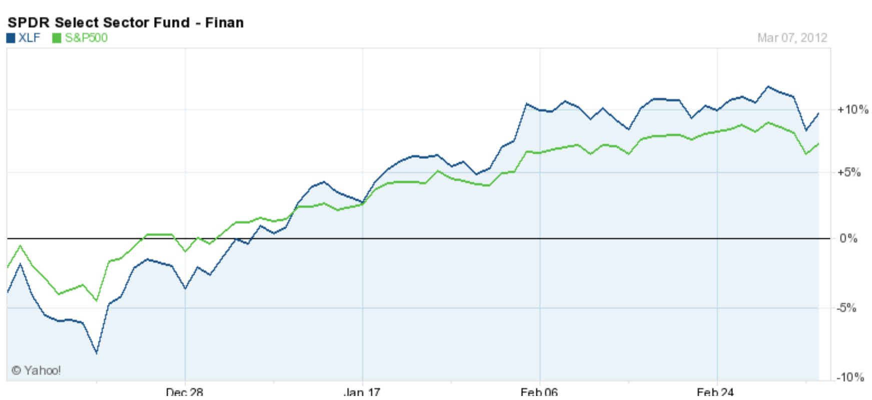
As the financial sector portfolio managers, we have a cautiously positive outlook for the future of our sector primarily due to its importance in the economic recovery. We believe the financial sector will outperform the S&P 500 over the upcoming months, due to the beaten down prices of financial companies, recovering investment opportunities, and an improving real estate market.

Despite a recovering economy, the unemployment rate is still a major concern at just over 8 percent. The recent economic recovery has enticed many companies to begin spending the cash they have been saving, however this is not yet translating into new jobs. The financial sector has performed well in the last few months, and should continue to grow and do well with increased confidence in the economy. Greece and the European debt situation will continue to be in the news till a resolution is reached. Until this occurs the finance sector will face scrutiny and possible contagion from Europe.

The Financial Sector is greatly impacted by the current and future expected low interest rate environment. Currently the Federal Funds rate has a target of remaining between 0.00 and 0.25 percent. The Federal Reserve has provided two rounds of quantitative easing: the first was $1.25 trillion of mortgage bonds and second was $600 billion of treasuries. This is a direct attempt to bolster confidence in the financial sector, while driving down interest rates in an attempt to increase lending. Fixed 30 year mortgage rates are currently around 3.75-4.0%, which is a direct result of the Federal Reserve's intervention. Ideally this will spur consumers to purchase homes with low rate mortgages.

Significantly lowering interest rates has a profound effect on commercial banks as well as on fixed income securities used by many insurance companies. The "interest rate spread" is the margin between what banks receive in long term loan and other interest, and what the banks must pay on its deposits and borrowings. Currently, this shrinking spread makes the banks less profitable.

Below is a chart of the three month comparison of the benchmark against the XLF financial SPDR, and shows the consistent higher returns by the XLF. Finally, as managers we are focused on the increase loan distribution, rebounding housing prices and sales, and compromise in the European debt countries as key foundations for strength in the Financial Sector.



Areas of Opportunity

Industry 1:

Real Estate Investment Trusts

Real Estate Investment Trusts (REIT's) are an important segment of the financial sector. This industry is split into two main categories, equity and mortgage REIT's. Mortgage REIT's make loans secured by real estate but usually do not own the real estate. Equity REIT's own and operate certain types of real estate or buildings.

Based on the current market conditions and our future projections we will focus on investing in equity REIT's. They provide exposure to a variety of income producing properties such as office buildings, residential, retail and healthcare facilities

In 2011, the U.S. experienced its lowest expansion in office buildings since 1960 with just 56 million square feet under construction. This leads us to favor equity trusts as opposed to mortgage based trusts because expansion of new properties has slowed dramatically over the past few years, a negative factor for mortgage based trusts.

The geographic location of the REIT's assets is important for revenue streams, as historical trends of increasing rent occurs in cities such as New York (Lower Manhattan) and San Francisco. For example, mid-2006 and mid-2007 rents rose 30% in Manhattan, following the recession of 2001. We will focus our efforts on the equity REIT's, as it is not likely office building construction will reappear until a combination of higher rents and higher property values return.

The equity REIT's are required to return 90% of their profits in the form of a dividend which leads to high yields compared to other financial securities. By owning an equity REIT we will be able to follow our investment strategy by owning a high dividend security.

Industry 2:
Domestic and International Commercial and Investment Banks and Regional Banks

Key to the future movement in the market and economy is the advancement, stability, and performance of major banks in the US. The beginning of first quarter of 2011 has witnessed an advancement of 3.6% in the Dow Jones Industrial average, primarily due to the resurgence of commercial lending. A healthy cycle of businesses borrowing to finance expansion coupled with consumers obtaining loans will feed directly into job creation and economic growth.

Key indicators for our analysts to continue to monitor will be banks' lending to small businesses and increasing their loan portfolio. Ideally lending to small businesses will increase and support well rounded economic growth. If small business sales grow, this would signal health and lead to increased loan demand for capital-intensive projects. We still feel that there are strong regional banks to consider, particularly those in areas that are seeing faster economic recovery than the broader economy.

We hold a positive outlook on international banks (ADR's) in emerging and developed markets such as Canada, Asia, South America, and Switzerland. We would like to avoid all possible exposure to Eurozone countries especially the PIIGS, as the Greece debt and European debt crisis unfolds.

Finding a strong real estate investment trust would be a strong addition to the fund as long as conditions remain favorable. Attention must be paid to the indicators for these companies which include **beta, return on equity and assets, and price to earnings** of REIT's. Dividend yields are typically much larger distributed by REIT's and must be focused on when choosing company.

Commercial and Investment banks will be critical to our performance over the next several quarters, and must be paid close attention to. Large Cap and Mid Cap value banks with below industry average indicators and consistent quarterly earnings growth will be targeted moving forward. We will take advantage of emerging markets and stable markets such as Canada, through the purchase of an ADR with a below market beta.

Areas to Avoid

When investing in Financials, there are various areas to avoid depending on the time. Currently, we believe that the areas to avoid are reinsurance, life insurance as well as mortgage REITs. Over the past year, the life insurance subsector has underperformed against the industry benchmark and reinsurance companies have also underperformed the industry due to a spike in claims from 2011 from various global catastrophes. Mortgage REITs is another area Financials should avoid mainly due to the amount of defaults happening in slow economic times.

Reinsurance is an area we would like to avoid due to recent catastrophe claims due to the fact of unprecedented worldwide run of catastrophe losses and weather related events which should reduce reinsurer's profits in 2012. Not only that but also because of rising primary rates, such as the personal property rates which rises in many areas during the summer months due to catastrophe concerns as well as moderate increases on renewals in the 4th quarter. The European debt crisis has left Reinsurers with disproportionate exposure to large foreign events or debt problems in Europe will show larger declines in market capital, giving us another reason to avoid Reinsurance.

As mentioned earlier, we would also like to avoid life insurance. As there continue to be losses in the investment portfolio as well as decreased amounts of income from businesses, the earnings for life insurers will continue to decline. Not only that but due to the economic downfall, the current situation for life insurance looks gloom due to the fact that they cannot enhance their customer base as well as maintain their existing clients.

Mortgage REITs is another area we would like to avoid because we have a negative outlook for the future for mortgage REITs. Since most of the mortgage REITs make a lot of their money borrowing at low interest rates and lending at highest interest rates, the amount of income they make will decrease due to recent short term interest rates which have gone up while long term interest rates have been going down. Earlier this year, there was a plan proposed to help 3.5 million people with good credit that are unable to refinance at historically low rates because their mortgages are worth more than their homes. This would lead to losses of millions in profits if the mortgages are paid off with cheaper loans, giving us another reason to avoid Mortgage

REITs. Finally, due to the lack of growth because of the decrease in amount of short term funding, mortgage REITs will be unable to continue business as usual due to the fact that people are saving their money instead of spending it.

Current Holdings

The current holdings in the financial sector are part of the Archway portfolio due to their adherence to the investment objectives for the fund. Each security has multiple characteristics of the seven specified in the investment objective that qualify it as a strong investment. As part of the value investing strategy, we hold only financial equities that have better numbers than industry averages. Currently, the financial sector owns the four following securities:

- **JPM:** JP Morgan Chase & Co is primarily an investment bank that also provides a variety of other financial services through their commercial banking and asset management segments. It was bought on April 23rd 2010 and has seen a loss of 8.46% to date. In line with the investment objective, it is better than industry average in a variety of areas. The dividend yield of 2.5%, return on assets of 0.9% and return on equity of 10.6% is higher than industry averages. Also better than industry are the lower price to earnings at 9.05, the 0.9 price to book value, and the 1.25 beta of JPM.

- **CB:** Chubb Corp provides property and casualty insurance through its personal, commercial, and specialty insurance segments. Purchased on February 22nd 2012, CB has seen a loss of 1.19% in its 16 days as a part of the fund. Having a beta of 0.51 and price to earnings of 11.69 positions it lower than industry averages. CB also displays higher than average dividend yield at 2.4%, return on assets of 2.7%, and return on equity of 10.8%.

- **BLK:** Blackrock is diversified financials company that was purchased on September 9th 2011 and has experienced a growth of 29.65%. It has a beta of 1.48 and a return on equity of 9.0%, both are right around industry averages. It also shows a higher than average dividend yield of 3.1% and return on assets of 1.2%.

- **REZ:** iShares FTSE NAREIT Residential Plus Capped Index Fund is an ETF that invests in stocks of companies that operate in residential real estate, healthcare and self-storage sectors. It was originally purchased on February 25th 2011 and has since appreciated in price 8.38%. It has a very low beta for the financial sector of 0.86 and also has an above average dividend yield of 3.1%. Due to its status as an exchange traded fund, data on other fundamental indicators is not available.

Inside of the financial sector, the four current holdings all fall under the investment objective of the Archway Investment Fund. There is a focus on key indicators that are better than industry averages. JPM, CB, BLK, and REZ all follow this guideline by having strong performance in multiple fundamental indicators. The securities held follow the strategy of the Archway Fund by focusing on value investing through high intrinsic value companies.

Closing Remarks

Moving forward with the Archway Investment Fund, specifically the financial sector, we would like to continue to invest in low beta, high price multiple ratios, and high dividend yielding stocks. We would like our analysts to continue to investigate large cap value stocks, international stocks, and companies not listed within our sector ETF and benchmark S&P 500. With a focus on subsectors that are showing improvement and signs of continued quarterly earnings growth, will lead us to greater returns and outperformance.

Archway Investment Fund

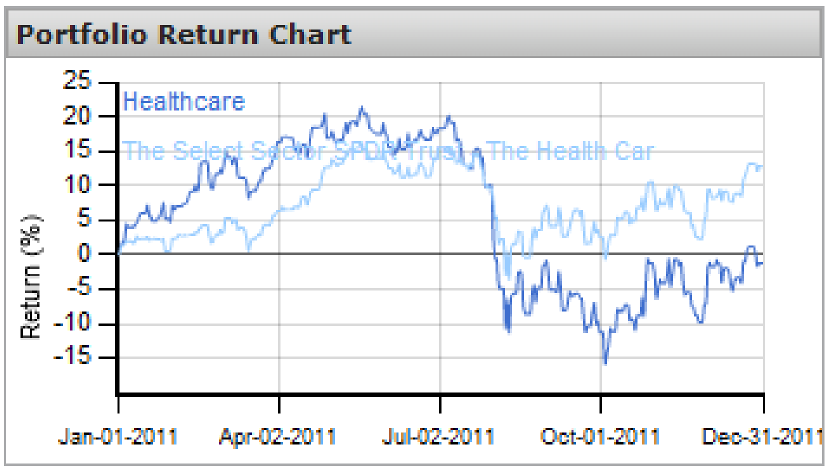
Healthcare Sector

Pat Cronin
Tim Figueredo

"The average investor will do well putting money into the obvious health care plays, companies you might read about in the Wall Street Journal*. But superior returns can be found in the behind-the-scene players."- Rob Fannon*

General Sector Outlook

The healthcare sector is generally viewed as a defensive sector and can provide consistent returns even in down markets. Since the market is currently rising, healthcare will be underweighted in order to maximize fund returns. The portfolio managers believe that in the upcoming months, the healthcare sector will outperform the XLV sector SPDR barring a minor shift in asset allocation to overweight pharmaceutical companies within our sector. Pharmaceuticals carry the most positive outlook due to the following important macroeconomic trends: an aging population, increase of spending in emerging markets, and a drop in unemployment in the United States. Below is a chart comparing the healthcare sectors performance to that of the XLV in 2011 (Note: XLV = light line, Archway Fund = dark line).



Areas of Opportunity

The portfolio managers believe the following sub sectors are important areas for value investment screening:

- **Generic Drugs**: The generic drug industry is benefiting from the large number of patent expirations of branded drugs. This 'patent cliff' is affecting some of the large pharmaceutical companies who are losing patent protection on some of their biggest blockbuster drugs. By 2015 $73 billion in branded drugs are expected to lose patent protection. We believe generic manufacturers and developers will continue to reap revenue from expiring patents for the next three to four years.
- **Biotechnology and Specialty Drugs**: Specialty drugs are complex pharmaceuticals often requiring large R&D budgets that target areas of unmet medical needs. Research suggests the specialty drug market will expand to twice the size of the traditional pharmaceutical market within a few years. Biotechnology products are predicted to account for 48% of the top 100 drugs of 2016, an increase from 31% from 2009. A trend of more personalized care and individualized medicine will benefit firms with promising specialty drug pipelines. However, investments in small cap biotech firms without any prominent drugs currently on the market may not fit the investment objective of our portfolio because of the underlying risks associated with drug development costs.
- **Technology**: We feel the healthcare technology sub sector may offer opportunities for value investing. The federal government's American Recovery and Reinvestment Act

(ARRA) creates financial incentives to hospitals to support investment in healthcare IT. A looming problem for healthcare facilities is outdated equipment, and as capital expenditure budgets begin to thaw, companies on the “cutting” edge of surgical technology should benefit tremendously. We feel the number of healthcare professionals using newer technologies is on the rise. A recent article in FT Health magazine estimated that roughly 20% of doctors' offices and 10% of hospitals currently use health care information technology.

- **Managed Care**: Almost all health insurers have been expecting higher earnings in 2012. Even with cost pressures from the new health care reform law, we view health care reform as positive for the managed care sub sector. Managed care will see enrollment gains of up to 32 million previously uninsured individuals by 2019 and there will be increased merger and acquisition opportunities.

The portfolio managers do not want to restrict the analysts’ screenings to these sub industries but we strongly feel they may offer more value investment opportunities. These areas present opportunities and will help manage the funds beta, as well as provide opportunities to seek out true value stocks that will be profitable for the foreseeable future.

Areas to Avoid

Devices and Supplies:

Companies heavily vested in healthcare products and supplies are facing some financial problems on both buyer and seller ends. Many hospitals have limited their capital expenditure budgets and have moved to make their operations more cost efficient. Also, due to new Patient Protection and Affordable Care Act (PPACA) regulation, these companies will experience a new tax that will be used to pay for the increased Medicare and Medicaid coverage over the next couple of years.

Current Holdings

The Healthcare Sector’s current holdings must be in compliance with the Investment Policy Statement and the investment objective of the portfolio. Below are the current holdings which are compared to appropriate value metrics.

- **Mylan Labs (MYL):** MYL still within our price targets and has been performing relatively well due to the expanding generics market and its deep pipeline. MYL makes up 2.19% of the portfolio and has been in the sector longer than any other current holding. The debt to equity may be reduced depending on FDA approvals from its 172 current drug applications. We currently feel satisfied with our current position in MYL.

(P/E: 17.2**, ROE:** 15.1%**,** Div**. Yield:** 0.00%, **Beta:** 0.85**, Total Debt to Equity:** 151.7%**)**

Generics Averages: P/E: 19.12

- **Express Scripts (ESRX):** ESRX is currently within our targets but has been our worst performer. Trading at around $54 with high target of $73 and sell target of $33. ESRX makes up 2.71% of the portfolio. It is a large pharmacy benefit management player and the potential merger with Medco has both positives and negatives. The merger is also responsible for high debt to equity.
  (P/E: 17.7**, ROE:** 42%**, Div. Yield:** 0.00%**,** Beta**:** 1.1**, Total Debt to Equity:** 326.5%**)**

PBM Averages: P/E: 16.3

- **Wellpoint Inc. (WLP):** WLP is within the price targets trading at around $64 with high target of $101 and sell target of $54. WLP is much closer to its sell target and is currently being reevaluated by the security analysts. Our adjustments to this holding will be dependent on the reevaluation.
  (P/E: 9.13**, ROE:** 11.2%**, Div. Yield:** 1.7%**, Beta:** .95**, Total Debt to Equity:** 42.1%**)**

Managed Care Averages: P/E: 13.81

- **Covidien plc (COV):** COV is currently above the price target and is currently being reevaluated by the security analysts. Trading at around $53 with high target of $51 and sell target of $35. COV makes up 1.72% of the portfolio and has been in the portfolio for the second longest period behind MYL. COV has a large presence in the device and supply sub industry with plans to spin off its pharmaceutical segment. Depending on the reevaluation we may eliminate, reduce, hold, or increase our position with COV.
  (P/E: 11.5**, ROE:** 20%**, Div. Yield:** 1.6%**, Beta:** 0.84**, Total Debt to Equity:** 42.9%**)**

Medical Instruments and Supplies Averages: P/E: 17.2

- **Ensign Group (ENSG):** ENSG is within the targets trading at around $27.50 with a high target of $33 and sell target of $20. ENSG was recently purchased based upon our positive outlook of the facilities sub industry and has been performing well.
  (P/E: 13.12**, ROE:** 18.86**, Div. Yield:** 0.8%**, Beta:** 0.7**, Total Debt to Equity:** 67.7%**)**

Long Term Facilities Averages: P/E: 14.29

Healthcare Industry Averages: **P/E:** 16.4, **P/BV:** 2.6, **ROA:** 10.3%, **ROE:** 13.0%, **Debt/Equity:** 23.5%

Our holdings reflect our Investment Policy Objectives because our securities are on the low end for P/E and have strong ROE's. We also see strong dividends relative to respective sub-industries for our securities.

Closing Remarks

This memo is meant to align the objectives of both the portfolio managers and security analysts in the Healthcare Sector. The information should help the security analysts understand the screening process for security valuation and presenting investment opportunities within the healthcare sector based on the portfolio managers' value strategy. When screening for value investments, it is important to review company financial statements and ratios to determine if the security falls within the value metrics previously mentioned. The analysts should feel free to look outside of these suggestions to find value opportunities. In all cases, the qualitative research must also be taken into consideration after screening for these value metrics. Any questions or suggestions regarding this information should be immediately directed to the portfolio managers.

Archway Investment Fund

Industrial Sector

Jordan Brown
Alena Korshunova
Brett Millier
Kee Ming Yeung

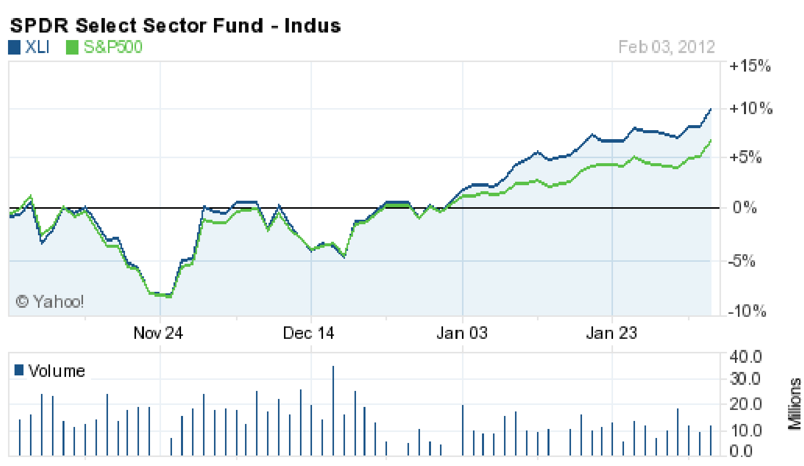
"If you take all the factories in the world today, they could make all the parts necessary to build more factories like themselves. So, in a sense, we have a self-replicating industrial system today, but it would take a tremendous effort to copy what we already have." – K.Eric Drexler

General Sector Outlook

Based on our research we have a positive outlook on the Industrials Sector overall. According to S&P the Industrials Sector index has gone up by 7.0%, compared to a 4.6% gain for the S&P 500 since January 2012. We have a positive fundamental outlook on the Industrials Sector as we expect an overall increase in sales as the economy slowly recovers and influx of orders coming in from rising emerging markets along with more exposure to these markets. We foresee a slow but steady U.S. and world economy recovery even though the issue of the European debt crisis still lingers and creates a sense of uncertainty. Due to the defensive strategies employed by companies in 2011, operating leverage is rising alongside revenues as a result of the cost-cutting and investments in R&D and expansion initiatives undertaken by companies in the declining economy of latter 2011. The sectors strength relative to the S&P 500 has been rising since late September of last year which is a positive sign (See Appendix A).

Year-to-date, the S&P 500 Industrials Sector has returned over 8%, the third best of all ten sectors. We foresee tough times ahead for Transportation stocks, especially Airlines which we would like to avoid as their underlying fundamentals tend to be and have remained negative overall. Trucking volumes improved in December of 2011 possibly due to increased volume from the holiday season. Construction and Farm Machinery, and Building Products are on our watch list. Our top performers within the sector remain Rails and Industrial Machinery, which continue to benefit from strong macroeconomic trends. We are also keeping an eye on construction and engineering services and continue to have a negative outlook on airlines as their underlying fundamentals remain negative overall. However we have faith in the sector due to improvement of global PMI's, a healthy business outlook outside of Europe, increased levels of equipment financing, growth in provision and availability of loans. We are not overly optimistic though because of a slightly overvalued sector at the moment.

Overall we agree with analysts that the sector is currently bullish and is in a position to outperform others as demand within the U.S. economy grows alongside that of the international economies which are currently feeding the Industrials Sector with increased demand which is creating a backlog for products, parts, servicing and maintenance and a somewhat stabilized European economy and debt crisis. The following graph from Yahoo Finance depicts the performance of the Industrials SPDR Select Sector Fund to the S&P 500 Index over the past three months:



Areas of Opportunity

With an overall positive sector outlook, there should be numerous value investing opportunities in the industries operating within the Industrials Sector. It is important to realize that although the sector has had strong performance recently, there are still industries within the sector that have yet to recover from economic downturns. There could be value investing opportunities in these underperforming industries, but the sector portfolio managers believe that price appreciation will not be seen within this outlook’s time horizon, and many companies in these underperforming sectors may still not be at their lowest prices. Moving forward, the Industrial Sector would like seek value investment opportunities in the following Industrial Industries:

Road and Rail

The Road and Rail industry within the sector should see price appreciation with many of its companies. This is due in large part to the continued development of transportation infrastructure in emerging markets. Areas in South America could provide multiple value opportunities for the sector. Emerging markets in South America (i.e. Brazil) are overshadowed by news of China’s growth as well as Europe’s debt crisis. There may be undervalued companies that are servicing South American markets in terms of road and rail transportation. According to Fidelity Investments, the industry is up about 16.5% since this time last year. The portfolio managers believe that the industry has just begun to recover and will continue to improve, providing some value investments in an industry the Fund does not currently participate in.

Construction and Engineering

The Construction and Engineering industry has declined by about 10% since this time last year, according to Fidelity Investments. Although the industry has declined, it is still a strong investment opportunity for the Fund. There are many undervalued stocks in this industry due to lingering investor uncertainty both domestically and abroad. Many companies operating within this industry are still continuing to build. Emerging markets are still requiring large amounts of construction even with China predicting that its growth will begin to slow. This may be an opportunity for the sector to buy into a larger corporation that is undervalued like many companies in the industry. The ability to get proven companies at low prices is attractive for the sector holdings and could offer value investments with very low risk. There also may be ADR opportunities within this industry as there are many foreign companies that are participating in the construction and engineering efforts in emerging markets.

Machinery

The Machinery industry consists of companies that produce construction, industrial, and farm machinery, as well as heavy trucks. The sector currently holds Cummins Incorporated and it has experienced strong price appreciation in a relatively short amount of time. Companies in this sector continue to benefit from recent equipment updates done by large construction companies during the recession. Also, there have been industry wide decreases in operating expenses as many companies producing this machinery were forced to create more efficient manufacturing processes to cut costs when sales declined drastically from 2008 to 2009. Cummins has been a strong holding for the sector, but as it continues to appreciate towards its target price, value investment opportunities within the Machinery industry should be investigated.

There are only a few dominant companies in the industry, but smaller companies could still provide gains to the Fund.

The positive outlook for the Industrials Sector stems from current macroeconomic conditions as well as the performance of these three industries. The sector managers and analysts will be working to find undervalued securities in these industries that should provide the fund with growth potential. Although other industries within the sector may pose value investing opportunities, these three industries are the most attractive to the managers and analysts of the Industrials Sector of the Fund given current economic conditions.

Areas to Avoid

Even with an overall positive sector outlook, there are still some industries that the sector portfolio managers believe should be avoided. It is important to realize that there are still some negative factors outside the economy which affects some of the industry, such as high gas prices, high raw material prices, and overweight stocks. The Industrials Sector would like to avoid the following industries:

Marine

The Marine industry within the sector remains very depressed recently due to the slower import or export activity in China, the financial crises in Europe, and the oil prices. But those are not the main reasons which lead to failure. According the report of Valueline, the ills of the group are largely self-inflicted. Owners ordered too many vessels during the last cyclical upswing (pre-2008), and that mistake has come back to haunt them. One of the companies within the industry, Matson Navigation, shut down one of its two China/West Coast America services. Moreover, its main competitor on the China/Guam/U.S. route exited the business. The portfolio managers believe the industry is risky and will take years to recover.

Airlines

The Airlines Industry has declined by around 14% since this time last year, according to Fidelity Investments. The main reason will probably suffer from higher jet fuel and the slowdown of the global economy. Moreover, the stock movement of the industry tends toward volatility. The companies within the industry are looking for acquisitions and merging to boost activities. Moreover, AMR Corporation sought Chapter 11 protection last year which leads to a clear direction for the portfolio managers that the Airlines Industry is not a good industry to invest. The industry is strongly tied with the economy and gas prices.

Aerospace and Defense

The portfolio managers remain neutral regard to the Aerospace and Defense Industry. The managers would not avoid the aerospace industry since Boeing and Airbus have orders through 2019. On the other hand, the managers do not feel comfortable on the defense industry. The president of the United States had cut the defense budget which leads to other nations plans to cut theirs also. United Kingdom plan to slash its defense budget by 20%. Italy has decided to follow; France, Germany, and Spain started to review their defense spending. According the report of Zacks Equity Research, the Obama administration stopped or delayed the funding of a few mega projects which were in research and development stage. Accordingly, after assessing the current and future market potential, Boeing decided to shut down its Boeing Defense, Space and Security facility in Wichita by the end of 2013 on the back of continuous reduction in U.S. defense spending.

Current Holdings

The Industrial Sector's current holdings need to be in line with the Investment Policy Statement and the overall objectives of the Fund. It is important to drill down and discuss current holdings to align objectives between the portfolio managers and the analysts.

- **FedEx (FDX):** This holding is still within price targets, but declines in the transport industry due to rising fuel prices are causes for concern. FedEx is currently the sector's largest weighted holding, and is still within price targets, but the portfolio managers would like to reduce the weight on this holding because of its industry and use the cash to purchase another value opportunity. **(P/E:** 16.5, **Div. Yield:** 0.6%, **Beta:** 1.11**)**

Airfreight & Logistics Averages: (P/E: 19.9, **Div. Yield:** 2.28%**)**

- **CSX (CSX):** CSX is the newest addition to the sector's holdings. The managers believe that this company is undervalued, stemming from our valuation models and our positive outlook on the Road and Rail Sector. CSX has been performing better than its industry averages and is in line to win more contract bids for years to come. **(P/E:** 12.97, **Div. Yield:** 2.2%, **Beta:** 1.4**)**

Road and Rail Averages: (P/E: 15.8, **Div. Yield:** 2.10%**)**

- **Honeywell (HON):** This holding is well within its price target and is a very stable company. With Honeywell still being undervalued, the managers are looking to continue holding it unless unexpected circumstances no longer make this holding worthwhile. **(P/E:** 16.1, **Div. Yield:** 2.5%, **Beta:** 1.31**)**

Electrical Equipment Averages: (P/E: 71.7, **Div. Yield:** 2.47%**)**

- **Cummins (CMI):** The most recent addition to the sector, Cummins has shown strong price appreciation in a short amount of time. It will need to be closely monitored as it quickly approaches its target price. While it has been a source of strong gains, its beta suggests that it is a more volatile holding. In the future, the portfolio managers would like to avoid this extent of volatility if possible, as losses can accumulate just as quickly as gains. **(P/E:** 12.9, **Div. Yield:** 1.3%, **Beta:** 1.82**)**

Machinery Averages: (P/E: 19.68, **Div. Yield:** 1.85%**)**

The above statistics were found utilizing Factset (for the individual stocks) and Fidelity Investments (for the industry averages). The views of the sector's portfolio managers are explicitly outlined and have built a framework from which the sector analysts can begin to research from. Again, these insights of offered from experience and current outlooks on the sector and what is held in the Fund. The analysts should feel free to look outside of these suggestions if there are other strong attributes to support a value investment. Identifying value is the Fund's primary objective, transitioning from a firm low beta position. This is meant to supplement what the analysts are currently learning and will evolve as discussions between the portfolio managers and analysts continue.

Closing Remarks

There are plenty of opportunities within the Industrials Sector. The most important thing for the Fund is that all of its portfolio managers and analysts stay true to the investment objective. The Fund will perform well if the value investing strategy outlined in the Investment Objective is carried forward. Securities with relatively low betas and P/E ratios, along with high dividend yields, may hint at value and should be investigated further. In this report the Industrials Sector portfolio managers have laid out areas of opportunity and areas to avoid in the sector. It is important to realize that there may be opportunities outside of what we have recommended and that there may be undervalued stocks in down industries because they are not getting any positive attention. Overall, just continue to look for value and stand by your investment objective. Select stocks that fit the Fund's definition of value.

Archway Investment Fund

Technology Sector

Jason Clinton
Timothy Drechsler-Martell
Samir Kothari

"Being the richest man in the cemetery doesn't matter to me … Going to bed at night saying we've done something wonderful… that's what matters to me." – Steve Jobs

Technology Sector Outlook

The technology sector is expected to outperform the S&P 500 over the course of the next six months. As the recovery continues in the United States, and the European Union reduces the likelihood of a Greek default, technology companies should see increasing sales to both business and consumers. Over the next six months consumers should increase their spending, as unemployment continues to decline and there is less worry of a double dip recession. The reduction of such fears will encourage consumers to increase their discretionary spending on products such as tablets, smart phones, and computer software. Business spending should similarly increase as companies will seek to upgrade their IT infrastructures while the economy is improving. Such improvements will decrease business costs and improve efficiency, proving beneficial should another economic downturn occur. These factors will contribute to the positive performance of the sector over the course of the next six months.

The chart above depicts the performance of the Technology Spider (XLK) versus the S&P 500 from March 2011 to March 2012. From the period of March 2011 to mid-September 2011, the technology spider's mimicked the performance of the S&P500. The technology sector over this period did not see the introduction of many new products, and economic fears discouraged consumers to spend their additional income on technology products and services. In August 2011, the Technology Spider declined about ten percent as the markets crashed due to the United States debt downgrade. Since the downgrade, the spider has recovered 20%, and is up 10% overall since March 2011. This recent positive performance is the result of increased technology sales as spending in the United States increases.

Areas of Opportunity

The biggest areas of opportunity for the technology sector are in IT Services, Telecommunications, and Computer Software sub-sectors. These three sub-sectors all tie together as consumers and businesses seek to transition to wireless services and shift data storage to the cloud. These three sub-sectors will be critical to the success of cloud computing as software and IT Services work to create cloud services that meet business needs and telecommunication companies improve wireless networks so data stored "in the cloud" can be globally accessed. Cloud storage and cloud computing is being implemented on smaller scales by many technology companies including IBM and Oracle. However, as the service continues to be improved, many technology companies will seek to implement large-scale cloud services in the coming year. Cloud computing represents the greatest opportunity in the technology sector for the future.

Areas to Avoid

Companies within the computer hardware sub-sector represent an area of risk that we seek to avoid over the next six months. Over the last year, many technology companies have sold their hardware segments in order to focus on software and IT services. This trend largely occurred as computer hardware could be produced cheaper leading to increased competition and lower prices. As a result of these factors, hardware companies have small profit margins. These companies can further be adversely affected by events that lead to raw material price increases. Due to the availability of substitutes, companies that try to raise product prices due to higher material prices would see a loss of revenue as customers switch to the substitute. This inability to raise prices provides these companies little room for error in harsh environments. Based on our analysis, we feel hardware companies should be avoided due to their low profits and the risks of the industry.

Current Holdings

As per the Investment Objective that has been outlined by the Portfolio Managers, it is imperative that both Portfolio Managers and the Securities Analysts focus on investments that meet the criteria of a value investment. From sector to sector, what constitutes a value investment can vary, as each sector is made up of a variety of securities. In the technology sector, a value investment will constitute a security that trades at a P/E ratio lower than the industry average, has a low beta, and preferably pays a dividend. Due to most technology companies not offering dividends, this criterion is viewed more as a bonus than a necessity.

Google, Inc.

Google, Inc. was purchased for the Archway Investment Fund on December 18, 2008. Google Inc. operates in the Internet Information Provider Industry and largest competitors are Apple, Microsoft and Yahoo. Google represents an attractive holding that is in compliance with our investment objective. The company currently trades at a P/E of 20.4, well below the industry average of 30.6. The company further trades at a low Price/book ratio of 3.4 compared to an industry average of 4.1. Over the past three years, Google has grown its revenue on average 20.3 percent and increased net margins 25.7%. The company has a high ROE of 18.7, above the industry average of 14.7. The company has virtually no debt, as shown by its Debt/Equity ratio of .1. Google is an ideal investment for a value investor due to its low beta of 1.09, its brand recognition, and record to continuously grow revenue and net income.

Vodafone Group Plc.

Vodafone was purchased for the Archway Investment Fund on November 02, 2011. Vodafone operates in the telecommunications industry, competing against various competitors in a variety of markets. Vodafone represents an attractive investment that is in compliance with our investment objective. The ADRs currently trade at a P/E of 12.5, well below the industry average of 23.8. The company further trades at a Price/Book of 1.0, which also is below the industry average of 1.6. Over the past three years, Vodafone has seen revenue growth of 9.0 percent compared to the industry which declined 11.1 percent. Vodafone furthermore has less debt than most telecommunication companies. Vodafone has a debt/equity ratio of .4 compared to the industry average of 2.6. Vodafone is an ideal investment for a value investor due to its low beta of .76, high dividend yield of 7.24%, and strong brand presence in a variety of foreign markets.

International Business Machines Corp.

IBM was purchased for the Archway Investment Fund on November 02, 2011. IBM operated in the computer software industry against competitors such as Hewlett-Packard, Oracle, and EMC Corporation. IBM represents an attractive investment that is in compliance with our investment objective. The company currently trades at a P/E of 15.3, slightly above the industry average of 13.8. IBM however, did have a P/E below the industry average at the time of purchase. IB, has a superior ROE of 73.4%, well above the industry average of 37.5. The company further has a net margin percentage of 14.8, above the industry average of 12.7. IBM is an attractive investment for value investors due to the stocks low P/E, dividend yield of 1.75%, low beta of .66, and record of continuously increasing earnings per share.

Cognizant Technology Solutions Corp.

Cognizant was purchased for the Archway Investment Fund on September 29, 2011. Cognizant operates in the business software and services industry against competitors such as Accenture PLC and Oracle. Cognizant trades at a P/E of 25.6, well below the industry average of 46.5. The company's Price/Book of 5.6 is slightly above the industry average of 5.0. Cognizant has a high ROE of 23.5 percent compared to the industry's 14.2. Cognizant has no debt as shown by a debt/equity ratio of 0. The industry average for debt/equity is 5.3. Cognizant represents an investment in compliance with our investment objective due to its lower than industry P/E ratio, low beta of 1.11 and the fact that the company has no debt.

Closing Remarks

This semester should serve to be a positive experience for both the Portfolio Managers and the Securities Analysts of the technology sector. One of our biggest goals this semester is to increase the communication that occurs between the Portfolio Managers and Securities Analysts. To keep the Securities Analysts up to date with the plans of the Portfolio Managers, we hopes to spend five to ten minutes each Thursday night class discussing investment opportunities and changes in the macro-economic environment that could positively or negatively affect our sector. Finally, we encourage the Securities Analysts to contact us with any questions they have regarding the material for the FIN 450 class, the deliverables we produce, or any general questions they have regarding the Archway Fund. Through active communication, we seek to keep our sector in compliance with the Investment Policy Statement and prepare the Securities Analysts to take on their later roles as Portfolio Managers.

After careful consideration, the technology sector will pursue a value approach to choosing investments this semester, with a focus on long-term growth opportunities. Overall, we are seeking to invest in companies that have a low price-to-earnings ratio, pay a dividend, and have a low-beta. Our goal is to seek conservative growth opportunities that hedge against large market price swings that result from macroeconomic conditions. One way we are seeking to hedge risk is by seeking investments that pay a dividend. Dividends provide an opportunity for income even if a stock experiences a price decline. Our final criteria for investments is to seek out companies that trade in the United States as an ADR or American companies with an international presence. Although all investment ideas will be considered, we are largely seeking companies that meet the stated criteria. We feel that this value approach will protect the sector in the current volatile market where fearful investors overreact to market news.