Applied Investment Management
UNIVERSITY OF NOTRE DAME • MENDOZA COLLEGE OF BUSINESS

AIM Quarterly

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Welcome to AIM XXX

We are pleased to present you with the most recent edition of the AIM newsletter. The current economic and market conditions have only reinforced the merits of a sound, long-term oriented investment philosophy such as that which Warren Buffett and John Neff have successfully employed.

To help you stay up-to-date with how the market is interpreting current economic information, this issue contains an interview AIM analyst Pat Mulvehill had with David Rosenberg, the Chief Economist and Strategist for Gluskin Sheff. Gluskin Sheff is a select, high net wealth investment management firm with a $586M market capitalization.

Along with providing insightful commentary from the likes of Mr. Rosenberg, we have included the most recent economic news, the current portfolio composition and an update of our portfolio performance.

Please feel free to contact us if you have comments or ideas about the newsletter. Enjoy!

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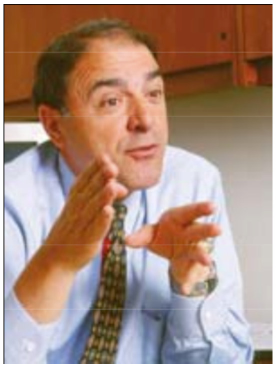
ALUMNI UPDATES

Kevin Poppink, AIM IV, Class of 1997
Kevin is Vice President at Angstrom USA, an automotive supplier in Detroit, following 8 years at Visteon Corporation. In the past year he has closed two deals while working on the company's start-up investment company, Greenseed LLC, which has been pursuing distressed automotive and manufacturing opportunities created in the downturn. Kevin says, “I am very thankful for my AIM experience and my time working with Dr. Reilly. The analytical approach I learned has been an asset to the variety of jobs I've held in my career thus far.”

Erin A. Gilroy, AIM XXIV, Class of 2007
After graduation, Erin went to Bear Stearns as an associate in the Financial Analytics and Structured Transactions Group, where her focus was on structuring mortgage backed securities. She later went on to became a Relationship Manager at Mondiale Partners, where she did asset raising for various hedge fund strategies. Since February 2009, Erin has served as a Managing Director of Institutional Sales at Third Avenue Management LLC, where she is responsible for cultivating relationships with leading foundations, endowments, and government plan sponsors.

GUEST SPEAKER - RALPH ACAMPORA



On Friday, February 12, the AIM XXX class gathered for a special lecture from guest speaker Ralph Acampora. Mr. Acampora has been a pioneer in technical analysis for over 40 years and is currently the managing director at Altaira Wealth Management. Mr. Acampora has taught for 37 years at the New York Institute of Finance. He has been the Director of Technical Research at Knight Equity Markets, Director of Technical Analysis at Prudential Equity Group, and he has worked at Kidder Peabody & Co. as well as Smith Barney. Mr. Acampora has been very involved in the development of modern technical analysis. He co-founded the Market Technicians Association (MTA) in 1970, and he was the founder and the first chairman of the International Federation of Technical Analysts (IFTA). Mr. Acampora is a trustee on the Board of the Security Industry Institute (SII) and currently is involved in the establishment of the Securities Traders Association University (STAU).

Mr. Acampora spoke to the AIM class at length, sharing personal stories from his many experiences in the financial world. He also shared knowledge about technical analysis and many examples of techniques used to analyze the market. Particularly interesting were his examples of how technical analysis showed warning signs of the recent financial collapse as well as signs of the stock recovery seen in the last year. He was cautious on his outlook for the future, saying that "something doesn't smell right". Mr. Acampora emphasized the importance of thinking globally when investing and also diversifying portfolios globally. This is one of the major drivers of his new company Altaira Wealth Management, which trades global ETFs based primarily on technical analysis. Mr. Acampora is a great speaker, whose talk was very informative and also entertaining. He is very knowledgeable, and he connected well with the students. The class appreciates having the opportunity to learn from him.

ECONOMIC UPDATE

GDP - GDP grew 5.7% in Q4 over Q3, and increases in inventories alone were responsible for 3.4% of this gain. An increase in the proportion of fixed asset investment relative to inventory investment would be a positive sign of growth momentum building. Our forecast is for slow to medium GDP growth in 2010, with quarterly increases of 2.8%, 2.0%, 2.9%, and 2.5% respectively.

Credit - A Q4 survey showed that the net percentage of lenders loosening restrictions on loans to medium and large firms was 5%, the first time in over a year that, on net, these restrictions have been loosening. The net percentage of institutions tightening restrictions on commercial loans fell to around 2%. It is likely this will turn into a net loosening of restrictions in 2010. Overall, this represents a strengthening of economic confidence and a positive sign for growth this year.

Unemployment - Having fallen from a high of 10.1% in October 2009, the unemployment rate was at 9.7% as of January 5, 2010. Although there was a decrease in the unemployment rate, the size of nonfarm payrolls dropped by 20,000. One reason for this drop was the addition of jobs in the manufacturing sector, the sector's first job increase in 3 years. Overall, the economy has lost over 8.4M jobs over the past two years. In addition, the number of long-term unemployed has been trending upward. Since the start of the recession, the number of long-term unemployed has increased by 5.0M, from 1.3M to 6.3M.

Temporary workers have been one bright spot in the unemployment figures. In January, the number of temporary workers increased by 52,000. Since September 2009, temporary workers have increased by 247,000. This may signal an increase in needs by businesses. Also, the Wall Street Journal reported that internal hires and transfers accounted for 51% of full time positions filled. This will be something to watch as firms may move these temporary workers to full time staff as the economy stabilizes.

Although hiring remains tight for new college graduates, they are faring much better than the rest of the workforce. In January 2010, the unemployment rate for laborers with a bachelor's degree or higher was 5.1% (not seasonally adjusted), much lower than the overall workforce. The next employment figures will be released by the Department of Labor on March 5, 2010.

Housing - A recent report by the Wall Street Journal stated that the government's mortgage loan modification efforts might not be as beneficial as originally hoped. A Standard & Poor's Financial Services LLC report implied that, if current trends maintain their status, 70% of modified loans would eventually default. The article also estimated that there are 7.7 million households behind on their mortgage payments.

The Federal Reserve Bank of New York has planned to purchase up to $1.25 trillion of mortgage backed securities. As of February 17th, the Fed had purchased $1.19 trillion or 96% of those planned purchases; most came from Freddie Mac, Fannie Mae and Ginnie Mae. The program expires on March 31, and there is some debate within the Fed about how to end this program. If private investor demand does not pick up for MBS, the Fed may extend the program to ensure MBS prices remain stable.

The Case-Shiller housing index reported that the annual rates of decline in its 10 and 20 city composites are continuing to improve. Home prices gained 0.3% in December, the 7th straight monthly gain. However, as of December 2009, the 20-city composite declined 3.1% from December 2008. This mark is still 30% off its high in May 2006. As a comparison, the average home price in the United States is at the same level as late 2003. On a positive note, sales of newly built homes were expected to rise 5.3% in January. Case-Shiller will issue its next report on Tuesday, March 30, 2010.

PORTFOLIO PERFORMANCE

The AIM portfolio has performed slightly better than the S&P 500 and the HBI (Hank Blended Index) over the one, three, and five year timeframes (figure 1, below). The strong recent outperformance was driven primarily by stock selection, while the longer-term outperformance was driven by asset allocation (figure 2).

Figure 1: AIM Portfolio's Relative Performance

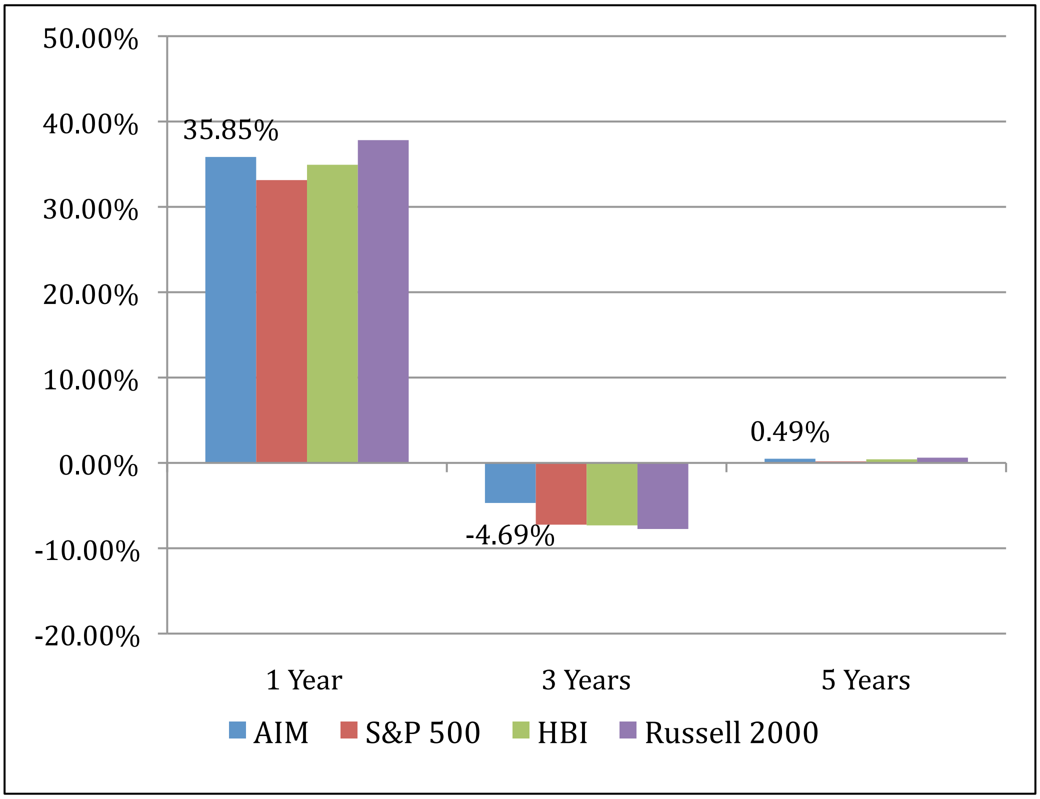
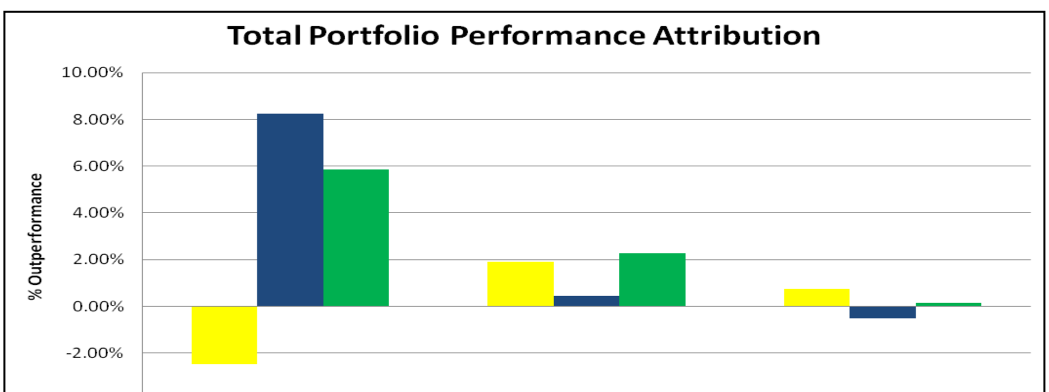


Figure 2: Portfolio Performance Attribution



	1 Year	3 Years	5 Years
Allocation	-2.46%	1.92%	0.76%
Selection	8.26%	0.46%	-0.52%
Total	5.87%	2.27%	0.15%

MARKET VALUE AND PORTFOLIO COMPOSITION

As of February 23, 2010, the market capitalization of the AIM portfolio was about $4.52 million, with $25.6K in cash. The portfolio has grown significantly since March 31, 2009, when its market cap was $3.19 million.

The table below shows the industry composition of the current AIM portfolio. There is a greater emphasis on consumer staples and significantly less investment in Consumer Discretionary as compared to last year.

Sector	AIM Weighting	Previous AIM Weighting	Difference
Financials	7.26%	3.00%	4.26%
Healthcare	11.81%	10.00%	1.81%
Utilities	4.19%	6.00%	-1.81%
Consumer Discretionary	13.91%	26.00%	-12.09%
Consumer Staples	29.10%	21.00%	8.10%
Energy	4.61%	8.00%	-3.39%
IT	10.30%	6.00%	4.30%
Industrials	15.21%	13.00%	2.21%
Materials	3.61%	4.00%	-0.39%
Telecom	0.00%	3.00%	-3.00%

Figure 4: Portfolio Composition by Sector

Ticker	# of Shares	Price at 2/24/10	Value of Position	% of Total
AAPL	800	$197.05	$157,640	3.49%
ADM	5,700	$29.62	$168,834	3.74%
AMZN	1,400	$117.24	$164,136	3.63%
BEN	1,500	$100.03	$150,045	3.32%
CB	3,200	$50.76	$162,432	3.59%
CL	2,400	$81.89	$196,536	4.35%
CMCO	10,500	$14.12	$148,260	3.28%
DVA	2,700	$61.12	$165,024	3.65%
ECL	3,500	$41.58	$145,530	3.22%
FSLR	1,400	$105.78	$148,092	3.28%
HANS	5,200	$39.89	$207,428	4.59%
KEX	5,200	$32.27	$167,804	3.71%
KO	2,800	$54.83	$153,524	3.40%
NBR	8,800	$21.88	$192,544	4.26%
PGN	4,500	$38.40	$172,800	3.82%
POT	1,570	$110.18	$172,983	3.83%
RSG	6,600	$27.66	$182,556	4.04%
RXL	160	$49.79	$7,966	0.18%
SAM	3,600	$46.85	$168,660	3.73%
SCOR	9,500	$15.51	$147,345	3.26%
SRS	160	$7.53	$1,205	0.03%
SYY	6,300	$28.92	$182,196	4.03%

THOR	**4,800**	**$28.29**	**$135,792**	**3.01%**
TPX	**9,500**	**$27.69**	**$263,055**	**5.82%**
TRLG	**9,300**	**$20.12**	**$187,116**	**4.14%**
UNH	**6,200**	**$32.81**	**$203,422**	**4.50%**
WAG	**5,000**	**$34.76**	**$173,800**	**3.85%**
XLNX	**6,600**	**$25.15**	**$165,990**	**3.67%**
Cash			**$25,632**	**0.57%**
Total AIM Portfolio			**$4,518,347**	

Figure 5: Portfolio Composition by Stock

Interview

David A. Rosenberg is Chief Economist & Strategist for Gluskin Sheff in Toronto, Canada. Before joining Gluskin Sheff, Mr. Rosenberg was Chief North American Economist at Bank of America-Merrill Lynch in New York. Previous to that, he was a Senior Economist at BMO Nesbitt Burns and Bank of Nova Scotia. For daily market musings authored by Mr. Rosenberg, please visit the Gluskin Sheff website at www.gluskinsheff.com/musings.

Patrick Mulvehill: In the February 15th issue of Barrons, "perma-bull" Jim Paulsen of Wells Capital stated that, "*corporations are sized as if the depression could ensue any day,*" and that - as a result of that belt tightening coupled with the unprecedented fiscal and monetary stimulus of the last 18 months - corporate profits are positioned to soar thanks to the greatest corporate profit leverage in decades. Given your less than rosy outlook, how would respond to Mr. Paulsen's assertion?

David Rosenberg: Well, the reality is that corporate profits have rebounded from levels that were barely comprehensible. Whether you are looking on an operating or reported basis, the S&P 500 generated a net loss nearing the end of 2008. So there was certainly a depression in corporate profits. Operating earnings were down 60% from peak to trough, and reported earnings during the recession, when factoring in all the write-downs, were down 90%. What I will say is that nothing is going to zero when you weigh how much stimulus there is in the system right now. We've already had a bounce in profits, and my contention is that the markets started to price in a profit revival long ago. I'm not going to say I have a big disagreement (with Mr. Paulsen), [but] you saw even in the 1990 Japanese crash 12 quarters of GDP growth exceeding a 5% annualized rate, but the problem was that there were twice as many quarters of negative GDP growth. When you go back to the Great Depression there were countless times when the economy jumped on the trampoline, but the reality is that - despite seven years of New Deal stimulus - the depression didn't really end until WWII started. So you can focus on the short term noise, which is what Mr. Paulsen is paying attention to, a very whippy, bungee jump type of bounce in corporate profits, but any student of other periods of financial deleveraging in a post credit collapse economy knows that these spasms in earnings, spending, and output are generally fleeting. And it's not that they don't happen, they are just not sustainable as credit continues to contract, and that is the environment we are in right now.

PM: You have written that, until the ratio of household credit to personal disposable income reverts to the mean, economic recovery will not take hold. Returning to a mean of 60% sounds extremely painful from recent levels of around 125%, but don't you think that mean is skewed downward due to only a relatively recent level of consumer credit expansion? Point being, financial institutions have built high consumer credit offerings into their business models and to hit a level of 60% would mean a complete structural overhaul of the sector.

DR: My answer to that would be to tell that to the 20 regional banks that have been already been closed down this year. So far in 2009, we've had a contraction of bank credit to the tune of a 15% annual rate, and what has acted as an antidote is the tremendous expansion of the Fed's balance sheet. I think that your premise is **dead wrong** (emphasis added); I think that the secular credit expansion ended two years ago, and we are now in a period of credit contraction. And it's not just the supply of credit, but also the demand for credit. If you're going to tell me that we have a situation where 1-in-7 households with a mortgage are either in arrears or in the foreclosure process and consumer loans and mortgage default rates are hitting unprecedented levels, [I'm going to say] there has been a real fundamental shift in people's approach to leverage. And this, of course, only worked in a period when home prices or the underlying asset prices rose at a parabolic rate. The problem with your view is that the willingness of borrowers to take on debt, [and] the willingness of lenders to extend that credit, only worked on a model of asset inflation, and what happened was that those assets deflated at a rate unseen since the 1930s.

PM: With Wal-Mart recently reporting a -1.7% YoY decline in Q4 sales, would it be fair to say that the U.S. consumer is still reeling from the effects of the recession and that 2010 will see at best, tepid sales growth?

DR: The problems are that the economy is at least 10 million jobs shy of being at full employment, the average U.S. worker is down $100,000 in his/her portfolio from where they were two years ago, and the median age of the baby boomer population is moving from 52 to 53. We have some major consumer demographic challenges ahead of us as far as consumer spending is concerned. But the short answer is that there is just no pent up demand. That's why programs like cash-for-clunkers simply provide a short-term boost to the data as opposed to providing any sort of sustainable demand.

PM: So given the demographic challenges we are facing, coupled the grim prospect of further consumer deleveraging, do you think we are facing a scenario like Japan's lost decade or a period like the 1970s with little real growth marked by periods of high volatility?

DR: In the 1970s, credit was flowing freely, and of course we had a big inflation problem not a deflation problem, so as awful as that period of the 1970s was, it bears no similarity to today's environment. Japan, too, came off an extensive period of rampant leverage and asset inflation that had to be unwound as asset prices deflated and the capacity to service the debt became impaired. Japan is not the only example out there of financial deleveraging. There are countless examples of different countries from different time periods, and the one common theme is that you might get a snapback in GDP off a depressed level, but it is never sustained. You go through a multiyear period of subpar economic growth. And so, if you want to compare it Japan or any other example, that's what you get. Japan is a very extreme example; I shudder to think that this could be like Japan because Japan had not one, but two decades of lost growth. I do think the U.S. is a much more dynamic economy [than Japan] with a completely different culture and is much more flexible. We will get through this, but even if it is a quarter or half as bad as Japan, it is still not a very good outcome.

PM: In your 2010 forecast you wrote: "It is what is embedded in asset prices benchmarked against the forecast that is of utmost importance for investors." After nearly two months into the year, where do feel we stand in relation to being properly valued? Are markets over-, under-, or fairly valued in your opinion?

DR: Looking at a classic "Shiller Normalized P/E ratio", this market is at least 20% overvalued in terms of equities. Residential real estate, specifically the home price-to-rent ratio, has not fully mean reverted and there could still easily be a 10%-15% downside to home prices if the market was allowed to clear. But of course there is the very heavy hand of Uncle Sam that has prevented the market from clearing over the course of the past twelve months. So I am not convinced that asset prices have found a bottom. The recovery that the market has priced in so far, in my opinion, is of very low quality and is premised on inventory adjustments and the lingering effects of the dramatic fiscal stimulus.

PM: Given everything that is transpiring over in Europe right now with Greece and potential future problems with Portugal and Spain, do you see the potential for the U.S. to be in a similar situation 5, 10 years down the road with its current unsustainable figures of deficit spending and debt-to-GDP?

DR: I agree that our debt levels are problematic, but the U.S. is not Spain and is not Greece, so I always find those comparisons laughable. These countries do not have the wealth that the U.S. has, nor do they have the revenue generating capacity in their economies that the U.S. has. So I do not believe that the U.S. has a classic funding crisis nor would I suggest that it is useful to compare the U.S. to Greece, Portugal, or Spain. Japan has close to a 200% debt-to-GDP ratio, and they have had no trouble in filling their JGB (Japanese Government Bonds) auctions.

PM: Regarding Japan, would it be a fair counterpoint to say that Japan has a unique demographic advantage in that Japanese are high savers and have an almost patriotic sense of duty to purchase JGBs, whereas in the U.S. we don't have that same

propensity to save and thus might not get the same high levels of debt tolerance from the markets?

DR: You're living in the old paradigm my friend. I would not extrapolate the last 10 or 20 years into the next few decades. Take a look at the fund flow data and you will find that the individual investor has been selling into this rally in equities and moving into fixed income assets. There is a secular move afoot towards income generating assets.

PM: Mr. Rosenberg, thank you very much for your time.