
THE FIXED INCOME CONTRARIAN COMPENDIUM

May 2014

Featured Companies

Nuance Communications (NUAN) 2.75% Due 11/01/31
Toll Brothers (TOL) 0.5% Due 9/15/32
SEACOR Holdings (CKH) 2.5% Due 12/15/27
The Ryland Group (RYL) 0.25% Due 6/01/19

Updates on Past Ideas

Molina Healthcare, Inc.



*Exclusive Marketers of
The Fixed Income Contrarian Report*

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Murray's Musings

THE IMPACT OF DECOUPLING ON UTILITIES

Decoupling is a term that will appear more frequently in utility company annual reports. Decoupling is a regulatory mechanism that targets flat or lessened usage as the basis of compensation. By using various adjustment mechanisms, the utility is made whole for reduced revenue or usage. It is also rewarded for efficiency.

The traditional regulatory mechanism is based on a concept called throughput: the more power used, the greater the rate base, against which regulators calculate a utility's allowed return. In other words, the greater the resources needed to produce power, the more money a utility theoretically can make.

Clearly, decoupling has major implications for the utility industry. Even though a utility, in theory, is not penalized in any financial sense for a decline in demand, if the demand is not going to go up, or if it goes down, the only way the utility can make more money is through inflation of nominal dollars.¹

Once decoupling is put in place, that is the same as saying there are limitations or constraints upon demand. It then becomes very difficult for the utility to grow.

The question then becomes: If, in the fullness of time, investors realize that only an exceptional utility will increase its earnings over time (meaning the utility is entering a non-regulated business and is growing in that manner), how will conventional utilities be priced? This is an extraordinarily complicated question; it is not a question we have had to deal with in investing before.

Utilities are classified in the high-yield segment of stock classification systems. Generally speaking, one also will find them in the quality segment because their earnings have not exhibited a great deal of variability. It is assumed that the utilities will produce the same magnitude and pattern of returns as they did in the past. The mechanisms, however, are such that this is just not possible. Still, the classification systems operate on the premise that the past is prologue to the future. (By the way, in Wall Street parlance, the physicists hired to make these models are called POWs—Physicists On Wall Street, not prisoners of war.)

¹ Natural Resources Defense Council, "Removing Disincentives to Utility Energy Efficiency Efforts," May 2012; Dylan Sullivan, Devra Wang, Drew Bennett, "Essential to Energy Efficiency, but Easy to Explain: Frequently Asked Questions About Decoupling," *The Electricity Journal*, Vol. 24, Issue 8, October 2011.

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What happens if a utility, by design, cannot generate new demand and its dividend can only grow at the rate of inflation, yet does retain a certain degree of business risk (because it might not properly orchestrate certain initiatives, such as a major construction project or acquisition) and could be penalized for events other than a decline in demand. If you knew, basically, that the positive optionality were removed from the company, how would one value that?

Even looking at utilities the world over, governed by completely different regulatory mechanisms, there is always a possibility they could increase their profits, however low that possibility is. Now, however, there essentially will be a zero possibility or, if anything, a much diminished possibility of growing profits at a rate in excess of inflation.

Historically, in a certain sense, a utility was a fixed-income proxy. Its dividend would rise at a rate in excess of inflation, and it was valued, relative to bonds, in a certain way. Now it has a dividend that will not rise in relation to inflation. If there were deflation, it might even decline. (While there might not be deflation nationally, there might be deflation in the utility industry, which will be discussed later.)

What, then, is a utility? In this new regulatory sense, a utility is a long-duration fixed-income asset, really in perpetuity, with a coupon that is expected to grow at the inflation rate, after allowance for a certain time lag. There is, however, no guarantee of that growth.

Suppose that the inflation rate were 2.5% and a certain utility share traded at a 4.5% yield. Let us also assume prices remain completely unchanged. Two years of 2.5% per annum inflation, assuming no change in the price of the utility stock, would give a future yield of 4.73%. If that were the classic utility, in relation to bonds—and the proxy for bonds here is the iShares Core U.S. Long-Term Bond Index (ILTB), which has a yield to maturity of 4.14%, and 75% of its bonds are rated A or better—the utility starts with a yield advantage. It is increasing its dividend, presumably, at a 2.5% annual rate. If one bought an index, even though it might include utilities that fail to increase their dividends, the average index member probably would, so that might compare adequately to bonds. However, the inflation premium—36 basis points in this crude example—does not appear to be the real-world inflation premium. The iShares U.S. Utilities ETF has a 30-day yield of 3.01%.² This is not a premium yield; it is a discounted yield. Basically the market is taking the utility risk, such as it is, and accepting 114 basis points less in yield. Of course, in return, the market gets, or presumes to get, the possibility of a rising dividend.

Now assume steady-state prices and steady-state yield and no change in interest rates. If you begin with a yield of 3.01% and your object is to catch up to the bond yield as expressed by the iShares Long-Term Bond Index (4.14%), at a 2.5% inflation rate it will

² The yields quoted for both the utility and bond ETFs are net of the associated fees. There is a differential, but it is slight.

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take 15 years to equal—just to equal—the current yield to maturity of the bonds as they are now. Of course, at the end of 15 years all you will have achieved is an equivalent yield to maturity of what the bonds would have achieved in a steady-state environment: 15 years and you earn, to that point, a lower rate of return.

The question, then, is: How many years must you keep increasing the dividend at a 2.5% rate to put the cumulative rate of return of the two in equilibrium? The answer is, obviously, another 15 years. In other words, 30 years for the two to be at return equilibrium. Clearly, it does not seem like utilities are properly priced. They are not properly priced because the utility index, which is up 11.4% year to date, is just raw material that feeds the asset allocation models and factor models that operate today and which determine the clearing price. The important models at the moment happen to be the yield-related and the quality-related ones.

Industry Thoughts

SOLAR ENERGY

Solar energy is important to study for reasons apart from its own merits. Below are some statistics and companies that are important for issues discussed later in this report.

NextEra Energy Resources (NEE) is really Florida Power and Light, one of the few forward-looking, or progressive, utilities. The idea behind NextEra Energy Resources was to operate in the unregulated market and in the clean energy market. There are 18,300 megawatts of generating capacity at NextEra Energy Resources. It also turns out that various forms of alternative energy, like wind and solar, generate tax credits for the company.

One wholesale power company, NRG was worried about the growing competitive threat of alternative energy, and rightly so. It created a very interesting security called NRG Yield Inc. NRG took newly created so-called clean energy production assets and placed them in this company. They are very different from coal-fired plants or nuclear plants in that they require very little maintenance capital expenditures for many years. Ultimately, they will require capital expenditures, but in the short run those needs are minimal. They take their tax credits and pay out 90% of their earnings to shareholders. They have managed to get, on NRG Yield, a very high P/E, something in the order of 25 times earnings.

To summarize, the idea was to place the long-term, contracted assets that are clean and renewable, like wind or solar, in a separate company that has minimal capital expenditures. The long-term contracts have escalating sale prices, usually tied to some estimate of the future rate of inflation. The new NRG Yield shows very consistent dividend growth, unlike

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conventional utilities, which are experiencing challenges to their earnings growth. Furthermore, the United States government will pay cash in lieu of investment tax credits, which the company can then pay out to shareholders.

It is possible that NextEra Energy might be able to do something similar. This is an important phenomenon; I cannot stress enough the importance of this development.

If it is possible to create companies of this type—and a solar energy company called SunEdison is planning to do something similar in the next several months—the consequences will be several-fold. This will create a cleavage, or a divide, in the utility industry between companies that can take advantage of the tax credit cost of capital and those utilities that cannot. The issue here is not so much that the utility receives a tax credit that can be passed on to shareholders or placed in a separate company; rather, a utility can now create a separate currency that it can issue either to raise cash or to acquire additional assets. This is a new mechanism for growth.

The second consequence is that those utilities that cannot take advantage of the tax-credit cost of capital could be damaged by those that can. It is conceivable that the unregulated generating assets in certain areas will eventually operate below the capacity utilization break-even rates and lose money. Electricity generation in many regions of the United States is now rate-of-return deregulated: If the utilization rate of the power plant falls below a certain level, it will lose money, and the regulators will not reimburse the utility. Many investors are unaware of this situation. The local transmission distribution assets are still rate-of-return regulated but, in many cases, not the generation assets.

From my perspective, an important point is that the asset allocators have no awareness of these changes in the energy industry. The asset allocators, who now operate on so-called factor models, consider historical dividend stability as one of the key performance factors, and accordingly give it a very high weight.

THE FACTOR INVESTING INDUSTRY

The orchestrators of indexes, various consultants, and asset allocators have come to the conclusion that superior performance is the result of portfolio emphasis on certain factors. Academicians might differ as to what are the important factors. We will focus on MSCI because it creates indexes.

MSCI issued a paper in December 2013 entitled “The Foundations of Factor Investing,” that identified six factors: value, low size (meaning small capitalization), low volatility, high yield, quality, and momentum. The Fama-French model, I believe, identifies three factors.

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The first point to be made is that a significant element in the yield strategy, utilities, now might be subject to change, because a disruption in the utility segment may be coming. (Note that utilities can also fall into the low-volatility segment, because they clearly have not been volatile, and also into the quality segment if their ROE is sufficiently elevated and sufficiently stable. Utilities, therefore, can be found in three of the six factors.)

The next point is that the cost of capital should be considered an important factor. I think it is a much better forward indicator, since the other factors are historical. Assuming the future will be like the past may be a very poor assumption. The problem is that there is no database providing ready information on the cost of capital for companies trying to access the capital markets. There are databases that are very good and very comprehensive for all of the other factors mentioned.

Consider the following table, which shows statistics that make this discussion relevant. The extent of solar-installed capacity in the United States might be shocking to some people.

Table 1: Solar-Installed Capacity in U.S.

	(in megawatts)
1999	117
2000	139
2001	168
2002	212
2003	275
2004	376
2005	479
2006	624
2007	831
2008	1,169
2009	1,616
2010	2,534
2011	3,966
2012	7,312

Source: BP Statistical Review of World Energy

As displayed above, the United States in 1999 had installed capacity of 117 megawatts of power. By 2012, that was 7,312 megawatts, equivalent to 7.3 gigawatts.

The 2013 data is not available yet but, looking at the companies that install solar capacity, it is very likely that the 2013 figure will surpass 18 gigawatts (and 18 gigawatts is 2% of

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the rated capacity in the United States for all electric power, meaning that 2% is now derived from solar.)

We are now at an inflection point. In the last 24 months, the rate of growth in installed capacity in solar alone—not counting wind—is over 100%. If that rate were to continue for two or three more years, it is readily conceivable that this country could have 200 gigawatts of solar capacity in 36 months. Congress, after all, has established a tax subsidy and companies have access to cheap capital if they can pass that subsidy along to their shareholders. In other words, this could be very disruptive to the utility industry as we have known it.

Many utilities note that the tax credit is set to expire in 2016 unless renewed by Congress. I have no idea if Congress is going to renew it. If it is not renewed, however, it is reasonable to expect that as the expiration of the tax credit approaches, the installation rate will increase even more as companies act to capture the tax credit. In fact, that might be happening right now. If such levels of growth were to occur, the rated capacity of electric generation in the United States would grow to 20% of total capacity. That would be incredibly disruptive because it would replace capacity from coal-fired plants, which perhaps it should, and from nuclear plants.

For all the big wholesale power markets, it would create a problem in supply not unlike the problems that arose when the tremendous quantities of natural gas discovered in the United States came on the market. Natural gas pricing still has not recovered. There had been an historical spread between oil and natural gas prices that had held for decades but new supplies disrupted that balance. There are no signs that the historical spread will return.

Asset allocation to yield-oriented stocks relies upon historical data regarding stability of dividends, which date back decades. The allocators treat these data as if they are immutable, scientific constants, as they would any scientific constant like Planck's constant or the gravitational constant or the speed of light. They are completely unaware that a dividend quality constant is about to manifest a certain degree of inconstancy. That is not a failure. It is simply that, given the methodology used, there is no line of inquiry to test periodically whether a variable remains constant, except when the variable actually changes. When a variable changes and everyone can see it, stock prices will already reflect that, and it will be too late. In that case, the models will be adjusted, but the problem is they will all make the same adjustment simultaneously. That usually does not have good consequences for stock prices. Let me repeat: This is an important phenomenon happening in the world of utilities, and people should remain very cognizant of it.

That does not mean that high-multiple solar stocks are a buy. Nor does it mean that they are in a bubble. It is conceivable—plausible, even—that they might achieve the rather aggressive earnings estimates that are set for them by their proponents. Or they might not. I

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have no idea which it is going to be. Still, whether they achieve those estimates or not, they could prove to be a very disruptive force in the world of electric utilities. With every passing day, that becomes a more plausible and likely development.

Solar energy has the potential to take consumers off the grid and in many jurisdictions that is already happening. If customers go off the grid in sufficient numbers, the possibility exists for utilities to make less money on an absolute basis. If utilities make absolutely less money, as opposed to relatively less money, than they otherwise would have made, then they will probably reduce their dividend distributions. In that case, the entire sector will be rerated lower. This clearly has the potential to be a very serious problem.

THE FOUR LEADING COMPANIES

Let us look at some solar energy companies. There are four leading firms: SolarCity (SCTY); SunPower Corp. (SPWR); SunEdison (SUNE), and First Solar (FSLR). As displayed in the following table, the first three have stock market capitalizations in the \$4 billion range, and the last one has a market cap of \$6.3 billion.

Table 2: Major Solar Companies

<u>Ticker</u>	<u>Company</u>	<u>Market Cap</u> <i>(\$ in billions)</i>	<u>Price-to-Sales Multiple</u> <i>(trailing 12 mo. revenue)</i>
SCTY	SolarCity	\$4.8	24.4x
SPWR	SunPower Corp	4.3	1.7x
SUNE	SunEdison	4.5	2.3x
FSLR	First Solar	6.3	1.8x

Source: Company reports

They trade at very interesting price-to-sales multiples. The latter three trade at 1.7, 2.3, and 1.8 times, respectively, but the first one, SolarCity, trades, at 24.4 times revenue. It is an outlier.

By way of comparison, the comparable statistic for Southern Company, a big, well-capitalized utility, is 2.18 times, clearly within the range of the latter three.

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The next table shows the P/Es based on 2015 consensus estimates.

Table 3: P/E 2015 Estimates

SolarCity	Losses (negative)
SunPower Corp	20.9x
SunEdison	38.9x
First Solar	13.0x
Southern Company	15.2x

Source: Company reports

SunEdison trades, on the basis of 2015 estimates, at 38.9 times earnings, SunPower at 20.9 times earnings, and First Solar at 13 times earnings. By way of comparison, Southern Company trades at 15.2 times earnings. SolarCity, unlike the others, has only losses, and it is predicted to have losses as far as anyone cares to make a projection. The P/E, therefore, is meaningless, because it is negative.

SolarCity, however, asserts that it has over \$1 billion in what it calls retained value. What is the definition of retained value? It is the present value of all the future contract cash flows, meaning the contracts already put in place and which extend up to 20 years, discounted at 6%. If the company were to immediately cease all expansion efforts—if it stopped marketing, stopped installing new equipment, stopped growing—it would collect, on a discounted present value basis, \$1 billion over 20 years.

Of course, if you un-discount that, it is a much higher figure. If you give credence to this assertion, SolarCity's market capitalization reflects not only the \$1 billion-plus that the company will make on a present-value basis but also all the growth potential. The company is taking all the cash flow, and more, and reinvesting it to get more customers. The customer base is growing at a rate in excess of 100%.

SolarCity's valuation is considered by some to be bizarre and reminiscent of bubble-like periods. It is not entirely clear, however, that SolarCity is a bubble. Although I would not recommend a stock like SolarCity, I cannot say that the valuation placed on the shares is irrational, assuming certain assumptions are correct. If certain facts are true, as SolarCity asserts, then it is a not-unreasonable price. Observe SolarCity's revenue growth from 2009 through 2013, shown in the following table.

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Table 4: SolarCity Revenue Growth

	(\$ in millions)
2009	\$32.7
2010	32.4
2011	59.5
2012	128.7
2013	163.8

Source: Company reports

In 2009 and 2010, Solar City earned about \$32 million of revenue; by 2013 revenue had risen to \$163 million. Clearly it is growing at a very rapid rate.

As to the other three companies, in two cases, revenue is relatively flat; in the case of First Solar, it is growing but not remotely at the rate of SolarCity.

Table 5: Solar Companies Revenue Growth

(\$ in billions)	<u>SunPower</u>	<u>SunEdison</u>	<u>First Solar</u>
2009		\$1.16	\$2.07
2010		2.24	2.56
2011	\$2.3	2.72	2.77
2012	2.4	2.53	3.37
2013	2.5	2.01	3.31

Source: Company reports

There are some who give credence to SolarCity's assertions regarding retained value. They argue, not unconvincingly, that it is a cheap stock not expensive.

Clearly, SolarCity is important because it raises some profound issues. The first is that disruption is occurring in the utility industry, and the classification mechanisms used by asset allocators have no way of picking that up using historical statistics.

The second problem is that valuation using conventional metrics plays a very important role in allocation among equity sectors. Therefore, companies that have the potential to be very disruptive to an otherwise stable industry, like First Solar, appear to an asset allocator as valuation outliers, maybe even indicative of a bubble. Where companies of this type are present, an asset allocator will avoid those sectors because the valuation statistics indicate that is where danger lurks. In reality, if SolarCity is really a disruptor, the danger might lie among the lower valuations not the higher valuations.

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Using Generally Accepted Accounting Principles is really important in the valuation of securities. A conventional, active analyst, however, can weigh qualitative factors that a quantitative analyst, a POW, has no opportunity to do.

Facts & Figures

FACTOR MODEL RISK AMONG UTILITIES AND FUNCTIONALLY RELATED INDUSTRIES

U.S. electricity generation is expressed in terawatt hours. As the following table shows, in 2005, the United States generated 4,257 terawatt hours of power. In 2012, the latest available figures show 4,256 terawatt hours. There is no historical precedent for unchanged electricity usage in a period as long as that.

Table 6: U.S. Electricity Generation

	(in terawatt hours)
2000	3,990.5
2001	3,924.1
2002	4,050.3
2003	4,075.8
2004	4,168.1
2005	4,257.4
2006	4,266.3
2007	4,365.0
2008	4,325.4
2009	4,146.6
2010	4,331.1
2011	4,320.9
2012	4,256.1

Source: BP Statistical Review of World Energy 2013

This statistic is important for utilities because the United States is really using more power. The first table in *Musings* section shows sharp increases in solar-installed capacity. Solar usage is not being recorded. Once enough households have solar panels on their dwellings, they are not drawing power from the grid. The electricity generation numbers measure what the grid is making available to the aggregation of all customers. Clearly, if customers generate their own power, and only occasionally draw from the grid, that is an issue for the industry.

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The United States is probably using more power, but it is being produced in a different way. These statistics have to be used with some degree of caution, but they do tell a story about what is happening in the utility industry. Furthermore, in many jurisdictions, the law provides that the utility must buy back the excess power from customers, and that puts the generation assets in peril.

Natural gas consumption, measured in billion cubic feet (BCF) per day, is another statistic to consider. In 1995, the United States consumed—meaning burned—60.8 billion cubic feet (“BCF”) per day. In 2006, that statistic was 59.4 BCF. In other words, no growth in gas demand for a decade.

Table 7: Natural Gas Consumption

	(billions of cubic feet per day)
1995	60.8
1996	61.8
1997	62.3
1998	60.9
1999	61.4
2000	63.8
2001	60.9
2002	63.1
2003	61.0
2004	61.2
2005	60.3
2006	59.4
2007	63.3
2008	63.6
2009	62.9
2010	66.0
2011	66.8
2012	69.4

Source: BP Statistical Review of World Energy 2013

It was only after all the gas that was discovered domestically sometime during the last decade started coming to market that consumption began to rise. In 2007, it was 63.3 BCF; in 2012, the most recent figure we have, it was 69.4 BCF. All the enormous discoveries of gas had to displace something, and it is displacing coal, which will be discussed later.

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First, consider U.S. reserves of natural gas, shown in the following table.

Table 8: U.S. Reserves of Natural Gas

	(trillion cubic meters)
1995	4.7
1996	4.7
1997	4.7
1998	4.6
1999	4.7
2000	5.0
2001	5.2
2002	5.3
2003	5.4
2004	5.5
2005	5.8
2006	6.0
2007	6.7
2008	6.9
2009	7.7
2010	8.6
2011	8.6
2012	8.5

Source: BP Statistical Review of World Energy 2013

As late as 2002, the United States had 5.3 trillion cubic meters of proven reserves of natural gas. In 2012, that number was up to 8.5 trillion cubic meters. Since there is so much gas and the discounted present value is so low, there is little incentive to create new gas reserves. Once you get materially beyond 10 years, it does not make a lot of economic sense to create the reserves, given the profit margin you will get when you sell the gas.

That, of course, has implications for the pipeline business. The gas is there, but if it is not going to be used because of alternative energy sources, like wind and solar, there are certain assumptions about the pipeline sector that may not be good assumptions. Nevertheless, the gas reserves, which have been increasing, have to displace something. As mentioned, it has displaced coal.

When talking about coal, we measure in tonnes of oil equivalent. The British Thermal Unit (“BTU”) content of a ton of coal is different depending on what kind of coal it is, so the way it is standardized is by expressing tons of coal in terms of tonnes of oil equivalent. For example, low-grade coal, which has low-BTU content, may weigh a lot, but it generates less power, potentially, than high-BTU content coal.

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In 2005, as the following table shows, there were 574 million tons of coal consumed in the United States (expressed in millions of tonnes of oil equivalent). In 2012, it was 437 million. That is an enormous drop, which has implications for the railroads, which hold coal and are a big customer. It also has implications for a railcar manufacturer that was making hopper cars, which carry coal. It also has implications for the railcar leasing companies that have a lease book geared to hopper cars, as opposed to other types of railcars.

Table 9: Coal Consumption

	(million tonnes of oil equivalent)
2005	574.2
2006	565.7
2007	573.3
2008	564.1
2009	496.2
2010	523.9
2011	495.5
2012	437.8

Source: BP Statistical Review of World Energy 2013

The oil business is changing in very dramatic ways. Fracking technology is one change. A well that is fracked, generally speaking, has a much shorter productive life than a conventional well, which is why, when big fracking fields are discovered, you might note the absence of pipelines being built in those regions. The fields are not going to last for the five or six decades that would be necessary to justify building a pipeline. That means there is going to be big demand for railcars.

Clearly, these are all important issues. All of these types of companies are classified in factor models—those factor models only make a lot of sense because there are certain qualitative features in the last several decades that accorded them a quality yield, growth, or some other factor.

The qualitative factors are beginning to change, but the system has no way of picking that up. Consequently, for those analytical systems, the results eventually will become very problematic.

Featured Companies

CONVERTIBLE BONDS V. HIGH YIELD

Before we turn to the specifics in the *Featured Companies* section of this report, I want to note that they are all convertible bonds. I want to make some remarks about convertible bonds that are busted versus conventional high yield bonds. Describing quantitatively the high yield index, I will use the iShares iBoxx \$ High Yield Corporate Bond ETF (HYG) as a benchmark. Its weighted average maturity is 4.22 years, which is unusually short by historical standards in high yield. Clearly, the investment community is not interested in accepting duration risk and the weighted average yield to maturity reflects that; it is only 4.69%.

Should one accept that offered return, or is there an alternative that might be better? (There will be more in the *Post-Musings* about this topic.) Would it be better to buy a convertible bond, assuming it is creditworthy, that might yield only 2.5%, yet which has 15 to 20 years to maturity, and for which the optionality is 30% to 40% out of the money? In principle, one is sacrificing roughly 2.19% in yield in exchange for a long-term call option on a stock that is 30% to 40% away from the strike price. If the stock drops enough, one is taking the 15- to 20-year duration risk. If the stock does not drop enough, then the convertible is equity-sensitive, and one is not taking that duration risk. Contingently, one might take the duration risk.

Is it better to do that, or is it better to buy the conventional high yield instrument? The trouble with conventional high yield is that the answer to this question depends on how many basis points will be lost to poor credit analysis. For example, say somebody bought a portfolio of high yield bonds, all trading at face value, and various credit problems arose thereafter. If 20% of those bonds then sold at a price of 80 instead of 100, there would be a 20% loss on 20% of the portfolio. That is 400 basis points of loss.

That trading loss basically eliminates the return on the high yield bonds, because at these historically low yields, with bonds trading above face value, there is nothing that can happen in the world of high yield bonds to equilibrate the loss. That is the basic problem of high yield. So, when someone quotes the yield to maturity of the index as being 4.69%, it is really not the yield. It is only a contingent yield. It is the yield only assuming that no security in the index evidences a credit problem. To the extent that some percentage of the companies may, or will, experience credit problems, the ultimate return is really lower. But we do not know how many companies will manifest a credit problem and what the consequences will be for the price of the securities in question. Therefore, we cannot go any further.

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Therefore, the comparison is not between 4.69% and 2.5%. It is comparing some number, possibly considerably less than 4.69%, to a 2.5% that incorporates some optionality. To use the prior example, if I wanted to presume a 20% loss on 10% of the portfolio instead of on 20% of the portfolio, then the trading loss would be roughly 200 basis points rather than 400 basis points. If somebody takes 20% losses on 10% of the portfolio, it is now more or less an equivalent yield to the convertible, which means that the analyst in question was 90% right, really a brilliant analyst. In that sense, if that ends up being the number, the convertible is far superior, because some of the convertibles will have their optionality result in a positive event.

NUANCE COMMUNICATIONS (NUAN) 2.75% DUE 11/01/31

Nuance Communications' convertible debenture, due November 1, 2031, is a \$690 million issue that was recently trading slightly below par. Now, interestingly enough, it is puttable on various dates: November 6, 2017, 2021, and 2026. It is convertible at \$32.30 into 30.96 shares, and now has a 100% conversion premium.

Nuance Communications makes voice-activated software systems. It is a fairly large company, with a \$4.7 billion market capitalization and 12,000 employees. Nearly half—47%—of its software systems are designed for use in the healthcare industry. It offers computer-assisted physician documentation that allows a physician, examining a patient, to speak into the system; the system then records it. Clearly this is a productivity improvement over hand-written notes.

Similarly, 24% of the company is in so-called mobile applications that allow users to create documents or to input data using voice only. Dragon Software is their product.

Another 19% of revenues come from Enterprise Systems, basically the same idea but designed for large companies, and 13% of revenues come from software for scanning and routing electronic documents.

This company owns roughly 3,000 patents. It is worth reflecting that the Northern Telecom patents were worth \$4 billion to Google. Google paid \$4 billion for the Motorola patents. Microsoft paid \$1 billion for AOL patents. Patents, clearly, are fairly valuable.

Nuance Communications is growing at a fairly rapid rate, as the following table shows.

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Table 10: Nuance Communications Revenue Growth

(FY ended Sept.)	(\$ in billions)
2013	\$1.86
2012	1.65
2011	1.32
2010	1.12
2009	0.950
2008	0.868
2007	0.602
2006	0.388
2005	0.232

Source: Company reports

Between 2005 and 2013, the last fiscal year, revenues rose from \$232 million to \$1.86 billion. However, on a GAAP basis, this company, as robust as its growth is, lost money in every year except for one. The reason is that it spends all of its profit, and then some, on building its patent portfolio and developing its products. The company spends 18% of revenue on research and development. In the past decade it has tripled the number of its shares outstanding.

On a cash earnings basis, not a GAAP earnings basis, it makes \$100 million a year. It has \$800 million in cash and marketable securities on the balance sheet, \$2.1 billion of debt, and \$2.6 billion of equity that is all intangible.

This bond is certainly money-good, at least at the moment, and it is not a long-term bond. Presently, care of the put feature, it is a three-and-a-half-year bond, or even shorter.

In buying this, one is surrendering roughly 200 basis points a year in yield relative to what one could get in a conventional high-yield bond, and trading it for an out-of-the-money call option. There is no practical duration risk and very little credit risk. It just so happens that Carl Icahn bought 18.7% of this company and he has a history of value creation.

TOLL BROTHERS INC. (TOL) 0.5% DUE 9/15/32

Toll Brothers has 0.5% convertible senior notes, due September 15, 2032. They are puttable December 15, 2017, 2022 and 2027. These are convertible into 20.3749 shares at \$49.08, and were recently trading around par for a 43.9% conversion premium.

Toll Brothers is the biggest builder of luxury homes in America. It does not even compete with the other publicly traded homebuilders, because the others are not luxury homebuilders. It controls 51,000 lots in the United States, which is a large quantity of lots,

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and 9,400 of them are in California. The company has recently been buying lots. It lately purchased 5,200 lots via an acquisition of Shapell, a luxury homebuilder in California.

The average home price for a Toll Brothers home is \$694,000, which is far above the national U.S. average. New home construction is running at roughly half the 40-year rate—not the 2008 rate or the 2006 rate but the 40-year average rate of home construction in the U.S. That is how low it is, even though it is up from the bottom.

Toll Brothers, because it is not clear that new home construction will recover any time soon, has expanded into urban redevelopment. It also builds suburban high-density dwellings, which makes it unique among homebuilders, at least the publicly traded ones. It constructs urban condos, and it is also unusual as a homebuilder because it manufactures much of its own materials, including wall panels, millwork, windows, doors, and floor and roof trusses.

It also has its own small mortgage facility. Unlike other companies that help buyers initiate a mortgage, it is not a mortgage broker. It owns Gibraltar Capital, which is involved in nonperforming loan resolution. Why does the company want to be involved in nonperforming loan resolution? Because that is a way to find land to acquire; some of the loans are land loans.

This company's senior debt is rated BB-plus by S&P and BA1 by Moody's. This bond is part of the senior debt. The company has \$1.2 billion of cash and marketable securities on the balance sheet, and a lot of land that is marketable. In other words, this is a good credit. The company has 47% debt to total capital ratio, \$2.8 billion of bank loans, and \$2.9 billion of senior debt.

The stock trades at 14.8 times 2015 earnings, and it is on an October fiscal year. Any improvement in the housing industry is certainly going to be reflected in improved earnings. This is an equity-sensitive bond. Due to its put features, there is not a lot of duration risk. There is not even true equity downside risk because if the situation in homebuilding were to become a lot worse—which is hard to imagine—by that time the bond would be not very far from a put date and rates would be at a very low level in that environment. Clearly, there is not a lot of downside risk and there is a fair amount of upside potential.

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SEACOR HOLDINGS (CKH) 2.5% DUE 12/15/27

SEACOR Holdings has 2.5% senior convertible notes, maturing December 15, 2027. They are convertible into 12.0015 shares at \$83.32. These bonds were recently trading at a modest premium to par and have a 16.7885% conversion premium. After December 15, 2017 if, for whatever reason, they trade at 120% of par or better, the holders get 25 basis points worth of contingent interest, based on the trading price. In other words, if the bonds trade at 120, as a holder of these bonds you get an extra 25 basis points of 120, not of par.

SEACOR's businesses involve support for offshore marine vessels, which accounts for 45% of its revenues. It is also involved in inland river transportation—barges, largely, but also repair facilities—and that is 17% of revenues. It has a fleet of very large gas carriers, as well as a fleet of bulk carriers and some assorted tugboats, which provide 16% of revenues.

The company has two other businesses. It has a 70% interest, which it consolidates, in a company known as Illinois Corn Processing. That represents 16% of SEACOR's revenues. Illinois Corn Processing basically makes alcohol. It generates \$190 million of revenue but does not make any money. It does not lose money, but it does not make money.

SEACOR also has some miscellaneous assets that are roughly 6% of the company, and they are involved in everything from agricultural commodity trading to a non-controlling interest in a company involved in crisis management.

These two are obvious candidates for spin-off, and this company has a history of spin-offs.

What makes the convertible intriguing is its terms. They provide that the conversion price is adjusted downward in the event of a distribution of assets, such as a spin-off. If these assets were to be spun off and the market were to determine that they have a value of X, that X would be reflected in a lower conversion ratio on the original bonds. Since these assets do not produce earnings and do not, in principle, really add to the value, a spin-off could be highly accretive to this convertible.

SEACOR has a pretty good balance sheet: it has \$550 million of cash and marketable securities on the books; \$850 million of debt, including the convertible; \$1.4 billion of equity; and minimal intangibles. That is a hard book value. The stock trades at 11.8 times 2015 consensus estimates, with a market capitalization of \$1.6 billion.

Obviously, taking over \$200 million of ancillary revenues, including the assortment of assets, and making a company or group of companies out of them can add to the market capitalization of this company, meaning that the stock will be worth more, hopefully, without these, and the convertible will be convertible into a greater number of shares,

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hopefully at a higher price. If that scenario does not play out, one collects the yield, which is not notably inferior to a conventional high yield bond. It makes a lot of sense to buy this bond.

THE RYLAND GROUP INC. (RYL) 0.25% DUE 6/01/19

Ryland is a homebuilder. Its 0.25% convertibles, due June 1, 2019, are convertible into 13.3307 shares at a price of 75.01 on the stock. These convertibles are priced at 92, and the conversion premium is 81.8%.

Ryland builds conventional homes across America, operating in 17 states, including California, Nevada, Colorado, Arizona, Texas, Virginia, North Carolina, South Carolina, Georgia, and Florida. Population is increasing in all of these states and most of the other publicly traded housing companies operate there as well. The specialty of this company is the entry-level home and the first-time and second-time move-up home. The average price of a home from Ryland is \$296,000, much lower than in the case of Toll Brothers.

During the 2008 crisis, Ryland had a less robust balance sheet than Toll Brothers, and took more risk as well. The company had to dispose of quite a lot of the land that it had in inventory just to maintain credit worthiness. That is all behind Ryland now. Cash flow is adequate and the company has begun buying lots with the objective of creating three to four years of land inventory.

It also owns a title insurance company and a mortgage origination company, which last year only originated 4,000 loans but earned \$20 million. That shows you how much you can make on mortgage origination.

The company has \$600 million of cash on the balance sheet. It has land inventory worth at least \$1 billion, \$1.4 billion of debt, \$925 million of equity, plus \$185 million of mortgage loans held for sale. Ryland has more than adequate liquidity. Its stock trades at 9.8 times 2015 consensus earnings estimates. The housing market is extraordinarily weak, but if there were an upward revision to the earnings estimate, which is always possible, Ryland would get rerated as well. If it were to trade at 12, 13 or 14 times a higher earnings figure because investors got the idea that the market for housing is finally going to recover, that is a lot of appreciation potential. This bond might go over par, maybe even substantially.

Post-Musings

THE IMPORTANCE OF EQUILIBRATING LOSSES IN A BOND PORTFOLIO

Unless an investor is a perfect genius, there will be credit losses in any bond portfolio that takes credit risk. It simply is a fact of life. However, in an environment in which bonds in most indexes are trading at their call prices, which in a lot of cases is above par, it is hard to imagine any event that would cause a bond price to be higher than it is now. Yet, it is easy to imagine that at least some portion of the bonds might trade at lower prices

Given the term structure of interest rates, given what is happening in the bond market, and given the absolute level of interest rates, it is just hard to imagine that one could have an equilibrating gain against a credit loss. Because the credit losses are idiosyncratic, they do not necessarily follow interest rates. Unless there is a credit crisis, there is no way to engineer equilibrating events into a bond portfolio involved in credit unless one goes to the level of convertible bonds. Bonds such as those just reviewed should play a very important role in a high yield portfolio but in practice they play no role. To the degree that asset allocators even think about high yield, convertible bonds are, generally speaking, excluded from consideration.

Updates on Past Ideas

MOLINA HEALTHCARE, INC.
3.75% Convertible Senior Notes due 2014

Original Recommendation: 5/1/09 at 76.6

Current Price: 134.0

Outstanding Par Amount: \$187 million

On May 1, 2009, the Molina Healthcare convertible senior notes were recommended for purchase. At the time, the notes were "busted," trading at a 23% discount to par and a yield to maturity of 9.3%.

Molina Healthcare is a provider of managed health care services to Medicaid, or low income, recipients. It also provides healthcare services for persons covered under Medicare. The company offers Medicaid plans in ten states: California, Florida, Illinois, Michigan, Ohio, New Mexico, Texas, Utah, Washington and Wisconsin.

At the time of recommendation, Molina Healthcare was not a distressed credit. The company had a strong balance sheet, with a debt-to-equity ratio of 39%, debt-to-assets of only 17%, and total cash exceeding total borrowings by a factor of almost 3x. In addition, the company was profitable, producing \$3.1 billion in revenues and \$62 million of net income in 2008. Operating income of \$112 million greatly exceeded interest expense of \$8.7 million that year.

The issue facing the company was not financial but, rather political. At the time, President Obama stepped into office, and was in the process of introducing sweeping health care reform, which eventually became law in 2010 as the Patient Protection and Affordable Care Act. Since the law was still being crafted, there was much uncertainty about the effects it would have on Molina's financial results, which caused investors to shun its publicly-traded securities.

The passage of time has proved that the health care reform has not negatively impacted the company to the extent feared. Rather, Molina has greatly expanded its scope of operations, with total revenues increasing by 111% between 2008 and 2013. Consequently, Molina's common stock has appreciated substantially, trading at a recent price of \$41.68, or almost twice the May 2009 price of \$21.96 per share.

As a result, the convertible notes are now trading at a price of approximately 134, resulting in a conversion premium of less than 1% (conversion ratio = 31.9601 shares) and a negative yield to maturity. Given that the security currently trades at a large premium to

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par, and that the scheduled maturity is in less than five months (at which time the holder would only receive par value), sale of the convertible notes is recommended.

WEALTH INDEX (Ticker: RCH Index)

As of March 31, 2014

Annualized Total Return	1 Year	3 Years	5 Years	7 Years	10 Years	15 Years	20 Years	Since Incep. 1991 - Mar '14
Wealth Index	28.84%	17.02%	32.02%	11.64%	12.47%	9.54%	12.74%	13.68%
S&P 500	21.86%	14.66%	21.16%	6.31%	7.42%	4.46%	9.53%	10.01%
S&P 500 Eq. Wgt.	24.59%	15.38%	26.61%	8.31%	9.75%	9.06%	11.45%	12.48%
Russell 3000	22.61%	14.61%	21.93%	6.60%	7.86%	5.22%	9.64%	10.34%
Russell 2000	24.90%	13.18%	24.31%	7.08%	8.53%	8.91%	9.48%	11.38%

Excess Return vs. S&P 500	6.98%	2.37%	10.86%	5.34%	5.05%	5.07%	3.21%	3.68%
Excess Return vs. S&P 500 Eq. Wgt.	4.25%	1.64%	5.41%	3.33%	2.72%	0.48%	1.29%	1.21%
Excess Return vs. Russell 3000	6.23%	2.41%	10.09%	5.04%	4.61%	4.32%	3.10%	3.35%
Excess Return vs. Russell 2000	3.94%	3.84%	7.70%	4.56%	3.94%	0.63%	3.26%	2.31%

*Note: Calculated Using Total Returns

Risk Adjusted Return	1 Year	3 Years	5 Years	7 Years	10 Years	15 Years	20 Years	Since Incep. 1991 - Mar '14
Wealth Index	2.36	1.10	1.60	0.51	0.61	0.41	0.58	0.65
S&P 500	2.20	1.18	1.51	0.37	0.50	0.29	0.63	0.68
S&P 500 Eq. Wgt.	2.44	1.07	1.55	0.41	0.55	0.51	0.68	0.76
Russell 3000	2.27	1.12	1.50	0.37	0.51	0.33	0.62	0.69
Russell 2000	2.10	0.79	1.28	0.32	0.43	0.43	0.48	0.60

*Note: Calculated As Annualized Total Return Divided By Annualized Total Return Volatility (Uses Monthly Total Returns)

Information Ratio	1 Year	3 Years	5 Years	7 Years	10 Years	15 Years	20 Years	Since Incep. 1991 - Mar '14
Wealth Index vs. S&P 500	1.24	0.43	1.15	0.56	0.57	0.45	0.30	0.36
Wealth Index vs. S&P 500 Eq. Wgt.	0.93	0.41	0.98	0.57	0.48	0.05	0.13	0.13
Wealth Index vs. Russell 3000	1.29	0.51	1.17	0.59	0.57	0.41	0.32	0.35
Wealth Index vs. Russell 2000	1.07	0.77	1.01	0.57	0.54	0.05	0.29	0.22

*Note: Calculated As Annualized Excess Total Return Divided By Annualized Excess Total Return Volatility (Uses Monthly Excess Total Returns)

Wealth Index Batting Average	Roll. 1 Year	Roll. 3 Year	Roll. 5 Year
vs. S&P 500	61.19%	69.26%	70.45%
vs. S&P 500 Eq. Wgt.	58.58%	63.93%	59.09%
vs. Russell 3000	63.81%	69.67%	76.36%
vs. Russell 2000	60.45%	66.39%	73.64%

*Note: Calculated Using Total Returns

Annualized Volatility	1 Year	3 Years	5 Years	7 Years	10 Years	15 Years	20 Years	Since Incep. 1991 - Mar '14
Wealth Index	12.20%	15.45%	20.00%	22.90%	20.29%	23.23%	21.84%	20.97%
S&P 500	9.96%	12.47%	13.99%	17.02%	14.71%	15.48%	15.20%	14.67%
S&P 500 Eq. Wgt.	10.08%	14.33%	17.12%	20.30%	17.64%	17.90%	16.92%	16.33%
Russell 3000	9.96%	13.04%	14.58%	17.63%	15.30%	15.87%	15.48%	14.93%
Russell 2000	11.83%	16.78%	19.00%	21.85%	19.74%	20.52%	19.66%	19.04%

*Note: Calculated Using Total Returns

Annualized Tracking Error	1 Year	3 Years	5 Years	7 Years	10 Years	15 Years	20 Years	Since Incep. 1991 - Mar '14
vs. S&P 500	5.61%	5.49%	9.44%	9.45%	8.87%	11.26%	10.53%	10.29%
vs. S&P 500 Eq. Wgt.	4.58%	4.03%	5.50%	5.80%	5.72%	10.55%	9.80%	9.43%
vs. Russell 3000	4.82%	4.75%	8.64%	8.60%	8.03%	10.48%	9.70%	9.48%
vs. Russell 2000	3.67%	5.01%	7.61%	7.94%	7.35%	11.95%	11.06%	10.61%

*Note: Calculated Using Total Returns

Wealth Index Beta	1 Year	3 Years	5 Years	7 Years	10 Years	15 Years	20 Years	Since Incep. 1991 - Mar '14
vs. S&P 500	1.09	1.17	1.29	1.25	1.27	1.36	1.29	1.28
vs. S&P 500 Eq. Wgt.	1.13	1.04	1.13	1.10	1.11	1.17	1.17	1.16
vs. Russell 3000	1.13	1.14	1.27	1.23	1.24	1.35	1.30	1.29
vs. Russell 2000	0.98	0.88	0.97	0.98	0.96	0.97	0.96	0.95

*Note: Calculated Using Total Returns

Calendar Year Total Returns	Wealth Index	S&P 500	S&P 500 Eq. Wgt.	Russell 3000	Russell 2000	ER v. SP500	ER v. SP500 EW	ER v. R3000	ER v. R2000
1991	44.25%	30.47%	35.51%	33.68%	46.04%	13.78%	8.73%	10.57%	-1.80%
1992	20.20%	7.62%	15.63%	9.59%	18.41%	12.58%	4.56%	10.61%	1.79%
1993	3.38%	10.08%	15.12%	10.88%	18.88%	-6.70%	-11.75%	-7.50%	-15.50%
1994	0.33%	1.32%	0.95%	0.19%	-1.82%	-0.99%	-0.62%	0.14%	2.15%
1995	31.31%	37.58%	32.03%	36.80%	28.45%	-6.27%	-0.72%	-5.49%	2.86%
1996	23.09%	22.96%	19.02%	21.82%	16.49%	0.13%	4.06%	1.27%	6.59%
1997	27.31%	33.36%	29.05%	31.78%	22.36%	-6.06%	-1.74%	-4.48%	4.94%
1998	24.95%	28.58%	12.19%	24.14%	-2.55%	-3.63%	12.76%	0.81%	27.49%
1999	44.68%	21.04%	12.03%	20.90%	21.26%	23.64%	32.66%	23.78%	23.43%
2000	-19.16%	-9.10%	9.64%	-7.46%	-3.02%	-10.06%	-28.80%	-11.70%	-16.14%
2001	-10.80%	-11.89%	-0.39%	-11.46%	2.49%	1.08%	-10.41%	0.65%	-13.29%
2002	-15.49%	-22.10%	-18.18%	-21.54%	-20.48%	6.61%	2.69%	6.05%	4.99%
2003	45.41%	28.68%	40.97%	31.06%	47.25%	16.72%	4.44%	14.35%	-1.85%
2004	17.97%	10.88%	16.95%	11.95%	18.33%	7.09%	1.02%	6.02%	-0.36%
2005	3.30%	4.91%	8.06%	6.12%	4.55%	-1.61%	-4.76%	-2.82%	-1.25%
2006	22.61%	15.79%	15.80%	15.71%	18.37%	6.81%	6.81%	6.89%	4.24%
2007	1.73%	5.49%	1.53%	5.14%	-1.57%	-3.76%	0.20%	-3.41%	3.30%
2008	-43.67%	-37.00%	-39.72%	-37.31%	-33.79%	-6.68%	-3.95%	-6.37%	-9.89%
2009	72.80%	26.46%	46.31%	28.34%	27.17%	46.33%	26.49%	44.46%	45.62%
2010	31.51%	15.06%	21.91%	16.93%	26.85%	16.45%	9.60%	14.58%	4.65%
2011	5.11%	2.11%	-0.11%	1.03%	-4.18%	3.00%	5.22%	4.09%	9.29%
2012	13.53%	16.00%	17.65%	16.42%	16.35%	-2.48%	-4.13%	-2.89%	-2.82%
2013	41.08%	32.39%	36.16%	33.55%	38.82%	8.69%	4.92%	7.53%	2.25%
2014 YTD	1.59%	1.81%	2.96%	1.97%	1.12%	-0.22%	-1.37%	-0.39%	0.47%

*Note: Calculated Using Total Returns

Source: Horizon Kinetics LLC, International Securities Exchange, Bloomberg

See important disclosures for additional information.

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Index Constituent Changes: 1. Nuveen Investments Inc (JNC US) was delisted from the US Security Exchange effective 11/14/2007 and has been removed from the index. 2. Alliance Financial Corp (ALNC US) was delisted from US Security Exchange effective 03/11/2013 and has been removed from the index. The divisor has been adjusted accordingly for each of these changes.

Money Manager Index

From Aug 1983 to April 2014

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Yr. End	Index	Yearly return	Annualized return (since inception)
1983								1.00	0.81	0.76	0.87	0.75	1983	0.75	(60.5)%	(50.2)%
1984	0.75	0.71	0.70	0.66	0.67	0.67	0.61	0.83	0.79	0.76	0.67	0.65	1984	0.65	(13.5)%	(26.5)%
1985	0.92	0.93	0.99	0.95	1.20	1.30	1.32	1.38	1.28	1.50	1.86	2.02	1985	2.02	211.8%	33.7%
1986	2.46	2.78	2.47	2.31	2.36	2.33	2.03	2.23	1.98	2.37	2.34	2.34	1986	2.34	15.9%	28.2%
1987	3.21	3.27	3.16	2.55	2.37	2.30	2.39	2.47	2.22	1.56	1.44	1.52	1987	1.52	(35.0)%	9.9%
1988	1.80	1.87	1.78	1.79	1.69	1.94	1.92	1.96	2.01	1.97	1.95	2.07	1988	2.07	36.0%	14.3%
1989	2.42	2.37	2.54	2.63	2.64	2.64	2.93	3.12	3.07	3.05	3.23	3.26	1989	3.26	57.8%	20.2%
1990	3.12	3.15	3.53	3.06	3.47	3.45	3.30	2.70	2.68	2.40	2.52	3.02	1990	3.02	(7.3)%	16.1%
1991	3.08	3.49	3.70	3.68	3.71	3.61	3.86	4.05	4.07	4.69	4.47	5.72	1991	5.72	89.4%	23.0%
1992	5.76	5.61	5.30	5.12	4.98	4.99	5.93	6.06	6.19	6.56	7.25	7.36	1992	7.36	28.6%	23.6%
1993	8.06	8.04	8.20	7.94	8.15	8.57	9.05	10.00	9.99	9.31	8.97	8.90	1993	8.90	21.0%	23.4%
1994	9.52	8.73	8.05	7.85	7.81	7.53	7.66	8.31	8.15	8.52	7.88	7.95	1994	7.95	(10.6)%	19.9%
1995	7.74	8.38	8.72	8.77	9.20	9.35	9.93	10.78	11.22	10.53	10.89	10.40	1995	10.40	30.8%	20.8%
1996	11.12	11.50	11.33	11.62	11.86	12.53	11.91	12.36	13.32	14.03	14.42	15.02	1996	15.02	44.4%	22.4%
1997	16.04	16.81	15.32	17.27	18.42	20.29	22.28	21.39	25.31	24.95	24.95	25.50	1997	25.50	69.8%	25.2%
1998	25.67	29.00	29.89	30.60	28.90	30.44	27.67	21.33	21.74	25.16	27.27	25.41	1998	25.41	(0.4)%	23.3%
1999	26.00	23.71	23.92	26.77	28.94	29.74	28.78	26.74	25.89	27.73	28.54	30.55	1999	30.55	20.2%	23.2%
2000	31.07	31.19	36.01	35.60	35.20	40.32	43.58	45.75	45.62	48.69	44.05	49.84	2000	49.84	63.1%	25.2%
2001	50.23	46.41	44.27	46.96	48.90	49.98	50.67	49.70	46.47	44.81	48.04	51.91	2001	51.91	4.2%	23.9%
2002	53.62	53.74	55.11	52.52	52.83	50.48	42.58	44.92	41.54	42.66	45.78	43.17	2002	43.17	(16.8)%	21.4%
2003	42.72	41.18	42.36	45.98	49.02	50.71	53.47	53.97	53.46	56.12	55.83	58.49	2003	58.49	35.5%	22.1%
2004	64.38	65.08	64.63	61.68	60.86	62.30	58.71	64.08	65.73	68.86	73.53	78.16	2004	78.16	33.6%	22.6%
2005	76.46	77.94	74.06	72.83	77.02	80.25	83.59	83.07	86.03	89.19	96.58	97.35	2005	97.35	24.6%	22.7%
2006	107.62	111.44	110.75	111.88	101.89	100.61	100.62	104.98	114.61	116.64	113.78	118.05	2006	118.05	21.3%	22.6%
2007	125.73	123.77	122.62	127.58	133.57	134.68	126.61	124.07	133.57	148.09	135.13	135.56	2007	135.56	14.8%	22.3%
2008	127.53	115.76	115.94	121.58	130.51	115.68	119.94	120.55	109.69	72.70	62.95	67.91	2008	67.91	(49.9)%	18.1%
2009	57.51	51.76	65.63	79.49	85.67	90.79	99.97	101.69	107.32	107.36	110.94	115.01	2009	115.01	69.4%	19.7%
2010	106.84	110.32	118.13	114.91	100.18	88.17	97.65	89.64	103.59	108.29	108.64	119.58	2010	119.58	4.0%	19.1%
2011	122.80	128.28	127.94	127.97	126.06	121.03	115.49	104.25	91.32	102.44	103.79	103.98	2011	103.98	(13.1)%	17.8%
2012	109.46	120.12	125.37	121.64	108.44	114.12	113.56	118.33	123.18	127.91	131.76	135.00	2012	135.00	29.8%	18.1%
2013	151.20	155.13	165.52	166.55	174.89	164.20	179.01	168.47	176.12	192.14	197.16	208.44	2013	208.44	54.4%	19.2%
2014	194.17	196.87	203.88	196.24									2014	196.24	(5.9)%	67.4%

S.No.	Ticker	Name	Amount Invested	Shares Purchased	Date of Investment	Current Index Value
1	AMG US Equity	Affiliated Manager	\$22,947	1,377	11/30/1997	\$272,883
2	BLK US Equity	BlackRock	\$23,205	1,658	9/30/1999	\$498,912
3	WDR US Equity	Waddell & Reed	\$27,513	1,587	3/31/1998	\$107,602
4	EV US Equity	Eaton Vance	\$2,641	3,998	1/31/1986	\$145,102
5	TROW US Equity	T. Rowe Price	\$2,423	2,014	4/30/1986	\$165,397
6	BEN US Equity	Franklin resources	\$908	1,263	4/30/1985	\$198,375
7	LM US Equity	Legg Mason	\$1,000	462	8/31/1983	\$21,672
8	FII US Equity	Federated Inv	\$26,381	2,206	5/31/1998	\$62,961
9	FIG US Equity	Fortress Investment Group	\$102,249	3,389	2/28/2007	\$24,232
10	PZN US Equity	Pzena Investment Management	\$122,426	6,317	10/31/2007	\$68,667

THE FIXED INCOME CONTRARIAN COMPENDIUM

Index Constituent Changes: 1. New Star Asset Management (NSAM LN) was delisted from the London Security Exchange effective 03/10/2009 and has been removed from the index. 2. Australia Wealth Management (AUW AU) was delisted from Australian Security Exchange effective 05/18/2009 and has been removed from the index. 3. Bluebay Asset Management/UNI (BBAY LN) was delisted from the London Security Exchange effective 12/20/2010 and has been removed from the index. 4. Everest Financial Group Limited (EFG AU) was delisted from the Australian Security Exchange effective 7/19/2011 and has been removed from the index. 5. RAB Capital Plc (RAB LN) was delisted from the London Security Exchange effective 9/2/2011 and has been removed from the index. 6. Invista Real Estate (INRE LN) was delisted effective 8/13/2012 and has been removed from the index. The divisor has been adjusted accordingly for each of these changes.

International Money Manager Index

From Nov 1986 to April 2014

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Yr. End	Index	Yearly return	Annualized return (since inception)
1986											1.00	1.02	1986	1.02	10.0%	10.0%
1987	1.25	1.37	1.48	1.48	1.37	1.33	1.39	1.40	1.33	0.81	0.76	0.73	1987	0.73	(27.7)%	(23.3)%
1988	0.75	0.92	1.02	0.95	0.80	0.89	0.88	0.82	0.86	0.88	0.89	0.93	1988	0.93	26.4%	(3.4)%
1989	1.03	1.02	1.06	1.17	1.19	1.18	1.25	1.16	1.17	1.20	1.21	1.28	1989	1.28	37.8%	8.1%
1990	1.24	1.24	1.18	1.19	1.22	1.24	1.26	1.26	1.23	1.24	1.25	1.33	1990	1.33	3.7%	7.0%
1991	1.34	1.52	1.56	1.58	1.57	1.47	1.52	1.64	1.81	1.89	1.94	1.92	1991	1.92	44.8%	13.5%
1992	2.01	1.93	1.88	2.14	2.19	2.13	2.08	1.99	1.95	1.77	1.76	1.96	1992	1.96	1.9%	11.5%
1993	1.98	2.03	2.20	2.39	2.42	2.45	2.54	3.05	3.01	3.07	3.01	3.30	1993	3.30	68.7%	18.1%
1994	3.72	3.39	3.17	3.04	2.99	2.89	3.01	3.14	3.13	3.19	3.15	3.15	1994	3.15	(4.7)%	15.1%
1995	3.07	3.12	3.28	3.41	3.56	3.59	3.87	3.76	3.76	3.77	3.70	3.73	1995	3.73	18.6%	15.4%
1996	3.76	3.85	3.70	3.79	3.96	3.90	3.75	3.96	4.16	4.47	4.90	4.86	1996	4.86	30.3%	16.8%
1997	5.11	5.37	4.99	4.96	5.43	5.94	6.57	6.32	7.45	7.24	6.80	7.19	1997	7.19	47.9%	19.3%
1998	7.12	8.05	8.78	9.25	8.95	8.74	8.91	6.67	6.08	7.01	7.51	7.71	1998	7.71	7.3%	18.3%
1999	7.99	8.21	8.68	9.07	8.71	8.61	8.63	8.43	8.47	8.79	9.80	10.79	1999	10.79	39.9%	19.8%
2000	11.23	12.27	13.95	13.50	13.73	15.39	15.85	16.82	17.07	16.31	14.43	16.76	2000	14.43	33.8%	20.7%
2001	17.42	15.88	13.46	15.14	15.84	15.15	14.21	13.61	10.77	11.43	13.90	14.12	2001	14.12	(2.2)%	19.1%
2002	14.74	13.78	15.09	15.11	16.38	14.14	12.92	12.10	11.23	11.06	11.33	10.50	2002	10.50	(25.6)%	15.7%
2003	10.18	9.52	9.69	10.62	12.17	13.04	13.98	15.38	16.67	17.88	18.16	18.07	2003	18.07	72.1%	18.4%
2004	20.00	22.41	29.98	35.46	26.68	30.80	25.37	25.20	23.67	23.34	27.56	31.48	2004	31.48	74.2%	20.9%
2005	32.19	32.57	31.88	27.79	27.36	29.05	30.38	31.49	33.39	32.24	32.95	37.18	2005	37.18	18.1%	20.8%
2006	41.01	40.97	43.69	46.45	42.39	41.58	40.60	43.32	43.55	43.70	44.58	49.38	2006	49.38	32.8%	21.3%
2007	50.95	51.18	53.59	56.09	58.16	56.37	53.90	48.65	50.96	57.03	48.21	45.75	2007	45.75	(7.3)%	19.8%
2008	38.71	39.71	38.59	40.18	39.25	35.10	34.59	33.33	26.09	18.72	14.50	15.79	2008	15.79	(65.5)%	13.3%
2009	14.62	13.24	14.96	19.63	22.82	23.73	26.14	27.05	28.41	28.53	28.69	29.83	2009	29.83	89.0%	15.8%
2010	28.50	27.58	29.90	29.58	25.53	24.72	27.82	26.74	30.36	33.68	31.85	34.52	2010	34.52	15.7%	15.8%
2011	34.91	36.17	36.51	39.63	37.86	35.31	35.83	32.76	29.28	32.04	31.23	30.59	2011	30.59	(11.4)%	14.56%
2012	32.12	34.36	35.67	35.08	31.03	32.92	32.66	34.17	36.33	37.28	38.11	40.73	2012	40.73	33.1%	15.22%
2013	43.61	42.58	44.42	49.29	50.40	47.75	50.58	49.32	52.49	55.65	55.41	58.88	2013	58.88	44.6%	16.19%
2014	55.35	58.98	61.86	59.92									2014	59.92	1.8%	16.05%

S.No.	Ticker	Name	Initial Amount Invested	Shares Purchased	Date of Investment	Current Index Value
1	IGM CN Equity	IGM Financial Inc	\$1,000	73	31/11/1986	\$3,661
2	FCAM LN Equity	F&C Asset Management Plc	\$1,203	485	5/31/1989	\$995
3	IVZ US Equity	Invesco Plc (Previously Amvescap)	\$1,357	1,153	1/31/1991	\$20,290
4	SDR LN Equity	Schroders Plc	\$1,208	505	3/31/1991	\$21,775
5	RAT LN Equity	Rathbone Brothers Plc	\$1,208	736	3/31/1991	\$24,443
6	ADN LN Equity	Aberdeen Asset Mgmt Plc	\$1,208	1,827	3/31/1991	\$13,468
7	CIX CN Equity	CI Financial Corp.	\$2,585	3,224	6/30/1994	\$105,087
8	EMG LN Equity	Man Group Plc	\$2,862	6,344	10/31/1994	\$8,306
9	AGF/B CN Equity	AGF Management Ltd-CI B	\$3,343	1,346	1/31/1996	\$15,337
10	8739 JP Equity	Sparx Group Co Ltd	\$11,762	108	12/31/2001	\$19,408
11	HGG LN Equity	Henderson Group Plc	\$14,447	8,666	12/31/2003	\$29,338
12	AZM IM Equity	Azimut Holding Spa	\$21,908	4,977	7/31/2004	\$154,937
13	CCAP LN Equity	Charlemagne Capital Ltd	\$36,848	22,300	3/31/2006	\$6,491
14	PGHN SW Equity	Partners Group-Reg	\$36,848	578	3/31/2006	\$158,175
15	ASHM LN Equity	Ashmore Group Plc.	\$36,688	9,873	10/31/2006	\$58,370