THE FIXED INCOME CONTRARIAN COMPENDIUM

November 2012

Featured Companies

Cemex (CX)
Meritor Inc. (MTOR)
MGM Resorts International (MGM)

Exclusive Marketers of
The Fixed Income Contrarian Report

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HORIZON KINETICS

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Murray's Musings

FURTHER COMMENTS ON THE CREDIT CRISIS OF 2012

The subject of the *Musings* is an update of the bond market crisis. In this reference, the bond market crisis reflects the absence of income that can be collected; it's a crisis viewed from the point of view of those who buy bonds. Generally speaking, bond market crises are viewed from the perspective of borrowers of capital, who find it impossible to obtain credit. In this bond market crisis, capital is available, but investors are unable to earn a suitable rate of return. That's the risk they assume.

On September 20, 2012, the iShares Barclays Aggregate Bond Fund (AGG) provided an average yield to maturity of 1.31%. The iBoxx High Yield Corporate Bond Fund (HYG) provided an average yield to maturity of 5.58%. It's extraordinary that bonds, some of which are obviously not very credit-worthy, collectively in this index produce a yield to maturity of 5.58%, and it has certain mathematical consequences. Within that index there will be defaults, so it's an actuarial absurdity for pension funds to have any exposure to it. Given the obvious fact that some bonds will default, the return cannot possibly be as high as the average yield to maturity. The bonds can only depreciate to par. The weighted average coupon in that index is 7.73% and the higher coupon bonds are gradually disappearing from it for obvious reasons. Consequently, it is likely that the yield to maturity of HYG will decline further.

That circumstance in the bond indexes has a parallel in income-oriented equity indices. For example, one finds a similar phenomenon, albeit more dangerous, in the real estate investment trust (REIT) indexes. The following table examines the five largest positions in the Vanguard REIT Index ETF (VNQ), which are Simon Properties; Public Storage; Equity Residential; Ventas and HCP.

Table 1: Five Largest Positions in Vanguard REIT Index ETF (VNQ)

	Weight in Index	Qtr. Div. Rate	Most Recent Qtr. Earnings	Yields
Simon Properties	11.0%	$1.05	$0.71	2.69%
Public Storage	5.0%	$1.10	$0.77	3.11%
Equity Residential	4.4%	$0.34*	$0.10	2.35%
Ventas	4.3%	$0.62	$0.14	3.69%
HCP	4.3%	$0.50	$0.48	4.45%

**Gain from discontinued operations in current quarter made earnings $0.3375.*

Source: Vanguard, Company Reports

As Table 1 shows, these five companies represent a very substantial proportion of the index. Considering the most recent quarterly dividend rate and the most recent earnings as reported by each company, you can see that they are paying out depreciation in addition to earnings, which REITs can do for some period of time. The market values the payout of that depreciation in earnings through the following yields: Simon Properties, 2.69%; Public Storage, 3.11%; Equity Residential, 2.35%; Ventas, 3.69% and HCP, 4.45%.

Table 2 lists the shares outstanding in the last five quarters for these REITs.

Table 2: Shares Outstanding of Top 5 Holdings in VNQ (*in millions*)

	Simon Properties	Public Storage	Equity Residential	Ventas	HCP
2Q 2011	293.6	169.5	296.3	188.1	407.1
3Q 2011	293.8	170.0	296.6	287.9	407.8
4Q 2011	293.9	170.2	297.5	288.8	408.6
1Q 2012	303.1	170.5	300.5	289.0	419.4
2Q 2012	303.3	170.5	301.0	295.4	429.4

Source: Company Reports

In all cases, the shares outstanding increased, albeit relatively modestly in the case of Public Storage. In all the other circumstances, the companies themselves were issuers of shares. Since the market values that business at a much lower capitalization rate than real estate entrepreneurs value the buildings contained in that business, it's possible for an REIT to issue shares at a certain capitalization rate and buy real estate at a much higher capitalization rate to engage in an antidilutive transaction. From an index point of view, the index trades on demand for the shares, which is a major factor in leading to high valuations, and the companies take advantage of those valuations. Companies are not the only ones to do so; recently the Simon family sold $1 billion worth of stock.

Table 3 provides the depreciation expense and the capital expenditures as recorded by the same five REITs.

Table 3: Depreciation Expenses vs. Capital Expenditures
First 6 months 2012 FY

	Depreciation Expense *($ in millions)*	Capital Expenditures *($ in millions)*
Simon Properties	$620.0	$343.8
Public Storage	$175.5	$40.3
Equity Residential	$348.1	$68.3
Ventas	$366.4	$23.8
HCP	$176.2	$27.1

Source: Vanguard

It would appear that the companies are altering their normal policies with regard to maintenance of the property with a view to maximizing dividends. That, of course, will have an impact on the stock price and on earnings. A virtuous circle is being created and, as a consequence of the intense demand for income on the part of many investors, the index is not fulfilling its customary function of simply being a measurement benchmark of reality. Rather, the index itself is becoming the reality.

It should be self-evident that this trend is entirely unsustainable. Although it could continue for some period of time, ultimately the properties will require capital expenditures. Either the companies will have to issue shares from that standpoint and thereby dilute investors, or they will have to change their dividend policies. This distortion is but one example of those being created by the bond market crisis and the practice of modern indexation.

Industry Thoughts

MASTER LIMITED PARTNERSHIPS

Master Limited Partnerships (MLPs) are mostly, but not entirely, in the pipeline area. An example is Enterprise Products Partners (EPD). The capital expenditure, dividend, and capital allocation policies of pipelines are very different from those of REITs. Nevertheless, the MLPs, like the REITs, are affected by the indexation movement.

As can be seen in Table 4, in the first six months of 2012, Enterprise Products reported net income of $1.22 billion and distributed $1.068 billion to its partners, a distribution that was less than the company's income.

Table 4: Enterprise Products (EPD)
First six months of 2012

	($ in billions)
Net Income	$1.220
Distribution to Partners	$1.068
Depreciation Expense	$0.537
Capital Expenditures	$1.813

Source: Company reports

Here is a company that is not allowed to accumulate retained earnings. For very logical reasons, it engages in expansion policies that require vast capital expenditures in amounts far in excess of depreciation expenses. In Table 5, one can see that the company has been able to increase its debt without materially increasing its leverage ratio.

Table 5: EPD Long Term Debt *vs* Shareholders' Equity

	($ in billions)		*(Shares in millions)*
	Debt	Shareholders' Equity	Shares Out
2011	$14.0	$12.1	890.0
2010	$13.3	$11.4	851.8
2009	$12.4	$1.9	613.1
2008	$11.6	$6.1	441.4
2007	$6.0	$6.1	435.3

Source: Company Reports

Enterprise Products had $6 billion in debt and $6.1 billion of book value in 2007. At the end of 2011 it had $14.0 billion in debt, but its shareholders' equity had risen to $12.1

billion at year-end 2011. All that was made possible by share issuance, which is a function of the index demand. The company had 435.3 million shares outstanding at year-end 2007 and 890 million shares outstanding at the end of 2011.

Table 6 displays the share issuance of various leading MLP companies over a slightly longer period of time. I've included just a few of these entities as illustrative examples.

Table 6: MLP Share Issuance: Shares Outstanding at Year-End *(in millions)*

	Kinder Morgan (KMP)	Magellan Midstream (MMP)	Enbridge Energy (EEP)	Energy Transfer (ETP)
2011	336.5	112.7	284.4	225.5
2010	316.1	112.5	230.6	193.2
2009	296.9	106.6	215.2	179.2
2008	266.3	106.6	190.5	151.1
2007	247.9	66.5	146.0	142.1
2006	230.4	66.4	127.5	137.0
2005	220.2	66.4	115.5	110.7
2004	207.0	66.4	103.4	107.9
2003	189.0	49.1	94.3	90.1
2002	180.9	40.9	75.8	14.2

Source: Company reports

All had significant increases in the number of shares outstanding from 2002 through the end of 2011. The market absorption of this incredible number of shares made possible the dividend growth of these five companies and the growth in earnings, debt and shareholders' equity. The companies were able to make antidilutive acquisitions in the sense that they could issue shares at a cost of capital that was lower than the reinvestment of that capital in acquiring other MLP businesses.

Table 7 shows how the market values the dividend streams of these five MLPs.

Table 7: Yields of 5 Representative MLPs

Enterprise Products	4.70%
Kinder Morgan	5.96%
Magellan Midstream	4.47%
Energy Transfer	8.35%
Enbridge Energy	7.38%

Source: Company reports

To understand why the dividend yields are so much higher for MLPs than for REITs, let's consider some Enbridge Energy data for the first six months of 2012.

Table 8: Enbridge Energy Data, First six months 2012

	($ in millions)
Net Income	$251.7
Depreciation	$169.7
Additions to Property	$651.7
Distribution to Partners	$318.8

Source: Company reports

For that period, Enbridge Energy reported $251.7 million of net profit and had depreciation expense of $169.7 million. It made distributions to its partners of $318.8 million and additions to property—in other words capital expenditures—of $651.7 million. In the case of the MLPs, the dividend increases can only be sustained by investing ever-increasing sums of capital, which can only be obtained from the capital markets.

The fundamentals for pipelines are quite good, since the U.S. is dramatically increasing its energy production and will clearly require more pipeline and storage capacity. However, the growth thus far has been made possible by the debt and equity markets allowing these firms to access capital at unusually favorable rates, but that will not continue forever. The high yields are simply a reflection of the market sentiment and such a circumstance cannot possibly endure. It's not quite as absurd as the REIT situation, but it does have an element of absurdity.

Facts and Figures

WIKIPEDIA

In this section, I'll compare Wikipedia with Google, Microsoft, Facebook and Yahoo!

Table 9: Comparing Wikipedia

	Number of Employees	Number of Unique Visitors *(in millions)*
Google	31,350	1,050
Microsoft	92,000	900
Facebook	3,000	752
Yahoo!	13,600	686
Wikipedia	80	423

Source: Wikipedia

Wikipedia has 423 million unique visitors annually, a figure that tends to double each year, and does so with only 80 employees. It has annual revenue of $24.8 million, and receives that from 573,568 individual donors, of which I am one, because I use it. The company has net assets of $24.2 million. It contains 23 million freely usable articles in 285 languages written by 36 million registered users. Wikipedia is the sixth most popular Internet site in the world. It receives 10 million global page reviews a month and it's already a reasonably reliable source of news, putting it in competition with traditional news channels and news networks as well as newspapers.

Wikipedia is now starting a collaboratively edited database. There's been an international uproar about data as evidenced by recent actions by scholars. The data required by scholars is owned by relatively few companies in the world. Data is extraordinarily expensive to access, and scholars have objected to those high costs. Wikipedia is responding to that need with a collaboratively edited database to be called Wikidata. There are companies that should feel very threatened by this, including Factset (FDS), Morningstar (MORN), MSCI (MSCI), Thomson Reuters (TRI), IHS (IHS), Reed Elsevier (ENL), and WebMD (WBMD).

Wikipedia's new collaborative database is made possible because Wikipedia is a large transnational effort operating on a not-for-profit basis. Without the internet, it never would have been possible. Over the years, the standard form for organizing human beings in a collaborative effort has been the for-profit system. Essentially, that's what a corporation is; a corporation organizes people and their related capital in an entity based on the concept of profit incentive.

Wikipedia, by contrast, is organized on a not-for-profit incentive. It's an extraordinary phenomenon for a large transnational cooperative enterprise to be organized and to flourish on a not-for-profit basis. Wikipedia appears to be gaining currency, adherence, and reach. Ultimately, it will affect other companies.

RUSSELL 2000'S TOP 20 HOLDINGS BY HIGH AND LOW P/E

Table 10 groups the top 20 holdings in the Russell 2000 into a high P/E group and a low P/E group. Of the top 20 names, I would argue that 17 belong in the high P/E group.

Table 10: Top 20 Holdings in Russell 2000

High P/E

Ticker	Company	P/E	Rank
PCYC	Pharmacyclics	364.4x	1
ATHN	athenahealth	195.6x	3
CBST	Cubist Pharmaceuticals	32.5x	4
OCN	Ocwen Financial	38.5x	5
UNFI	United Natural Foods	32.2x	7
DRQ	Dril-Quip	26.7x	8
HMSY	HMS Holdings	62.3x	9
CRUS	Cirrus Logic	33.3x	11
AYI	Acuity Brands	25.1x	12
PMTC	Parametric Technology	31.9x	13
WXS	Wright Express	20.4x	14
ULTI	Ultimate Software	102.1x	15
ALGN	Align Technology	34.7x	16
GWR	Genesee & Wyoming	22.2x	17
SGEN	Seattle Genetics	(33.3x)	18
CDE	Coeur D'Alene Mines	37.7x	19
CPHD	Cepheid	(569.7x)	20

Low P/E

TWO	Two Harbors	8.9x	2
EXXI	Energy XXI (Bermuda)	9.6x	6
STWD	Starwood Property Trust	16.4x	10

As of 9/21/2012

Source: Russell Investments, Bloomberg

Pharmacyclics, for example, is the largest company in the Russell 2000. As of the most recent reckoning, its P/E ratio is 364.4x.[1] It's really higher than that, however, because the company reports episodic research development grants from Johnson & Johnson as earnings, which for tax purposes they are, but for equity valuation purposes, they are not. Nevertheless, using the company's methodology, Pharmacyclics has a P/E ratio of 364.4x.

Other companies on the high P/E list include athenahealth, with a P/E of 195.6x; Cubist Pharmaceutical, with a P/E of of 32.5x; and United Natural Foods, with a P/E of 32.2x. There are some companies on this list, like Cepheid, for example, that don't belong on the list. Cepheid doesn't have a P/E because it has no earnings. It's possible, however, to trade at a negative P/E and, if one were to do that, Cepheid would be trading at 569.7x negative earnings, if that has any meaning.

The remaining three companies of the top 20 have low P/Es: Two Harbors at 8.9x, Energy XXI of Bermuda at 9.6x, and Starwood Properties at 16.4x.

Two Harbors purchases mortgaged-backed paper on leverage of about 6x. Given declines in interest rates and the Federal Reserve's policy of buying mortgage-backed paper, as well as the constant refinancing of existing mortgages, it should be readily apparent that the earnings and dividends of Two Harbors are completely unsustainable. Within not very many quarters, its dividends will be substantially cut. Annaly, which is not in the Russell 2000 but is the leading company in Two Harbors' segment, has already reduced its dividend, and it will probably have to reduce it further.

Starwood Properties purchases CMBS and some RMBS on less leverage, 50% leverage, as opposed to the 6x leverage of Two Harbors, and the company recently issued more shares. Starwood's P/E ratio is 16.4x, and its earnings are quite unsustainable for reasons that are very similar to that of Two Harbors. Energy XXI of Bermuda is a company that has grown by acquisition. It's obviously exposed to fluctuations in energy prices—which have been declining of late—but its growth has been a function of the issuance of shares to subsidize that growth.

[1] As of 9/21/12.

Featured Companies

The names featured in this section reflect the paucity of choices in the high-yield arena. Nevertheless, for those inclined to partake in high yield, these might be reasonable investments.

CEMEX (CX)

Cemex, the Mexican cement company, produces concrete, cement and aggregates in 50 nations around the world. At this writing, the Cemex 4.875% Senior Unsecured Convertible maturing on March 15, 2015 has a yield to maturity of 8%, a 48% conversion premium, and it is convertible at $12.09.

Clearly, the earnings are depressed because of the issues in the housing market, not merely in the United States, but all over the world. Despite the housing market depression, the company is profitable and it is even free cash flow positive. It generated $386 million of free cash flow in the most recently completed fiscal year.

Ninety-nine percent of its debt is long term; however, 44% of that long-term debt is at variable interest rates. If long-term rates were to increase, that might be a source of concern to investors. If long-term rates increase without a compensating increase in construction activity around the world, it would possibly be problematic for a company like Cemex, although it doesn’t look like that is going to happen.

The company now has cash flow that generates interest coverage of 1.99x. Given the state of the worldwide construction industry, it’s very unlikely that rates will rise anytime soon. There’s always a possibility that the equity might appreciate and the housing industry will recover. It doesn’t appear that it will recover in the near term to levels that will move the stock very much, but it’s possible to earn more than 8% yield to maturity if the housing industry around the world does recover. If not, this bond will produce an 8% yield to maturity.

MERITOR INC. (MTOR)

Another company in similar circumstances is Meritor, formerly known as ArvinMeritor. Meritor is one of the leading companies in the world for the manufacture of drivetrains for trucks, trailers, and various other types of commercial vehicles. At the moment, that business is very depressed. The company’s 4.625% convertible bond matures on March 1, 2026, and is puttable to the company on March 1, 2016. In other words, the time-to-put is about 3.5 years. The current yield-to-put is 8.5%. It’s convertible at $20.98, and its conversion premium is an astronomical 323%.

This company operates around the world, and its earnings are very depressed because commercial vehicle production—especially truck production—in most parts of the world is running at about two-thirds of what production had been in 2006. The company has about $1 billion in debt and $900 million of negative shareholders' equity. It does have $226 million in cash and is profitable, although modestly so. At current levels, it would require at least a decade, and probably more, before this company could produce positive shareholders' equity.

Unlike many companies of this ilk, Meritor has pension fund assets that exceed the accumulated benefit. The company uses an 8.5% assumed rate of return in its pension fund assets, which may not be achievable, and it uses a 4.85% discount rate, which might make the liability appear unduly low. Nevertheless, using those figures the plan assets do exceed the accumulated benefit. Meritor contributes to its pension fund each and every year, which is one reason its earnings are so depressed. Given the current level of profitability, it seems reasonably likely the company will be in a position to redeem these bonds when they will certainly be put to them on March 1, 2016 and one can earn a yield-to-put of 8.5%. It's remotely possible, and very remotely possible, that the stock will appreciate if circumstances change in the commercial vehicle arena. That's nothing other than a remote possibility and, of course, the market puts no value on that remote possibility.

MGM RESORTS INTERNATIONAL (MGM)

A company with more assets is MGM Resorts International. The MGM Resorts 4.25% Senior Unsecured Convertible maturing on April 15, 2015 is less-than-three-year paper, has a yield to put of 3.64%, and a conversion price of $18.53, which gives it a conversion premium of 93%. MGM Resorts operates at a slight loss and, unless visitation improves in Las Vegas, it will probably continue to operate at a slight loss for the foreseeable future. Nevertheless, it's able to operate at a slight loss. It has $1.7 billion in cash on the balance sheet, $13.2 billion in debt—which the company is gradually reducing—and it has $9.4 billion of shareholders' equity.

It has substantial liquidity available just in cash, and additional liquidity available in liquid assets, because it owns shares of the publicly traded MGM China. Of course, its properties in Las Vegas, if it chose to sell them, are readily saleable to entrepreneurs who unquestionably would buy them. Therefore, it's very unlikely that this company is going to have to file for bankruptcy. Essentially, one is being paid 3.64% for roughly 2.5 years to own this bond and with it comes an out-of-the money call option. You're 93% out of the money, but stranger things have happened. Any slight improvement in the Las Vegas circumstances will lead to substantial appreciation in that share. Las Vegas is still the No. 1 trade show destination in the United States.

If one seeks a higher yield, however, it can be attained by undertaking the following exercise to generate what we refer to in these pages as 'synthetic income.' As an example, if one had sold to open a put option on the MGM Resorts common, with expiration in January 2014 at a strike price of $8.00, the premium received would have been $1.10. The stock price closed at $10.72 on September 21. The capital at risk, since the worst that could happen would be that MGM Resorts goes to zero, would be the $8.00 strike less the $1.10 received, or $6.90. If the stock were to decline from $10.72 to $8.01, a decline of 25.3% from current levels, the stock will not be put. Based on the capital at risk of $6.90 for roughly 1.33 years, one would earn $1.10, which works out to a 15.94% rate of return.

One could actually earn a positive rate of return even if the stock were to decline by 25%. In order to earn a mere 6% rate of return, which is higher than the yield to maturity available in the iBoxx High Yield ETF, the stock must be no lower than $7.31, which would be a decline of 31.8% from current levels. In the option strategy example, losses occur after the stock declines below $6.90, a decline of 35.6% from the $10.72 level. Assuming the stock declines to $6.89, a loss of nearly 36%, that would produce a very, very modest loss in this position. That modest loss would almost certainly be vastly exceeded by the spread widening that would take place on the publicly traded bonds of MGM Resorts, because if the market capitalization of the company were to start shrinking to those levels, the bonds would come into question. In that case, the option strategy is still the better investment. One could hypothesize that MGM Resort stock would go yet lower, but in that case no one would buy MGM Resort's bonds, nor should they.

Post Musings

THE TRAGEDY OF THE RUSSELL 2000

Getting back to the issue of the Russell 2000, let's observe what's been happening in this index, because it's absolutely fascinating. Table 11 lists the top 20 stocks and their percentage increases in shares outstanding since December 31, 2007 or, as noted, the end of the 2007 fiscal year.

Table 11: Top 20 Holdings in Russell 2000
Percent Increase in Shares Outstanding Since 12/31/2007 (except as noted)

Rank	Company	% Increase	
1	Pharmacyclics	166.9%	*Since 6/30/2007*
2	Two Harbors	328.5%	
3	athenahealth	9.5%	
4	Cubist Pharmaceuticals	11.6%	
5	Ocwen Financial	107.7%	
6	Energy XXI (Bermuda)	388.8%	
7	United Natural Foods	14.5%	*Since 7/31/2007*
8	Dril-Quip	(1.5)%	
9	HMS Holdings	15.3%	
10	Starwood Property Trust	95.9%	*Since 12/31/2009*
11	Cirrus Logic	(27.0)%	*Since 3/31/2007*
12	Acuity Brands	(4.2)%	*Since 8/31/2007*
13	Parametric Technology	1.9%	*Since 9/30/2007*
14	Wright Express	(2.2)%	
15	Ultimate Software	6.0%	
16	Align Technology	14.8%	
17	Genesee & Wyoming	19.9%	
18	Seattle Genetics	71.8%	
19	Coeur D'Alene Mines	62.9%	
20	Cepheid	15.4%	

Source: Russell Investments

The tragedy of the Russell 2000 and of the float-adjusted weighting system is that the money flows into it increase demand for shares of companies that meet the float requirement, and not to the companies whose float is not necessarily increasing, and might even be decreasing. Increased demand for those shares, as merely the mechanism that makes the index possible, increases the price of the equities in question. The companies then connect to the capital markets for yet more equity financing at extraordinarily favorable costs of capital such that virtually any use of these funds will create a higher return on equity, which makes the shares yet more alluring in the fundamental sense.

As a purely mathematical proposition, however, that trend cannot endure for long because, in June 2013, there will be a rebalancing of the Russell indexes. The leading companies in the Russell 2000 index now support market capitalizations of $3-4 billion. If the virtuous circle continues, these companies cannot legitimately be maintained within the context of the Russell 2000 and will have to move to the Russell 1000. If they move to the Russell 1000, however, they will have to compete for weighting with huge companies like Apple and Exxon. Instead of a the 25 basis-point weight they enjoy in the Russell 2000, they are much more likely to have a one-quarter of one basis point weight in the Russell 1000.

Therefore, the virtuous circle will end and the demand for shares of those companies will lessen greatly, especially because there is less money indexed to the Russell 1000 than to the Russell 2000. Of course, the companies can interrupt that process by ceasing share issuance but, if they do so, they cease the mechanism by which they generate earnings, and that would make their shares less alluring. Simply put, the circumstance of Russell cannot possibly continue, because it's essentially biased.

The list in Table 12 includes just a few of the many companies in that circumstance. For instance, Pharmacyclics has a market capitalization of roughly $4.3 billion; it is the largest position in the Russell 2000.

Table 12: Examples of Bias Among Some Russell 1000 Stocks

Company	Market Cap *($ in billions)*	Owned by	% Ownership
U.S. Cellular	$3.31	Telephone & Data Systems	84.3%
Echostar	$2.48	C. Ergen	50.6%
Kronos	$1.88	Valhi	50.5%
		NL Industries	30.4%
Titanium Metals	$2.32	Various Harold Simmons Entities	54.3%
Clearwire	$2.26	Sprint	58.9%
		Intel	16.9%
		Comcast	15.2%
		Time Warner	8.6%
Clear Channel Outdoor	$2.14	Clear Channel Communications	88.7%

Source: Company reports

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U.S. Cellular (USM) has a $3.31 billion market capitalization and 84.3% of its shares are owned by Telephone and Data Systems, so clearly its float can't be very large. Nevertheless, its market capitalization is $3.31 billion and it is in the Russell 1000.

Echostar (SATS) has a $2.48 billion market capitalization. A little bit more than half, or 50.6%, is owned by Charles Ergen. There are other insiders who own shares, but I'll ignore them for these purposes. Its float is a little bit less than half of $2.48 billion. It is in the Russell 1000.

Kronos (KRO) has a $1.88 billion market capitalization. This company is 50% owned by Valhi and 30.4% owned by NL Industries. Obviously, 80% of this $1.88 billion market capitalization is owned by these two companies and not included in the float. It is in the Russell 1000 index.

Titanium Metals (TIE) has a $2.32 billion market capitalization; 54.3% is owned by various Harold Simmons entities. A little bit more than half of the $2.3 billion market cap is owned and, therefore, is not included in the float. It is in the Russell 1000.

Clearwire (CLWR), a development-stage company, doesn't make any money, never made any money and possibly never will make any money, but it has great promise and a $2.26 billion market capitalization. It is 58.9% owned by Sprint, 16.9% owned by Intel, 15.2% owned by Comcast and 8.6% owned by Time Warner Cable. It is in the Russell 1000.

Clear Channel Outdoor (CCO) has a $2.14 billion market capitalization and it is 88.7% owned by Clear Channel Communications, so the float can't possibly be very large, and it happens to be in the Russell 1000.

If the aforementioned securities and many more that are included in the Russell 1000 were instead included in the Russell 2000, it would be very difficult to execute the index along the lines of the current methodologies, since the scalability of an index is essentially limited by the float of its least liquid members. However, these securities are assigned to the Russell 1000 where they have essentially a zero weight, because they compete for shelf space, so-to-speak, with the likes of Apple and Exxon. Therein lies the tragedy of the float-adjusted weighting system. It is a clear example of the valuation and other distortions that are made possible each and every day by the indexation mania.

Money Manager Index

From Jan 1983 to Oct 2012

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			2012	127.91	23.0%	18.0%

S.No.	Ticker	Name	Initial Amount Invested	Shares Purchased	Date of Investment	Current Index Value
1	AMG us equity	Affiliated Manager	$22,947	1377	11/30/1997	174,166
2	ALNC us equity	Alliance	$7,633	491	4/30/1994	22,218
3	BLK us equity	BlackRock	$23,205	1658	9/30/1999	314,397
4	WDR us equity	Waddell & Reed	$27,513	1587	3/31/1998	53,301
5	EV us equity	Eaton Vance	$2,641	3998	1/31/1986	113,314
6	TROW us equity	T. Rowe Price	$2,423	2014	4/30/1986	130,658
7	BEN us equity	Franklin Resources	$908	1263	4/30/1985	161,428
8	LM us equity	Legg Mason	$1,000	462	8/31/1983	11,828
9	FII us equity	Federated Inv	$26,381	2206	5/31/1998	51,269
10	FIG us equity	Fortress Investment Group	$102,249	3389	2/28/2007	14,641
11	PZN us equity	Pzena Investment Management	$122,426	6317	10/31/2007	35,629

Index Constituent Changes: 1. Everest Financial Group Limited (EFG AU) was delisted from the Australian Security Exchange effective 7/19/2011 and has been removed from the index. 2. RAB Capital Plc (RAB LN) was delisted from the London Security Exchange effective 9/2/2011 and has been removed from the index. 3. Invista Real Estate (INRE LN) was delisted effective 8/10/2012. The divisor has been adjusted accordingly for each of these changes.

International Money Manager Index

From Jan 1983 to Oct 2012

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	16.76	55.4%	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	(15.8)%	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)%	14.7%
2012	32.12	34.36	35.67	35.08	31.03	32.92	32.66	34.17	36.33	37.28			2012	37.28	21.9%	14.9%

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	2,911
2	FCAM LN Equity	F&C Asset Management Plc	$1,203	485	5/31/1989	783
3	IVZ US Equity	Invesco Plc (Previously Amvescap)	$1,357	1,153	1/31/1991	14,015
4	SDR LN Equity	Schroders Plc	$1,208	505	3/31/1991	12,415
5	RAT LN Equity	Rathbone Brothers Plc	$1,208	736	3/31/1991	15,382
6	ADN LN Equity	Aberdeen Asset Mgmt Plc	$1,208	1,827	3/31/1991	9,568
7	CIX CN Equity	CI Financial Corp.	$2,585	3,224	6/30/1994	75,524
8	EMG LN Equity	Man Group Plc	$2,862	6,344	10/31/1994	6,104
9	AGF/B CN Equity	AGF Management Ltd-Cl B	$3,343	1,346	1/31/1996	13,792
10	8739 JP Equity	Sparx Group Co Ltd	$11,762	108	12/31/2001	7,082
11	HGG LN Equity	Henderson Group Plc	$14,447	8,666	12/31/2003	13,087
13	AZM IM Equity	Azimut Holding Spa	$21,908	4,977	7/31/2004	63,068
15	CCAP LN Equity	Charlemagne Capital Ltd	$36,848	22,300	3/31/2006	2,878
16	PGHN SW Equity	Partners Group-Reg	$36,848	578	3/31/2006	122,467
18	ASHM LN Equity	Ashmore Group Plc.	$36,688	9,873	10/31/2006	57,933