Sabrient Baker’s Dozen for 2015

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INTRODUCTION

Sabrient’s *Baker’s Dozen* annual portfolio of top picks was launched largely in response to the financial crisis of 2008 and our desire to broaden our reputation in the marketplace. Since that first list was posted in January 2009, the Sabrient Baker’s Dozen portfolio has for six consecutive years produced market-beating returns by an average of over 1500 basis points (15 percentage points) per year.

Here is a chart that summarizes the annual performance against the S&P 500 Index. The six portfolios and detailed performance can be seen on our Baker’s Dozen website.

![Baker's Dozen vs. S&P 500 Index](chart)

*Note: The 2013 and 2014 portfolios launched on January 11 and January 13, respectively, to coincide with the launch of the First Trust unit investment trusts (UIT) that tracked them. The benchmark returns shown reflect the same timeframes, which is why they are different from the full-year returns.*

The strategy for selecting the 13 top-ranked stocks in the Baker’s Dozen portfolio is described on page 8. In short, the strategy seeks stocks that we believe exhibit strong earnings growth potential relative to their peers, trade at an attractive valuation for the projected growth, display particularly high earnings quality and sustainability, and generally appear to be well-positioned to outperform the benchmark going forward. The final stock selections represent a cross-section of sectors and industries, and each scores particularly well in our model. In previous portfolios, many of the stocks were not household names.

The next section provides a general market overview. The 2015 portfolio is on page 10, and descriptions of the stocks and rationale for their selection begin on page 11.
MARKET OVERVIEW

Looking back, 2014 was yet another solid year for U.S. equities. But it’s not like everyone was jumping up and down with enthusiasm, which is a good thing. With plenty of bogeymen in the closet and under the bed, there is little danger of irrational exuberance. Although some commentators noted that 2014 finished much the same as 2013, there was really quite a bit of difference between the past two years, primarily in the way of lower correlations in 2014 as opposed to the highly correlated “all boats lifted in a rising tide” environment of 2013.

Let’s review some of last year’s bogeymen that caused investor consternation. The Federal Reserve’s tapering of quantitative easing (QE3) came to a conclusion (although maturing securities are still being reinvested rather than retired). There was the huge collapse in oil prices (and still falling into the New Year), causing major disruptions in global markets. Then of course we had the slowdowns in China, Japan, and Europe – and Greece is again in crisis mode. There was major turmoil in Russia and the Ukraine. We witnessed the sudden emergence of ISIS as a terrorist organization with its own army (and social media savvy). There was the fear of Ebola spreading into a global epidemic. And here at home, we had the uncertainty surrounding implementation of Obamacare, as well as the mid-term elections putting the GOP in control of both houses of congress.

The Dow Jones Industrials blue chips, the S&P 500 large cap index, and the Nasdaq 100 ended the year up about +7.5%, +11.4%, and +17.4% respectively, while the S&P MidCap 400 gained about +8% and the Russell 2000 small cap index, only +3.7%. The Russell 2000 made an attempt to break out above strong resistance at 1200, but ultimately failed. Nasdaq Composite at one point looked ready to challenge the 5,000 level for the first time in nearly 15 years, but couldn’t gather enough bullish conviction before the year ended. The MSCI emerging markets index finished down -6%.

Notably, defensive strategies like low volatility and dividend yield outperformed in a general flight to quality among investors, and this “cautious but hopeful” mentality persists going into 2015.

Still, with leadership coming from large-cap and defensive strategies, total capital invested in U.S. ETFs surpassed the $2 trillion mark for the first time. In addition, fixed income indexes rose in 2014 as long-dated yields continued to decline despite the Fed no longer adding new money to its quant easing stimulus program (i.e., bond buying).

Among the ten U.S. business sectors, the top performers for 2014 were Utilities (+25%), Healthcare (+24%), and Technology (+19%), and all spent a lot of time during the year near the top of Sabrient’s forward-looking, fundamentals-based SectorCast rankings. The worst performer by far was Energy, which is not surprising given the 50% haircut in oil prices. Also showing lackluster performance were Telecom and Basic Materials, which both spent a lot of time at the bottom of our sector rankings. Consumer Discretionary and Financials both showed good late year outperformance to make up some ground.
Economic reports continue to impress, at least domestically. Redbook weekly retail sales report showed a robust +5.4% year-over-year increase. Consumer confidence rose to 92.6, which is quite strong. Also, U.S. manufacturing activity continues to expand despite the struggles of overseas economies.

Moreover, leading economic indicators are strong, job growth is the best since the ‘90s, and corporate profits sit at all-time highs. Strong GDP growth is broadly expected to continue into 2015 and beyond, which should propel equities to new heights, although the future for long-term bond prices is not as clear. Although the near-term likely will provide further flattening in the yield curve, eventually economic health will demand higher long-term rates and a steeper yield curve.

The IPO market last year was the busiest since 2000, and the Healthcare sector was buoyed by FDA approval of the most new drugs in 18 years, including many high-priced drugs that address rare conditions and “orphan” diseases.

For several years, oil production has been climbing in the U.S. and Canada, and there has been a lot of recovery among oil fields in Iraq and elsewhere, while rising demand in China and India and other developing nations have kept supply/demand in balance. However, North American production kept climbing far beyond expert predictions, while slowing growth and/or recession in China, Japan, and Europe along with rising fuel efficiencies in the U.S. have led to lighter demand than expected. Thus, with traders and speculators no longer willing to keep the price artificially high due to geopolitical concerns, oil prices plummeted quickly, plunging much further than anyone thought possible. Sell-side analysts covering the Energy sector began slashing earnings projections once it became clear that lower prices were here to stay. However, keep in mind that asset classes tend to overshoot in both directions, and it is likely that oil prices will stabilize soon.

It is said that bull markets don’t die of old age but rather from euphoria (in which valuations get totally out of whack) or when the economy falls into recession. Neither euphoria nor recession is present or expected. And there seems to be nothing that can prevent solid economic growth in 2015.

However, there is no denying the cautious and often defensive behavior of investors—as the little voice in the back of their heads tells them that something just doesn’t feel right about it all. But this is healthy skepticism that is helping to prevent an unhealthy euphoria, a.k.a., “irrational exuberance.”

The CBOE Market Volatility Index (VIX), a.k.a. fear gauge, closed the year at 19.20, which is well above what might be termed the “threshold of complacency” (below 15). However, January has seen it breach the 20 threshold that suggests real fear developing, but still below the 30 threshold that suggests panic. It is indicating heightened volatility and some lingering investor worry going into the New Year. The 10-year U.S. Treasury yield closed at a modest 2.17% and has continued to fall to below 1.80% into the New Year, which indicates a continued flight to quality among global investors in spite of the Fed’s desire for a normalization of interest rates (to higher levels and a steeper yield curve). In addition, the U.S. dollar continues to strengthen while the euro sinks to its lowest level since 2006 due to speculation that the ECB will soon begin its own quantitative easing program by purchasing sovereign debt.
Given the near-zero yields on the high-quality sovereign debt elsewhere around the world, any increase in interest rates here at home will attract even more global capital into U.S. Treasuries, keeping lending rates down in the U.S. and helping boost the housing market. But it also further strengthens the dollar, making it harder for those countries with the weaker currencies to pay down their debt. While many are expecting the Fed to begin raising rates nominally sometime in the middle of 2015, the FOMC has taken a more dovish turn with its latest voter rotation, so some observers actually are speculating that we won’t see a boost in rates until 2016. But in any case, rates are not likely to rise rapidly.

Of course, persistently low bond yields also serve to support higher P/E multiples in equities. The forward P/E on the S&P 500 is only about 16, and the spread between the S&P 500 earnings yield and the 10-year Treasury yield is in excess of 4% versus the historical norm of about 3%. Also, robust stock buybacks are likely to continue given the ultra-low borrowing rates, which lower the denominator in EPS and offset the effect of new stock offerings and IPOs (which typically serves to increase the denominator and dilute the overall profit pool). So, the market’s forward valuation is still quite reasonable—particularly if corporate earnings continue to grow as expected.

With Q3 earnings season behind us and Q4 reports underway, sell-side analysts are anticipating earnings per share for S&P 500 companies to increase by +5.5% from Q4 2013. Total 2014 EPS growth is expected to come in at +7.5%, compared with +4.5% for 2013. This would be the best earnings growth since 2011’s +14.3%. Companies that generate real sales and earnings growth should outperform the speculative companies, particularly in a global economy characterized by subdued demand and pricing pressures.

Yes, the U.S. is the main driver of global growth, while Europe slogs along, Japan slides into recession, and the BRIC countries appear destined for their slowest pace since emerging from the Great Recession. This performance gap between the U.S. and the rest of the world shows just how insulated we are. Exports are just 14% of U.S. output, and big exporting countries like China, Germany, and Japan will be depending on us to help ignite their economies.

So, the New Year appears ready to continue the path set in 2014. The end of QE3 is allowing asset classes to perform according to their fundamentals rather than rewarding highly-correlated “risk-on/risk-off” behavior. Lower equity correlations, higher volatility, and a modest increase in U.S. equity prices are likely in 2015. Moreover, we expect a continuation of the general “flight to quality” in which the best companies with the most sustainable earnings growth and reasonable valuations get the most traction, while the speculative high-flyers (which often led risk-on rallies in the past) are avoided.

Yes, this sounds like rational investing. But this trend last year apparently made life difficult for a lot of portfolio managers. In fact, the Financial Times reported that only about 10% of stock pickers beat their benchmarks in 2014, and Morningstar reported that only about 13% of actively managed large-company mutual funds beat the S&P 500.

However, Sabrient’s annual Baker’s Dozen portfolio of 13 high-quality stock picks finished its sixth straight strong year (since January 2009 inception). Top performers last year included Southwest
Airlines (LUV), NXP Semiconductors NV (NXPI), and Actavis plc (ACT). And going into 2015, our forward-looking quantitative rankings once again reveal notable strength in airlines, semiconductors, and biopharma.

Looking ahead, 2015 looks promising for further gains in high-quality growth stocks amid generally cautious optimism about the U.S. economy and stock markets, but not without bouts of volatility.

STOCK SELECTION STRATEGY

In essence, Sabrient’s core selection methodology for the Baker’s Dozen combines a “quantamental” GARP approach (created and led by our founder, a former NASA “rocket scientist” who worked on the lunar landing project) with a forensic accounting “backstop” to help avoid the landmines.

“Quantamental” refers to a multifactor quantitative screen with a qualitative/fundamental overlay. “GARP” stands for Growth at a Reasonable Price, and “forensic accounting” refers to the evaluation of the quality and sustainability of a company’s reported earnings, its accrual accounting practices, and anomalous insider selling behavior by our subsidiary Gradient Analytics, an institutional equity research firm with specialized expertise in this field.

Sabrient acquired Gradient in 2011 to help us better evaluate a company’s filings and financial statements. Gradient has long served institutional portfolio managers and hedge funds, and never before has their unique expertise been available for supporting portfolios like this. Together we created a quantitative Earnings Quality Rank (EQR) that has proven valuable both as an alpha factor for quantitative models and as a fundamental screening and risk assessment tool.

EQR is an important factor in the multifactor GARP model to help down-weight stocks with the appearance of growth earnings growth trends that might not be sustainable due to their accounting practices. Other factors in the GARP model include historical and forecasted earnings growth and valuations, and the recent dynamics of Wall Street analysts’ estimates (i.e., the number of analysts who have revised up or down and magnitude of those revisions).

Our goal is to identify high-potential performers that still trade at attractive valuations, while reducing the risk of surprise meltdowns (due to accounting issues leading to earnings misses, restatements, or investigations) that offset the winners.

The portfolio selection process comprises these steps:

1) Quantitative GARP model narrows a large universe (essentially, the Russell 3000) down to a manageable group of candidates

2) Chief Market Strategist and former NASA scientist David Brown and the Sabrient team review news, fundamentals, charts, and pick a small group of finalists.
3) The Gradient analyst team looks under the hood at the finalists’ financial statement filings (10-Ks and 10-Qs) and suggests which ones should be dropped due to elevated risk.

4) David Brown picks the final sector/industry-diversified portfolio.

The quantitative ranking model favors stocks with the strongest forward valuations given their growth expectations. So, if broad economic growth is expected, the model tends to favor growing companies from the more economically-sensitive sectors, like Technology, Industrial, Consumer, and Materials (plus all-weather Healthcare). On the other hand, if a weakening or recessionary economy is expected, the analyst consensus earnings projections tend to be weaker for those companies from the economically-sensitive sectors, and the model tends to favor stable companies from the more defensive sectors.
BAKER’S DOZEN 2015 PORTFOLIO

The 2015 stocks are presented in alphabetical order. Whereas prior Baker’s Dozen portfolios have tended to be heavy with mid-caps (between $3.3-15.5 billion, as defined by First Trust), this year’s portfolio includes 10 large-caps, 2 mid-caps, and 1 small-cap. The portfolio performance will be tracked on the Baker’s Dozen website at http://bakersdozen.sabrient.com.

<table>
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<tr>
<th>TICKER</th>
<th>COMPANY NAME</th>
<th>SECTOR</th>
<th>INDUSTRY</th>
<th>MARKET CAP ($ B)</th>
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<td>Basic Materials</td>
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<td>Consumer Cyclical</td>
<td>Auto Parts</td>
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<td>Cognizant Technology Solutions Corporation</td>
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<td>Express Scripts Holding Company</td>
<td>Consumer Non Cyclical</td>
<td>Food &amp; Drug Retailing</td>
<td>52.31</td>
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<tr>
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Data Sources

Financial data: Reuters Knowledge Direct (RKD)
Wall Street earnings projections: Thomson Reuters I/B/E/S
Insider trading activity: Washington Services
Sector classifications: Thomson Reuters Business Classification (TRBC) system
StockCharts.com
NOTE: Consensus estimates may vary slightly among different sources.
STOCK DESCRIPTIONS AND RATIONALE

The following pages contain descriptions of each of the 13 stocks along with the rationale for selection. We’ve included price charts to give you a graphic view of each stock. Although price action wasn’t really a factor in the initial selection, we viewed the charts for the final cut to avoid stocks in freefall. We’ve also referenced the company website for your convenience in learning more about each company.

Two of this year’s selections are repeats from the 2014 portfolio: Express Scripts Holding Company (ESRX) and NXP Semiconductors NV (NXPI).

# # #

Alcoa, Inc. (AA)

Alcoa is a global leader in lightweight metals technology, engineering, and manufacturing. Alcoa produces bauxite, alumina and primary aluminum products and delivers value-add products made of titanium, nickel and aluminum. The products are used in aircraft, automobiles, commercial transportation, packaging, building and construction, oil and gas, defense, consumer electronics, and industrial applications. The company employs approximately 62,000 people in 30 countries. The company was founded in 1888 and is based in New York, New York.

Reasons for Selection

Alcoa had a history of underperformance before the new CEO Klaus Kleinfeld came on board in 2008. He basically turned the company from a dullard to a high achiever, with steady improvement in every division. How? He closed down inefficient factories and opened modern new ones, and got rid of unnecessary overhead. Alcoa tripled earnings from 33 cents in 2010 to 97 cents in 2014 and added 3% a year to the company’s margins since 2011. Alcoa now has highest margins in the industry at nearly 25%.

New growth will come from the alumina refinery in Saudi Arabia, built by the joint venture formed with Saudi Arabian Mining Company (Ma'aden) in 2013, which kicked off production last month; and from the acquisition in November 2014 of Firth Rixson, a global leader in aerospace jet engine components. With Kleinfeld at the wheel, the road trip for Alcoa looks very exciting.

Fundamentals

- Sector: Basic Materials
- Industry: Metals & Mining
- Trailing P/E ratio: N/A
- Forward P/E ratio: 15.4
- Dividend yield: 0.7%
- Expected earnings growth 2015: 77%
- Expected (5-year) long-term earnings growth: 15%+
- Among highest scores for upward earnings revisions by analysts
- Website: http://www.alcoa.com

American Airlines Group, Inc. (AAL)

American Airlines Group is the holding company for American Airlines and US Airways. Together with American Eagle and US Airways Express, the airlines operate an average of nearly 6,700 flights per day to 339 destinations in 54 countries from its hubs in Charlotte, Chicago, Dallas/Fort Worth, Los Angeles, Miami, New York, Philadelphia, Phoenix and Washington, D.C. A founding member of the oneWorld® alliance, American Airlines and its members and members-elect, serve 981 destinations with 14,244 daily flights to 151 countries. The original American Airlines was founded in 1934; the company merged with US Airways in 2013. The company was formerly known as AMR Corporation and changed its name to American Airlines Group Inc. in December 2013 with the closing of the merger between American Airlines and US Airways Group. The company is headquartered in Fort Worth, Texas.
Reasons for Selection

American Airlines declared bankruptcy in 2011 to solve some serious problems with unions and pension liabilities. Three years later, it has cleaned up its balance sheet and emerged as a strong, robust company. In the last three years, revenues have grown approximately 70% to over $35 billion. Earnings have grown from a loss of $0.65 to a gain of $4.06 for the trailing 12 months, and cash flow from operations has grown from $743 million to $1.064 billion, putting AAL in the top ten percent of all airlines for cash flow growth. The company has a lot of debt, but that is offset by the cash flow. AAL has an extremely low valuation, with a forward P/E of 5.4, which is one of the lowest of any Baker’s Dozen stocks.

Going forward, an environment of low and falling oil prices helps all airlines, although in many cases that has been offset by hedging oil futures. In American’s case, it is the potential for air travel to Cuba that is a cause for excitement. Travel restrictions will likely continue to relax and eventually disappear, and American is one of the two airlines that have permits for routes to Cuba. (The other is JetBlue.)

American Airlines has a projected earnings growth rate of 88% in 2015 with a forward P/E ratio of 5.8, which makes those earnings very cheap. Its revenue growth for the trailing three years is 27%, which puts it in the top ten percent of all airlines for revenue growth. AAL has good Bear and Bull scores, which means it should do well in a rising or falling market.

(Note: Sabrient’s Bull and Bear scores measure relative performance on particularly strong or weak market days. High Bull score indicates relative outperformance when the market is strong, while a high Bear score indicates a tendency to hold up relatively well when the market is weak.)

Fundamentals

- Sector: Industrials
- Industry: Major Airlines
- Trailing P/E ratio: 98
- Forward P/E ratio: 5.8
- Dividend yield: 0.8%
- Expected earnings growth 2015: 88%
- Expected (5-year) long-term earnings growth: 50%+
- Upward revisions of EPS estimates by 75% of analysts in last 30 days
- Website: http://www.aa.com
Cummins, Inc. (CMI)

Cummins designs, manufactures, distributes and services diesel and natural gas engines and related technologies, including fuel systems, controls, air handling, filtration, emission solutions and electrical power generation systems. Cummins currently employs approximately 48,000 people worldwide and serves customers in approximately 190 countries and territories through a network of approximately 600 company-owned and independent distributor locations and approximately 6,800 dealer locations. Cummins earned $1.48 billion on sales of $17.3 billion in 2013. The company was formed in 1919 is headquartered in Columbus, Indiana.

Reasons for Selection

Cummins is one of the more conservative, efficient, and well managed companies in the Baker's Dozen portfolio, winning many awards for its management. It is in the top 5% of all companies in its sector for cash flow, in the top 3% for free cash flow, and it has very low debt. CMI’s long-term growth is about 14% per year, not eye-popping, to be sure, but that comes with a forward P/E of 14.6. (Most stocks currently have a forward P/E of about 2 to 3 points above their long-term growth rates.) All this makes CMI a low-risk investment for the portfolio, yet one with the potential for a handsome return.
Fundamentals

- Sector: Consumer Cyclicals
- Industry: Diversified Machinery
- Trailing P/E ratio: 15.9
- Forward P/E ratio: 13
- Dividend yield: 2.2%
- Low debt-to-equity ratio
- Good margin growth
- Excellent cash flow and free cash flow
- Expected earnings growth 2015: 20%
- Expected (5-year) long-term earnings growth: 13.8%
- High score for upward earnings revisions by analysts
- Website: www.cummins.com

Price chart for CMI as of January 9, 2011 (Source: StockChart.com)

# # #
Cognizant Technology Solutions Corporation (CTSH)

Cognizant is a leading provider of information technology, consulting, and business process outsourcing services. It serves various industries, including banking and insurance; healthcare and life sciences; manufacturing and logistics; retail, travel, and hospitality; consumer goods; communications; information, media, and entertainment; and technology. The company markets and sells its services through professional staff, senior management, and direct sales personnel. Cognizant is a member of the Nasdaq-100, the S&P 500, the Forbes Global 2000, and the Fortune 500 and is ranked among the top performing and fastest growing companies in the world. The company was founded in 1998 and is headquartered in Teaneck, New Jersey.

Reasons for Selection
A highly respected software producer, Cognizant is adding increased emphasis to its healthcare solutions and is considered to be very competitive in this area. We’re paying almost 19x earnings for the stock, but we’re getting a 17% long-term growth rate, which we believe will accelerate because of the potential for their healthcare product. Cognizant has among the most conservative accounting of any company, with a Sabrient/Gradient EQR rank of 5, the highest score possible.

Fundamentals

- Sector: Technology
- Industry: Software IT Services
- Trailing P/E ratio: 22.3
- Forward P/E ratio: 18.6
- No debt
- Expected earnings growth 2015: 14%
- Expected long-term (5-year) earnings growth: 18%
- Highest score in portfolio for upward earnings revisions by analysts
- Website: www.cognizant.com
Express Scripts Holding Company (ESRX)

Express Scripts provides integrated pharmacy benefit management (PBM) services, including network-pharmacy claims processing, home delivery, specialty benefit management, benefit-design consultation, drug-utilization review, formulary management, and medical and drug data analysis services. The company also distributes a full range of biopharmaceutical products and provides extensive cost-management and patient-care. The company operates primarily in the United States and Canada. Formerly known as Aristotle Holding, Inc., it changed its name to Express Scripts Holding Company in April 2012. The Company was founded in 1986 and is headquartered in St. Louis, Missouri.

Reasons for Selection

Express Scripts has been in the last two Baker’s Dozen portfolios. We believed the company was best-positioned to benefit from the roll-out of ObamaCare, and still is. So far, ESRX lived up to our expectations, gaining 26.33% in 2013 and +16.59% in 2014. The company has nearly tripled revenues in the last three years (from $40M to $100M). Last year’s legal issues in several states slowed the stock’s price growth Most if not all of these issues have been cleared and the company’s strong growth has resumed.
As the major supplier of online drug ordering, the company has solved the nagging problem of “what happens if I don’t get my drugs in time.” The company made a deal with Walgreen’s, which is a major local drugstore chain and hence provides emergency supplies if ESRX deliveries are interrupted.

**Fundamentals**

- Sector: Consumer Non-Cyclicals
- Industry: Retail-Drugs
- Trailing P/E ratio: 31
- Forward P/E ratio: 12.9
- $553 M leveraged free cash flow
- Expected earnings growth 2015: 154%
- Expected (5-year) long-term earnings growth: 36%
- Website: www.express-scripts.com
FedEx Corporation (FDX)

FedEx provides customers and businesses worldwide with a broad portfolio of transportation, e-commerce and business services. With annual revenues of $46 billion, the company offers integrated business applications through operating companies competing collectively and managed collaboratively, under the FedEx brand. FedEx has more than 300,000 employees and is consistently ranked among the world’s most admired and trusted employers. The company was founded in 1971 and is based in Memphis, Tennessee.

Reasons for Selection
FedEx is a solid company, with a 25% projected earnings growth for 2015, a 20% long-term growth rate, and a forward P/E of 17. All good reasons to select it for the portfolio. But it also made the cut to help the portfolio take advantage of low oil prices. Undoubtedly, prices will go back up at some point, but we believe they will go back up slowly. Meanwhile, FedEx will benefit just as airlines will, but FedEx doesn’t have the same exposure to hedging contracts as the major airlines (AAL being an exception). In addition, FedEx scored very well on the Sabrient Bear Score, which measures how well a company will do in a down market. Again, good growth and good protection for the portfolio.

Fundamentals
- Sector: Industrials
- Industry: Air Delivery & Freight Services
- Trailing P/E ratio: 23
- Forward P/E ratio: 17.3
- Cash reserves: $2.3 billion
- Free cash flow: $1.3 billion
- Low debt
- Expected earnings growth 2015: 33%
- Expected long-term earnings growth (5 year): 14%+
- Website: www.fedex.com
Gilead Sciences, Inc. (GILD)

Gilead Sciences is a research-based biopharmaceutical company that discovers, develops, and commercializes medicines for the treatment of life threatening diseases in North America, South America, Europe, and the Asia-Pacific. Among its products are Stribild, Complera/Eviplera, Atripla, and others for the treatment of human immunodeficiency virus (HIV) infection in adults; Sovaldi, Viread, and Hepsera products for the treatment of liver diseases such as chronic hepatitis B virus infection and chronic hepatitis C virus infection; Letairis, an endothelin; Letairis, an endothelin receptor antagonist for the treatment of pulmonary arterial hypertension; Ranexa for the treatment of chronic angina; Cayston, an inhaled antibiotic for the treatment of respiratory systems in cystic fibrosis patients; and Tamiflu, an oral antiviral capsule for the treatment and prevention of influenza A and B. One of the world’s largest biopharmaceutical companies, Gilead has operations in more than 30 countries and employs more than 7,000 people. Gilead was founded in 1987 and is headquartered in Foster City, California.
Reasons for Selection

Gilead is one of the most respected biotech companies in the world. They virtually own the HIV drug market, but their stock took a hit recently when a major drug distributor (ESRX) chose a competitive hepatitis C drug for its 25 million subscribers, over Gilead’s Harvoni regimen. The stock fell from $108.45 on December 19, the day of the announcement, to $89.45 on December 23. But Gilead is a favorite of doctors who write the prescriptions, due to Harvoni’s effectiveness and lower side effects, and Gilead will likely continue to do quite well with this drug even though the stock was already discounted. GILD is a highly innovative company, run by scientifically-oriented people. It has released blockbuster after blockbuster in the past years. Its projected earnings growth rate is over 50% for 2015 and 2016, and its long-term growth rate is about 25% per year. Yet its forward P/E is only 10. All in all, we think the market overreacted to the loss of the hepatitis C contract and gave us a good entry point for this Baker’s Dozen selection.

Fundamentals

- Sector: Healthcare
- Industry: Pharmaceuticals
- Trailing P/E ratio: 18.6
- Forward P/E ratio: 10.75
- Good cash flow and free cash flow
- Very low debt
- Expected earnings growth 2015: $2.04 to $7.86
- Expected long-term earnings growth (5 years): 35%
- Website: www.gilead.com

Price chart for GILD as of January 9, 2014  (Source: StockChart.com)

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NXP Semiconductors NV (NXPI)

NXP provides mixed signal and standard product solutions for radio frequency (RF), analog, power management, interface, security, and digital processing products worldwide. The company is a leading innovator in the automotive, identification and mobile industries, and in application areas including wireless infrastructure, lighting, healthcare, industrial, consumer tech and computing. The company has operations in more than 25 countries. It was founded in 2006 and is headquartered in Eindhoven, The Netherlands.

Reasons for Selection
NXP has appeared the last two Baker’s Dozen portfolios, gaining 64.04% in 2013 and 77.92% in 2014. We think it has significant growth left. The company is considered by many to be the smartest chip manufacturer out there. It is a leader in building chips for GPS manufacturers and is #1 in supplying chips for the security industry. But the most exciting development for NXP is its contract to supply its NFC technology in the Apple iPhone 6’s mobile payment system. NFC is a short-range, wireless communications technology that allows you to wave your phone against a reader to make a purchase, instead of swiping a credit card. NXP’s average annual earnings growth for the past five years has been 36%; its projected growth rate is 20% per year for the next five; and these earnings can be purchased for 14.4 times forward earnings. The company is also in the top ten percent of all companies for free cash flow growth.

Fundamentals
- Sector: Technology
- Industry: Semiconductors - Broadline
- Trailing P/E ratio: 39
- Forward P/E ratio: 14.4
- Good free cash flow
- Expected earnings growth 2015: 39%
- Expected long-term (5-years) earnings growth: 22%
- Website: www.nxp.com
U.S. Silica Holdings, Inc. (SLCA)

U.S. Silica Holdings is a leading producer of industrial minerals, including sand proppants, whole grain silica, ground silica, fine ground silica, calcined kaolin clay and aplite clay. In addition to offering over 250 products in these categories, the company also operates as a research and development specialist for customized products and solutions utilizing the same raw materials. U.S. Silica serves a wide variety of industries and applications, including oil and gas, glass, chemicals, foundry, building products, fillers and extenders, recreation, industrial filtration and treatment, and testing and analysis. The company currently operates nine industrial sand production plants and seven oil and gas sand production plants. The company, formerly known as GGC USS Holdings, Inc., is headquartered in Frederick, Maryland and also has offices located in Chicago, Houston, and Shanghai, China.

Reasons for Selection

We have three reasons for including SLCA in the portfolio. (1) Over the past two months, SLCA stock fell from $71 in early September to $23 in mid-December due to falling oil prices. During the past month officers and directors bought nearly $1 million worth of SLCA stock on the open market.
(2) Despite this drop in stock price, SLCA is relatively insulated from oil prices because 40 percent of the sand they produce is also used in auto glass. On January 5 Moody’s issued an announcement entitled “Proppant companies earnings at risk from drop in oil prices.” The report stated that U.S. Silica is one of two companies “best positioned to weather softening demand since they sell into industrial, specialty and recreation end markets in addition to oil and gas end markets . . . [and] also have more destination terminal facilities at the basins where oil is drilled than competitors.” (Here is the full announcement.)

(3) A number of reports from oil producers have said experiments have shown that if they double the amount of sand used in fracking they can increase oil yield and reduce the fracking cost-per-barrel. This could result in a doubling or tripling of SLCA’s sand sales.

**Fundamentals**

- Sector: Basic Materials
- Industry: Industrial Metals & Mining
- Trailing P/E ratio: 13.2
- Forward P/E ratio: 9.4
- Expected earnings growth 2015: 66%
- Expected long-term (5-year) earnings growth: 30 – 40%
- Website: www.ussilica.com

Price chart for SLCA as of January 9, 2014 (Source: StockChart.com)

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Taiwan Semiconductor Manufacturing Company Ltd. (TSM)

Taiwan Semiconductor is the world’s largest dedicated semiconductor foundry, providing the industry’s leading process technology and the foundry segment’s largest portfolio of process-proven libraries, IPs, design tools and reference flows. TSMC serves about 440 customers and manufactures more than 8,600 products for various applications covering a variety of computer, communications and consumer electronics market segments. TSMC is also investing in lighting and solar energy related-industries. The company was founded in 1987 and is headquartered in the Hsinchu Science Park, Taiwan. It has account management and engineering service offices in China, Europe, India, Japan, North America, and, South Korea.

Reasons for Selection

TSM is one of the largest smart-chip manufacturers in the world and is generally considered one of the leaders. It is a low-cost manufacturer and competes largely on price. The ADR, which is what we buy in the U.S., has revenues of $21 billion. (The company’s total revenue is well over $100 billion.) TSM has low debt, $9.2 billion in cash (cash flow has grown 21% in last three years), and a 2015 projected earnings growth rate of 21%. With a forward P/E of 11.9, we’re getting twice the growth of the forward P/E. Thirty-three percent of analysts following the company have raised their estimates in the past 30 days. We have had TSM in other UIT portfolios and it has performed very well.

Fundamentals

- Sector: Technology
- Industry: Semiconductors - Integrated Circuits
- Trailing P/E ratio: 16.7
- Forward P/E ratio: 11.9
- Dividend yield: 2.3%
- Expected earnings growth 2015: 21%
- Expected long-term (5-year) growth: 15%
- Among highest scores for upward earnings revisions by analysts
- Website: www.tsmcssl.com
Tyson Foods, Inc. (TSN)

Tyson Foods is one of the world’s largest producers of chicken, beef, pork and prepared foods that include brands such as Tyson®, Jimmy Dean®, Hillshire Farm®, Sara Lee® frozen bakery, Ball Park®, Wright®, Aidells® and State Fair®. Tyson Foods provides a wide variety of protein-based and prepared foods products to retailers and foodservice operators through the U.S. as well as about 130 countries. The company has approximately 124,000 employees at more than 400 facilities and offices in the U.S. and around the world. Tyson Foods was founded in 1935 and is headquartered in Springdale, Arkansas.

Reasons for Selection

Tyson has long been a strong, consistent performer, with the stock price growing from about $12 to $40 share over the past five years. Earnings are projected to grow 19% per year over the next five. With 35% cash flow growth for the past three years, Tyson is one of the top five stocks in the 2015 portfolio for cash flow growth. Tyson acquired Hillshire Brands Company last year, which is a game-changer for the company. Hillshire provides a major diversification of TSN’s product line which has been mainly chicken and beef. (Two of the well-known brands acquired in the Hillshire acquisition are Jimmy Dean and Sara Lee.) With this acquisition, TSN should see an increase in its sales of prepared foods, which now makes up only 10% of sales.
Fundamentals

- Sector: Consumer Noncyclicals
- Industry: Food Products
- Trailing P/E ratio: 16.9
- Forward P/E ratio: 11.4
- Dividend yield: 1%
- Good cash flow
- Expected earnings growth 2015: 16%
- Expected long-term (5-year) earnings growth: 19%
- Website: http://www.tyson.com

Price chart for TSN as of January 9, 2014  (Source: StockChart.com)
Tesoro Corporation. (TSO)

Tesoro Corporation is an independent refiner and marketer of petroleum products. Through its subsidiaries, Tesoro operates six refineries in the western United States with a combined capacity of over 850,000 barrels per day and has ownership in a logistics business which includes a 33% interest in Tesoro Logistics LP, which has a significant presence in gathering, transporting, storing and distributing the crude and other feedstocks refined by Tesoro. Tesoro’s retail-marketing system includes over 2,200 retail stations under the ARCO®, Shell®, Exxon®, Mobil®, USA Gasoline(TM) and Tesoro® brands. Tesoro is a Fortune 100 company. The company was founded in 1939 and is headquartered in San Antonio, Texas.

Reasons for Selection

Tesoro, one of the larger independent refiners, has been a consistent performer. The stock has gone from $12 in January 2010 to $74 at the end of December 2014, which supports our belief that refiners have less exposure than marketers to falling oil prices. Case in point: When oil prices began their slide last year, dropping from $83.45 on June 23 (as represented by the SPDR Oil & Gas ETF – XOP), to a low of $42.75 on December 15—a whopping 49% loss—TSO gained 21% during the same period ($62.19 to $75.45). This is partly because refiners’ profits are based on the spread between heavy oil and light oil (referred to as the “crack spread). So we think TSO is a good pick despite falling oil prices. The fact that the stock has dropped back to about $67 in the past two weeks gives us a good entry price.

As for the numbers, TSO’s earnings more than doubled in 2014, $from $2.81 to $6.81, and its projected earnings growth rate for 2015 is 142% percent. It has a cash flow growth rate of 34 percent, the best in the 2015 portfolio. Within the Energy sector, TSO is in the top two percent of free cash flow. A dividend yield of 1.7% is frosting on a very tasty cake.

Fundamentals

- Sector: Energy
- Industry: Oil & Gas Refining & Marketing
- Trailing P/E ratio: 13
- Forward P/E ratio: 10.6
- Dividend yield: 1.7%
- Cash flow growth rate: 34%
- Expected earnings growth 2015: 142%
- Expected long-term earnings growth (5 years): 28%
- Website: www.tsocorp.com
Valeant Pharmaceuticals International, Inc. (VRX)

Valeant Pharmaceuticals develops, manufactures, and markets pharmaceuticals, over-the-counter (OTC) products, and medical devices in the areas of eye health, dermatology, and neurology therapeutic classes worldwide. Among its pharmaceutical products are Solodyn, an oral antibiotic that treats pimples; Wellbutrin XL, a formulation used for the treatment of major depressive disorder in adults; Lotemax gel for post-operative inflammation and pain; Arestin, a subgingival sustained-release antibiotic; and Prolensa, a non-steroidal anti-inflammatory ophthalmic solution. Its OTC products include PreserVision and Ocuvite, eye vitamin and mineral supplements; SofLens and PureVision contact lenses; Restylane, an injectable implant dermal fillers; and ophthalmic surgical products, such as Akreos and Crystalens. Formerly known as Biovail Corporation, the company changed its name to Valeant Pharmaceuticals International, Inc. in 2010. Valeant was founded in 1983 and is headquartered in Laval, Canada.

Reasons for Selection
VRX has been a consistent growth player in the pharmaceuticals industry for the past 30 years. During 2014 the company was in a contest with Actavis (ACT) to buy Allergan (AGN), and finally refused to match ACT’s final bid. One of the reasons we consider VRX a good buy is that it is no
longer wasting resources chasing after Allergen, which, with the comparable size of the two companies, was a case of the fish chasing the whale. Valeant can now settle down and execute its business.

And it’s a good business. The company has grown 60% per year for the past five years. It has a 33% projected earnings growth rate for 2015, and a long-term growth rate of 23% per year over the next 5 years. In addition, the company has good cash flow, as well as good free cash flow, and a forward P/E of 15, which makes the stock undervalued. In November 2014 the company announced a $2 billion stock repurchase program.

VRX’s Bear Score is the best in the portfolio, offering protection should 2015 become a down market.

Fundamentals

- Sector: Healthcare
- Industry: Pharmaceuticals
- Trailing P/E ratio: 19
- Forward P/E ratio: 15
- Expected earnings growth 2015: 33%
- Expected long-term (5-year) earnings growth: 23%
- Among highest scores for upward earnings revisions by analysts
- Website: www.valeant.com

Price chart for VRX as of January 9, 2014 (Source: StockChart.com)

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THE BAKER’S DOZEN TEAM

Leading the research team in the stock selection for the Baker’s Dozen 2015 was Chairman and Chief Market Strategist David Brown. The research team included Nick Gibbons, CFE, director of research for Gradient Analytics, and analysts Nicholas Yee, CPA; Chad Potter, CFA; Byron Macleod, CFA, Mike Blasi, CFA; Dominic Finney, Daniel Stone, and Robert Grueneberg. Also providing valuable input were President Danny Vickers, Deputy Chief Market Strategist Vinh Tran, Chief Financial Officer Ray Chiarello, and Senior Vice President Scott Martindale. Assisting in the writing and production of the Baker’s Dozen report and maintenance of the Baker’s Dozen website were Scott Martindale, Kassandra Bentley, Jeffrey Brown, Matt Bailey, and Rick Hoselton. You can read their bios at www.Sabrient.com and www.GradientAnalytics.com.

COMPANY OVERVIEW

Sabrient Systems is an independent equity research firm based in Santa Barbara, CA. The firm is led by former NASA scientist David Brown, who worked on the lunar landing project and has been developing computer models for over 40 years. We offer fundamentals-based quantitative (and “quantamental”) equity research, rankings, tools, strategies, and commentaries to portfolio managers, hedge funds, sponsors of investment products, and broker/dealers. For example, we have been enjoying a great deal of success with published long portfolios, many of which are offered as packaged investment products (ETFs and UITs) through institutional partners like First Trust, Guggenheim, BlackRock, Direxion, and BMO. Website: http://www.Sabrient.com

In 2011, we acquired Gradient Analytics, an independent forensic accounting research firm based in Scottsdale, AZ. The research team of CFAs, CPAs, and CFEs (Certified Fraud Examiner) publishes in-depth reports that analyze earnings quality and anomalous insider behavior for selected U.S. and International companies, and these reports are distributed by subscription exclusively to a clientele of institutional portfolio managers and hedge funds. Although the majority of Gradient’s clients use our alerts for generating short ideas and for helping to develop a strong short thesis around those ideas, we also help clients avoid big losers to enhance overall performance of their long portfolios. Moreover, Gradient’s expertise has proven invaluable in the final review process for Sabrient’s long portfolios. Website: http://www.GradientAnalytics.com

Sabrient’s models rely heavily on historical trends and forward projections in a company’s earnings, so we felt it was important to acquire a firm that is adept at looking “under the hood” at a 10-K, 10-Q and a company’s accounting practices. Since acquiring Gradient, Sabrient’s already-strong performance has further improved by improving our ability to avoid the stocks that pose a higher risk of meltdowns. We strongly believe that avoiding losers is the best path toward strong overall performance of a long portfolio, and being able to look “under the hood” from an earnings quality perspective is the best way to do that – i.e., proven quantitative models with a forensic accounting “backstop.”
FOR FURTHER INFORMATION


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