

The Dragon Fund Analyst Team FIN 342
Prof. Daniel Dorn



Drexel University The Dragon Fund

**Annual Update
December 31, 2014**

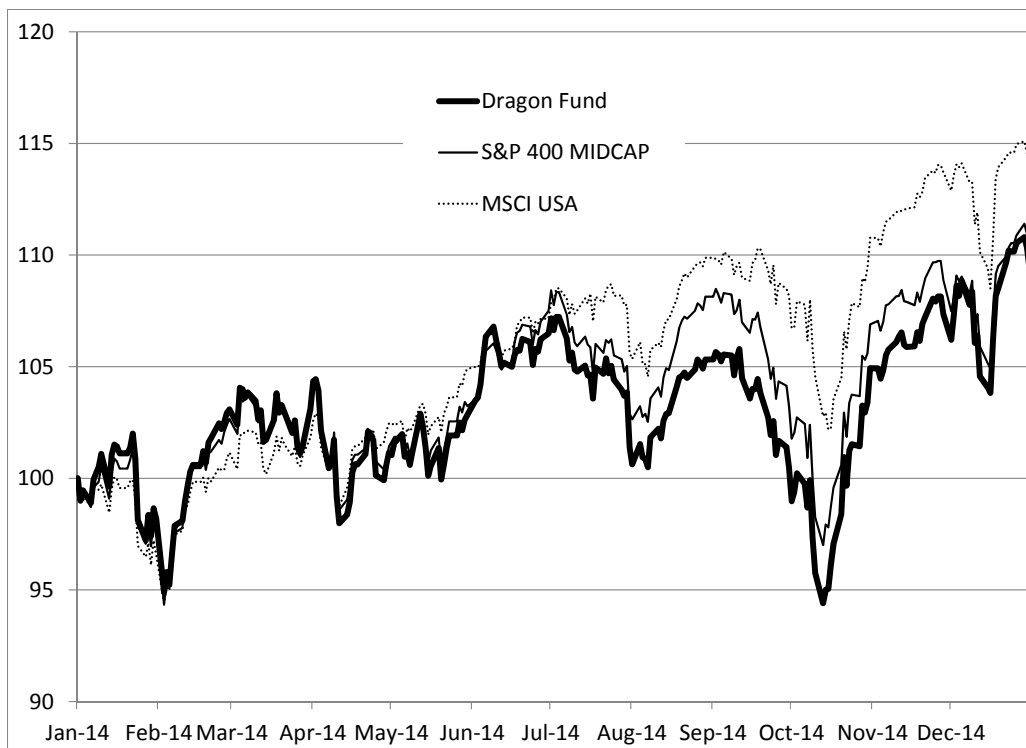


The Dragon Fund

The fund, which has been managed by Drexel undergraduates since the fall of 2007, seeks capital appreciation by primarily investing in U.S. stocks with a market capitalization of between \$500 million and \$10 billion. The student analysts apply a combination of sector analysis and discounted cash flow as well as multiples valuation techniques to identify attractive investment opportunities. The fund was started with \$250,000 and received additional infusions of \$100,000 in March 2011 and \$450,000 in June 2013. As of the end of December 2014, the fund's total assets stood at \$1.353 million.

How did the fund perform in 2014?

The Dragon Fund returned 9.3% for the year whereas its benchmark, the S&P 400, returned 9.8%. 2014 was a relatively tough year for small caps: the S&P 600 appreciated only 5.8%, lagging substantially behind the broader market; the MSCI USA returned 13.4% for the year. 2014 was also a tough year for stock pickers. According to Morningstar, just 20% of U.S. equity fund managers beat their benchmarks (<http://online.barrons.com/articles/return-of-the-mutual-fund-stockpickers-1420870199>).



Sources: Dragon Fund account reports provided by US Bank, Datastream

Performance analysis

Since the Dragon Fund weights were largely aligned with the benchmark weights during 2014, most of the performance differential relative to the benchmark for a given sector is due to selection effects as opposed to over- or underweighting that sector.

The bulk of the underperformance came from poor security selection in the two sectors that experienced the highest returns in 2014: Healthcare and Consumer Staples. In both cases, the underperformance was partly due to the extremely good performance of a benchmark holding that was not part of the Dragon Fund. In the case of Consumer Staples, it was the high-profile acquisition of Hillshire Farms by Tyson Foods driving the broader sector upward. The poor performance in Healthcare was mainly due to the selling of United Therapeutics UTHR three weeks before a U.S. court unexpectedly ruled in favor of the company and against Sandoz regarding a patent for their main drug; that day, UTHR soared 30%.

On the positive side, the IT sector contributed attractive returns to the Dragon Fund, while also outperforming the benchmark S&P 400 IT stocks. This was due to strong performance in twelve of the thirteen IT stocks held. In particular, VeriFone Systems Inc. (PAY) and NVIDIA Corporation (NVDA) performed well, returning 38.7% and 27.4%, respectively. Energy outperformed as well, largely due to Siemens's acquisition of Dresser-Rand (DRC).

Attribution analysis, January 2014-December 2014

DF 2014 Sector	Dragon Fund		ishares S&P400		Performance effects [%]			
	Weight	Return	Weight	Return	Allocation	Selection	Interaction	Total
Cash	0.8%	0.0%	0.0%	0.0%	-0.05	--	--	-0.05
Consumer Discretionary	14.9%	8.3%	13.8%	11.0%	-0.02	-0.20	-0.10	-0.33
Consumer Staples	2.8%	8.1%	3.2%	25.5%	-0.14	-0.54	0.12	-0.56
Energy	4.2%	-11.6%	4.0%	-23.8%	-0.16	0.74	0.04	0.62
Financials	23.0%	16.8%	23.3%	15.4%	-0.00	0.30	-0.08	0.22
Health Care	10.3%	12.8%	9.9%	22.7%	0.04	-0.60	-0.14	-0.70
Industrials	15.8%	-1.7%	15.3%	1.9%	-0.05	-0.67	0.00	-0.72
Information Technology	18.0%	19.8%	17.3%	7.3%	-0.00	1.86	0.04	1.90
Materials	6.7%	2.1%	7.3%	4.4%	0.04	-0.17	-0.02	-0.15
Utilities	3.8%	15.4%	4.9%	18.9%	-0.09	-0.14	0.02	-0.21
Total		9.35%		9.23%	-0.47	0.65	-0.05	0.12

Note that the above table shows the Dragon Fund outperforming its benchmark for 2014. This is due to us having to use the ishares S&P 400 midcap as opposed to the actual S&P 400 index (which requires an expensive additional subscription). Also, the ishares S&P 400 returns available through FactSet are based on month-end holdings and will thus differ slightly from the actual ishares S&P 400 returns as reported by ishares.

Also note that the attribution analysis is based on a FactSet model portfolio of the Dragon Fund which is updated on a quarterly basis. Therefore, the returns shown can slightly differ from the actual fund returns. This difference is slight: 9.31% actual return versus 9.35% FactSet model portfolio return. “Weight” refers to the portfolio allocation as of December 31, 2014.

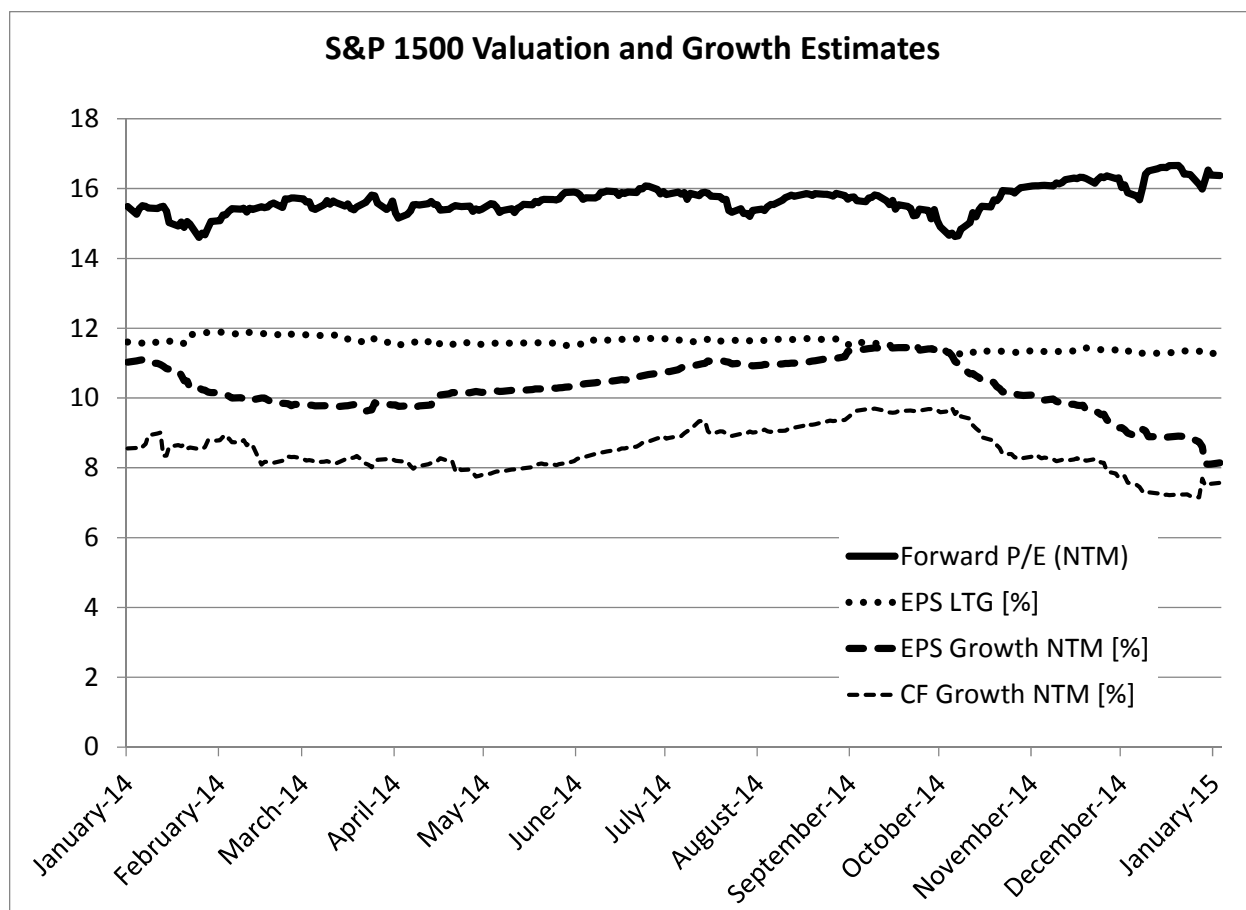
Attribution analysis, September 2014-December 2014

DF 2014 Q4 Sector	Dragon Fund		ishares S&P400		Performance effects [%]			
	Weight	Return	Weight	Return	Allocation	Selection	Interaction	Total
Cash	1%	0.0%	0%	0.0%	-0.02	--	--	-0.02
Consumer Discretionary	15%	16.9%	14%	10.2%	0.03	0.86	0.05	0.94
Consumer Staples	3%	10.6%	3%	10.3%	-0.02	0.01	-0.00	-0.02
Energy	4%	-15.8%	4%	-23.7%	-0.11	0.44	0.02	0.35
Financials	23%	13.3%	23%	10.1%	-0.01	0.70	-0.03	0.65
Health Care	10%	15.9%	10%	11.8%	0.02	0.44	-0.03	0.42
Industrials	16%	1.4%	15%	2.3%	-0.06	-0.15	-0.02	-0.23
Information Technology	18%	10.1%	18%	9.5%	0.00	0.13	-0.01	0.12
Materials	7%	3.6%	7%	2.9%	0.02	0.04	-0.01	0.06
Utilities	4%	10.2%	5%	12.1%	-0.05	-0.10	0.02	-0.13
Total		8.81%		6.62%	-0.32	2.40	0.12	2.20

Market review and outlook

In last quarter’s market outlook, we stated that the U.S. economy is on track to grow. Given the fourth quarter numbers, especially the strong nonfarm payroll growth and the 5% GDP growth in the third quarter, this turned out to be an understatement. Lower energy prices obviously hurt Energy stocks, especially energy equipment and services, but benefitted the Consumer Discretionary sector. Going forward, our outlook regarding the U.S. economy remains fairly optimistic.

We remain less optimistic about the stock market. The strong fourth quarter 2014 during which the broader U.S. stock market appreciated 5% came as a bit of a surprise. In last quarter’s report, we pointed out elevated valuations and flattening long-term growth expectations. As can be seen from the chart below, this picture has worsened: valuations have climbed even higher while long-term earnings growth expectations have been flat and short-term growth expectations for both earnings and cash flows have been revised substantially downward. In part, the performance of the U.S. stock market was due to the interest rate environment – the 10-year yield managed to decline to its lowest level in 2014 during the fourth quarter as opposed to rising as predicted by many pundits. Also, given global growth worries, U.S. stocks may look good relative to their peers elsewhere. However, these good looks come at a fairly steep price/valuation multiple.



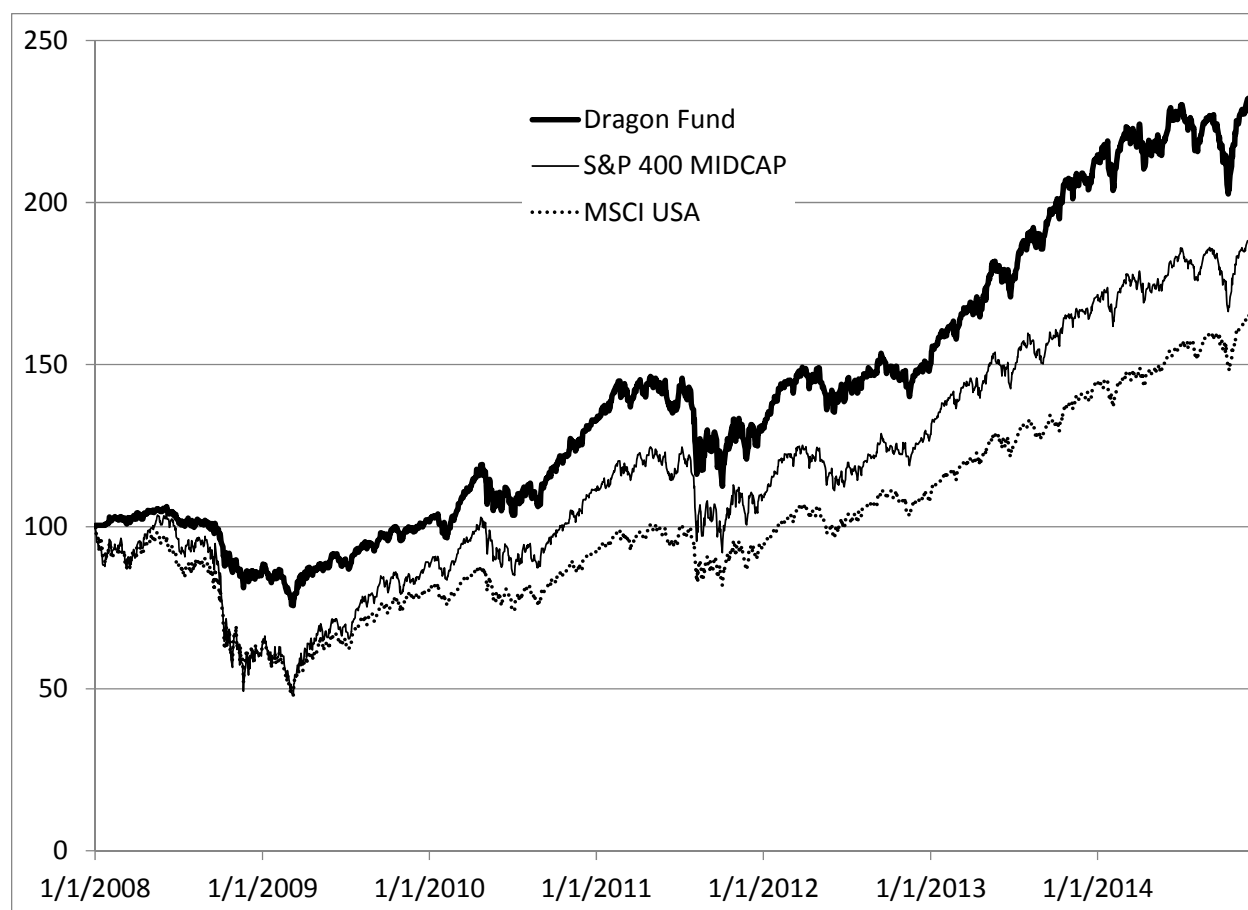
Historical risk and return profile

The fund’s past return and risk profile continues to compare favorably to those of the S&P 400 benchmark as well as the broader U.S. market.

Portfolio returns	2008	2009	2010	2011	2012	2013	2014	3-yr avg	5-yr avg	Since inception
Dragon Fund	-12.5%	16.1%	30.7%	-1.7%	15.4%	42.7%	9.3%	21.6%	18.3%	13.0%
S&P 400	-36.2%	37.4%	26.6%	-1.7%	17.9%	33.5%	9.8%	20.0%	16.5%	9.5%
MSCI USA	-37.1%	27.1%	15.4%	2.0%	16.1%	32.6%	13.4%	20.4%	15.5%	7.4%

Sources: Dragon Fund account reports provided by US Bank, Datastream, FactSet

\$100 invested at the fund’s inception would have grown to \$235 by the end of 2014. An investment in the S&P 400 index of midcap stocks or the MSCI USA index of the broad-based U.S. stock market would have yielded \$188 and \$164, respectively.



The fund’s total return volatility and beta, based on weekly returns in 2014, were 14.6% and 1.14, respectively, slightly above the corresponding values for the S&P 400. In part, this can be explained by the Dragon Fund being underweight defensive sectors such as Consumer Staples and Utilities for much of 2014. The fund’s tracking error, calculated as the annualized standard deviation of weekly fund returns in excess of the S&P 400, declined in 2014 relative to previous years which can be attributed to the close alignment of sector weights with the benchmark. The tracking error is in line with other actively managed mid-cap funds.

Portfolio risk	2008	2009	2010	2011	2012	2013	2014
Dragon Fund volatility	14%	15%	18%	23%	12%	12%	15%
S&P 400 volatility	41%	30%	21%	26%	13%	12%	13%
MSCI USA volatility	35%	25%	17%	22%	11%	10%	12%
Dragon Fund tracking error (relative to S&P 400)			4.8%	4.6%	3.7%	3.6%	3.1%
Dragon Fund beta	0.38	0.55	1.00	1.05	1.01	1.02	1.14
S&P 400 beta	1.12	1.16	1.15	1.17	1.12	1.11	1.04

Sources: Dragon Fund account reports provided by US Bank, Datastream, FactSet

Turnover and costs

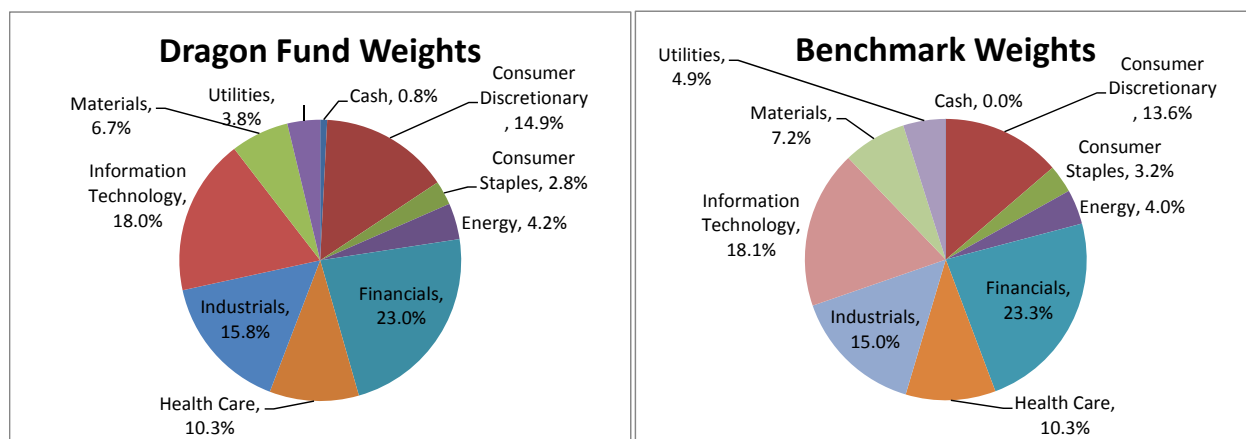
Dragon Fund portfolio turnover and the associated total costs have consistently been below those of actively managed mid-cap funds.

Turnover	2008	2009	2010	2011	2012	2013	2014
Dragon Fund	6%	9%	76%	25%	41%	33%	40%
Purchases	\$155,842	\$40,241	\$292,691	\$198,830	\$202,734	\$749,760	\$526,765
Sales	\$6,227	\$12,528	\$204,383	\$102,942	\$183,613	\$278,003	\$505,989
Average portfolio	\$99,742	\$135,668	\$267,739	\$405,260	\$445,451	\$845,938	\$1,268,732
Trading costs	\$158	\$66	\$545	\$270	\$363	\$718	\$707
Trading costs [%]	0.2%	0.0%	0.2%	0.1%	0.1%	0.1%	0.1%

Sources: Dragon Fund account reports provided by US Bank, FactSet

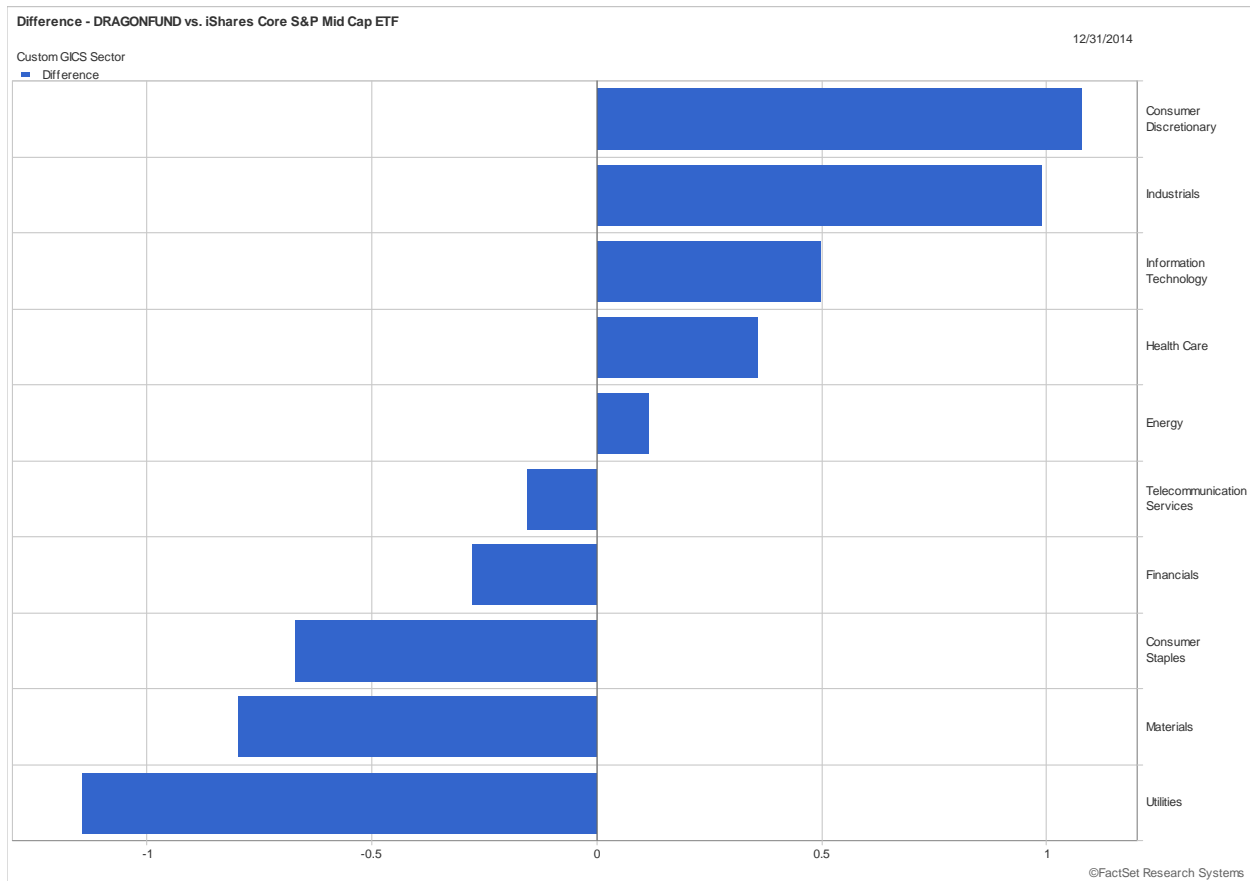
Current holdings profile as of December 31, 2014

Sector allocations as of December 31, 2014



Source: Dragon Fund model portfolio in FactSet, FactSet, benchmark refers to the iShares S&P 400 ETF

Sector over-/underweights as of December 31, 2014



Source: Dragon Fund model portfolio in FactSet

Top ten holdings

Over time, the fund has substantially decreased its dependence on sector ETFs to get sector exposure. Sector ETFs accounted for 34% of the portfolio at the beginning of 2012, 18% at the end of 2012, 5% at the end of 2013, and 6% at the end of 2014. The analyst team evaluates existing positions on a quarterly basis, with a special emphasis on the largest ones, to determine whether rebalancing is necessary for valuation or compliance reasons.

Ticker	Name	Weight [%]
HF	HFF, Inc. Class A	3.1
BX	Blackstone Group L.P.	2.8
AOS	A. O. Smith Corporation	2.8
DLTR	Dollar Tree, Inc.	2.7
JAH	Jarden Corporation	2.5
SBNY	Signature Bank	2.3
SNA	Snap-on Incorporated	2.3
BC	Brunswick Corporation	2.3
OHI	Omega Healthcare Investors, Inc.	2.3
NPSP	NPS Pharmaceuticals, Inc.	2.2
Total		25.2

Source: Dragon Fund model portfolio in FactSet

Characteristics of Dragon Fund versus benchmark holdings as of 12/31/2014

The forward price to earnings ratio is based on consensus estimates for the next fiscal year. The Dragon Fund statistics other than the “# of Securities” do not reflect the fund’s ETF holdings.

Characteristics (medians)	Dragon Fund	S&P 400
Market Capitalization	5,852	3,785
# of Securities	62	401
Dividend Yield	1.2	1.2
Price/Earnings	21.8	22.7
P/E using FY1 Est	18.6	19.6
Price/Cash Flow	13.9	13.4
Price/Book	3.1	2.5
Price/Sales	2.0	1.9
Hist 3Yr Sales Growth	8.0	5.6
Hist 3Yr EPS Growth	12.6	8.8
Est 3-5 Yr EPS Growth	10.7	10.8
ROA	7.3	5.2
ROE	14.0	10.7
Operating Margin	13.8	12.8
Net Margin	8.8	7.8
LT Debt/Capital [%]	32.7	34.0

Source: Dragon Fund model portfolio in FactSet, FactSet