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StockInvestor℠

Investing in the wide-moat stocks of today and tomorrow

The Bucket Approach to Asset Allocation, Part 2

In last month's cover story, we spoke with Christine Benz, Morningstar's director of personal finance, about the "bucket approach" to asset allocation. Regardless of your investment strategy, the bucket framework can help prevent near-term cash flow needs from interfering with your long-term investing discipline. This month, we wrap up our interview with Christine by discussing recent trends in asset management, practical aspects of portfolio maintenance, and some specific mutual fund picks.

Matt Coffina: What's your view on target-date funds and robo-advisors—two increasingly popular ways to automate the asset-allocation process?

Christine Benz: Advisors often criticize target-date funds as "one-size-fits-none," and I understand that critique. For example, the typical target-date fund will be too conservative for a person with a pension, and it may be too aggressive for a person with really volatile human capital, like a real estate broker.

But I am a fan of target-date funds, because I remember the days before they were widely available. Back then, many 401(k) investors would allocate their portfolios by selecting the funds with the highest five-year returns, or perhaps put 10% in each of the 10 choices. Target-date funds enable investors to build and maintain sensible, well-diversified portfolios that account for their life stage and are totally hands-off. Another finding from our fund flow data is that target-date fund investors tend to stay put, so their realized returns are very close to their funds' returns. In terms of outcomes, I view target-date funds as the industry's biggest home run over the past several decades.

That said, I like target-date funds less for retirees. When you take a distribution from one of these funds in retirement, you are selling a portion of your holdings in every asset class. If you're following a bucket approach, it would be better to have a choice of whether to trim the stock or bond piece of your portfolio, based on whatever has performed best.

Robo-advice has enormous potential—it can deliver some of the same benefits of target-date funds, but with greater customization. Tax management seems to be one of the key areas in which robo-advice can add value. But there are several caveats. The first is that there's a cost associated with robo-advice. If your situation isn't that complicated, you may be better off with a simple target-date fund, especially for your retirement assets. (Target-date funds aren't managed with regard to tax efficiency, so they aren't as well-suited to taxable accounts.) Second, if you have enough assets with a given fund company or brokerage firm, you may be eligible for some free financial planning time with a human being. Finally, I would argue that the robo-advisors currently available do just a small piece of the planner's job. A good financial planner or advisor will counsel you on much more than just your asset allocation: for example, whether to pay down your mortgage or invest in the market, or whether you need long-term care insurance. We may eventually get to the point where robo-advisors deliver holistic advice like that, but we're not there yet.

MC: Most investors have a hodgepodge of accounts—I know my family does. For example, you might have a 401(k), some rollover IRAs from former jobs, a taxable

Continued on Page 2

Matthew Coffina, CFA
Editor and Portfolio Manager

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brokerage account, and a handful of savings accounts or CDs, all at different financial institutions. Any tips for managing this complexity?

CB: You're right—portfolio sprawl is a big issue. I often advise pre-retirees to think about how they can collapse like-minded accounts—for example, roll over the 401(k)s and all of the small IRAs into a single large IRA for each spouse. But there's only so much streamlining you can get away with. Most importantly, investments with differing tax treatments need to stay apart.

When it comes to deciding how to sequence withdrawals from those various accounts in retirement, the key is to preserve accounts with the best tax-saving features for as long as you can. Taxable accounts often go first in the queue, followed by tax-deferred, followed by Roth. Besides having the best tax-saving features, Roth IRAs are ideal assets for your heirs to inherit, since they aren't subject to required minimum distributions during your lifetime and your heirs won't owe taxes on withdrawals. If you're past age 70½ and subject to required minimum distributions, taking those RMDs from tax-deferred accounts should be a priority over any other type of withdrawal, because the penalties for missing RMDs are so large.

You can also think about this general framework when deciding what kinds of assets to put in each account. If your taxable account is going to get tapped first, you'd want to be sure to hold some liquid assets in it; perhaps that's where you put "bucket 1." But keep in mind that these are just guidelines—there may be years in which it makes sense to take Roth distributions because you're in a really high tax bracket and have few deductions. A good tax advisor can be a great companion in retirement, not just as you prepare your return, but as you plan withdrawals.

MC: Any other suggestions to maximize tax efficiency in a portfolio? What are the three most important steps investors can take to lower their tax burden?

CB: The first would be to take advantage of tax-sheltered wrappers, because even a tax-efficient taxable portfolio is not going to be able to keep up with one that offers tax-free or tax-deferred compounding. I'm also a big fan of health savings accounts as an investment vehicle for healthy people who have the wherewithal to pay healthcare expenses out of pocket. The HSA offers the only three-fer in the whole tax code: pretax contributions, tax-free compounding, and tax-free distributions for qualified healthcare expenses.

Being careful about what you put inside your taxable accounts is also crucial. ETFs and index funds can be very tax-efficient, but individual stocks can make a lot of sense here, too, because they give you control over when you realize capital gains and losses. Individual stocks are great assets to pass to heirs, since your heirs' cost basis will "step up" to the stock price at the date of your death. If investors hold bonds in their taxable portfolios, Fidelity's municipal-bond funds are easy to recommend, with their low costs and experienced management. Investors who live in particularly high-tax states, such as California or New York, might investigate a state-specific municipal bond fund to avoid both state and federal taxes on their income.

My last tip gets back to withdrawal sequencing from your various accounts during retirement. You have the most control over your income in the years after you've retired but before RMDs commence, which can make this an ideal time to either spend from your tax-deferred accounts, thereby reducing your RMD-subject balance, or convert those assets to Roth. If you plan well, you may be able to take a little bit from several of your accounts each year to stay in the lowest possible tax bracket throughout your retirement.

MC: How do Social Security, pensions, and other retirement income fit into the bucket approach?

CB: I usually advise retirees and pre-retirees to start by thinking about their income needs in retirement. Let's say you'll need $5,000 a month. Subtract from that any stable sources of income you'll be able to rely on, such as Social Security or a pension. Maybe those income sources supply $2,000 per month. So that means you're counting on your portfolio for $3,000 of monthly income, or $36,000 a year. You can then stress-test that amount by seeing what percentage of your total portfolio balance it works out to: Is the initial withdrawal in the ballpark of the 4% guideline? If your total portfolio is worth $1 million, you're in good shape—the withdrawal of $36,000 is 3.6%. But if you only have $750,000 saved, the initial withdrawal would be 4.8%—arguably too high.

This illustrates the value of maximizing other income sources to help reduce portfolio withdrawals, which is why we've seen an explosion of interest in maximizing Social Security benefits. Every year a retiree is able to delay receipt of Social Security beyond full retirement age (currently 66) yields a roughly 8% increase in guaranteed benefits—a very attractive payoff. Of course, not everyone can delay, and those who are in poor health probably shouldn't. But it can be a powerful strategy for those who can take advantage.

MC: What's your view on exchange-traded funds versus open-end mutual funds?

CB: Exchange-traded funds are another of the investment industry's best innovations from the past few decades. I like them for their tax efficiency and generally low fees, and it's easy to craft a very well-diversified portfolio with just a handful of ETFs. Simplicity is a great and underrated virtue in investing, in my opinion. Even so, my personal feeling is that traditional index funds can be just as cheap and tax-efficient as ETFs, so unless investors specifically value the intra-day trading of ETFs (and I'm not sure why they should!), an index fund can usually do the job just as well. One common point of confusion is that ETFs and index funds are universally tax-efficient. That's not so: Tax-inefficient assets like bonds and REITs are still tax-inefficient inside of an index fund or ETF wrapper.

Active mutual funds have higher costs. There's also the fact that most active funds don't beat their benchmarks. And active funds can make big, unwanted capital gains distributions at inopportune times, which is why I recommend that investors keep them out of their taxable accounts. However, I do think there is a case to be made for certain active funds, specifically those that offer downside protection. A good example is **Vanguard Dividend Growth** VDIGX, which focuses on high-quality, wide-moat companies. It lost 26% in 2008 versus a 37% decline for the S&P 500. It's the linchpin holding in my mutual fund model portfolios.

MC: As I said at the beginning, *StockInvestor* is all about individual stocks. I can't recall ever mentioning a mutual fund or exchange-traded fund, let alone recommending one. For a change of pace, what are some of your favorite funds and ETFs at the moment?

CB: Because I like simplicity, it's easy to recommend the total market trackers from Vanguard, Schwab, or iShares. All three firms offer excellent core index funds with very low costs; price wars among index fund providers have been good for consumers! Fidelity also fields some good, inexpensive index funds. I already mentioned Vanguard Dividend Growth as a go-to recommendation for retirees. In my personal portfolio, I've long been a happy holder of **Oakmark Select** OAKLX and **Tweedy, Browne Global Value** TBGVX. I also heartily recommend any of the Primecap-managed funds; the team's contrarian-growth strategy makes sense to me. I own **Vanguard Primecap Core** VPCCX, but it's closed to new investors. Some of the Primecap Odyssey funds are still open.

I also like mutual funds for bonds, because it's very difficult for smaller investors to build adequate diversification with individual bonds, and trading costs can cut into returns. I own Vanguard's muni funds in my personal taxable portfolio; both Vanguard and Fidelity field solid lineups on both the taxable and muni sides. For a high-quality short-term bond fund that could serve as "next-line reserves" within bucket 2, I recommend **Fidelity Short-Term Bond** FSHBX.

MC: Thanks for sharing your perspective with us, Christine. To sum up, we believe investors can benefit from thinking of their portfolios as containing distinct buckets based on when they're likely to need the funds. This setup provides the psychological support to continue holding stocks through a prolonged bear market: Confidence comes from knowing that you have at least one or two years' living expenses in cash in bucket 1, and several more years' expenses (more for retirees, less for younger investors) in high-quality short-term bonds in bucket 2. As always, patience, discipline, and a long-term investment horizon are prerequisites for a successful stock investor. M

Tortoise Portfolio

Stock Name and Ticker	Star Rating	Moat	Moat Trend	Steward-ship	Fair Val Uncert.	Current Price	Fair Value	P/FV	Div. Yield	First Purchase	Shares Owned	Cost/ Share[1]	Capital Gain/ Loss (%)	Total Return (%)[2]	Total Cost[1]	Current Value	% of Port
	Morningstar Ratings & Fundamentals									**Portfolio Data**							
Berkshire Hathaway BRK.B	★★★★	Wide	→	Exemp.	Med.	140.54	170	0.83	0.0	06-18-01	260	60.52	132.2	132.2	15,736	36,540	10.2
Lowe's LOW	★★★	Wide	→	Exemp.	Med.	80.13	83	0.97	1.8	11-15-07	400	25.07	219.6	240.5	10,028	32,052	8.9
Philip Morris International PM	★★	Wide	→	Stand.	Low	98.68	92	1.07	4.1	05-07-14	250	85.42	15.5	24.9	21,355	24,670	6.9
Visa V	★★★★	Wide	→	Stand.	Med.	78.94	104	0.76	0.7	07-11-14	300	53.76	46.8	48.4	16,128	23,682	6.6
Wells Fargo WFC	★★★★	Wide	→	Exemp.	Med.	50.72	61	0.83	3.0	03-08-13	400	39.62	28.0	37.6	15,848	20,288	5.6
Unilever UL	★★★	Wide	→	Stand.	Low	45.56	44	1.04	3.2	02-06-14	440	39.15	16.4	23.4	17,226	20,046	5.6
Magellan Midstream Partners MMP[3]	★★★★	Wide	→	Exemp.	Low	70.05	76	0.92	4.6	12-15-14	275	75.82	-7.6	-2.0	20,849	19,264	5.4
Oracle ORCL	★★★	Wide	→	Stand.	Med.	40.20	44	0.91	1.5	03-07-16	400	38.22	5.2	5.6	15,287	16,080	4.5
HCP HCP	★★★★	Narrow	→	Stand.	High	32.87	41	0.80	7.0	12-09-13	480	36.76	-10.6	4.3	17,647	15,778	4.4
General Dynamics GD	★★★	Wide	→	Exemp.	Med.	141.87	145	0.98	2.1	03-12-03	110	33.12	328.3	387.3	3,643	15,606	4.3
Enterprise Products Partners EPD[3]	★★★★	Narrow	→	Exemp.	Low	27.76	32	0.87	5.7	08-12-13	560	30.64	-9.4	1.4	17,157	15,546	4.3
Union Pacific UNP	★★★★	Wide	→	Stand.	Med.	84.19	95	0.89	2.6	05-11-15	175	103.26	-18.5	-16.6	18,070	14,733	4.1
Novartis NVS	★★★★	Wide	→	Stand.	Low	79.51	89	0.89	3.4	02-09-07	185	56.80	40.0	71.5	10,509	14,709	4.1
Johnson & Johnson JNJ	★★	Wide	→	Stand.	Low	112.69	104	1.08	2.8	12-06-05	130	59.51	89.4	127.4	7,736	14,650	4.1
American Express AXP	★★★★	Wide	→	Stand.	Med.	65.76	76	0.87	1.8	07-18-01	125	29.46	123.2	156.8	3,682	8,220	2.3
PepsiCo PEP	★★★	Wide	→	Stand.	Low	101.17	100	1.01	3.0	07-19-02	75	35.92	181.6	245.9	2,694	7,588	2.1
⊖ ITC Holdings ITC	★★	Wide	→	Exemp.	Low	44.52	42	1.06	1.7	06-19-13	0	31.41	39.7	44.5	—	—	0.0
Cash Holdings																60,181	16.7
Tortoise Portfolio Total																359,632	

Goal of the Tortoise

The Tortoise Portfolio includes our more conservative recommendations. We aim to outperform the S&P 500 Index over a full market cycle while minimizing risk. We prefer companies with wide moats, stable moat trends, and low or medium uncertainty. Historically, the Tortoise has lagged the S&P 500 in bull markets but outperformed significantly in bear markets.

Morningstar ratings, fundamentals, and performance as of May 31, 2016.

Portfolio inception date: June 18, 2001.

For investors who prefer not to own MLPs or tobacco companies

Current Holdings	Suggested Alternatives
Enterprise Products Partners	Spectra Energy SE
Magellan Midstream Partners	Enbridge ENB
Philip Morris International	Mondelez International MDLZ

Footnotes

1 Cost basis includes commissions.

2 Total returns include dividends.

3 Master limited partnership units have different tax characteristics than common stocks and may not be suitable for tax-deferred accounts such as IRAs. Please consult your tax advisor before investing.

Legend

⊕ Shares Added
⊖ Shares Sold
★ New Addition
UR Under Review
↗ Positive
→ Stable
↘ Negative

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Hare Portfolio

	Morningstar Ratings & Fundamentals									Portfolio Data							
Stock Name and Ticker	Star Rating	Moat	Moat Trend	Steward-ship	Fair Val Uncert.	Current Price	Fair Value	P/FV	Div. Yield	First Purchase	Shares Owned	Cost/ Share[1]	Capital Gain/ Loss (%)	Total Return (%)[2]	Total Cost[1]	Current Value	% of Port
Alphabet GOOG/GOOGL[3]	★★★	Wide	→	Stand.	High	744.47	780	0.95	0.0	07-14-11	51	352.99	110.9	111.0	18,003	37,968	9.2
MasterCard MA	★★★★	Wide	→	Stand.	Med.	95.90	120	0.80	0.8	05-30-06	350	33.56	185.8	190.8	11,746	33,565	8.1
Express Scripts ESRX	★★★★	Wide	→	Stand.	Med.	75.53	100	0.76	0.0	04-03-12	420	59.34	27.3	27.3	24,923	31,723	7.7
BlackRock BLK	★★★	Wide	↗	Exemp.	Med.	363.85	365	1.00	2.5	04-10-14	75	299.09	21.6	27.2	22,431	27,289	6.6
Baidu BIDU	★★★	Wide	→	Stand.	V.High	178.54	186	0.96	0.0	01-28-13	150	115.81	54.2	54.2	17,372	26,781	6.5
Time Warner TWX	★★★★	Wide	→	Stand.	Med.	75.66	85	0.89	2.1	05-15-15	350	84.05	-10.0	-8.3	29,417	26,481	6.4
Priceline Group PCLN	★★★★	Narrow	↗	Exemp.	High	1,264.33	1,800	0.70	0.0	01-09-15	20	1,069	18.2	18.2	21,384	25,287	6.1
Ventas VTR	★★★	Narrow	→	Exemp.	Med.	66.33	63	1.05	4.4	09-10-15	360	53.11	24.9	29.0	19,118	23,879	5.8
Cerner CERN	★★★★	Wide	→	Stand.	Med.	55.61	63	0.88	0.0	02-17-16	400	50.37	10.4	10.4	20,150	22,244	5.4
Compass Minerals CMP	★★★★	Wide	→	Exemp.	Med.	77.95	89	0.88	3.6	08-18-05	215	29.02	168.6	231.7	6,240	16,759	4.1
Cooper Companies COO	★★★	Narrow	→	Stand.	Med.	162.81	150	1.09	0.0	10-20-15	100	144.09	13.0	13.0	14,409	16,281	3.9
PayPal PYPL	★★★★	Narrow	→	Stand.	V.High	37.79	48	0.79	0.0	04-20-06	400	22.13	70.7	70.7	8,853	15,116	3.7
AmerisourceBergen ABC	★★★★	Wide	→	Stand.	Med.	74.98	101	0.74	1.8	04-28-16	200	86.80	-13.6	-13.6	17,360	14,996	3.6
CME Group CME	★★★	Wide	→	Stand.	High	97.89	89	1.10	2.4	01-13-12	150	47.03	108.2	145.4	7,054	14,683	3.6
Discover Financial Services DFS	★★★	Narrow	↗	Exemp.	High	56.81	52	1.09	2.0	08-08-07	250	36.05	57.6	66.5	9,013	14,202	3.4
CarMax KMX	★★★	Narrow	↗	Stand.	High	53.66	47	1.14	0.0	01-20-04	200	14.71	264.8	264.8	2,942	10,732	2.6
EBay EBAY	★★★	Narrow	↘	Stand.	High	24.46	25	0.98	0.0	04-20-06	400	14.31	70.9	70.9	5,724	9,784	2.4
⊖ ITC Holdings ITC	★★	Wide	→	Exemp.	Low	44.52	42	1.06	1.7	10-29-15	0	32.26	37.3	38.4	—	—	0.0
Cash Holdings																44,648	10.8
Hare Portfolio Total																412,418	

Goal of the Hare

The Hare Portfolio includes our more aggressive picks. We aim to outperform the S&P 500 Index over a full market cycle. Companies in this portfolio tend to be faster-growing, with both higher risk and higher return potential than those in the Tortoise. We prefer companies with wide or narrow moats, positive or stable moat trends, and medium or high uncertainty.

Morningstar ratings, fundamentals, and performance as of May 31, 2016.

Portfolio inception date: June 18, 2001.

Footnotes

[1] Cost basis includes commissions.
[2] Total returns include dividends.
[3] Includes 34 Class A shares (ticker GOOGL) and 17 Class C shares (ticker GOOG). Data based on weighted averages of the two share classes.

Invest in the Tortoise and Hare Approach—The Hassle-Free Way.

Did you know that Morningstar Investment Services now offers customizable portfolios patterned after *StockInvestor*'s Tortoise and Hare portfolios?

To learn more, call **1-866-765-0663**.

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Legend

⊕ Shares Added
⊖ Shares Sold
✶ New Addition
UR Under Review
↗ Positive
→ Stable
↘ Negative

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Portfolio Roundup

by Matthew Coffina, CFA

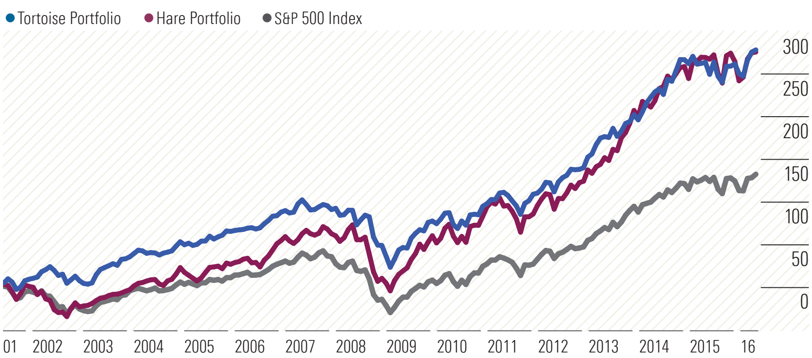
Selling ITC Holdings raised our cash weightings significantly. Fully valued market is a reason to be cautious.

Our portfolios' strong showing in April largely reversed itself in May, as we underperformed the S&P 500 by 1.3 percentage points on a combined basis. This demonstrates the limits of monthly performance reporting—I'm obliged to continue the practice, but it's our returns over five or 10 years that really matter. Our biggest laggards last month included **AmerisourceBergen** ABC, **Priceline** PCLN, and **Baidu** BIDU, the first two because of disappointing management guidance and Baidu because of a scandal involving its healthcare advertisements. Winners in May included **Ventas** VTR, **CME Group** CME, **Alphabet** GOOG, **Cooper Companies** COO, and **Lowe's** LOW.

Annualized Total Returns (%)

Time Period	Tortoise Portfolio	Hare Portfolio	Combined	S&P 500 Index
1-Month	0.7	0.3	0.5	1.8
Year-to-Date	4.5	3.0	3.8	3.6
1-Year	4.0	1.7	2.9	1.7
3-Year	11.0	14.3	12.6	11.1
5-Year	12.4	14.0	13.2	11.7
10-Year	8.4	11.4	9.7	7.4
Since Inception	9.3	9.3	9.3	5.8

Cumulative Total Returns (%)



Data through May 31, 2016.

Trades

⊖ Sold 320 shares of **ITC Holdings** ITC from the Hare on May 3 at $44.31 per share.

⊖ Sold 800 shares of **ITC Holdings** ITC from the Tortoise on May 9 at $43.91 per share.

While ITC is still awaiting regulatory approval for its acquisition by Fortis, recent strength in the Canadian dollar and a recovery in Fortis' share price boosted the value of the deal. I sold our entire ITC stake from both the Hare and the Tortoise after concluding that the upside potential no longer justified the risks. If we had held through the closing of the Fortis deal—expected later this year—we might have realized an additional total return of around 6%. However, if the acquisition were rejected by regulators or failed for some other reason, and ITC fell back to where it was trading before putting itself up for sale, the stock's near-term downside could have been 25% or more. Merger arbitrage really isn't our game—I'd prefer to watch the rest of this story unfold from the sidelines.

Selling ITC left us with oversized cash weightings, especially in the Tortoise, where ITC was a nearly 10% position. As of May 31, cash accounted for 16.7% of the Tortoise's value and 10.8% of the Hare. I'm torn about what to do with this cash. On one hand, I think the market as a whole looks fully valued. I estimate that the S&P 500 is trading for more than 21 times trailing 12-month operating earnings, and the multiple would be even higher if we used GAAP earnings. Longer-term valuation measures—such as the Shiller P/E and price/trailing peak operating earnings—are similarly elevated. So I don't think it's a bad time to be holding extra cash.

On the other hand, the long-term direction of stocks is upward, and I have very little confidence in our ability to accurately time the market. Furthermore, while the S&P 500 may look fully valued from a top-down perspective, there are more than a few bottom-up values among individual stocks. I'm optimistic that we'll be able to gradually put our cash to work in the coming months.

Questions? Comments?
You can contact me via email at matthew.coffina@morningstar.com. I can't promise a reply to every message, but I do read them all, and when a topic shows up repeatedly I will address it for all subscribers in *StockInvestor* or our weekly email update.

Matthew Coffina, CFA, owns all of the stocks in the Tortoise and Hare Portfolios in his personal accounts.

Portfolio News

- Baidu was at the center of a scandal that seemed to come out of nowhere. A college student in China with a rare form of cancer used Baidu's search engine to find an experimental treatment for his disease, having exhausted all other options. Unfortunately, the treatment proved ineffective and the student died. His story gained widespread attention in Chinese social media and prompted a government investigation.

The investigation was resolved about a week later, with regulators demanding that Baidu a] use stricter screening of its advertisers, especially in the healthcare field; b] modify its search ranking algorithm to give greater weight to the credibility of the advertiser; c] limit paid search results to no more than 30% of each web page; d] clearly indicate which search results are paid advertisements; and e] enhance its dispute resolution process, such as making it easier for users to file complaints, immediately removing any unlawful search listings, and creating a fund to compensate users harmed by misleading ads. Baidu agreed to implement these changes within a few weeks.

It's still too early to say what impact these changes might have on Baidu's long-run earnings power, though growth is almost certain to slow in the near term. Our analyst raised her uncertainty rating to very high and cut her fair value estimate to $186 per ADR from $209. Then again, Baidu has survived multiple similar scandals in the past with few lasting consequences. The government's response appears to be more severe in this case, but it could have been far worse—for example, Baidu could have been banned from accepting healthcare advertisements altogether (healthcare is believed to be one of its biggest advertising verticals).

In my view, more important than this specific incident is what it shows about the dangers of investing in China in general. Fraud is all too common in the country, and public trust is low. Even if we give Baidu the benefit of the doubt and assume that it is doing everything in its power to combat fraud, policing hundreds of thousands of advertisers is a daunting

Tortoise Breakdown

Style (%)

	Value	Core	Grwth
Lrg	17	41	16
Med	4	5	0
Sm	0	0	0

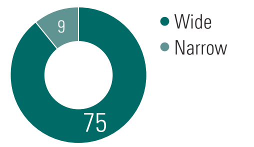
51–100 · 26–50 · 11–25 · 0–10

Top Sectors (%)

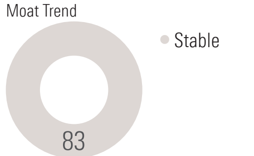
Financial Services	24.7
Consumer Defensive	14.5
Energy	9.7
Consumer Cyclical	8.9
Industrials	8.4

Portfolio Distributions (%)

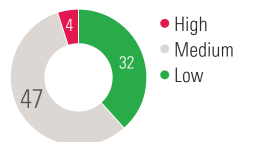
Moat



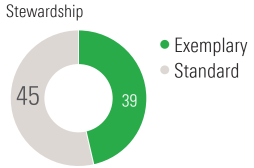
Moat Trend



Uncertainty



Stewardship



Tortoise Averages

Price/Fair Value	Star Rating
0.92	3.36
Div. Yield (%)	**Market Cap ($B)**
2.3	152.2
Ann. Turnover (%)	**Beta**
15.5	0.71

Hare Breakdown

Style (%)

	Value	Core	Grwth
Lrg	6	22	50
Med	0	0	7
Sm	0	4	0

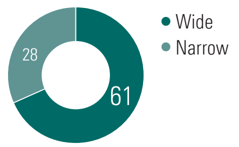
51–100 · 26–50 · 11–25 · 0–10

Top Sectors (%)

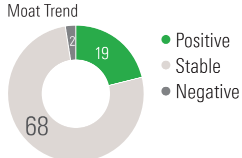
Financial Services	25.4
Technology	21.1
Consumer Cyclical	17.5
Healthcare	15.3
Real Estate	5.8

Portfolio Distributions (%)

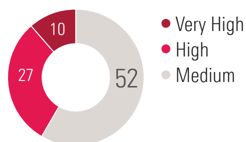
Moat



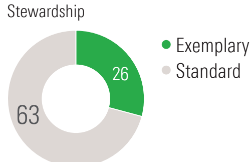
Moat Trend



Uncertainty



Stewardship



Hare Averages

Price/Fair Value	Star Rating
0.90	3.41
Div. Yield (%)	**Market Cap ($B)**
1.0	92.9
Ann. Turnover (%)	**Beta**
20.6	0.98

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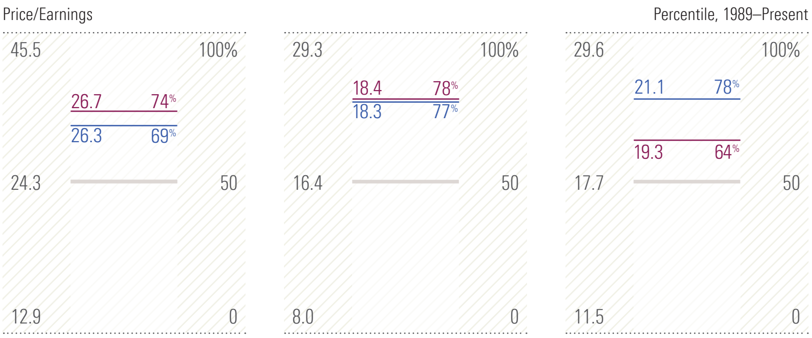
Market Valuation

Shiller Price/Earnings[1]	Price/Trailing Peak Op. Earnings	Price/TTM Operating Earnings
	S&P 500 Level: **2,097**	Morningstar Median P/FV: **1.02**



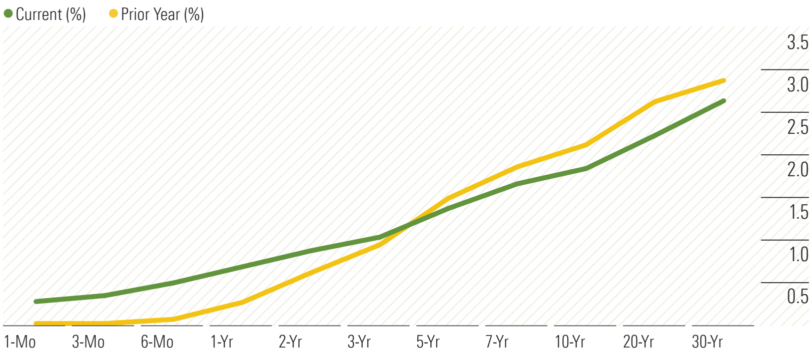
● Current ● Year Ago ● Median, 1989–Present. [1]10-Yr Average Real EPS.

Morningstar Index Total Returns

Trailing 3-Month (%)		Trailing 1-Year (%)	
Large-Cap Value	10.1	Large-Cap Value	2.9
Large-Cap Growth	8.1	Large-Cap Growth	0.8
Energy	19.4	Utilities	14.7
Basic Materials	14.8	Consumer Defensive	10.3
Financial Services	13.3	Real Estate	8.2
Real Estate	10.8	Communication Services	6.5
Technology	9.5	Industrials	2.0
Industrials	8.5	Consumer Cyclical	1.6
Healthcare	8.4	Technology	0.5
Utilities	7.6	Financial Services	-1.7
Communication Services	6.9	Basic Materials	-3.4
Consumer Cyclical	6.8	Healthcare	-4.9
Consumer Defensive	4.9	Energy	-13.0
Morningstar Wide Moat Focus	15.0	Morningstar Wide Moat Focus	9.6

Yield Curve

10-Year Treasury Yield: **1.84%**



Economic Data

S&P 500 Fundamentals (%)		U.S. Economy (%)		
EPS Growth (TTM)	Dividend Yield	Q1 Real GDP Growth	CPI Inflation	Unemployment
-9.0	2.1	0.8	1.1	5.0

Sources: Morningstar, S&P, BLS, BEA, Federal Reserve, Robert Shiller. Data as of May 31, 2016, or latest available.

task. For example, the hospital at the center of the current controversy was affiliated with the military and reportedly had all of the necessary licenses. However, it had outsourced the experimental cancer treatment to a less-reputable private third party.

There have been other red flags about China lately, such as the government's proposal to take a 1% ownership stake and a board seat in all major Internet companies (it's not clear if this proposal will move forward). Furthermore, I'm increasingly worried about a hard landing for the broader Chinese economy, which faces structural overcapacity across a variety of industries, a growing bad debt problem, and a government that may not be willing to make the difficult choices needed to ensure long-term economic sustainability. While I'm inclined to hold our Baidu shares at least until the scandal dies down, I'll be on the lookout for ways to further reduce our exposure to China.

- AmerisourceBergen issued disappointing guidance for 2016 and 2017, mostly because of falling prices for generic drugs. The company is also planning to step up investments in key infrastructure and information technology systems, which is expected to reduce its 2017 earnings per share growth rate by 3 percentage points.

Fortunately, I don't think the 4%–6% EPS growth projected for 2017 represents a new run rate. Aside from the one-time investments, this outlook doesn't include any benefit from share repurchases. When AmerisourceBergen first signed its distribution agreement with **Walgreens Boots Alliance** WBA, it issued Walgreens a large number of warrants to purchase ABC's stock. I view this as a long-term positive, since it aligns the two firms' interests and makes it reasonably likely that Walgreens will eventually decide to buy AmerisourceBergen outright. However, it also means that near-term share repurchases are being used to offset dilution rather than reduce the share count. AmerisourceBergen's stock trades at a low multiple of earnings, and free cash flow routinely exceeds net income. If not for the warrants, I think the company would be capable of reducing its share count by 5% or more per year.

If we take management's 4%–6% EPS growth guidance and add back 3% for the investments and 5% for share buybacks, we get to a sustainable growth rate of 12%–14%. Throw in a 1.8% dividend yield, and AmerisourceBergen should be capable of delivering long-run total returns in the midteens. Considering the economic defensiveness of the business and the low price/earnings ratio, you can see why I find AmerisourceBergen's risk/reward trade-off so attractive.

- **HCP** HCP announced a plan to spin off its troubled skilled nursing portfolio as an independent real estate investment trust. While the spin-off won't rectify HCP's fundamental problem—that HCR ManorCare, its main skilled nursing tenant, can't afford its contractual rent payments—the separation will hopefully give the remaining HCP business a more competitive cost of capital so that it can resume acquisitions. Although management didn't explicitly say so, I also suspect this may be a covert way for HCP to cut its dividend; we'll see whether the combined dividend of the two successor companies at least matches HCP's current dividend rate. I doubt the skilled nursing business will meet our basic quality standards, but we can decide what to do with our position closer to the spin-off.

- As part of a comprehensive review of our moat ratings in the midstream energy sector, we downgraded **Enterprise Products Partners** EPD to narrow moat. I understand our rationale—Enterprise does own a lot of commodity-sensitive assets such as gathering lines, processing plants, and fractionation facilities—but I'm probably a bit more optimistic than our analyst. I believe the tight integration of Enterprise's assets up and down the value chain makes the company more than the sum of its parts. Meanwhile, we maintained our wide moat rating on **Magellan Midstream Partners** MMP, reinforcing that this is one of the highest-quality midstream firms around.

Changes to the Wide-Moat Watchlist

Discovery Communications DISCK and **Time Warner Cable** TWC were removed from the watchlist, the latter after it was acquired by **Charter Communications** CHTR. ITC Holdings was reclassified from a holding to a prospect. **Hanesbrands** HBI was added to the watchlist.

Tortoise Earnings Estimates, 2016

Company	Share Price	EPS ($)	P/E
American Express	65.76	5.58	11.8
Berkshire Hathaway[1]	140.54	7.34	19.1
Enterprise Products[2]	27.76	1.97	14.1
General Dynamics	141.87	9.47	15.0
HCP[3]	32.87	2.68	12.3
Johnson & Johnson	112.69	6.55	17.2
Lowe's[4]	80.13	4.05	19.8
Magellan Midstream[2]	70.05	4.00	17.5
Novartis	79.51	4.79	16.6
Oracle[4,6]	40.20	2.63	15.3
PepsiCo	101.17	4.70	21.5
Philip Morris Int'l	98.68	4.41	22.4
Unilever[5]	45.56	2.28	20.0
Union Pacific	84.19	5.10	16.5
Visa[4]	78.94	2.74	28.8
Wells Fargo	50.72	4.14	12.3
Tortoise Total (Ex. Cash)	299,452	17,376	17.2

Hare Earnings Estimates, 2016

Company	Share Price	EPS ($)	P/E
Alphabet[6]	744.47	27.49	27.1
AmerisourceBergen[4]	74.98	5.50	13.6
Baidu[5]	178.54	5.15	34.7
BlackRock	363.85	19.47	18.7
CarMax[4]	53.66	3.33	16.1
Cerner[6]	55.61	2.18	25.5
CME Group	97.89	4.32	22.7
Compass Minerals	77.95	3.52	22.1
Cooper Companies[4]	162.81	8.29	19.6
Discover Financial Services	56.81	5.69	10.0
EBay[6]	24.46	1.60	15.3
Express Scripts	75.53	6.36	11.9
MasterCard	95.90	3.54	27.1
PayPal[6]	37.79	1.26	30.0
Priceline[6]	1,264.33	61.53	20.5
Time Warner	75.66	5.39	14.0
Ventas[3]	66.33	3.70	17.9
Hare Total (Ex. Cash)	367,770	19,432	18.9

[1] Operating earnings significantly understate Berkshire's true earnings power because of its stock portfolio.
[2] Distributable cash flow used as the measure of earnings for MLPs.
[3] Funds available for distribution used as the measure of earnings for REITs.
[4] Nonstandard fiscal calendars aligned to the closest calendar year.
[5] Earnings converted to U.S. dollars at current exchange rate.
[6] Stock-based compensation deducted from adjusted earnings.

Source: Morningstar.

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Matt's Favorites for New Money

How to Use the Tortoise and Hare in Your Portfolio

1 Buy every holding, regardless of valuation, in roughly the same proportion as its weighting in our portfolios. This is the best way to replicate the performance of the Tortoise and Hare and is our preferred approach.

2 Focus only on the most undervalued holdings — the stocks below are a good place to start. However, we only recommend this strategy to experienced investors with the time, knowledge, and inclination to construct an appropriately diversified portfolio on their own.

AmerisourceBergen ABC ★★★★

Fair Value Est.	Current Price	P/FV	Portfolio
$101.00	$74.98	0.74	H

Our investment in AmerisourceBergen is off to a rough start. Barely a week after I first bought the shares, management lowered its full-year earnings outlook and issued disappointing guidance for fiscal 2017, sending the stock down 13.6% from our purchase price. The main problem is generic drug deflation, which we knew was a risk going in. Falling generics prices hurt distributors' fee income and prevent gains on inventory. Management now forecasts roughly 11% EPS growth this year and 4%–6% growth in 2017. Nevertheless, I find AmerisourceBergen's valuation more attractive than ever, with the stock trading for just 13.6 times earnings. Growth should reaccelerate in the longer run as share repurchases pick up.

Visa V ★★★★

Fair Value Est.	Current Price	P/FV	Portfolio
$104.00	$78.94	0.76	T

Visa and MasterCard are experiencing a bit of a lull in their normally reliable earnings growth trajectories, weighed down by global macroeconomic challenges, currency headwinds, and investments in new technology and capabilities. On the plus side, both firms are still enjoying double-digit underlying payments volume growth, which bodes well for the long-run sustainable growth rate. Visa also benefits from some high-profile new client wins, including Costco and USAA. Such large clients don't change networks often — perhaps only once every 15 or 30 years — so I wouldn't downplay Visa's accomplishment. The Visa Europe integration should result in greater pricing power and meaningful synergies.

Express Scripts ESRX ★★★★

Fair Value Est.	Current Price	P/FV	Portfolio
$100.00	$75.53	0.76	H

There have been rumblings of discontent between Anthem and Cigna as the two firms await regulatory approval to merge. According to *The Wall Street Journal*, Anthem's lawsuit with Express Scripts is a key point of contention, since Cigna fears it could hurt the merger's prospects for closing. While it will ultimately be up to the courts to decide, I don't think Anthem has made a compelling case that Express Scripts failed to negotiate in good faith over pricing terms. I'm frankly surprised that Anthem has allowed the dispute to escalate this far without much evidence, especially when it has its hands full with the Cigna deal. Any move to settle the lawsuit would likely be a significant positive for Express Scripts' shares.

Berkshire Hathaway BRK.B ★★★★

Fair Value Est.	Current Price	P/FV	Portfolio
$170.00	$140.54	0.83	T

As described in the spotlight on Page 24, Berkshire's annual meeting largely reinforced our view of the firm and its valuation. Two of Berkshire's largest segments are facing major headwinds at the moment. For the railroad, it's the secular decline in coal volumes and cyclical weakness in other freight categories. For reinsurance, it's the competitive pricing environment. However, the beauty of Berkshire's business model is that it has the flexibility to reallocate capital wherever it finds the greatest opportunities. Instead of spending on railroad capital expenditures or underwriting new reinsurance contracts, Berkshire can invest in renewable energy projects, aircraft engine components, or car dealerships.

Data as of May 31, 2016. Fair values based on Morningstar analyst estimates.

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Priceline PCLN ★★★★

Fair Value Est. $1,800

Current Price $1,264

P/FV 0.70

Portfolio H

Priceline's share price took a hit last month after the company reported solid first-quarter results but predicted a sharp deceleration in growth in the second quarter. Management has a habit of underpromising and overdelivering, and I wouldn't be surprised if the company is being extra conservative because of the recent CEO turnover. Seasonal holiday shifts will also contribute to slower growth in the second quarter. More importantly, I would find Priceline's valuation attractive even if its latest growth outlook (11%–18% growth in gross travel bookings) turned out to be the new normal. At 20.5 times earnings (including stock-based compensation expense), we don't need heroic growth for this investment to work.

Cerner CERN ★★★★

Fair Value Est. $63.00

Current Price $55.61

P/FV 0.88

Portfolio H

Cerner is up about 10% since our initial purchase, which makes me a little less enthusiastic about its valuation. However, the company has a decadeslong track record of delivering double-digit earnings growth, with a long growth runway ahead. Electronic medical records have become the industry standard, and Cerner is one of the few vendors seen as capable of delivering technologically relevant solutions to large hospital systems. Hospital consolidation also benefits the company, since its customers are typically the acquirers. As a greater share of insurance reimbursements are linked to health outcomes, having an integrated, comprehensive EMR platform will only become more critical for hospitals.

Other Favorites

Novartis NVS
Wells Fargo WFC
HCP HCP
Magellan Midstream Partners MMP
Lowe's LOW
Time Warner TWX
PayPal PYPL
Alphabet GOOG
Compass Minerals CMP
MasterCard MA

Top Prospects

Tortoise

Microsoft MSFT
Growth in cloud infrastructure and software should help Microsoft offset declines in legacy Windows.

Citigroup C
Citigroup has rebuilt capital, shed unwanted assets, and improved regulatory relations.

McKesson MCK
Partnership with Wal-Mart for generics purchasing helps offset recent and potential client losses.

Walt Disney DIS
The traditional TV bundle is evolving, but Disney's networks make it a key partner for any distributor.

Hare

Synchrony Financial SYF
Faster growth and a stronger capital position than other credit card issuers.

Hanesbrands HBI
Underwear commands greater consumer loyalty than most apparel categories.

L Brands LB
A trendier take on undergarments. Victoria's Secret is just getting started on international growth.

Allergan AGN
Allergan has been an aggressive dealmaker. Generics divestiture will strengthen its balance sheet.

Data as of May 31, 2016. Fair values based on Morningstar analyst estimates.

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Wide-Moat Watchlist

200 high-quality companies that would fit with our strategy, plus our current Tortoise and Hare holdings

Distribution & Transportation Railroads, Distributors, Logistics, Waste Management

McKesson's stock outperformed AmerisourceBergen's by more than 20 percentage points last month—a stunning turn of events. The former won a major expansion of its relationship with Wal-Mart, while the latter lowered its near-term earnings guidance. But the biggest driver of the relative performance was convergence between McKesson's and AmerisourceBergen's price/earnings multiples. Previously, ABC was trading roughly two multiple turns richer than McKesson, but now it's McKesson that's trading at the slightly higher multiple. Since I believe our long-term investment thesis is intact—that AmerisourceBergen has a better business mix, less risk of client attrition, and superior management—current valuations reinforce my preference for ABC. As the company resumes normal share repurchases and moves past some nonrecurring investments, I think double-digit EPS growth is still within reach over the long run.

Company	Star Rating	Moat	Moat Trend	Stewardship	Uncertainty	P/FV	Current Price	Fair Value	Yield	Portfolio
AmerisourceBergen ABC	★★★★	Wide	Stable	Standard	Medium	0.74	74.98	101	1.8	H
Stericycle SRCL	★★★★	Wide	Positive	Standard	Medium	0.77	97.99	127	0.0	H
CSX CSX	★★★★	Wide	Stable	Standard	Medium	0.80	26.43	33	2.7	T
McKesson MCK	★★★★	Wide	Stable	Standard	Medium	0.82	183.14	222	0.6	T
Canadian Pacific Railway CP	★★★★	Wide	Stable	Standard	Medium	0.83	129.59	157	1.2	T
Norfolk Southern NSC	★★★★	Wide	Stable	Standard	Medium	0.87	84.06	97	2.8	T
Union Pacific UNP	★★★★	Wide	Stable	Standard	Medium	0.89	84.19	95	2.6	T
MSC Industrial Direct MSM	★★★	Narrow	Stable	Standard	Medium	0.91	74.95	82	2.3	H
FedEx FDX	★★★	Narrow	Positive	Standard	Medium	0.95	164.97	173	0.6	H
US Ecology ECOL	★★★	Wide	Stable	Standard	High	0.99	45.31	46	1.6	H
W.W. Grainger GWW	★★★	Wide	Stable	Standard	Medium	0.99	228.35	230	2.1	H
Cardinal Health CAH	★★★	Wide	Stable	Standard	Medium	1.00	78.95	79	2.3	T
Canadian National Railway CNI	★★★	Wide	Stable	Standard	Medium	1.02	59.29	58	2.0	T
United Parcel Service UPS	★★★	Wide	Stable	Standard	Medium	1.02	103.09	101	3.0	T
Expeditors International of Washington EXPD	★★★	Wide	Stable	Exemplary	Medium	1.03	48.55	47	1.7	H
Patterson PDCO	★★★	Wide	Stable	Standard	Medium	1.04	48.81	47	2.0	T
Fastenal FAST	★★★	Wide	Stable	Standard	Medium	1.10	46.03	42	2.6	H
C.H. Robinson Worldwide CHRW	★★	Wide	Negative	Exemplary	Medium	1.12	74.98	67	2.3	H
Sysco SYY	★★	Narrow	Stable	Standard	Medium	1.12	48.11	43	2.6	T
Landstar System LSTR	★★	Wide	Stable	Standard	Medium	1.13	67.85	60	0.5	H
Kansas City Southern KSU	★★	Wide	Stable	Standard	High	1.21	93.10	77	1.4	H
Henry Schein HSIC	★	Wide	Stable	Standard	Medium	1.39	173.73	125	0.0	T

Data as of May 31, 2016. Fair value based on Morningstar analyst estimates.
↑ = Rating Increase ↓ = Rating Decrease T = Tortoise Holding T = Potential Tortoise Holding H = Hare Holding H = Potential Hare Holding ✱ = New Addition UR = Under Review

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Infrastructure & Real Estate Utilities, Midstream Energy, Telecom, REITs, Airports

Our midstream energy analyst followed up on her downgrade of Kinder Morgan's moat rating by also cutting our moat ratings on Enterprise Products Partners, Energy Transfer Equity, Williams Companies, and Oneok, along with other partnerships in those families. Only a few wide-moat midstream firms are left standing: Magellan Midstream Partners, the Spectra Energy pair, the Plains family, and Enbridge. As the energy downturn unfolded, it became increasingly clear that we had been too generous with our moat ratings for midstream firms. Our new system reserves wide moat ratings for companies with the highest and most stable returns on capital, which typically means a focus on long-haul pipelines (preferably liquids pipes because of their favorable regulatory framework) and minimal exposure to gathering, processing, fractionation, and similar commodity-price-sensitive activities.

Company	Star Rating	Moat	Moat Trend	Stewardship	Uncertainty	P/FV	Current Price	Fair Value	Yield	Portfolio
HCP HCP	★★★★	Narrow	Stable	Standard	High	0.80	32.87	41	7.0	Tortoise Holding
Tanger Factory Outlet Centers SKT	★★★★	Narrow	Stable	Exemplary	Medium	0.84	35.22	42	3.7	Potential Hare Holding
Plains GP Holdings PAGP	★★★	Wide	Stable	Standard	Very High	0.85	9.39	11 ↑	—	Potential Hare Holding
Spectra Energy Partners SEP	★★★★	Wide	Stable	Standard	Low	0.86	44.94	52	5.8	Potential Tortoise Holding
Enterprise Products Partners EPD	★★★★	Narrow ↓	Stable	Exemplary	Low ↓	0.87	27.76	32	5.7	Tortoise Holding
Magellan Midstream Partners MMP	★★★★	Wide	Stable	Exemplary	Low	0.92	70.05	76	4.6	Tortoise Holding
Welltower HCN	★★★	Narrow	Stable	Standard	Medium	0.92	68.91	75	5.0	Potential Hare Holding
Dominion Resources D	★★★	Wide	Stable	Exemplary	Low ↓	0.95	72.25	76 ↑	3.9	Potential Tortoise Holding
Duke Energy DUK	★★★★	Narrow	Stable	Standard	Low	0.95	78.23	82	4.2	Potential Tortoise Holding
Enbridge ENB	★★★	Wide	Positive	Standard	Medium	0.95	39.89	42	4.1	Potential Tortoise Holding
Sunoco Logistics Partners SXL	★★★	Narrow ↓	Stable	Standard	High	0.95	27.45	29	—	Potential Hare Holding
AmeriGas Partners APU	★★★	Narrow	Stable	Standard	Medium	0.96	45.88	48	8.2	Potential Tortoise Holding
Crown Castle International CCI	★★★	Narrow	Stable	Standard	Medium	0.96	90.81	95	3.9	Potential Hare Holding
Spectra Energy SE	★★★	Wide	Stable	Exemplary	Medium	0.97	31.86	33	5.1	Potential Tortoise Holding
American Tower AMT	★★★	Narrow	Stable	Standard	Medium	1.01	105.78	105	1.9	Potential Hare Holding
Verizon VZ	★★★	Narrow	Stable	Standard	Medium	1.02	50.90	50	4.4	Potential Tortoise Holding
Southern SO	★★★	Narrow	Stable	Exemplary	Low	1.03	49.44	48	4.5	Potential Tortoise Holding
Energy Transfer Equity ETE	★★★	Narrow ↓	Stable	Standard	High	1.05	12.64	12	—	Potential Hare Holding
Ventas VTR	★★★	Narrow	Stable	Exemplary	Medium	1.05	66.33	63	4.4	Hare Holding
ITC Holdings ITC	★★	Wide	Stable	Exemplary	Low	1.06	44.52	42	1.7	Potential Tortoise Holding
Williams Companies WMB	★★★	Narrow ↓	Stable ↓	Standard	Medium ↓	1.06	22.16	21 ↑	—	Potential Hare Holding
Comcast CMCSA	★★	Wide	Negative	Standard	Low	1.09	63.30	58	1.7	Potential Tortoise Holding
Grupo Aero del Centro Norte OMAB	★★★	Wide	Stable	Standard	High	1.14	45.77	40	—	Potential Hare Holding
Exelon EXC	★★	Narrow	Stable	Standard	Medium	1.14	34.27	30	3.7	Potential Hare Holding
Grupo Aero del Sureste ASR	★★	Wide	Stable	Standard	High	1.17	157.39	135	—	Potential Hare Holding
TransCanada TRP	★★	Narrow	Stable	Standard	Medium	1.18	41.46	35	4.3	Potential Tortoise Holding
ONEOK, Inc. OKE	★★	Narrow ↓	Stable ↓	Standard	High ↓	1.20	43.25	36 ↑	—	Potential Hare Holding
Realty Income O	★★	Narrow	Stable	Exemplary	Medium	1.20	60.09	50	4.0	Potential Tortoise Holding
Grupo Aero del Pacifico PAC	★★	Wide	Stable	Standard	High	1.26	100.91	80 ↑	—	Potential Hare Holding

Data as of May 31, 2016. Fair value based on Morningstar analyst estimates.
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Consumer Staples Packaged Food/Beverages, Household/Personal Care, Tobacco, Retailers

The consumer staples sector carries the second-largest weighting in the Tortoise at 14.5%. That's split between a 6.9% position in Philip Morris International, a global tobacco leader (excluding the U.S.); a 5.6% position in Unilever, a diversified packaged foods and household and personal-care vendor; and a 2.1% position in PepsiCo, which sells snack foods and nonalcoholic beverages. In many ways, the consumer staples field is a natural fit for the Tortoise's strategy: The companies are economically defensive, offer above-average dividend yields, and frequently have very wide moats. Philip Morris, Unilever, and PepsiCo can all trace their roots back more than 100 years, and in all likelihood they'll still be around 100 years from now. The drawback is that consumer staples stocks come with hefty price tags—P/E multiples in the low to mid-20s are the norm—which can be difficult to justify in light of modest growth prospects.

Company	Star Rating	Moat	Moat Trend	Stewardship	Uncertainty	P/FV	Current Price	Fair Value	Yield	Portfolio
Boston Beer SAM	★★★★	Narrow	Stable	Standard	Medium	0.86	155.40	180	0.0	Potential Hare Holding
Hershey HSY	★★★★	Wide	Negative	Standard	Medium	0.90	92.85	103	2.5	Potential Tortoise Holding
Procter & Gamble PG	★★★★	Wide	Stable	Standard	Low	0.90	81.04	90	3.3	Potential Tortoise Holding
Nestle NSRGY	★★★★	Wide	Stable	Standard	Low	0.91	73.90	81 ↓	3.1	Potential Tortoise Holding
Diageo DEO	★★★	Wide	Stable	Standard	Medium	0.92	109.13	118	3.1	Potential Tortoise Holding
Mondelez International MDLZ	★★★	Wide	Stable	Standard	Medium	0.93	44.49	48	1.5	Potential Tortoise Holding
Wal-Mart Stores WMT	★★★★	Wide	Negative	Standard	Low	0.94	70.78	75	2.8	Potential Tortoise Holding
Mead Johnson Nutrition MJN	★★★	Wide	Stable	Standard	High	0.95	82.28	87 ↓	2.0	Potential Tortoise Holding
Colgate-Palmolive CL	★★★	Wide	Stable	Exemplary	Low	0.99	70.41	71	2.2	Potential Tortoise Holding
Anheuser-Busch Inbev BUD	★★★	Wide	Stable	Exemplary	Medium	1.00	126.22	126	3.2	Potential Tortoise Holding
Coca-Cola KO	★★★	Wide	Stable	Exemplary	Low	1.01	44.60	44	3.1	Potential Tortoise Holding
PepsiCo PEP	★★★	Wide	Stable	Standard	Low	1.01	101.17	100	3.0	Tortoise Holding
Reynolds American RAI	★★★	Wide	Negative	Standard	Medium	1.04	49.70	48	3.4	Potential Tortoise Holding
SABMiller SBMRY	★★★	Wide	Stable	Exemplary	Medium	1.04	62.26	60	2.0	Potential Tortoise Holding
Unilever UL	★★★	Wide	Stable	Standard	Low	1.04	45.56	44	3.2	Tortoise Holding
Ambev ABEV	★★★	Wide	Positive	Exemplary	Medium	1.05	5.26	5	—	Potential Hare Holding
Costco Wholesale COST	★★	Wide	Stable	Exemplary	Low	1.06	148.77	140	1.2	Potential Tortoise Holding
British American Tobacco BTI	★★	Wide	Stable	Standard	Low	1.07	121.65	114 ↓	3.7	Potential Tortoise Holding
Philip Morris International PM	★★	Wide	Stable	Standard	Low	1.07	98.68	92	4.1	Tortoise Holding
Altria Group MO	★★	Wide	Negative	Standard	Low	1.08	63.64	59	3.5	Potential Tortoise Holding
Imperial Brands IMBBY	★★	Wide	Stable	Standard	Low	1.09	108.80	100 ↑	3.9	Potential Hare Holding
McCormick MKC	★★	Wide	Stable	Standard	Low	1.09	97.07	89	1.8	Potential Tortoise Holding
Clorox CLX	★★	Wide	Stable	Exemplary	Low	1.12	128.54	115 ↑	2.5	Potential Tortoise Holding
Brown-Forman BF.B	★★	Wide	Stable	Exemplary	Low	1.17	98.07	84	1.4	Potential Tortoise Holding
Kimberly-Clark KMB	★★	Narrow	Stable	Exemplary	Medium	1.17	127.04	109	2.9	Potential Tortoise Holding
Molson Coors Brewing TAP	★★	Narrow	Stable	Standard	Medium	1.19	99.18	83 ↑	1.7	Potential Tortoise Holding
Kraft Heinz KHC	★★	Narrow	Stable	Standard	Medium	1.21	83.19	69	2.8	Potential Tortoise Holding

Data as of May 31, 2016. Fair value based on Morningstar analyst estimates.
↑ = Rating Increase ↓ = Rating Decrease T = Tortoise Holding T = Potential Tortoise Holding H = Hare Holding H = Potential Hare Holding ★ = New Addition UR = Under Review

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Consumer Discretionary Internet, Media, Retailers, Restaurants, Luxury, Apparel, Vehicles

I probably don't sing Lowe's praises often enough. In an environment where most retailers are struggling with cautious consumers and increased competition from Amazon.com, Lowe's continues to deliver outstanding results. Same-store sales advanced 7.3% in the first quarter—only the second time in the past seven years that Lowe's has outperformed Home Depot on this measure. Operating margin expansion and share repurchases contributed to 24% growth in adjusted earnings per share. While consumers are avoiding the mall, they're still willing to splurge on home improvement projects. Furthermore, this remains one of the few retail categories that is largely insulated from e-commerce. Many of Lowe's products are bulky and expensive to ship, others are needed immediately while a project is underway, and in some cases consumers may want to see products in person or consult a salesperson before buying.

Company	Star Rating	Moat	Moat Trend	Stewardship	Uncertainty	P/FV	Current Price	Fair Value	Yield	Portfolio
Priceline Group PCLN	★★★★	Narrow	Positive	Exemplary	High	0.70	1,264.33	1,800 ↓	0.0	**H**
✶ Hanesbrands HBI	★★★★	Narrow	Stable	Standard	Medium	0.71	27.07	38	1.6	H
Polaris Industries PII	★★★★	Wide	Stable	Exemplary	High	0.71	85.02	119	2.6	H
Tiffany TIF	★★★★	Wide	Stable	Standard	Medium	0.73	61.96	85 ↓	2.9	H
Walt Disney DIS	★★★★	Wide	Stable	Standard	Medium	0.74	99.22	134	1.4	T
Apple AAPL	★★★★	Narrow	Positive	Standard	High	0.75	99.86	133	2.3	H
Expedia EXPE	★★★★	Narrow	Stable	Standard	Very High	0.77	111.24	145	0.9	H
VF Corporation VFC	★★★★	Wide	Positive	Exemplary	Medium	0.80	62.32	78	2.4	H
Ferrari RACE	★★★★	Wide	Stable	Standard	Medium	0.82	42.43	52 ↑	1.2	H
Twenty-First Century Fox FOXA	★★★★	Wide	Stable	Standard	Medium	0.83	28.88	35	1.0	H
Chipotle Mexican Grill CMG	★★★	Narrow	Positive	Standard	High	0.84	441.96	525	0.0	H
Starbucks SBUX	★★★★	Wide	Positive	Exemplary	Medium	0.84	54.89	65	1.5	H
TripAdvisor TRIP	★★★★	Narrow	Stable	Standard	High	0.84	67.74	81	0.0	H
Harley-Davidson HOG	★★★★	Wide	Stable	Standard	High	0.86	46.39	54	3.0	H
LinkedIn LNKD	★★★	Wide	Stable	Standard	High	0.88	136.50	155	0.0	H
L Brands LB	★★★★	Wide	Stable	Standard	Medium	0.89	68.55	77 ↓	3.5	H
Time Warner TWX	★★★★	Wide	Stable	Standard	Medium	0.89	75.66	85	2.1	**H**
Yum Brands YUM	★★★★	Wide	Negative	Standard	Medium	0.89	82.09	92	2.2	H
Amazon.com AMZN	★★★	Wide	Stable	Exemplary	High	0.90	722.79	800	0.0	H
Alibaba Group BABA	★★★	Wide	Stable	Poor	High	0.93	82.00	88 ↑	0.0	H
Alphabet GOOG	★★★	Wide	Stable	Standard	High	0.94	735.72	780 ↑	0.0	**H**
McDonald's MCD	★★★	Wide	Negative	Standard	Medium	0.94	122.06	130	2.9	T
AutoZone AZO	★★★	Narrow	Positive	Exemplary	Medium	0.95	762.20	800	0.0	H
Baidu BIDU	★★★	Wide	Stable	Standard	Very High ↑	0.96	178.54	186 ↓	0.0	**H**
Lowe's LOW	★★★	Wide	Stable	Exemplary	Medium	0.97	80.13	83 ↑	1.8	**T**
MercadoLibre MELI	★★★	Narrow	Positive	Standard	High	0.97	136.50	140 ↑	0.4	H
Nike NKE	★★★	Wide	Stable	Exemplary	Medium	0.97	55.22	57	1.2	H
EBay EBAY	★★★	Narrow	Negative	Standard	High	0.98	24.46	25	0.0	**H**
Sherwin-Williams SHW	★★★	Narrow	Stable	Exemplary	High	1.00	291.09	290	1.1	H
Home Depot HD	★★★	Wide	Stable	Exemplary	Medium	1.06	132.12	125 ↑	2.1	T
TJX TJX	★★★	Narrow	Stable	Exemplary	Medium	1.06	76.12	72 ↓	1.4	H
CarMax KMX	★★★	Narrow	Positive	Standard	High	1.14	53.66	47	0.0	**H**
O'Reilly Automotive ORLY	★★	Narrow	Positive	Exemplary	Medium	1.15	264.43	229 ↓	0.0	H
Facebook FB	★★	Wide	Stable	Standard	High	1.29	118.81	92	0.0	H
Netflix NFLX	★★	Narrow	Stable	Standard	Very High	1.49	102.57	69	0.0	H

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Business Services & Technology Software, Semiconductors, Data, Consulting, Outsourcing

Among wide-moat business-services companies, Jones Lang LaSalle and CBRE Group are trading at the greatest discounts to our fair value estimates. These firms are leaders in commercial real estate services; you've probably seen their signs on commercial properties in your area. They are involved in all aspects of managing commercial real estate, including leasing and sales, investment management, capital markets services, appraisals, and facility maintenance. This a relationship-based business, and if enterprise customers are satisfied with the services provided, they're usually hesitant to switch vendors. JLL and CBRE are further increasing customer switching costs through comprehensive outsourcing deals. On the negative side, the business is deeply cyclical—real estate activity can grind to a halt in a recession. Investors fear we may be close to peak cyclical conditions, which explains why the stocks are so out of favor.

Company	Star Rating	Moat	Moat Trend	Stewardship	Uncertainty	P/FV	Current Price	Fair Value	Yield	Portfolio
Jones Lang LaSalle JLL	★★★★	Wide	Stable	Exemplary	High	0.69	117.86	172	0.5	H
CBRE Group CBG	★★★★	Wide	Stable	Standard	High	0.77	29.85	39	0.0	H
Qualcomm QCOM	★★★★	Narrow	Negative	Standard	High	0.81	54.92	68	3.9	H
Microsoft MSFT	★★★★	Wide	Stable	Standard	Medium	0.87	53.00	61	2.7	T
Cerner CERN	★★★★	Wide	Stable	Standard	Medium	0.88	55.61	63	0.0	H
Oracle ORCL	★★★	Wide	Stable	Standard	Medium	0.91	40.20	44	1.5	T
Salesforce.com CRM	★★★	Wide	Positive	Standard	High	0.93	83.71	90 ↑	0.0	H
Adobe Systems ADBE	★★★	Wide	Stable	Standard	Medium	0.96	99.47	104	0.0	H
Analog Devices ADI	★★★	Wide	Stable	Exemplary	Medium	0.96	58.50	61	2.9	H
Cognizant Technology Solutions CTSH	★★★	Narrow	Stable	Standard	Medium	0.96	61.44	64	0.0	H
IHS IHS	★★★	Wide	Stable	Standard	Medium	0.96	122.93	128	0.0	H
Autodesk ADSK	★★★	Wide	Stable	Standard	Medium	0.97	58.27	60	0.0	H
ARM Holdings ARMH	★★★	Wide	Positive	Standard	High	0.98	43.10	44	0.9	H
Intel INTC	★★★	Wide	Negative	Standard	Medium	1.02	31.59	31	3.3	T
Blackbaud BLKB	★★★	Wide	Stable	Standard	High	1.03	62.67	61	0.8	H
Linear Technology LLTC	★★★	Wide	Stable	Exemplary	Medium	1.03	47.32	46	2.7	H
CoStar Group CSGP	★★★	Wide	Positive	Exemplary	High	1.06	206.59	194	0.0	H
International Business Machines IBM	★★★	Narrow	Negative	Standard	High	1.06	153.74	145	3.6	T
Texas Instruments TXN	★★★	Wide	Stable	Exemplary	Medium	1.06	60.60	57	2.5	H
Automatic Data Processing ADP	★★	Wide	Stable	Standard	Medium	1.11	87.84	79	2.4	T
Dassault Systemes DASTY	★★	Wide	Stable	Standard	Medium	1.13	78.92	70	0.7	H
Paychex PAYX	★★	Wide	Stable	Standard	Medium	1.13	54.22	48	3.1	T
Ritchie Bros Auctioneers RBA	★★	Wide	Stable	Standard	Medium	1.13	32.72	29	2.0	H
Dun & Bradstreet DNB	★★	Wide	Stable	Standard	Medium	1.16	126.90	109	1.5	H
Accenture ACN	★★	Wide	Stable	Exemplary	Medium	1.18	118.97	101	1.8	H
Intuit INTU	★★	Wide	Stable	Standard	Medium	1.19	106.66	90	1.1	H
FactSet Research Systems FDS	★★	Wide	Stable	Standard	Medium	1.21	159.07	131	1.3	H
Fiserv FISV	★	Wide	Stable	Exemplary	Medium	1.37	105.33	77	0.0	H
Equifax EFX	★	Wide	Stable	Standard	Medium	1.38	125.73	91	1.0	H
Jack Henry & Associates JKHY	★	Wide	Stable	Standard	Medium	1.41	84.43	60	1.3	H

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Healthcare Pharmaceuticals, Medical Devices/Instruments, Healthcare Services

With a wide moat, exemplary stewardship, low uncertainty, and a price/fair value ratio of 0.64, our analysts are clearly very bullish on Allergan. My hesitation thus far is because of two factors that I see as red flags, especially since they were also present at Valeant Pharmaceuticals. First, Allergan was built through a series of large acquisitions executed in a very short period of time, involving predecessor firms such as Actavis, Watson, Warner Chilcott, Forest Labs, and Allergan. I've found that integrating large acquisitions is a challenging task even in the best of circumstances; doing too many deals too quickly could be a sign that shortcuts were taken. Second, there is a large discrepancy between Allergan's adjusted earnings—the focus of most analysts—and its results under generally accepted accounting principles. I'm not entirely comfortable with the non-GAAP adjustments, particularly the exclusion of amortization.

Company	Star Rating	Moat	Moat Trend	Stewardship	Uncertainty	P/FV	Current Price	Fair Value	Yield	Portfolio
Valeant Pharmaceuticals International VRX	★★★★★	Narrow	Stable	Standard	Very High	0.33	28.45	85 ↓	0.0	Potential Hare Holding
Allergan AGN	★★★★★	Wide	Stable	Exemplary	Low	0.64	235.75	370	0.0	Potential Hare Holding
Biomarin Pharmaceutical BMRN	★★★★★	Narrow	Positive	Standard	Medium	0.68	89.65	132	0.0	Potential Hare Holding
Gilead Sciences GILD	★★★★★	Wide	Stable	Exemplary	Medium	0.70	87.06	124	2.2	Potential Hare Holding
Express Scripts ESRX	★★★★	Wide	Stable	Standard	Medium	0.76	75.53	100	0.0	Hare Holding
Sanofi SNY	★★★★	Wide	Stable	Standard	Medium	0.76	41.20	54	4.0	Potential Tortoise Holding
Biogen BIIB	★★★★	Wide	Stable	Standard	Medium	0.78	289.73	370	0.0	Potential Hare Holding
Roche Holding RHHBY	★★★★★	Wide	Stable	Standard	Low	0.78	32.88	42 ↑	3.1	Potential Tortoise Holding
Amgen AMGN	★★★★	Wide	Stable	Standard	Low	0.81	157.95	194	2.5	Potential Hare Holding
Varian Medical Systems VAR	★★★★	Wide	Stable	Standard	Medium	0.83	82.79	100	0.0	Potential Hare Holding
Celgene CELG	★★★★	Narrow	Positive	Standard	Medium	0.88	105.52	120	0.0	Potential Hare Holding
Merck MRK	★★★★	Wide	Stable	Standard	Low	0.89	56.26	63	3.3	Potential Tortoise Holding
Novartis NVS	★★★★	Wide	Stable	Standard	Low	0.89	79.51	89	3.4	Tortoise Holding
Abbott Laboratories ABT	★★★★	Narrow	Stable	Standard	Low	0.90	39.63	44 ↓	2.6	Potential Tortoise Holding
Pfizer PFE	★★★★	Wide	Stable	Standard	Low	0.91	34.70	38	3.5	Potential Tortoise Holding
St. Jude Medical STJ	★★★	Wide	Stable	Standard	Medium	0.92	78.36	85	1.6	Potential Hare Holding
CVS Health CVS	★★★	Wide	Stable	Standard	Medium	0.93	96.45	104	1.8	Potential Tortoise Holding
Icon ICLR	★★★	Narrow	Positive	Standard	Medium	0.93	70.44	76	0.0	Potential Hare Holding
Bristol-Myers Squibb BMY	★★★	Wide	Stable	Standard	Medium	0.94	71.70	76	2.1	Potential Hare Holding
GlaxoSmithKline GSK	★★★	Wide	Stable	Standard	Medium	0.94	42.37	45	5.5	Potential Tortoise Holding
Laboratory Corp of America LH	★★★	Narrow	Positive	Standard	Medium	0.95	127.95	135	0.0	Potential Hare Holding
Quintiles Transnational Holdings Q	★★★	Narrow	Positive	Standard	Medium	0.96	67.89	71	0.0	Potential Hare Holding
Stryker SYK	★★★	Wide	Stable	Standard	Medium	0.97	111.16	115	1.4	Potential Tortoise Holding
Anthem ANTM	★★★	Narrow	Negative	Standard	Medium	1.00	132.16	132	2.0	Potential Hare Holding
Baxter International BAX	★★★	Narrow	Stable	Standard	Medium	1.03	43.16	42	1.2	Potential Hare Holding
Waters WAT	★★★	Wide	Stable	Exemplary	Medium	1.04	137.55	132	0.0	Potential Hare Holding
Zimmer Biomet Holdings ZBH	★★★	Wide	Stable	Standard	Medium	1.05	122.11	116	0.8	Potential Tortoise Holding
Medtronic MDT	★★★	Wide	Stable	Standard	Medium	1.06	80.48	76	1.9	Potential Tortoise Holding
Novo Nordisk NVO	★★★	Wide	Stable	Exemplary	Medium	1.06	56.04	53	1.7	Potential Hare Holding
Johnson & Johnson JNJ	★★	Wide	Stable	Standard	Low	1.08	112.69	104	2.8	Tortoise Holding
Cooper Companies COO	★★★	Narrow	Stable	Standard	Medium	1.09	162.81	150	0.0	Hare Holding
Illumina ILMN	★★★	Narrow	Stable	Exemplary	High	1.11	144.83	130	0.0	Potential Hare Holding
Intuitive Surgical ISRG	★★★	Wide	Stable	Standard	High	1.11	634.71	570	0.0	Potential Hare Holding
UnitedHealth Group UNH	★★	Narrow	Negative	Standard	Medium	1.15	133.67	116	1.5	Potential Hare Holding

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Financial Services Banks, Asset Managers, Payment Networks, Exchanges, Insurers

We own five separate payments firms across our two portfolios: MasterCard, Visa, PayPal, Discover, and American Express. There's a lot to like about the payments industry, including the secular shift away from cash and checks; high returns on capital, especially relative to other financial-services firms; and multiple sources of moats, including network effects, brands, cost advantages, and switching costs. On the other hand, issuers like AmEx and Discover face intense competition and growing regulatory pressure on merchant discount rates. Mobile payments pose a long-term disruptive risk for Visa and MasterCard. And lots of financial technology companies are gunning for PayPal's core business. I'm intrigued by a sixth payments firm — private-label credit card issuer Synchrony Financial — but I don't think we can seriously consider the stock unless we sell or trim one of our current holdings.

Company	Star Rating	Moat	Moat Trend	Stewardship	Uncertainty	P/FV	Current Price	Fair Value	Yield	Portfolio
Blackstone Group BX	★★★★	Wide	Stable	Exemplary	High	0.64	26.19	41	—	Potential Hare Holding
Citigroup C	★★★★	Narrow	Stable	Standard	High	0.68	46.57	68	0.4	Potential Tortoise Holding
Visa V	★★★★	Wide	Stable	Standard	Medium	0.76	78.94	104	0.7	Tortoise Holding
Westpac Banking WBK	★★★★	Wide	Stable	Exemplary	Medium	0.76	22.04	29 ↑	6.2	Potential Hare Holding
Synchrony Financial SYF	★★★★	Narrow	Stable	Exemplary	High	0.78	31.20	40	0.0	Potential Hare Holding
PayPal PYPL	★★★★	Narrow	Stable	Standard	Very High	0.79	37.79	48	0.0	Hare Holding
MasterCard MA	★★★★	Wide	Stable	Standard	Medium	0.80	95.90	120	0.8	Hare Holding
Invesco IVZ	★★★★	Narrow	Positive	Standard	Medium	0.81	31.40	39	3.6	Potential Hare Holding
US Bancorp USB	★★★★	Wide	Stable	Exemplary	Medium	0.82	42.82	52	2.4	Potential Tortoise Holding
Berkshire Hathaway BRK.B	★★★★	Wide	Stable	Exemplary	Medium	0.83	140.54	170	0.0	Tortoise Holding
State Street STT	★★★★	Wide	Stable	Standard	Medium	0.83	63.06	76	2.2	Potential Hare Holding
Wells Fargo WFC	★★★★	Wide	Stable	Exemplary	Medium	0.83	50.72	61	3.0	Tortoise Holding
Bank of Nova Scotia BNS	★★★	Wide	Stable	Exemplary	High	0.84	48.93	58	4.5	Potential Hare Holding
Bank of New York Mellon BK	★★★★	Wide	Stable	Standard	Medium	0.86	42.06	49	1.6	Potential Tortoise Holding
American Express AXP	★★★★	Wide	Stable	Standard	Medium	0.87	65.76	76	1.8	Tortoise Holding
Bank of America BAC	★★★	Narrow	Stable	Standard	High	0.87	14.79	17	1.3	Potential Tortoise Holding
Toronto-Dominion Bank TD	★★★	Wide	Stable	Exemplary	High	0.87	43.60	50	4.0	Potential Hare Holding
Franklin Resources BEN	★★★	Wide	Stable	Standard	High	0.96	37.35	39	1.9	Potential Hare Holding
JPMorgan Chase JPM	★★★	Narrow	Stable	Standard	High	0.99	65.27	66	2.9	Potential Tortoise Holding
Royal Bank of Canada RY	★★★	Wide	Stable	Standard	High	0.99	60.21	61	4.1	Potential Hare Holding
BlackRock BLK	★★★	Wide	Positive	Exemplary	Medium	1.00	363.85	365	2.5	Hare Holding
T. Rowe Price Group TROW	★★★	Wide	Stable	Exemplary	Medium	1.00	77.06	77	2.8	Potential Hare Holding
Charles Schwab SCHW	★★★	Wide	Stable	Standard	High	1.02	30.58	30	0.9	Potential Hare Holding
Eaton Vance EV	★★★	Wide	Stable	Standard	Medium	1.04	36.36	35	2.9	Potential Hare Holding
Intercontinental Exchange ICE	★★★	Wide	Stable	Standard	High	1.04	271.12	260	1.2	Potential Hare Holding
Cullen/Frost Bankers CFR	★★★	Narrow	Stable	Exemplary	Medium	1.05	66.90	64	3.2	Potential Hare Holding
Northern Trust NTRS	★★★	Wide	Stable	Exemplary	Medium	1.07	74.10	69 ↑	1.9	Potential Tortoise Holding
Discover Financial Services DFS	★★★	Narrow	Positive	Exemplary	High	1.09	56.81	52	2.0	Hare Holding
CME Group CME	★★★	Wide	Stable	Standard	High	1.10	97.89	89	2.4	Hare Holding

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Industrials & Commodities Manufacturers, Energy Producers/Services, Mining, Agriculture

A new analyst has assumed coverage of the defense industry, but our view is largely unchanged: After delivering exceptional returns over the past several years, most defense stocks look fairly valued to overvalued. Defense spending is cyclical and depends on the geopolitical environment. After a massive ramp-up in the 2000s for the wars in Iraq and Afghanistan, the U.S. defense budget has been steadily declining so far this decade. However, the defense spending cycle appears to be turning, with modest growth expected over the next five years as the U.S. replaces and upgrades equipment and prepares for a variety of new threats, such as Islamic State in the Middle East and China's increasing assertiveness in the South China Sea. While stock prices have already anticipated the improved growth outlook, General Dynamics is our analyst's top pick for its exemplary management and solid portfolio of businesses.

Company	Star Rating	Moat	Moat Trend	Stewardship	Uncertainty	P/FV	Current Price	Fair Value	Yield	Portfolio
Potash Corp. of Saskatchewan POT	★★★★	Narrow	Stable	Exemplary	Very High	0.71	16.33	23	6.1	H
Emerson Electric EMR	★★★★	Wide	Stable	Standard	Medium	0.84	52.02	62	3.6	T
United Technologies UTX	★★★★	Wide	Stable	Standard	Medium	0.84	100.58	120	2.6	T
Compass Minerals CMP	★★★★	Wide	Stable	Exemplary	Medium	0.88	77.95	89	3.6	H
Boeing BA	★★★	Wide	Stable	Standard	Medium	0.91	126.15	138	3.5	H
Deere DE	★★★	Wide	Stable	Exemplary	Medium	0.92	82.29	89	2.9	H
Praxair PX	★★★	Wide	Stable	Standard	Medium	0.93	109.86	118	2.7	T
Monsanto MON	★★★	Wide	Stable	Standard	Medium	0.94	112.47	120	1.9	H
General Dynamics GD	★★★	Wide	Stable	Exemplary ↑	Medium	0.98	141.87	145	2.1	T
General Electric GE	★★★	Wide	Stable	Standard	Medium	1.01	30.23	30	3.0	T
Rockwell Automation ROK	★★★	Wide	Stable	Exemplary	Medium	1.01	116.05	115	2.5	H
3M MMM	★★★	Wide	Stable	Exemplary	Low	1.02	168.32	165	2.6	T
Honeywell International HON	★★★	Wide	Stable	Standard	Medium	1.03	113.83	110	2.1	H
Martin Marietta Materials MLM	★★★	Narrow	Stable	Exemplary	High	1.03	189.04	184 ↑	0.9	H
ABB ABB	★★★	Wide	Stable	Standard	Medium	1.04	20.78	20	3.7	T
Chevron CVX	★★★	Narrow	Negative	Exemplary	Medium	1.06	101.00	95	4.2	T
Core Laboratories CLB	★★★	Wide	Stable	Exemplary	Medium	1.06	121.25	114	1.8	H
Caterpillar CAT	★★★	Wide	Negative	Standard	High	1.07	72.51	68	4.2	H
Cabot Oil & Gas COG	★★★	Narrow	Stable	Standard	High	1.09	23.97	22	0.3	H
Exxon Mobil XOM	★★	Narrow	Negative	Exemplary	Low	1.13	89.02	79	3.4	T
Illinois Tool Works ITW	★★	Narrow	Stable	Standard	Medium	1.13	106.03	94	2.1	H
Lockheed Martin LMT	★★	Wide	Positive ↑	Standard	Medium	1.15	236.23	206	2.8	T
Ecolab ECL	★★	Narrow	Positive	Standard	Medium	1.16	117.24	101	1.2	H
Schlumberger SLB	★★	Wide	Stable	Standard	High ↑	1.16	76.30	66 ↑	2.6	H
Vulcan Materials VMC	★★	Narrow	Stable	Standard	High	1.17	116.75	100 ↑	0.7	H
Halliburton HAL	★★	Narrow	Stable	Standard	High	1.36	42.18	31 ↑	1.7	H
Occidental Petroleum OXY	★★	Narrow	Stable	Exemplary	High	1.42	75.44	53	4.0	H

Data as of May 31, 2016. Fair value based on Morningstar analyst estimates.
↑ = Rating Increase ↓ = Rating Decrease T = Tortoise Holding T = Potential Tortoise Holding H = Hare Holding H = Potential Hare Holding ★ = New Addition UR = Under Review

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Microsoft MSFT | ★★★★

Rodney Nelson

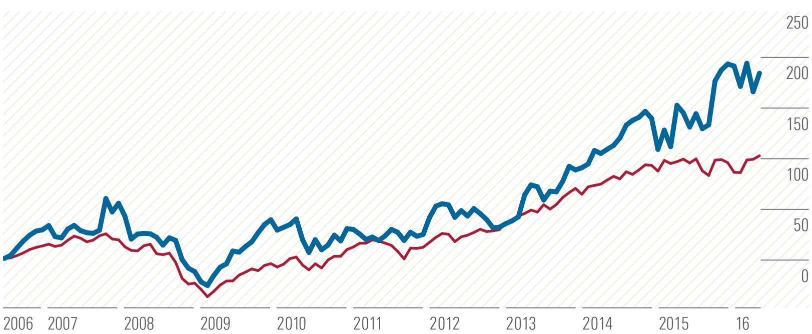
With new management, Microsoft is prioritizing cloud computing to offset declines in legacy businesses.

Morningstar Ratings & Forecasts

Moat	Moat Trend	Stewardship	Uncertainty
Wide	Stable	Standard	Medium

Price/Fair Value	Price ($)	Fair Value ($)	Market Cap ($ bil)
0.87	53.00	61.00	416.6

Total Returns (%)



Morningstar Estimates, 2016		Growth Rates, 2016-20		Valuation, 2016	
Revenue ($ bil)	86.5	Revenue Growth (%)	4.9	Price/Sales	4.8
Earnings Per Share ($)	2.71	EPS Growth (%)	9.6	Price/Earnings	19.6
Free Cash Flow Per Share ($)	2.58	FCF/Share Growth (%)	10.9	FCF Yield (%)	4.9
Annual Dividend Per Share ($)	1.44	Dividend Growth (%)	3.9	Dividend Yield (%)	2.7

Profitability, 2016

Operating Margin (%)	Return on Equity (%)	Return on Invested Capital (%)
26.3	23.4	33.2

Data as of May 31, 2016. Source: Morningstar estimates.

Following the lead of CEO Satya Nadella, Microsoft has embraced changes that we think will leave it better positioned for long-term success. In our view, the company has become nimbler and more user-friendly under Nadella, terms that would have never been applied to the Microsoft of old. Most importantly, Microsoft has emerged as a leader in cloud computing with products like Azure (the firm's public cloud service) and Office 365 (the software-as-a-service version of Microsoft's productivity applications).

We assign Microsoft a wide economic moat. Despite declining PC shipments and an influx of new devices, enterprises continue to rely heavily on Windows-based desktops and laptops. Windows Server is a vital component of enterprise IT infrastructure, while Azure has evolved into a solid number-two behind Amazon Web Services in infrastructure-as-a-service. Microsoft Office remains the leading productivity suite, with more than 1 billion global users. These businesses enjoy a powerful combination of network effects and customer switching costs.

Bulls Say

- Nadella's cloud-first, mobile-first vision for Microsoft is beginning to take hold, and we believe the company is making the appropriate investments to reinforce its economic moat. Rapid growth in cloud services should offset declines in legacy businesses.
- Microsoft's newfound willingness to embrace third-party and open-source developer tools should help it attract and retain developers. The versatility of Windows 10 should drive development of applications that can span desktop and mobile environments.

Bears Say

- Microsoft has struggled in mobile computing. Its mobile operating system is a distant also-ran to **Alphabet's** GOOGL Android and **Apple's** AAPL iOS. The acquisition of Nokia's handset business resulted in a huge write-down just over a year later.
- Declining PC shipments and growing competition threaten Microsoft's core Windows ecosystem. M

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Allergan AGN | ★★★★★

Michael Waterhouse

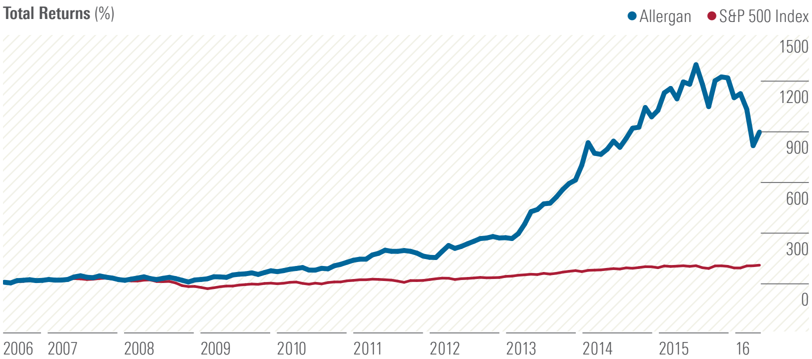
Selling its generic drug unit will enable Allergan to reduce debt, buy back stock, and seek opportunistic acquisitions.

Morningstar Ratings & Forecasts

Moat	Moat Trend	Stewardship	Uncertainty
Wide	Stable	Exemplary	Low

Price/Fair Value	Price ($)	Fair Value ($)	Market Cap ($ bil)
0.64	235.75	370.00	93.3

Total Returns (%)



Morningstar Estimates, 2016	**Growth Rates, 2016-20**	**Valuation, 2016**
Revenue ($ bil) 17.1	Revenue Growth (%) 7.2	Price/Sales 5.5
Earnings Per Share ($) 14.43	EPS Growth (%) 11.2	Price/Earnings 16.3
Free Cash Flow Per Share ($) 13.32	FCF/Share Growth (%) 16.2	FCF Yield (%) 5.7
Annual Dividend Per Share ($) —	Dividend Growth (%) —	Dividend Yield (%) —

Profitability, 2016

Operating Margin (%)	Return on Equity (%)	Return on Invested Capital (%)
—	—	—

Data as of May 31, 2016. Source: Morningstar estimates.

Allergan is a leading specialty pharmaceutical manufacturer, with a focus on aesthetics, ophthalmology, women's health, gastrointestinal, and central nervous system products. The company also has a small drug distribution segment called Anda. Allergan plans to divest its generic drug segment to **Teva Pharmaceutical** TEVA in a deal that should close later this year. The company's acquisition by **Pfizer** PFE fell apart after the U.S. Treasury Department issued new rules intended to prevent tax inversions.

We think Allergan possesses a wide economic moat thanks to its diverse portfolio of branded drugs. The ophthalmology and aesthetic markets enjoy higher barriers to entry and lower risk of generic competition than most pharmaceutical categories. The company also has an extensive presence in the primary care market, with the ability to sell new products to primary care doctors at little incremental cost.

Bulls Say

- Botox will account for around 16% of consolidated revenue after the divestment of the generics business. Botox requires complex manufacturing, and since each injectable neurotoxin can produce unique effects, doctors and patients are hesitant to switch brands.

- The deal with Teva is expected to deliver aftertax proceeds of $36 billion, enabling Allergan to pay down debt, repurchase its own shares, and pursue opportunistic acquisitions to supplement its internal pipeline.

Bears Say

- Lower levels of research and development spending compared with peers puts greater pressure on management to supplement growth through acquisitions. Misallocated capital or integration snafus could lead Allergan astray.

- Allergan's women's health, urology, gastrointestinal, and nervous system franchises face elevated generic competition, which erodes pricing power. Some high-risk pipeline products have development challenges, such as the anti-VEGF DARPin.

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Synchrony Financial SYF | ★★★★

Dan Werner

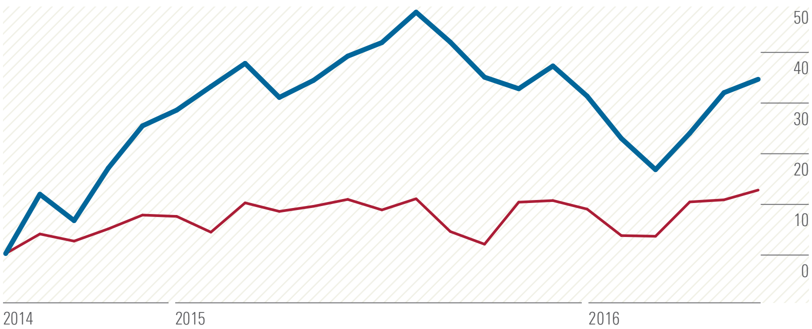
Private-label credit card lending offers solid growth, high returns on capital, and sticky customer relationships.

Morningstar Ratings & Forecasts

Moat	Moat Trend	Stewardship	Uncertainty
Narrow	Stable	Exemplary	High

Price/Fair Value	Price ($)	Fair Value ($)	Market Cap ($ bil)
0.78	31.20	40.00	26.0

Total Returns (%)



Morningstar Estimates, 2016	**Growth Rates, 2016-20**	**Valuation, 2016**
Revenue ($ bil) 10.1	Revenue Growth (%) 8.4	Price/Sales 2.6
Earnings Per Share ($) 2.78	EPS Growth (%) 12.9	Price/Earnings 11.2
Free Cash Flow Per Share ($) 2.22	FCF/Share Growth (%) 14.1	FCF Yield (%) 7.1
Annual Dividend Per Share ($) —	Dividend Growth (%) —	Dividend Yield (%) —

Profitability, 2016

Operating Margin (%)	Return on Equity (%)	Return on Invested Capital (%)
36.7	18.1	15.9

Data as of May 31, 2016. Source: Morningstar estimates.

Synchrony Financial—previously a subsidiary of **General Electric** GE—is the largest issuer of private-label credit cards in the United States measured by purchase volume or receivables. The company extends credit to consumers through partnerships with a diverse group of national and regional retailers, manufacturers, and healthcare providers. Some of its more prominent partners include **Lowe's** LOW, **Wal-Mart** WMT, **JCPenney** JCP, and **Amazon** AMZN.

Synchrony has created a meaningful value proposition for both its retail partners and consumers. When consumers use private-label cards, retailers avoid interchange fees, receive a share of the profits from lending, and enjoy higher customer loyalty. Consumers benefit from in-store discounts and other incentives. Synchrony handles underwriting and retains the receivables, which typically carry high yields.

Bulls Say

- Private-label credit card loans have grown faster than general-purpose credit cards in recent years. High card yields enable Synchrony to earn attractive returns on capital. The company never recorded a net loss during the financial crisis, demonstrating strong underwriting.

- Relationships with retail partners tend to be sticky. Synchrony has worked with its retail card partners for an average of 17 years. Retailer share arrangements—totaling $2.7 billion last year—help to align incentives between Synchrony and its partners.

Bears Say

- Management is relatively untested in operating Synchrony as a stand-alone entity. The separation from General Electric significantly increased back-office and regulatory costs.

- As interest rates rise, funding costs will initially increase faster than receivable yields, compressing margins. Industrywide credit losses are also near a cyclical low and are likely to deteriorate in a recession. On the plus side, Synchrony is very well-capitalized, with a fully phased-in common equity Tier 1 ratio under Basel III of 17.5%. M

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HBI | ★★★★

Bridget Weishaar

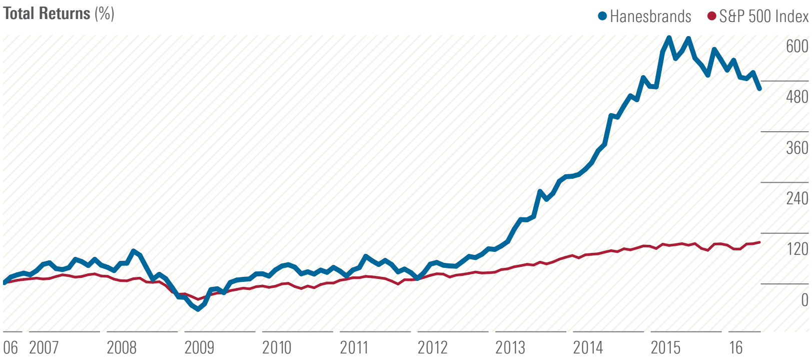
When choosing undergarments, consumers value comfort, fit, and consistency over price.

Morningstar Ratings & Forecasts

Moat	Moat Trend	Stewardship	Uncertainty
Narrow	Stable	Standard	Medium

Price/Fair Value	Price ($)	Fair Value ($)	Market Cap ($ bil)
0.71	27.07	38.00	10.2

Total Returns (%)



Morningstar Estimates, 2016	**Growth Rates, 2016-20**	**Valuation, 2016**
Revenue ($ bil) 6.0	Revenue Growth (%) 5.9	Price/Sales 1.7
Earnings Per Share ($) 1.94	EPS Growth (%) 13.6	Price/Earnings 14.0
Free Cash Flow Per Share ($) 2.60	FCF/Share Growth (%) 5.4	FCF Yield (%) 9.6
Annual Dividend Per Share ($) 0.44	Dividend Growth (%) 13.9	Dividend Yield (%) 1.6

Profitability, 2016

Operating Margin (%)	Return on Equity (%)	Return on Invested Capital (%)
15.8	52.3	31.7

Data as of May 31, 2016. Source: Morningstar estimates.

Hanesbrands manufactures innerwear and activewear apparel under brand names including Hanes, Champion, and Maidenform. Almost 50% of sales are through mass merchants in the United States, with another 20% from international markets and approximately 7% direct to consumers. The remainder of sales come from department stores and specialty retailers.

Hanesbrands' products are found in 80% of American households. When it comes to undergarments, we believe consumers value comfort, fit, and consistency over price. Most people find it unpleasant to try on multiple brands of underwear to find the right fit and size, creating switching costs and brand advantages that are rare in the apparel industry. The company's narrow moat is reinforced by its manufacturing scale.

Bulls Say

- While the apparel business is vulnerable to a slowdown in overall consumer spending, we think Hanesbrands is better positioned than most apparel firms. The majority of its revenue comes from moderately priced basic undergarments, which naturally wear out and need to be replaced.

- Hanesbrands is adept at integrating acquisitions and realizing synergies. We see acquisitions as a way to leverage the company's manufacturing platform to drive down costs, as well as to increase exposure to higher-growth, higher-margin product lines.

Bears Say

- Hanesbrands' operating margins have already expanded to the company's target range, so there may not be much room for improvement. Retailer consolidation, private-label programs, and stringent inventory management could limit sales growth. **Wal-Mart** WMT and **Target** TGT account for 23% and 15% of sales, respectively.

- The innerwear and activewear categories are relatively commodified, with other strong brands offering very similar products. Competitors include Fruit of the Loom, Jockey, Warnaco, **L Brands'** LB Victoria's Secret, **Gap** GPS, and **Gildan Activewear** GIL.

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Berkshire's Annual Meeting Offers More Business Insights Than Past Years

by Greggory Warren, CFA

Berkshire Hathaway BRK.B	
Star Rating	★★★★
Size of Moat	Wide
Moat Trend	Stable
Stewardship	Exemplary
Uncertainty	Medium
Price/Fair Value	0.83
Current Price ($)	140.54
Fair Value ($)	170.00
Sector	Financial Services
Market Cap ($bil)	346.3
P/E	14.1
Dividend Yield (%)	—

Our trek to Omaha for **Berkshire Hathaway's** BRK.B annual meeting found Warren Buffett and Charlie Munger speaking in greater depth about Berkshire's myriad operating businesses and investments than they have in recent years. Based on the pair's responses to our six questions (we were honored to be included on the analyst panel again this year)—as well as those from the other analysts, journalists, and shareholders—we gained valuable insight into several of Berkshire's subsidiaries and walked away with greater confidence in our valuation. We continue to believe that the firm is more than the sum of its parts, and while the eventual departure of Buffett and Munger creates some legitimate concerns for investors, we think they have built a culture and way of doing business that will endure and ultimately make the next CEO's job easier.

Energy Shifts Present Opportunities and Challenges

Declining coal volumes have been a significant headwind for North American railroads. Berkshire's Burlington Northern Santa Fe is no exception, with a 33% decline in coal volumes in the first quarter. Buffett talked about the impact of falling coal volumes several times during the meeting, noting that coal demand is in secular decline because of increased regulation around carbon emissions and greater use of natural gas and alternative energy sources. The situation has been exacerbated by the steep decline in natural gas prices brought on by technological innovation and increased supply from shale plays. The unusually warm 2015–16 winter and an overhang of coal inventory haven't helped either.

BNSF garnered 22% of its freight volumes and revenue from coal last year, and the sharp decline in coal demand is going to continue to have a meaningful impact on near-term results. Coal generally earns solid margins for railroads because it is hauled in unit trains from point to point, with few transportation alternatives. So far, BNSF hasn't been helped by its focus on Wyoming's Powder River Basin, which offers lower-cost and lower-emissions coal. **Union Pacific** UNP, Burlington Northern's primary competitor, has suffered similarly dramatic declines in coal volumes.

We've seen the shift to renewables play out at Berkshire's own utility subsidiaries. Berkshire Hathaway Energy has reduced the share of electricity that it generates from coal-fired plants from 51% at the turn of the century to close to 30% at the end of 2015. We expect this trend to continue; for example, Berkshire has committed to retiring more than 75% of its coal-fired capacity in Nevada by 2019, replacing it primarily with new solar installations. Ongoing investments in wind power in Iowa are expected to lift the share of electricity generated from wind in the state from 47% at the end of 2015 to 85% by the end of 2020.

Berkshire's utilities have a number of competitive advantages when investing in renewable energy. For example, they are able to retain more capital for internal investment, instead of paying out 60%–70% of earnings as dividends like most utilities do. Berkshire is also able to make better use of federal tax credits for renewables thanks to its diverse operations. Buffett noted that **Alliant Energy** LNT, Berkshire's main utility competitor in Iowa, hasn't invested nearly as much in wind power. As a result, Alliant's customer rates are higher than Berkshire's, yet Alliant is likely to need a rate increase within a year. In contrast, Berkshire's Iowa utility is unlikely to pursue a rate increase until 2029 at the earliest. Berkshire's ability to continue investing in renewables will depend in large part upon accommodative state and federal regulation.

Capital Expenditure Plans for the Railroad

One of our questions was about Berkshire's expectations for railroad capital expenditures given lower demand for transporting coal and crude oil by rail. As a reminder, BNSF spent more than just about every railroad on capital expenditures over the past several years, including hundreds of millions of dollars in North Dakota's oil-producing Bakken Shale region.

BNSF reduced its capital expenditure budget from $5.7 billion in 2015 to $4.3 billion this year. That still represents around 20% of BNSF's revenue. Buffett noted that railroads need to spend well in excess of their annual depreciation (about 10% of BNSF's revenue) merely to keep operations running smoothly. Around 65% of BNSF's capital expenditures this year will go toward infrastructure maintenance, with additional spending for locomotives, freight cars, and other equipment. Implementing positive train control safety technology, as mandated by regulators, is expected to cost $200 million–$300 million this year. Buffett indicated that capital spending in 2014–15 was unusually high because of the need to correct past service delays. We believe the $4.3 billion planned for 2016 represents a more normal run rate.

Outlook for Railroad Consolidation

We also asked about the potential for consolidation in the railroad industry after **Canadian Pacific's** CP unsuccessful bid for **Norfolk Southern** NSC. That combination—which would have linked Canada's second-largest carrier with one of the two largest railroads in the eastern U.S.—provoked a negative reaction from federal and state lawmakers, shippers, and other railroads. When the U.S. Surface Transportation Board last blocked a proposed large railroad merger, between BNSF and **Canadian National** CNI in 1999, it declared that "any additional mergers among railroads would have to be accretive to competition."

In response to our question, Matt Rose—BNSF's executive chairman—said that any railroad merger would have to satisfy the rails' four main constituents: customers, labor, the communities they serve, and shareholders. In Berkshire's view, Canadian Pacific's proposal served only shareholders. Rose doesn't see any real interest on the part of the other stakeholders to authorize further consolidation at this time. However, the dynamics of this situation may eventually change because of the growing U.S. population, scarce transportation capacity, and the need to alleviate rail congestion in the Chicago hub. If there is ever another major round of railroad consolidation, BNSF would probably want to participate.

Management Shifts Hint at Succession Planning

Another of our questions centered on Buffett's recent decision to have Ajit Jain take over responsibility for all of Berkshire's reinsurance operations after the retirement of General Re CEO Tad Montross. We expect that the pricing environment for reinsurance will be unfavorable for the foreseeable future, limiting Berkshire's ability to underwrite new business. With Jain overseeing the entire operation, he can streamline costs, pursue international growth opportunities, and make sure that Berkshire Hathaway Reinsurance Group and General Re aren't competing with each other. Buffett reaffirmed that he believes Jain will be able to handle the extra workload, commenting that over the years he has found there is no limit to what really capable people can take on.

While Buffett declined to provide specifics on his own succession planning, we believe that Berkshire's next chief executive will be primarily responsible for capital allocation. The company's many subsidiaries will continue to be managed on a decentralized basis. In this case, we can't think of a better candidate for the CEO role than Jain, who understands risk across a wide range of industries better than just about anyone else at Berkshire. Buffett has also claimed on numerous occasions that Jain has "probably made a lot more money" for Berkshire than Buffett has over Jain's nearly three decades with the firm. The only problem with Jain is that he has publicly stated that he isn't interested in the CEO role. We view the next most likely candidate as Greg Abel, the head of Berkshire Hathaway Energy. Abel has extensive experience with operations, acquisitions, and making large capital investments in the utility business. We expect management of Berkshire's investment portfolio to continue to gradually transition to Todd Combs and Ted Weschler.

Committed to Share Repurchases, at the Right Price

Berkshire is authorized to repurchase its own shares at prices no higher than a 20% premium to book value. However, there has been relatively little share repurchase activity during the past four years, since the stock has rarely traded at that level. Buffett says that he would be very happy to buy back a lot of stock below 1.2 times book value. It may eventually make sense to raise that threshold, as the company won't always be able to reinvest the large sums of cash it pulls in every year.

Changes to Wide Moat Focus Index Aim to Improve the Investor Experience

by Dan Lefkovitz and Ananya Roy

Just as active portfolio managers adapt their investment strategies over time, index providers must periodically revisit their rules. This is especially true in the case of "strategic beta" indexes that aim to beat the market.

Morningstar Indexes recently embarked on an extensive process of research and analysis regarding our flagship Wide Moat Focus Index. This process included consultation with a range of internal and external stakeholders. Based on lessons learned, we are making a number of changes effective June 2016.

The changes will not alter the index's fundamental character. It will continue to target attractively priced, competitively advantaged companies. It will also remain a concentrated, high-conviction strategy. These are methodology enhancements intended to reduce portfolio turnover, ease index tradability, and improve the overall investor experience.

For background, the Wide Moat Focus Index highlights the best ideas of Morningstar's 100-plus equity analysts across the globe. The index was created in 2007 using analyst ratings going back to 2002. It has historically consisted of the 20 U.S.-based stocks with economic moat ratings of wide priced at the steepest discounts to Morningstar's fair value estimates. The index is equal-weighted and has had its membership reset and weightings rebalanced quarterly.

More Holdings

The first change we are making is to increase the number of constituents for the Wide Moat Focus Index from 20 stocks to at least 40 stocks. The universe of moat-rated stocks is large enough to expand the constituent count while remaining discerning on valuation. The expansion will improve index capacity, which is especially relevant given the equal weighting scheme. Increasing the number of stocks should also moderate volatility.

Longer Holding Periods

The second change will enable the Wide Moat Focus Index to hold onto stocks longer. In the past, we reset the entire membership of the index quarterly. Going forward, the index will be divided into halves, each with 40 stocks, and we'll rebalance each half on a staggered quarterly basis. This means the constituent count will fluctuate: Sometimes the halves will contain more of the same stocks than at other times.

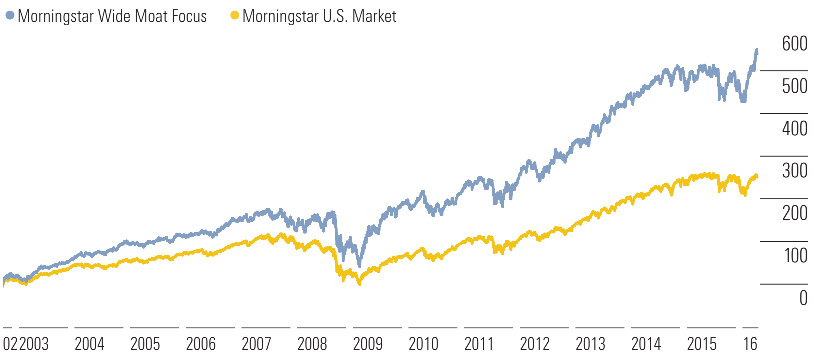
Exhibit 1 Methodology Enhancements

			Impact On:		
Parameter	Current Methodology	Updated Methodology	Capacity	Turnover/ Holding Period	Unintended Sector Bets
Number of Constituents	20	40–80	✓	✓	✓
Reconstitution Frequency	Quarterly	Half of index rebalanced each quarter on a staggered basis	✓	✓	—
Turnover Buffer	N/A	50% buffer	✓	✓	—
Sector Allocation Limit	N/A	Max of 40% or benchmark weight plus 10%	—	—	✓

Source: Morningstar Indexes.

We intend to better align stock holding periods with the long-term investment philosophy of Morningstar's equity research department. Trading will more closely resemble the manner in which an active fund manager gradually builds and unwinds positions. This change will also allow the index to scale more easily.

Exhibit 2 Cumulative Total Returns Since Inception (%)



Source: Morningstar.

Exhibit 3 Constituents as of May 31, 2016 (Old Methodology)

	Stock Price	Fair Value Estimate
Allergan AGN	235.75	370
Amgen AMGN	157.95	194
Bank of New York Mellon BK	42.06	49
Biogen BIIB	289.73	370
CBRE Group CBG	29.85	39
CSX CSX	26.43	33
Express Scripts ESRX	75.53	100
Gilead Sciences GILD	87.06	124
Jones Lang LaSalle JLL	117.86	172
LinkedIn LNKD	136.50	155
MasterCard MA	95.90	120
McKesson MCK	183.14	222
Monsanto MON	112.47	120
Norfolk Southern NSC	84.06	97
St. Jude Medical STJ	78.36	85
State Street STT	63.06	76
US Bancorp USB	42.82	52
Varian Medical Systems VAR	82.79	100
Visa V	78.94	104
Walt Disney DIS	99.22	134

Source: Morningstar.

Third, we will implement a turnover buffer on Wide Moat Focus. At the time of reconstitution, current holdings can remain in the index as long as they are within the 60 cheapest wide-moat stocks based on price/fair value ratios. Combined, these changes should lower turnover significantly compared with the historical rate of around 140% per year.

Emphasizing Stock Picks, Not Sector Picks

Fourth, we will limit sector exposures for the Wide Moat Focus Index. Exposure to any one economic sector will be restricted to 40% of index weight. If a sector weighting in the Morningstar US Market Index happens to exceed 30%, the Wide Moat Focus weighting may go up to 10 percentage points higher.

Performance attribution shows that excess returns recorded by the Wide Moat Focus Index versus the Morningstar US Market Index since its 2002 inception are explained by good stock picks. Unintended sector bets—especially financial services during the 2007–08 period and energy more recently—have detracted from returns. We intend for this methodology change to better capture the analysts' stock selection prowess. We expect the index composition to continue to deviate significantly from the overall market at the stock and sector levels.

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Performance: Portfolios vs. S&P 500 ()

Period	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	YTD 2016	Cumulative[1]	Annualized[1]
Tortoise	13.7	1.6	-22.2	19.4	9.7	7.3	14.9	25.9	21.4	-1.3	4.5	279.1	9.3
Hare	22.0	5.2	-32.4	45.6	14.3	1.4	20.8	37.1	16.8	1.7	3.0	276.6	9.3
Combined [2]	17.3	3.3	-26.8	30.5	11.9	4.5	17.7	31.3	19.1	0.1	3.8	277.8	9.3
S&P 500	15.8	5.5	-37.0	26.5	15.1	2.1	16.0	32.4	13.7	1.4	3.6	132.7	5.8
Relative	1.5	-2.2	10.2	4.1	-3.2	2.4	1.7	-1.1	5.4	-1.2	0.2	145.2	3.5

Performance through May 31, 2016. Returns include interest and reinvested dividends, both for our portfolios and the S&P 500 benchmark.
[1]Since inception June 18, 2001. [2] Time-weighted, assuming equal investments at inception.

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