VALIDEA.COM

2006 GURU PORTFOLIO PERFORMANCE REPORT

REVIEW AND ANALYSIS OF VALIDEA'S GURU BASED MODEL PORTFOLIOS

4 BUCKINGHAM LANE
WEST HARTFORD, CT 06117

GURU PORTFOLIO PERFORMANCE REPORT

REVIEW AND ANALYSIS OF VALIDEA'S GURU BASED MODEL PORTFOLIOS

2006 MARKET OVERVIEW

The stock market did well last year, very well. The Dow Jones Industrial Average hit an all-time high. It started the year at 10,717.50 and closed it at 12,463.15, a gain of 16.3 percent. The Russell 2000 Index did every bit as well as the Dow. It began the year at 673.22 and closed it at 787.22, up an impressive 17.0 percent. The S&P 500 went from 1,248.20 to 1,418.30, a boost of 13.6 percent. NASDAQ did well, but not as well as the other indices. Beginning the year at 2,205.32, it closed at 2,415.29, for a 9.5 percent gain.

These are impressive numbers, but though these various indices did well, the models we use at Validea.com generally did better. In fact, of our 10 major guru models plus the Validea Hot List, only one failed to outperform the Dow *and* the S&P 500 *and* NASDAQ. (The laggard was the William O'Neil strategy, which was down 15.2 percent for the year.)

TOP 2006 VALUE STRATEGIES

The Kenneth Fisher Strategy

The winner among value strategies – and the winner among all our portfolios – is based on the writings of the man who emphasizes sales. Star columnist, star investment guru, star author Kenneth Fisher was the star of 2006. Using the strategy I base on his writings, the Fisher strategy produced a stratospheric return of 40 percent last year.

This strategy is best known for using the price-to-sales ratio (PSR), which Fisher made famous. Think: price-to-earnings ratio, only with sales replacing earnings. He emphasizes sales because earnings, even for good companies, can be highly volatile (and manipulated), while sales rarely decline for top-flight businesses. Changes in accounting rules, changes in the amount of research and development a company does, changes in tax rates, and many other changes can affect earnings, which is why they are so often volatile.

But sales are generally not vulnerable to such vagaries. Fisher believes sales to be more revealing of how well a company is really doing. As a result, a company with troubled earnings but strong sales is a company Fisher may well want to own. If a company has a low PSR, a slight improvement in margins can produce a big gain in earnings (and a big gain in stock price), but the reverse is not true.

Since inception of the Validea guru strategies (July 15, 2003), this strategy has produced a 124.4 percent return. While the Fisher strategy was Number One for 2006, this long-term track record places it only Number Six among all the guru strategies. It has done well (the S&P 500 has gone up 41.8 percent in the same time period, about one-third the gain enjoyed by the Fisher strategy), but other strategies have done better over the long-term.

In fact, in 2005, it lost 2.7 percent (a year when the S&P 500, admittedly, wasn't a star performer, having had a gain of only 3.0 percent). One measure of a strategy is its accuracy, which is the percentage of stock positions within the model portfolio that have produced a positive return divided by the total stocks positions in the portfolio since inception. For example, a portfolio that took five stock positions throughout its history , and four of these positions went up from the start to end date, would have an accuracy of 80%. The Fisher strategy's accuracy rate is 62.4 percent. This compares with the 70.9 percent accuracy rate for the strategy based on the writings of David Dreman, which has the highest rate of return of all our portfolios since inception (July 15, 2003).

Another measure for a strategy is the beta, which measures the volatility of a portfolio relative to the S&P 500. A portfolio with a beta above 1 is more volatile than the overall market, while a portfolio with a beta below 1 is less volatile. A beta of 1 precisely mirrors the movement of the market. The Fisher strategy's beta is 1.08, making it a bit more volatile than the market.

Winners this strategy identified in 2006 included Chevron (CVX), which entered the portfolio on March 24, 2006, and remained until the end of the year, having enjoyed a 23.3. percent gain during that time. Other winners: Conn's (CONN), August 11, 2006 to Nov. 3, 2006, gain of 24.1 percent; Krispy Kreme Doughnuts (KKD), April 21, 2006 to May 19, 2006, gain of 17.4 percent; and Ternium SA (TX), Dec. 1, 2006 to Dec. 29, 2006, gain of 28 percent.

The David Dreman Strategy

The strategy I base on David Dreman's writings rose 34.3 percent in 2006. Dreman is Wall Street's Mr. Contrarian. A well known columnist and author, he looks for stocks that are unfairly out of favor with the market. First, he makes sure the stock is really low priced. To earn this moniker, it must pass at least two of four tests. These are tests where the stock must be among the bottom 20 percent of the market in terms of P/E ratio, price-to-cash flow ratio, price-to-book ratio and price-to-dividend ratio.

If it passes at least two of these tests, then the strategy checks to be sure the stock is being treated unfairly. After all, a stock may be low priced for good reason, namely the company is not performing well. To be sure this is not the case, the strategy looks at a number of financial and other variables to test for its financial strength. These include the current ratio, payout ratio, return on equity, pretax profit margins, yield and debt-to-equity ratio.

Since inception, the Dreman strategy has been our best performing strategy, up 181.4 percent. Its accuracy is 70.9 percent, while its beta is 0.9, meaning that better than seven in 10 picks went up and the strategy is less volatile than the overall market.

Among the winners this strategy picked in 2006 were: ABN Amro (ABN), August 11, 2006 to the end of the year, up 23.3. percent; PetroChina (PTR), Sept. 8, 2006 to Dec. 29, 2006, up 31.0 percent; and Siliconware Precision (SPIL), July 14, 2006 to Nov. 3, 2006, 32.3 percent.

TOP 2006 GROWTH STRATEGIES

James P. O'Shaughnessy Strategy

My interpretation of the writings of James P. O'Shaughnessy resulted in a strategy that had an impressive gain of 24.0 percent in 2006. This is a strategy with one of our better returns, having had a gain of 132 percent since inception. It is more consistent than some other strategies. It gained, for example, 22.4 percent in 2005. This strategy is really designed for those looking for long-term investments, and who are willing to hold for years in order to experience a full cycle of the market.

The O'Shaughnessy strategy looks at such factors as earnings per share persistence (it wants to see EPS increase for each of the last five years), price-to-sales ratio (which should be below 1:5:1.0) and relative strength (how well the stock has done in the past year compared with the other stocks in the market).

Its accuracy has been 59.3 percent and its beta is 1.09, which means its accuracy is lower than either Fisher or Dreman's, and its volatility is a shade more than Fisher's, and a bit more than the market's.

The biggest winner of the year for the O'Shaughnessy strategy was EZCorp (EZPW), which during the short time period of June 16, 2006 to July 14, 2006, went up 27.2 percent. Another quick winner was CitiTrends (CTRN), which was held from October 6, 2006 to Nov. 3, 2006, during which time it gained 21.2 percent. Other winners: Chevron (CVX), held from March 24, 2006 to the end of the year, gain 23.3 percent; PetroChina (PTR), May 19, 2006 to the end of the year, gain 22.6 percent; and The Home Depot (HD), August 11, 2006 to the end of the year, gain 23.4 percent.

You may wonder why some of these stocks were held for only a few weeks, even though we just mentioned that to get the full advantage of this strategy, one has to hold for years. It is the strategy that must be followed for years, not individual stocks. All of our portfolios are rebalanced every 28 days. This, our research has found, maximizes returns. Yet we are long-term investors, though this is not a contradiction.

We invest for the long term in our guru strategies, not in individual stocks. We buy and sell stocks every 28 days, but we follow the thinking of the gurus for years and years. Our research indicates this is the most effective type of long-term investing. It allows the investor to react to quick moves in the market (either up or down), while sticking to a long-term game plan. We get in and out of stocks regularly, but how we decide which stocks to buy and sell is done following a strategy for the long term. This is, in fact, a fundamental element in the Validea.com investment approach – find strategies that work, follow them for the long term, and buy and sell as frequently as they indicate you should do.

Peter Lynch Strategy

Peter Lynch made a name for himself during the 1980s when he captained the Fidelity Magellan mutual fund to the rank of the largest mutual fund in the world. Then, at about age 40 and at the top of his game, he decided to retire. As all good gurus, he then wrote a book, *One Up on Wall Street,* which was a best seller and well received by even sophisticated investors.

Among our growth strategies, this one came in a close second to that of O'Shaughnessy, having gone up 23.3 percent during 2006 (it went up 8.4 percent in 2005). When taking into account all the individual guru strategies, the Lynch strategy ranks a strong third, with a gain from inception of 151.2 percent.

Lynch is known for his homey advice. He tells his readers, for example, that they should look for companies they know and like but are not yet on Wall Street's radar screen. These are the companies to pay attention to, he recommends, though one shouldn't buy them until one does their homework and studies their financials, their competitive position, and the like.

There is one variable the Lynch strategy is best known for, namely the P/E/G ratio. This looks at the P/E ratio relative to growth. Basically, its looking for growth and P/E to be equal (a ratio of 1:1); as one goes up, so does the other. But it favors bargains, which means it really prefers to buy stocks whose P/E/G is less than 1:1. The lower the P/E/G the better.

Its accuracy since inception has been 63.5 percent, while its beta has been 1.11, which makes it, by a slight degree, the most volatile of the strategy's we've discussed.

The winners this strategy picked in 2006 included: PetroChina, held from May 19, 2006 to the end of the year, gain 22.6 percent; American Home Mortgage (AHM), held from Feb. 24, 2006 to the end of the year, gain 21.3 percent; Apollo Investment (AINV), held from July 14, 2006 to the end of the year, gain 26.0 percent; and Foundry Networks (FDRY), held from June 16, 2006 to Oct. 6, 2006, gain 25.9 percent.

CONSENSUS STRATEGIES

Validea Hot List

The last strategy we'll look at is the flagship strategy of Validea.com, namely the Validea Hot List. The Validea Hot List, which consists of 10 stocks, is rebalanced every 28 days, as are all of our portfolios. The Hot List is made up of the 10-stocks in our system with the highest degree of overlap from the best risk-adjusted individual guru strategies.

In 2006, the Validea Hot List had a robust gain of 28.5 percent. Since inception, it has had the best record of any of our strategies – 185.2 percent. Its gain in 2005 was a very respectable 14.4 percent. Note that even though the Validea Hot List was not the best performing of the

strategies in 2006 (Fisher was first, Dreman second, the Validea Hot List, third), it is still first since inception. That is because it is the most consistent performer of all of the strategies. It takes the best of the other strategies and combines them. By doing so, it is a consistent winner.

Its accuracy since inception has been 63.3 percent and its beta, 1.07, making it a shade more volatile than the market overall.

Among its better performing picks for 2006: ENI (E), held from Oct. 6, 2006 to the end of the year, gain 12.4 percent; PetroChina (PTR), held from May 19, 2006 to Dec. 29, 2006, up 25.1 percent, Total (TOT), held from June 16, 2006 to Dec. 1, 2006, a gain of 15.8 percent; and Tower Group (TWGP), held from May 19, 2006 to Dec. 1, 2006, up 14.0 percent.

To note the performance of our other strategies in 2006: Martin Zweig, up 17.3 percent; Benjamin Graham, up 26.0 percent; John Neff, up 22.3 percent; Joseph Piotroski, up 17.9 percent, Warren Buffett, up 16.5 percent, and William O'Neil, down 15.2 percent.

All of these strategies are constructed to perform well over the long-term. Put another way, none of the gurus are day traders. Though different strategies may have varying time horizons, they all work on the belief it is best to invest for the long term.

Investors need to realize that it's nearly impossible to pick the best performer in any given year. As noted, the Fisher strategy was the best performer in 2006, when it had a return of 40 percent, but in 2005 it had a loss of 2.7 percent, when the S&P 500 gained 3 percent. Here at Validea, we understand that each strategy will have periods when it under performs the other strategies and even under performs the market (as Fisher did in 2005 and O'Neil in 2006). Almost no one, including such greats as Warren Buffett, out perform the market year after year. Better that you stick to the strategy (or strategies) you like over the long term, and ride their evitable downs as well as their ups. When you do, the winning years will likely more than make up for the dog years, and overall your investments should do well.

For historical performance on all of Validea's models, please see the accompanying table on the next page.

VALIDEA'S MODEL PERFORMANCE CHART

10 Stock Model Portfolios		Annual Portfolio Return				Total Return	Portfolio Risk
Portfolio	Based On Book by or about	2003	2004	2005	2006	Return	Beta
Contrarian Investor	David Dreman	36.2%	30.0%	18.4%	34.3%	181.4%	0.90
Growth Investor	Martin Zweig	32.1%	54.8%	5.8%	17.3%	153.7%	1.26
Value Investor	Benjamin Graham	45.1%	21.5%	10.4%	26.0%	145.1%	1.14
Growth/Value Investor	James P. O'Shaughnessy	51.6%	1.0%	22.4%	24.0%	132.4%	1.09
P/E/Growth Investor	Peter Lynch	39.6%	34.7%	8.4%	23.3%	151.2%	1.11
Price/Sales Investor	Kenneth Fisher	30.7%	26.0%	-2.7%	40.0%	124.4%	1.08
Small-Cap Growth Investor	Motley Fool	19.8%	22.5%	9.6%	22.2%	96.5%	1.44
Book/Market Investor	Joseph Piotroski	N/A	39.9%	9.0%	17.9%	79.7%	1.08
Low PE Investor	John Neff	N/A	21.2%	15.1%	22.3%	70.7%	1.04
Patient Investor	Warren Buffett	2.0%	37.3%	-4.6%	16.5%	55.6%	0.96
Momentum Investor	William O'Neil	31.6%	5.9%	13.7%	-15.2%	34.2%	1.39
Validea Hot List	Validea	56.9%	23.5%	14.5%	28.5%	185.2%	1.07
Top Five Gurus	Validea	46.4%	29.5%	8.8%	-2.1%	101.9%	1.18
S&P 500	N/A	11.1%	9.0%	3.0%	13.6%	42.7%	1.0

- All Models except for Book/Market Investor, Low PE Investor and Patient Investor Portfolios began on July 15th, 2003. Inception Dates for: Book/Market Investor (2/27/2004), Low PE Investor (1/2/2004) and Patient Investor (12/5/2003).
- All Models based on 10-stock portfolios that are rebalanced monthly. Rebalancing occurs once every 28 days and constructs and equally weighted portfolio.
- Validea Hot List and Top Five Guru Models are based on a blend of individual guru models.
- Returns do not include dividends or transaction costs. Total returns take into consideration compounding and assume $100,000 investment at portfolio inception date.

The names of individual investment advisors (i.e., the 'gurus') appearing in this list and on Validea.com are for identification purposes of his methodology only, as derived by Validea.com from published sources, and are not intended to suggest or imply any affiliation with or endorsement or even agreement with our reports personally by such gurus, or any knowledge or approval by such persons of the content of our site.