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Master the Stock Call Techniques of Highly Experienced Analysts

Learner Workbook

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- With a keyboard (as a Word document); or
- With pen (as a hard copy)

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Master the Stock Call Techniques of Highly Experienced Analysts

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Overview

Purpose & Learning Objectives

Why a *Master the Stock Call Techniques of Highly Experienced Analysts* program?

Many analysts, especially those early in their career, make the mistake of assuming stock picking is primarily about creating a detailed financial model and conducting a thorough valuation. While these are critical, there are many other key elements to making great stock calls, which are more difficult to master and often underappreciated. Mastery requires creating a forecast more accurate than consensus, selecting an optimal valuation multiple, setting a realistic price target, identifying a catalyst, ensuring the ideal entry point and objectively reviewing your performance and thesis.

Less experienced analysts can increase their odds of generating alpha by understanding the behind-the-scenes methods employed by successful analysts. Successful stock picking is unquestionably the most important element of a buy-side analyst's job, as well as one of the key elements for sell-side analysts, and yet until now, formal training in this area has been scarce. As discussed in the best-selling book Best Practices for Equity Research Analysts, interviews with successful buy-side and sell-side analysts reveal they follow a process before upgrading or downgrading a stock. Through its TIER™ system, AnalystSolutions has deconstructed their "art" to provide analysts the "science" behind making high quality stock calls. While there's no foolproof method to ensure every stock call generates alpha, there are lessons to be learned that will increase an analyst's odds for success.

Learning Objectives

- Assess if enough research has been conducted to justify a stock call
- Identify the key challenges to successful stock picking and apply lessons from experienced stock pickers
- Make accurate stock recommendations by mastering these steps:
  - Identifying the catalyst most likely to move a stock
  - Identifying the ideal entry point for recommending a stock
  - Reviewing stock picking performance to improve future stock picking
- Ensure stock calls are differentiated
- Avoid the most common mind traps (e.g. sunk cost fallacy, loss-aversion) and biases (such as familiarity, recency, confirmation, self-attribution momentum and overreaction)
- Review a universe of stocks in an unbiased manner to ensure those being recommended offer the best return compared to their level of risk

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Introduction

Opening Case

Instructions for the Potential Upgrade of SBUX:

- As you're reviewing the case, keep track of "best practices" (something you would do or advocate other analysts to do) and "bad practices" (those things you would recommend an analyst not do). We encourage you to use underlining, bolding (if using electronic version) or the right column for notes so that you can keep track of the best and bad practices.

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Potential Upgrade of SBUX Script

Lucas Gallo, a buy-side analyst who covers the restaurant sector, has had trouble with some of his stock picks in the past. In fact, during his mid-year review his boss said if his stock picking doesn't improve, he'll likely not receive a bonus this year and be put on probation, which is the first step to having his employment terminated from the firm. Lucas would like to upgrade Starbucks, ticker SBUX, and decides he should discuss it first with a more senior member of the firm, Robert, who has been a successful analyst for 10 years.

Lucas' Dialogue	Robert's Dialogue	Your Notes:
Hi Robert. I was hoping you could give me some feedback about a stock call I'd like to make.	I'd be happy to help. What's the stock?	
I've wanted to upgrade Starbucks for years and now I have my opportunity because it's launching new breakfast sandwiches and a new cold drink.	Interesting…what's your price target?	
Putting a price target on it is difficult because there's a lot of uncertainty about the company's long-term earnings power…I suspect there's at least 20%-30% upside. I'm not sure why, but some analysts in the market are valuing using a PEG ratio while others are using a P/E ratio.	How are you valuing the stock?	
I'm using $0.87 of earnings for the upcoming year and $1.00 for the year after.	That's 15% growth. Where's consensus in terms of estimates?	
Very close to my numbers.	If you see 25% upside in the stock and the company is growing EPS only 15%, you must be assuming the P/E multiple expands.	
I'm not sure I follow your logic. The stock is trading at a 28x multiple, but it was trading as high as a 42x multiple just 3 months ago.	Has the multiple expanded in the past?	
I'm not sure -- when I pulled up the historical valuation metrics for the past two years, it showed a historical peak of 48x forward earnings.	What about the trough?	
I'm not sure, but the stock is up 18% for this year – I don't want to miss a further move.	But the market is up about that much.	
…And SBUX has climbed along with it, despite nothing really new to the story. They're poised for a break-out. One sell-side analyst I speak with said if you buy SBUX late in the year, you always see upside by the end of February.	Do you know when the new breakfast sandwiches and cold drink will be released?	
Not entirely, but I just read in *The Financial Journal* that a supplier to SBUX said they've been asked to build equipment to make the frozen drink. I've wanted to upgrade this stock for a while and this now gives me the opportunity.	How does the risk-return trade-off for SBUX compare to the other stocks in your universe?	
SBUX has the most upside.	What about risk?	
I don't follow your point.	What's the downside in the stock?	
Why would it go down from here?	Could something go wrong?	

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Not likely because the new products haven't been debuted yet.	Didn't the company struggle with its same-store-sales comps in the recent quarter?	
Yes, they grew only 4%, but that was due to a slower morning throughput caused by the increased popularity of Frappuccinos. The company still plans to generate 20%-25% EPS growth for the next 3-5 years and recently raised its long-term global unit target to 40,000 stores, up from 30,000.	Have you looked into how much stock management owns?	
I'm not sure, but it's a young company and so management must own a big chunk.	What are your thoughts about the current quarter?	
Last time I looked, consensus was at 18 cents, but I think everyone knows the near-term numbers need to come down by a penny or two.	Lucas, I want to help you avoid making a call similar to the two problematic ones earlier this year.	
Thanks, but those calls weren't my fault – consensus dropped for both of those companies, showing that everyone was surprised.	Maybe, but I recall short-interest in those stocks were very high at the time. And wasn't Golden Bull Securities recommending shorting one of those names before the drop?	
True, but even a blind squirrel finds a nut every once in a while.	I think we need to discuss this potential upgrade a bit further.	

- If this workshop is being led by a facilitator, alert him/her after you have noted "best practices" and "bad practices above, then continue onto the answer key
- If you are taking this workshop without a facilitator, continue to the answer key

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Answer Key for "Potential Upgrade of SBUX"

All of the answers below will be discussed throughout the workshop's four-step TIER™ framework and so do not be concerned if you do not have time to read through or fully understand before moving onto the next module.

Best Practices by Robert and Lucas:

1. Lucas is aware of how his estimate compares to consensus
2. Robert breaks down the potential upside into the two key components: the forecast or valuation
3. Robert correctly notes that most of the upside in the stock over the past year has been in line with the market's move
4. Robert is trying to ascertain the catalyst that will move the stock (i.e. the date of the new products being released)
5. Robert wants to explore what could go wrong
6. Robert is looking for imminent risks such as a potential disappointment in the current quarter
7. Robert is questioning if Lucas has selective memory, where he revises history to meet his needs

Bad Practices by Lucas:

1. Says he's been wanting to "upgrade SBUX for years" suggesting he has a pre-existing bias that could be clouding his view (aka "confirmation" bias)
2. Doesn't have a price target or range of targets
3. Doesn't know if the stock has seen an expanding P/E in the past
4. Is impressed the stock has moved 18% this year even though this is likely due to the overall market move
5. Is relying on a basic rule of thumb (heuristic) in terms of buying the stock late in the year to get upside by February, which he doesn't appear to have validated
6. Doesn't know when the new products will be released, which is the catalyst for his stock call
7. When asked to compare SBUX to other stocks in his universe, he's only looking at returns and appears to have excluded an assessment of risk
8. Hasn't considered what could go wrong with his call
9. Doesn't seem to be concerned with the company having poor same-store-sales comps or the amount of stock owned by management
10. Doesn't seem to be concerned by the company's potential for falling short of the current quarterly consensus estimates
11. Dismisses prior bad calls to things that were a surprise to everyone even though a sell-side firm had correctly made an accurate call on one of the stocks

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Postscript:

The passage above was inspired by actual events occurring from 2006 to 2008. (The EPS were slightly modified so the math would be easy to compute without a calculator.) Here are some actual events that occurred after Lucas' proposed upgrade:

- In late 2006, Howard Schultz, the company's founder and chairman at the time, wrote a memo (leaked to the press) that identified challenges caused by the company's excessive growth. In addition to specific concerns, he closed the letter with, "I have said for 20 years that our success is not an entitlement and now it's proving to be a reality. Let's be smarter about how we are spending our time, money and resources."
- Due to weaker-than-expected growth and margins, the stock dropped 42% in 2007, while the S&P 500 was up 3%
- In January 2008, Howard Schultz took back the CEO role
- Breakfast sandwiches were discontinued in 2008
- The frozen drink "Sorbetto" was discontinued after a debut to 300 stores

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"ENTER™ Quality Checklist" Exercise

Instructions for the "ENTER™ Quality Checklist" exercise:

- The majority of portfolio managers have under-performed their benchmarks as far back as the records have been kept on this topic. Our work suggests some of the problem is the research they are using is low quality, which prevents them from making the right decisions
- The ENTER™ quality checklist below has been designed to help analysts review their research efforts to ensure they meet or exceed a quality threshold
- For each item in the checklist, in the right column, provide a value for how regularly you follow this practice before making a stock recommendation
- This will not be collected and so respond in a manner that will help you assess your performance

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"ENTER™ Quality Checklist" Exercise

ENTER™ Quality Checklist

ENTER™ Quality Checklist (to be used before starting the communication of a stock recommendation)	1=Never 5=Always
Expectational	
I have a forward-looking view in terms of the stock and the critical factor(s) likely to move the stock	
I have identified the catalyst(s) likely to move my stock and important dates when the catalyst is most likely to cause the stock to move to my price target	
When I believe the company management's forecast is relevant, I frame it in terms of my independent financial forecast (rather than just repeat management)	
When I review historical information or events, it in the context of considering the future implications to my investment thesis. (I don't dwell on the past for other reasons.)	
Novel	
I have a piece of information or insight that is new and not widely understood within the financial markets	
I know where my unique view falls within the FaVeS™ framework (unique Financial forecast, Valuation method/multiple, or unique view about market Sentiment)	
I know why the market does not have my view	
Thorough	
For critical factors that are key to the stock call, I research more than one source or confirm the insight with an independent source	
If the stock call is based on a unique financial forecast, I conduct detailed modeling in the area surrounding the critical factor(s)	
I do not use management guidance as the sole justification for the call	
Examinable	
If asked, I can provide the following details of my analysis to a trusted colleague(s): • Data or insights about the critical factor(s) • Detailed financial forecast or valuation analysis, if key to the investment thesis	
I clearly separate: • Opinion or forecast from… • Views of others from… • Undisputable facts	
Revealing	
I create upside, downside, and base-case scenarios to identify where the investment thesis could have flaws	
I identify specific risks beyond the macro	
I provide my conviction level to others, even if it is not strong	

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Module 1: Target Realistic Price(s) (Step 1 of TIER™)

"Stress Test Your Forecast" Exercise

Instructions for the "Stress Test Your Forecast" exercise:

- For one stock of interest, in Table 1 below:
  - In the column labeled "Factor", list the critical factors you believe will potentially have the greatest impact on the stock price movement over the next 12 months
  - In the next three columns, provide the assumptions for your base-case, upside, and downside scenarios for each critical factor
  - Weigh the probability of each scenario (the three boxes for each critical factor should add up to 100%)
  - If possible, quantify the EPS impact for at least one of the critical factors by using the company's earnings model, if you brought with you (you probably won't have time to quantify all three factors during the time for this exercise)
- In Table 2, evaluate the quality of each critical factor by the using the EPIC™ framework
- Complete the entire process in Tables 1 and 2 for your first critical factor and if time allows, do the same for your critical factors #2 and #3.

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"Stress Test Your Forecast" Exercise

Your stock of interest: _____
In the table below, first complete the "Factor" and "Base Case" columns and then complete the "Downside" and "Upside" scenario columns

Table 1: Identify 3 Critical Factors

Factor	Base Case	Downside Scenario	Upside Scenario
Examples for FedEx: Change in ability to collect fuel surcharge	**BASE CASE:** Based on the current environment, FDX continues to pass through 75% of its fuel inflation to its customers **WEIGH PROBABILITY**: 65%	**CAUSE**: A weaker economy creates excess capacity in the express parcel sector, causing FDX to be less disciplined in implementing its fuel surcharge, causing it to pass through only 25% of its fuel inflation **WEIGH PROBABILITY**: 15% **QUANTIFY**: Drops EPS by 12% from base case	**CAUSE**: Stronger demand causes FDX and its competitors to be more disciplined on implementing fuel surcharges so that FDX is successful in passing through 95% of its fuel inflation **WEIGH PROBABILITY**: 20% **QUANTIFY**: Increases EPS by 8% compared to base case
1.	**BASE CASE:** **WEIGH PROBABILITY**: %	**CAUSE**: **WEIGH PROBABILITY**: % **QUANTIFY** (if you have data with you):	**CAUSE**: **WEIGH PROBABILITY**: % **QUANTIFY** (if you have data with you):
2.	**BASE CASE:** **WEIGH PROBABILITY**: %	**CAUSE**: **WEIGH PROBABILITY**: % **QUANTIFY** (if you have data with you):	**CAUSE**: **WEIGH PROBABILITY**: % **QUANTIFY** (if you have data with you):
3.	**BASE CASE:** **WEIGH PROBABILITY**: %	**CAUSE**: **WEIGH PROBABILITY**: % **QUANTIFY** (if you have data with you):	**CAUSE**: **WEIGH PROBABILITY**: % **QUANTIFY** (if you have data with you):

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"Stress Test Your Forecast" Exercise

In Table 2 below, rank your factors from above on a scale of 1 to 5, with 5 as "strongly agree", using the EPIC™ framework in the column headings below:

Table 2: Evaluate the Quality of the Critical Factors

Critical Factor from Table 1	If this factor were to occur or change from trend, it would cause changes in consensus' expectations to **E**xceed my materiality threshold	This factor will **P**robably deviate materially from consensus expectations during my investment time horizon	Based on my research on the factor, **I**'m good at forecasting this factor and its catalyst (it's not just a guess)	The overall **C**onsensus will be poor at accurately forecasting or spotting an anomaly for this factor	Total
1.					
2.					
3.					

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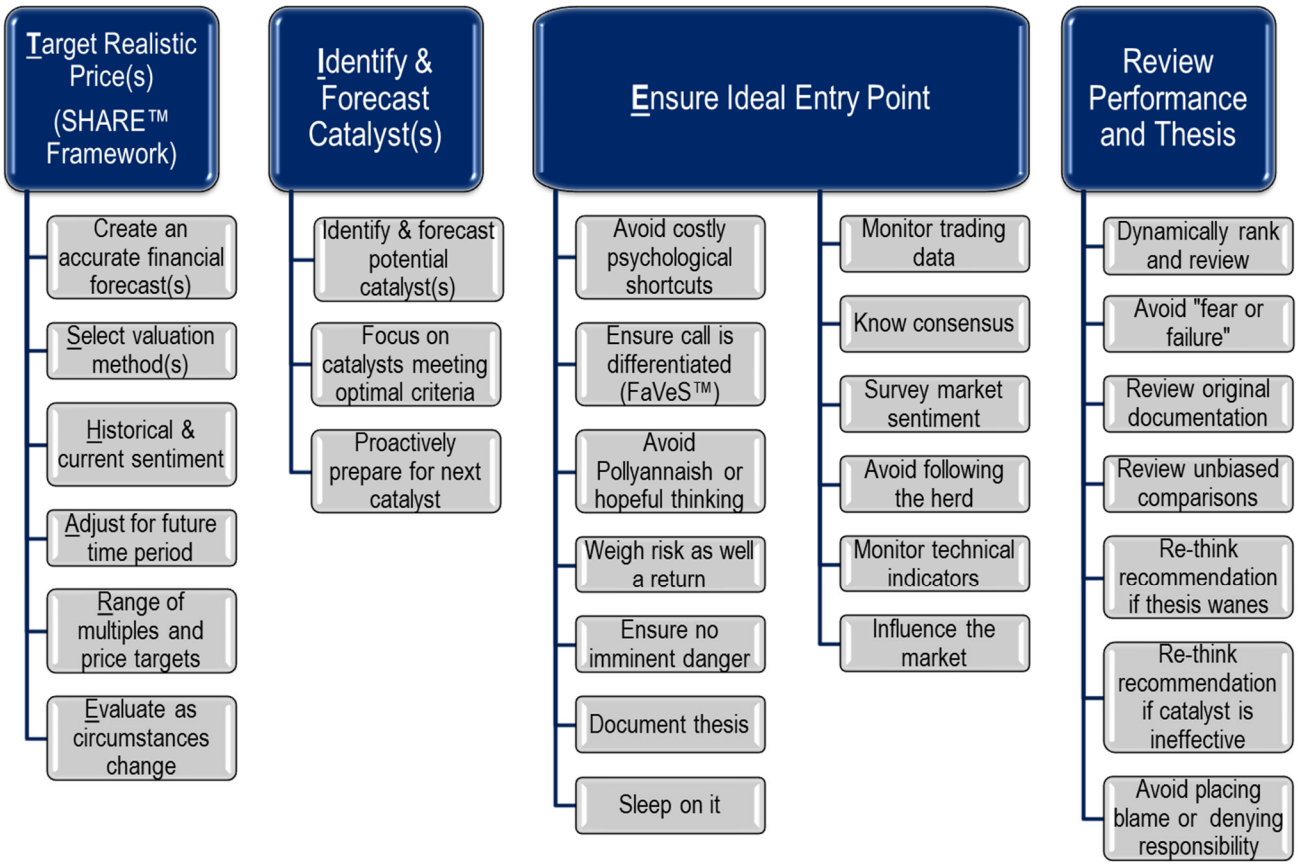
TIER™ & SHARE™ Frameworks



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Module 2: Identify and Forecast Catalyst(s) (Step 2 of TIER™)

"Identify the Catalyst" Exercise

Instructions for the "Identify the Catalyst" exercise, PART 1:

- There are two parts to this exercise, labeled "PART 1" and "PART 2" which both pertain to identifying catalysts but are not related to each other
- In PART 1, read the first scenario and follow the prompts in the column headings to determine:
  - The catalyst
  - Quality of the catalyst
  - Timing of when the catalyst will be noticeable enough for the stock to begin to react (the timing may be unknown, which is an acceptable answer, but shows the catalyst is low quality)
- After completing the first scenario in PART 1, review the answer key that follows
- After completing the first scenario in PART 1 move to the first catalyst in PART 2
- If you would like to reinforce this concept, go back and complete PART 1 and PART 2 for the other scenarios

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"Identify the Catalyst" Exercise

Table 1 for "Identify the Catalyst" Exercise

	Stock Call	Catalyst	Quality of Catalyst: High, Medium, or Low	Timing of when the catalyst will be noticeable enough for the stock to begin to react
1.	We are recommending purchasing McDonald's Corp (MCD) and have a one-year price target of $116 (up 21% from its current $96). We believe accelerated growth from remodeled stores and expansion in China will allow the company to beat this year's consensus of $5.80 by $0.20 (most noticeable in 3Q and 4Q) which will be even more apparent next year, causing next year's consensus of $6.20 to rise to our $7.00.			
2.	We are no longer recommending purchasing SBUX because we believe the consensus expectation for the next fiscal year is 11% too high. Using our EPS forecast for next year of $2.85 (while consensus is at $3.20), we arrive at a base-case scenario price target of $68, which would be a 9%-10% drop from the stock's close of $75. Our proprietary work (survey and interview with industry sources) suggests by 3Q of this year the company will be unable to pass through the upward labor cost pressure driven by increases in minimum wages. By early next year, the company will see higher cost inflation or, if it raises prices, slower unit sales, either of which will slow EPS growth.			
3.	We are upgrading Alaska Air Group (ALK) because we believe it will be taken out at a premium as part of the North American airline industry consolidation trend. The stock is currently trading approximately 15% above its historical relative P/E ratio on forward earnings, which we believe could expand further as part of a takeout.			

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"Identify the Catalyst" Exercise

Note: the following table is the answer key to Table 1 above

ANSWER KEY for Table 1 for "Identify the Catalyst" Exercise

	Stock Call	Catalyst	Quality of Catalyst: High, Medium, or Low	Timing of when the catalyst will be noticeable enough for the stock to begin to react
1.	We are recommending purchasing McDonald's Corp (MCD) and have a one-year price target of $116 (up 21% from its current $96). We believe accelerated growth from remodeled stores and expansion in China will allow the company to beat this year's consensus of $5.80 by $0.20 (most noticeable in 3Q and 4Q) which will be even more apparent next year, causing next year's consensus of $6.20 to rise to our $7.00.	Store remodeling and growth in China	Moderate quality because these are factors the analyst may not be able to forecast with a high degree of accuracy	Earnings during the second half of this year and all of next year
2.	We are no longer recommending purchasing SBUX because we believe the consensus expectation for the next fiscal year is 11% too high. Using our EPS forecast for next year of $2.85 (while consensus is at $3.20), we arrive at a base-case scenario price target of $68, which would be a 9%-10% drop from the stock's close of $75. Our proprietary work (survey and interview with industry sources) suggests by 3Q of this year the company will be unable to pass through the upward labor cost pressure driven by increases in minimum wages. By early next year, the company will see higher cost inflation or, if it raises prices, slower unit sales, either of which will slow EPS growth.	Inability to pass through wage inflation to customers	Medium to high quality because it's plausible, with effort, the analyst can determine if wage inflation is being passed through to customers	Third-quarter results should see some of the impact and will become more pronounced going into the following year
3.	We are upgrading Alaska Air Group (ALK) because we believe it will be taken out at a premium as part of the North American airline industry consolidation trend. The stock is currently trading approximately 15% above its historical relative P/E ratio on forward earnings, which we believe could expand further as part of a takeout.	Industry consolidation	Low because it is almost impossible to forecast the timing. Also, the market may already be anticipating as shown in the stock's current premium.	Unknown

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"Identify the Catalyst" Exercise

Instructions for the "Identify the Catalyst" exercise, PART 2:

- Go to Table 2 below (which is not related to Table 1 above), and refer back to the earlier exercise where you identified 3 critical factors for a stock of interest ("Stress Test Your Forecast" exercise). In Table 2 below, identify the catalyst for each of your 3 critical factors and then rank on a scale of 1 to 5, with 5 as "strongly agree", using the table column headings

Table 2 for "Identify the Catalyst" Exercise
(Rank on a scale of 1 to 5, with 5 as "strongly agree", using the table column headings)

Catalyst for Your Critical Factor Identified in Earlier Exercise	Catalyst pertains to a critical factor that is material enough to move the stock	Catalyst likely to occur during the investment time horizon	Catalyst not currently understood by the market	Catalyst can be forecast with some level of certainty	Total
Your Critical Factor #1 Catalyst(s):					
Your Critical Factor #2 Catalyst(s):					
Your Critical Factor #3 Catalyst(s):					

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Module 3: Ensure Ideal Entry Point (Step 3 of TIER™)

"Find the 'F's'" Exercise

Instructions for the "Find the F's" exercise:

- Step 1: Count the number of "f's" you see in the sentence below and put here: _____

Two of the most powerful and effective of all human fears are the fear of failure and the fear of success.

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Four Scenarios Table

This table is also found in your Slide Booklet

	Scenario			
	A	B	C	D
1. Current data				
Current stock price	$50.00	$50.00	$50.00	$50.00
Next 12-month ("NTM") consensus EPS forecast at present (we call this "Year 1")	$5.00	$5.00	$5.00	$5.00
Stock's current valuation multiple based on Year 1 EPS	10.0	10.0	10.0	10.0
Current market multiple	15.0	15.0	15.0	15.0
Stock's current premium or discount to the market multiple	-33%	-33%	-33%	-33%
2. Change from consensus EPS between Year 1 and Year 2				
NTM consensus in Year 2 (i.e. forecast at beginning of Year 2 for Year 2)	$5.60	$5.60	$5.60	$5.60
Difference between Year 2 and Year 1 consensus forecasts	12%	12%	12%	12%
Item #2 above is due to passage of time while #3 and #4 below are influenced by the analyst				
3. Change due to analyst's financial forecast differing from consensus				
Analyst's NTM EPS forecast in one year (i.e. forecast for Year 2)	$5.60	$6.00	$6.00	$6.60
Premium or discount of analyst's EPS estimate in Year 2 compared to consensus'	0%	7%	7%	18%
4. Change due to analyst's future valuation multiple differing from current multiple				
Analyst's estimate of market multiple at beginning of Year 2 (typically keep same as present)	15.0	15.0	15.0	15.0
Analyst's estimate of stock's premium or discount to market multiple at beginning of Year 2	-33%	-33%	-27%	-20%
Valuation multiple used for price target at beginning of Year 2	10.0	10.0	11.0	12.0
Difference between analyst's future multiple and stock's current multiple				
5. Price target	$56.00	$60.00	$65.70	$79.20
Change from current price	12%	20%	31%	58%

* NTM = next twelve months

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"How Do You Differ?" Exercise

Instructions for the "How Do You Differ?" exercise:

- This exercise helps to reinforce the critically-important concept that all great stock calls must differ from consensus. You will do this using the FaVeS framework, specifically, looking for an out-of-consensus view in one of these areas:
  - Financial forecast; or
  - Valuation multiple or method; or
  - Sentiment towards the stock (void of impending changes to the financial forecast or valuation multiple/method above, which is rare, but does occur)
- If you brought or can quickly access example research reports that contain recommendation/ratings changes that include price targets (if not, go to the next square bullet below):
  - Review page 1 of each report to identify where the author (which could be you) differs from consensus using the FaVeS framework.
  - If you would like to use a standard format to lay out your answers, feel free to use the blank columns under "Your Answer" in the 3 scenario worksheets that follow. (If you brought your own reports, you will not need the upcoming pages for any other purpose)
- If you do not have access to recommendation/ratings change reports that contain price targets:
  - Review the 3 scenarios below, noting they are occurring at the start of calendar Year 1 (Y1) and so one-year price targets are based on forecast earnings for Y2. The term "NTM" is "next 12 months."
  - To ensure you arrive at the same answer as our answer key, we assume the market's multiple is 15x NTM earnings (not the stock's multiple)
  - Before reading the scenario, cover up or minimize your window so that you do not see the two right-most columns until after you have tried to complete the scenario
  - After reading the passage, complete the column titled "Your Answer" and then check the right-most columns to see if you were correct
  - After reviewing the answer key, answer the question "Did the analyst have a unique call" which can be found below each answer key
- Note the answer key may differ slightly from your answer due to rounding issues
- Using a calculator will likely speed up the exercise

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"How Do You Differ?" Exercise

Scenario 1: McDonald's

(Reminder: cover up or minimize your window so that you do not see the two right-most columns below until after you have attempted to complete the scenario.)

"We are recommending purchasing McDonald's Corp (MCD) and have a one-year price target of $116 (up 21% from its current $96). We believe a recovering Europe and growing emerging markets will allow the company to beat Y2 consensus EPS of $6.20 (we are at $7.00). Our price target assumes the stock continues to trade at its current 10% premium to the market's 15x multiple (putting MCD at a 16.6x forward multiple)."

	Your Answer	Answer Key	Stock Price Impact
1. Current data			
Current stock price	$96.00	$96.00	
Next 12-month ("NTM") consensus EPS forecast at present (we call this "Year 1")	5.80	$5.80	
Stock's current valuation multiple based on Year 1 EPS	16.6	16.6	
Current market multiple	15.0	15.0	
Stock's current premium or discount to the market multiple		10%	
2. Change from consensus EPS between Year 1 and Year 2			
NTM consensus in Year 2 (i.e. forecast at beginning of Year 2 for Year 2)		$6.20	
Difference between Year 2 and Year 1 consensus forecasts		7%	$6.62
Item #2 above is due to passage of time while #3 and #4 below are influenced by the analyst			
3. Change due to analyst's financial forecast differing from consensus			
Analyst's NTM EPS forecast in one year (i.e. forecast for Year 2)		$7.00	
Premium or discount of analyst's EPS estimate in Year 2 compared to consensus'		13%	$13.24
4. Change due to analyst's future valuation multiple differing from current multiple			
Analyst's estimate of market multiple at beginning of Year 2 (typically keep same as present)	15.0	15.0	
Analyst's estimate of stock's premium or discount to market multiple at beginning of Year 2		10%	
Valuation multiple used for price target at beginning of Year 2		16.6	
Difference between analyst's future multiple and stock's current multiple		0%	$0.00
5. Price target	$116	$115.86	$19.86
Change from current price	21%	21%	

* NTM = next twelve months

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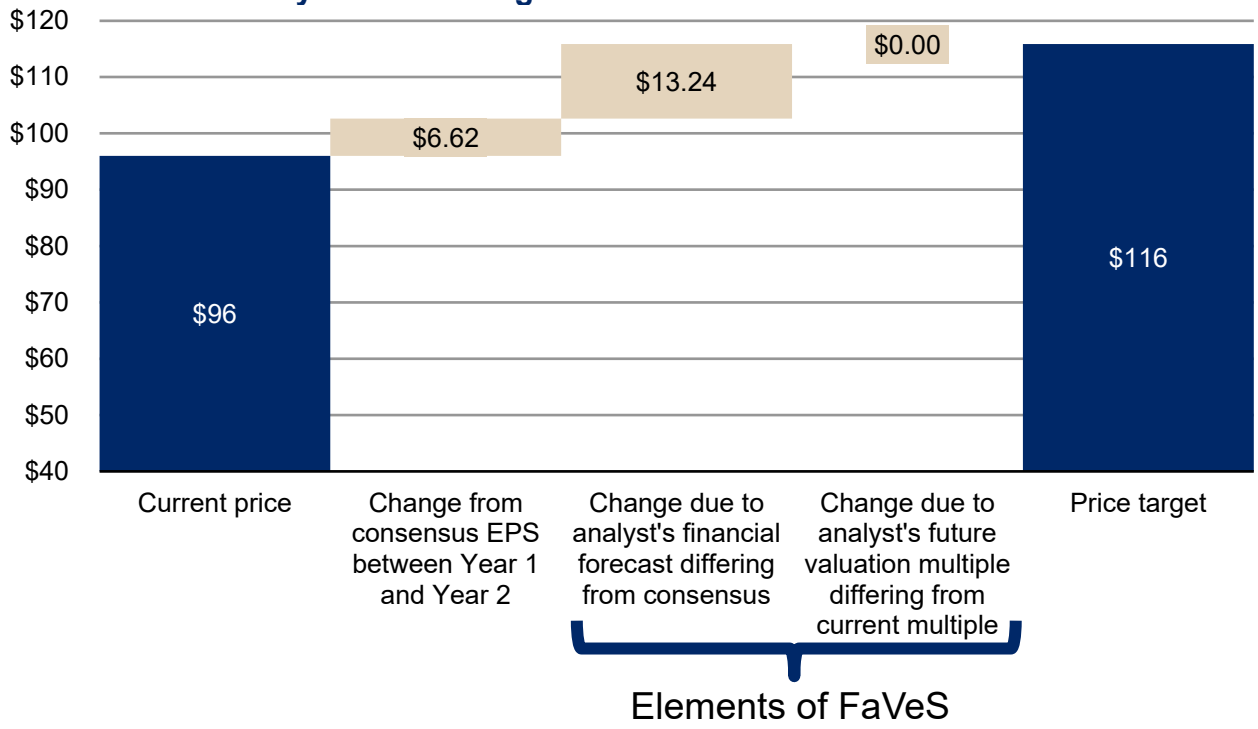
"How Do You Differ?" Exercise

Breakdown of Analyst's Price Target vs. Current Price



Did the analyst have a unique call?

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"How Do You Differ?" Exercise

Scenario 2: Starbucks (SBUX)

(Reminder: cover up or minimize your window so that you do not see the two right-most columns below until after you have attempted to complete the scenario.)

"We are no longer recommending purchasing SBUX because we believe the consensus expectations for the next fiscal year (Y2) are 11% too high. Using our EPS forecast for next year (our Y2 estimate is $2.85, while consensus is at $3.20); we arrive at a base-case scenario price target of $68, which would be a 9%-10% drop from the stock's close of $75. Our proprietary work (survey and interview with industry sources) suggests the company will be unable to pass through the upward labor cost pressure driven by increases in minimum wages. The company will see higher cost inflation or, if it raises prices, slower unit sales, either of which will slow EPS growth. Given the company's current above-average valuation multiple of 28x current consensus Y1 earnings (which is an 85% premium to the market multiple of 15x), we believe this multiple will contract to 24x when the market realizes next year's consensus earnings are too high."

Scenario 2: Starbucks (SBUX)

	Your Answer	Answer Key	Stock Price Impact
1. Current data			
Current stock price	$75.00	$75.00	
Next 12-month ("NTM") consensus EPS forecast at present (we call this "Year 1")	$2.70	$2.70	
Stock's current valuation multiple based on Year 1 EPS	27.8	27.8	
Current market multiple	15.0	15.0	
Stock's current premium or discount to the market multiple		85%	
2. Change from consensus EPS between Year 1 and Year 2			
NTM consensus in Year 2 (i.e. forecast at beginning of Year 2 for Year 2)	$3.20	$3.20	
Difference between Year 2 and Year 1 consensus forecasts	19%	19%	$13.89
Item #2 above is due to passage of time while #3 and #4 below are influenced by the analyst			
3. Change due to analyst's financial forecast differing from consensus			
Analyst's NTM EPS forecast in one year (i.e. forecast for Year 2)		$2.85	
Premium or discount of analyst's EPS estimate in Year 2 compared to consensus'		-11%	-$8.40
4. Change due to analyst's future valuation multiple differing from current multiple			
Analyst's estimate of market multiple at beginning of Year 2 (typically keep same as present)	15.0	15.0	
Analyst's estimate of stock's premium or discount to market multiple at beginning of Year 2		60%	
Valuation multiple used for price target at beginning of Year 2		24.0	
Difference between analyst's future multiple and stock's current multiple		-14%	-$12.09
5. Price target	$68	$68.40	-$6.60
Change from current price	-9%	-9%	

* NTM = next twelve months

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"How Do You Differ?" Exercise

Did the analyst have a unique call?

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"How Do You Differ?" Exercise

Scenario 3: Chipotle (CMG)

(Reminder: cover up or minimize your window so that you do not see the two right-most columns below until after you have attempted to complete the scenario.)

"We are recommending the purchase of CMG because we believe the market doesn't appreciate the company's earnings power. Specifically, we believe as the company expands into the Northeast, revenue (and profit) per store should increase faster than its historical trend, based on experience we have witnessed from other chains that expand into the Northeast. Our $720 one-year price target, which is 30% above yesterday's close of $554, is based on the company trading at a 45x P/E ratio (slightly above its current 42.6x) on our $16.00 EPS estimate for next year (Y2) (compared to consensus at $15.50)."

Scenario 3: Chipotle (CMG)

	Your Answer	Answer Key	Stock Price Impact
1. Current data			
Current stock price	$554.00	$554.00	
Next 12-month ("NTM") consensus EPS forecast at present (we call this "Year 1")	$13.00	$13.00	
Stock's current valuation multiple based on Year 1 EPS	42.6	42.6	
Current market multiple	15.0	15.0	
Stock's current premium or discount to the market multiple		184%	
2. Change from consensus EPS between Year 1 and Year 2			
NTM consensus in Year 2 (i.e. forecast at beginning of Year 2 for Year 2)	$15.50	$15.50	
Difference between Year 2 and Year 1 consensus forecasts	19%	19%	$106.54
Item #2 above is due to passage of time while #3 and #4 below are influenced by the analyst			
3. Change due to analyst's financial forecast differing from consensus			
Analyst's NTM EPS forecast in one year (i.e. forecast for Year 2)		$16.00	
Premium or discount of analyst's EPS estimate in Year 2 compared to consensus'		3%	$22.50
4. Change due to analyst's future valuation multiple differing from current multiple			
Analyst's estimate of market multiple at beginning of Year 2 (typically keep same as present)	15.0	15.0	
Analyst's estimate of stock's premium or discount to market multiple at beginning of Year 2		200%	
Valuation multiple used for price target at beginning of Year 2		45.0	
Difference between analyst's future multiple and stock's current multiple		6%	$36.96
5. Price target	$720	$720	$166.00
Change from current price	30%	30%	

* NTM = next twelve months

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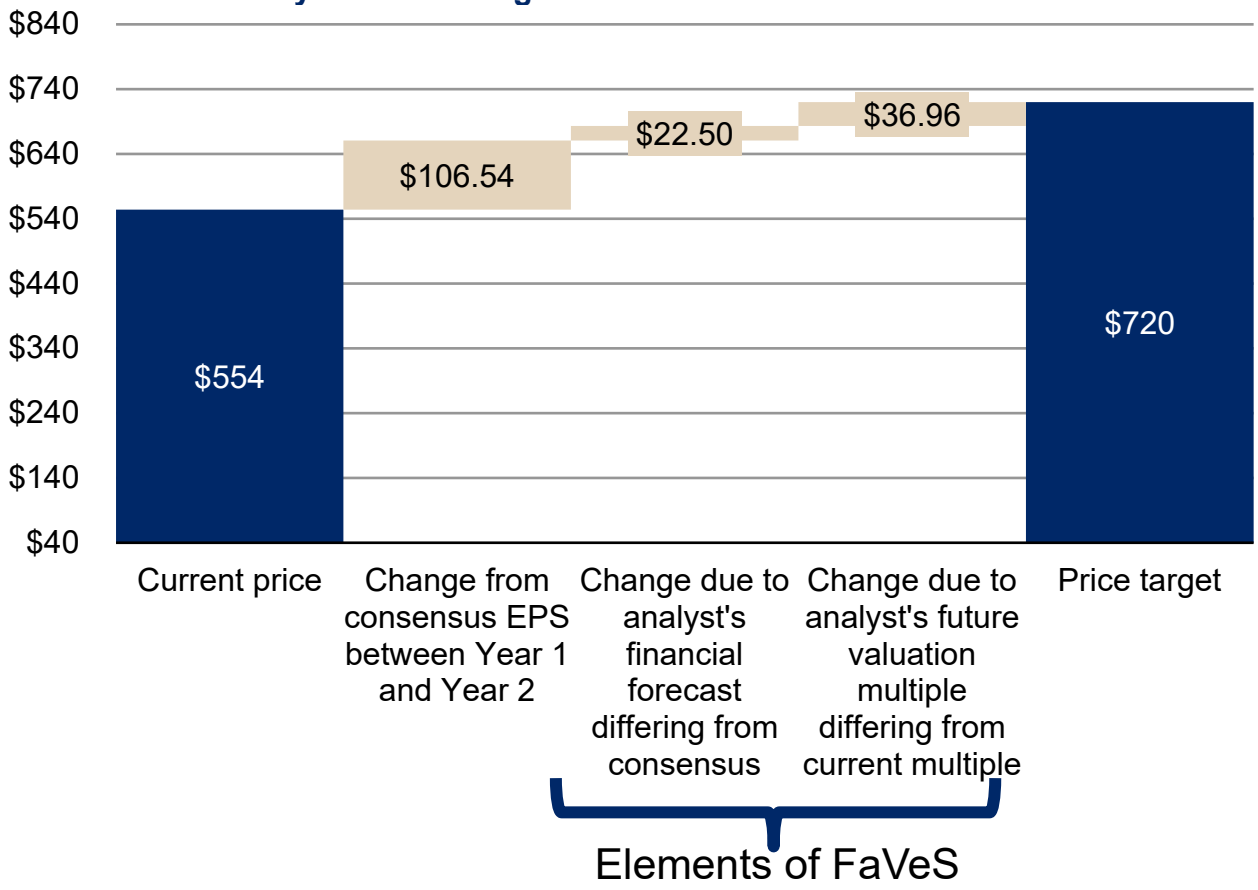
"How Do You Differ?" Exercise

Breakdown of Analyst's Price Target vs. Current Price



Did the analyst have a unique call?

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"How Do You Differ?" Exercise

Answer Key for "Did the analyst have a unique call?"

- McDonald's
  - Using the FaVeS framework, the biggest driver to the 21% upside to the analyst's price target is driven by an EPS estimate that is 13% ahead of consensus for next year, and so this is where we need to look to determine if it's a unique call. The analyst cites "recovering Europe and growing emerging markets", but it's not clear if this is based on a hunch or due to unique research. The best stock calls are based on factors that can be forecast better than the market and therefore it's not clear this is a truly "unique" call
- Starbucks
  - This call is somewhat unique in that it involves an EPS estimate and valuation multiple that are both out of consensus, which means they should both be examined. It appears the analyst has a unique call in terms of the financial forecast (based on a proprietary survey and conversations with industry sources), but it's not clear that the valuation multiple is truly "unique" because there's no explanation why 24x is being used versus the stock's current 28x (why not 25x? or 20x?).
- Chipotle
  - What makes this call interesting is that the analyst's EPS forecast is only 6% higher than consensus and the P/E ratio is essentially in line with consensus (i.e. the current P/E multiple). About two-thirds of the upside to the price target is driven simply by the company continuing to grow its earnings near 20%. Regardless of how the analyst wants to pitch the story, given that his EPS estimate and multiple do not differ much from consensus, he doesn't have a "unique" stock call. (Unfortunately, this happens all too often.)

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"Rank Your Ability" Exercise

Instructions for the "Rank Your Ability" exercise:

- In the table below, rank your ability to perform the 10 tasks in terms of above or below average compared to professional peers *at your experience level*
- Specifically, rank your ability on a scale of 1% to 100% in terms of where you fall compared to your peers
- 100% would make you the master or "black belt" at that task
- 1% would say you have no idea how to conduct the task
- The column does not need to total 100%

Rank Your Ability

Task	Rank Your Ability Compared to Peers (1% to 100%)
1. Using Excel efficiently for financial modeling	
2. Accurately forecasting earnings for a universe of stocks	
3. Effectively interviewing company management	
4. Extracting the most important pieces of information from a company conference call	
5. Finding important information quickly in a regulatory filing	
6. Setting accurate price targets	
7. Efficiently scanning the news wire services for stories that impact my sector	
8. Effectively presenting stock ideas to others	
9. Being a good listener	
10. Being empathetic to other people's needs	

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"How Does Your Future Look?" Exercise

Instructions for the "How Does Your Future Look?" exercise:

- Put a check mark next to the events below that have occurred in your life or you believe may occur in your lifetime

Instructions for the "How Does Your Future Look?" Exercise:

	Life Experience
	Own my own home
	Achieve annual earnings that are in the top 1% of the population of my country
	Travel overseas for 10 or more days with my spouse or family
	Experience a doubling of my personal investment portfolio in a five-year period
	Be among the top 10% of alpha-generators among my peers
	Live past 80 years old
	Be recognized by my peers for a major achievement
	Not spend a night in the hospital until I'm in retirement
	Have an academically-gifted child
	Be at the ideal weight for my age for at least 10 years
	Have a drinking problem
	Permanently lose my house keys
	Get divorced from my spouse (or future spouse)
	Lose my passport when traveling
	Be diagnosed with cancer or heart disease before age 75
	Have dental problems requiring surgery or implants
	Conclude I'm in the wrong career
	Be a victim of a crime
	Be involved in a major car accident
	Home significantly damaged by natural disaster (flood, storm, fire, etc.)

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Assess and Influence the Market's View

Short Interest as Percentage of Float for Selected Restaurant Stocks (early 2014)

Ticker	Short Interest % of Float
DRI.N	10.1%
DNKN.O	8.5%
NDLS.O	8.1%
BJRI.O	6.1%
RRGB.O	5.6%
SONC.O	5.5%
PNRA.O	5.4%
BLMN.O	5.3%
CAKE.O	4.8%
WEN.O	4.6%
TXRH.O	4.0%
EAT.N	2.5%
BWLD.O	2.3%
MCD.N	2.2%
DPZ.N	2.2%
YUM.N	2.2%
JACK.O	2.0%
CMG.N	1.8%
THI.TO	1.0%
SBUX.O	0.6%

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Assess and Influence the Market's View

Insider Buying and Selling of SBUX

Trade Date	Participants	Net Sell (Shares)	Net Buy (Shares)	Close Price
11/15/13	**SCHULTZ HOWARD D, ALST**	**-104,840**		**$81.19**
11/14/13	**SCHULTZ HOWARD D, ALST**	**-53,171**		**$81.14**
9/30/13	ALSTEAD TROY M, CULVER		431	$76.97
9/30/13	ALSTEAD TROY M, CULVER		431	$76.97
8/19/13	HOBSON MELLODY		141,573	$70.29
8/2/13	SCHULTZ HOWARD D, ALST	-7,056		$74.23
6/28/13	ALSTEAD TROY M, CULVER		568	$65.51
6/28/13	ALSTEAD TROY M, CULVER		568	$65.51
6/17/13	HANSBERRY JEFFERY	-735		$66.03
5/31/13	HELM LUCY LEE	-4,066		$63.14
5/1/13	GATES ROBERT MICHAEL		3,300	$60.14
5/1/13	GATES ROBERT MICHAEL		3,300	$60.14
3/6/13	**SCHULTZ HOWARD D**	**-900,000**		**$57.10**
3/5/13	**SCHULTZ HOWARD D**	**-100,000**		**$56.51**
2/22/13	SHENNAN JR JAMES G	-10,000		$54.17
1/30/13	GASS MICHELLE P	-35,000		$56.00
12/31/12	HANSBERRY JEFFERY, HELM		264	$53.63
12/21/12	**SCHULTZ HOWARD D**		**1,020,000**	**$53.60**
12/18/12	HELM LUCY LEE	-5,227		$54.34
12/14/12	SCHULTZ HOWARD D	-50,000		$53.36
12/12/12	SCHULTZ HOWARD D, ALST	-91,013		$53.60
12/10/12	SCHULTZ HOWARD D, HELM	-200,000		$52.96
11/29/12	SHENNAN JR JAMES G	-10,000		$51.80
11/16/12	SCHULTZ HOWARD D, ALST	-127,408		$48.76
11/15/12	SCHULTZ HOWARD D, ALST	-105,370		$48.43
9/28/12	CULVER JOHN, HANSBERRY		425	$50.71
9/4/12	CULVER JOHN	-626		$49.51
8/24/12	BRADLEY WILLIAM W		23	$48.70
8/20/12	ULLMAN III MYRON E	-10,000		$48.05
6/29/12	CULVER JOHN, HANSBERRY		332	$53.32
6/15/12	HANSBERRY JEFFERY	-711		$52.54
5/25/12	BRADLEY WILLIAM W		21	$54.56
3/30/12	CULVER JOHN		142	$55.89
3/14/12	SCHULTZ HOWARD D, GASS	-20,000		$52.68
3/9/12	ALSTEAD TROY M, HOBSON	-30,000		$51.84
2/1/12	**SCHULTZ HOWARD D**	**-1,480,000**		**$48.24**
1/30/12	WEATHERUP CRAIG E, ULLM		10,000	$81.19

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Assess and Influence the Market's View

Investment Style of SBUX Largest Institutional Holders (late 2013)

Holder Name	Investment Style	Market Value ($)	Position Change ($)
Fidelity Contrafund	Aggressive Growth	1,195,304,286	521,800
Vanguard Total Stock Market Index Fund	Index	784,760,310	153,094
T Rowe Price Growth Stock Fund	Aggressive Growth	673,005,746	535,800
PowerShares QQQ Trust	Index	603,466,492	275,927
Vanguard Institutional Index Fund	Index	543,150,307	5,878
Vanguard 500 Index Fund	Index	533,037,280	46,211
SPDR S&P 500 ETF	Index	521,562,333	-946,968
MainStay Large Cap Growth Fund	Aggressive Growth	463,338,408	0
American Funds Fundamental Investors	Growth	432,588,000	-830,000
JPMorgan Large Cap Growth Fund	Aggressive Growth	420,324,497	-101,700
Government Pension Fund - Global (The)	GARP	406,277,265	305,275
T Rowe Price Blue Chip Growth Fund	Aggressive Growth	389,769,120	-55,000
Fidelity Series Growth Company Fund	Aggressive Growth	356,195,892	4,858,100
Fidelity Growth Company Fund	Aggressive Growth	351,056,160	-70,100
Fidelity Advisor New Insights Fund	Aggressive Growth	320,650,796	0
Fidelity Capital Appreciation Fund	Aggressive Growth	294,805,203	348,520
CREF Stock Account	Growth	276,570,739	15,259
Harbor Capital Appreciation Fund	Aggressive Growth	272,216,557	-94,244
American Funds New Perspective Fund	Aggressive Growth	260,286,000	-500,000
Vanguard Growth Index Fund	Index	245,024,369	50,097
Janus Twenty Fund	Growth	241,392,902	-3,360
Fidelity Spartan 500 Index Fund	Index	230,570,870	25,391
Fidelity Blue Chip Growth Fund	Aggressive Growth	187,611,216	-19,600
American Century Ultra Fund	Aggressive Growth	184,913,040	0
American Funds American Balanced Fund	GARP	183,300,000	0
iShares Core S&P 500 ETF	Index	175,528,153	-55,417
SPDR Series - Consumer Discretionary Select Sector SPDR Fund	Index	168,679,552	-447,759
Eaton Vance Tax Managed Growth Portfolio	GARP	166,452,970	-90,262
Principal Investors - Large Cap Growth Fund I	Aggressive Growth	154,098,257	-114,687
T Rowe Price Institutional Large Cap Growth Fund	Aggressive Growth	151,853,052	37,000
CREF Growth Account	Aggressive Growth	146,776,668	13,580
American Funds Growth Fund of America	Growth	146,640,000	0
Morgan Stanley Invt. Fds. - US Advantage Fund	Aggressive Growth	131,627,950	46,829
iShares Russell 1000 Growth ETF	Index	126,687,868	-20,302
American Funds Insurance Series - Growth Fund	Growth	121,344,600	-345,000
Fidelity Puritan Fund	Growth	121,073,316	0
ASTON/Montag & Caldwell Growth Fund	Growth	119,753,556	0
Touchstone Sands Capital Select Growth Fund	Aggressive Growth	116,578,800	96,000
ING Investors Trust - Large Cap Growth Portfolio	Growth	113,973,447	92,766

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"Circle the Symbols" Exercise

Instructions for the "Circle the Symbols" exercise:

- Review the table of symbols that follow
- For each row, identify the one that you find the most intriguing
- Put the letter for that symbol in the right-most column

Circle the Symbols

Note: those shaded are currently ranked as most intriguing by experienced buy-side and sell-side analysts who have participated in this activity in the past

Row	A	B	C	D	E	Your Choice
1.	©	ǁ	♥	↻	Ö	
2.	⊂	«	⅋	Ẅ	⚲	
3.	Ⱶ	ŋ	₵	Ï	Ж	
4.	℗	Ώ	₹	√	∞	
5.	⊤	β	ʒ	Ė	ʒ	
6.	↨	»	∂	Δ	∏	
7.	∟	⌂	‡	ʁ	≡	
8.	├	Ѫ	≥	♫	⍵	
9.	ɣ	₩	˥	☼	⊥	
10.	≈	≤	♂	₱	ⅡL	

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Module 4: Review Performance and Thesis

"Ski Vacation" Exercise

Instructions for the "Ski Vacation" exercise:

- Review the two options below and record how you would most likely respond.

- It's October and you're looking to book the two ski vacations that you typically take each winter.
- Trip 1: You find a 7-night trip to a nice location for $2,000 and so you purchase it.
- Trip 2: You later find a similar trip to an even better location and it's discounted down to $1,250, which you book as your second winter ski trip.
- Both trips offer multiple dates to choose from but are non-refundable.
- In November, you unexpectedly take on a new job that will allow you only one week of vacation for the first six months. Neither of your ski vacation packages can be refunded or resold.
- Which one do you chose to use?: _____

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Appendix

Transformation Action Plan (TAP)

Instructions for the Transformation Action Plan (TAP):

- Throughout this workshop complete the TAP below
- Apply the key points after the workshop to help you improve your performance
- This will not be collected and so write in a manner that will help you utilize the concepts being learned

Section 1: Are You Producing the Highest Quality Research?

After reviewing the ENTER™ quality checklist you completed in this module, identify areas where you scored a 1 or 2 and would like to improve, all to create higher quality research:

Based on the ENTER™ quality checklist:
To improve the quality of my research, I intend to do this more often:
To improve the quality of my research, I intend to stop doing this:

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Transformation Action Plan (TAP)

Section 2: Improve Your Stock Picking Skills by Reflecting on Module 1

- Complete the self-assessment below and then answer the question in the box that follows

Setting Price Targets Self-assessment

For stocks I'm recommending, I…	1 = disagree 5 = agree
Include a valuation method that includes an element of free cash flows?	
Am aware of all the limitations to the valuation method(s) I currently use	
Forecast multiple EPS (or cash flow) scenarios based on changes to assumptions for my critical factors	
Analyze the stock's historical valuation trends and current levels in order to create an accurate range of likely valuation multiples that I expect the stock to command at the time my price target should be achieved	
Know which of my stocks trade with peak multiples on peak earnings (or cash flow) and those that trade with peak multiples on trough earnings (or cash flow)	
Apply my multiple valuation scenarios to my multiple EPS (or cash flow) forecasts to derive a range of price targets, which helps me think outside my comfort zone	

- If you rated any item above as a 1, 2 or 3, in the box below, tell yourself what you will do to adopt best practices (start with the item you rated with the lowest score)

Based on the assessment above, I intend to do the following to improve setting price targets:

Section 3: Improve Your Stock Picking Skills by Reflecting on Module 2

Briefly review the material covered in Module 2 as well as the DRC/QRCs for "Step 2: Identify & Forecast Catalyst(s)" and provide yourself key coaching tips to use in the future to help improve your stock picking performance.

Based on this module focused on identifying and forecasting catalysts:
I intend to do this more often:
I intend to stop doing this:

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Transformation Action Plan (TAP)

Section 4: Survey Market Sentiment

For your stock of interest, create 2-3 questions that need to be answered in terms of understanding market sentiment around the critical factor(s) and the types of market participants you can contact to obtain the answers.

Questions that need to be answered:	Market participant that can provide insight:
Example: Does the market understand that FedEx has a fuel surcharge in place that generates a short-term profit in times of declining fuel prices? How much of this benefit is currently understood by the market because it could result in $0.05 upside in the quarter if fuel prices stay at current levels or drop further.	I'll contact 3 other buy-side analysts who cover the stock. I will also call the company's IR person to see if he knows how much of this is typically modeled by the sell-side.
1.	
2.	
3.	

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Transformation Action Plan (TAP)

Section 5: Improve Your Stock Picking Skills by Reflecting on Module 3

Briefly review the material covered in Module 3 as well as the DRC/QRCs for "Step 3: Ensure Ideal Entry Point." Also, briefly review the slides covering Module 3A and 3B so that you can provide yourself key coaching tips in the table below to use in the future to help improve your stock picking performance.

Based on the module focused on ensuring I find the ideal entry point:
I intend to do this more often:
I intend to stop doing this:

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Transformation Action Plan (TAP)

Section 6: Evaluate Your Comp Table

Self-evaluate the quality of your current comparison ("comp") table using the table below:

My Current Comp Table…	1=Yes 2=Somewhat 3=No
1. Updates stock prices automatically (via a feed to third-party service)	
2. Updates my forecast estimates (e.g. EPS, CFPS, BV, etc.) automatically from my models	
3. Includes consensus estimates which are automatically updated (via a feed to third-party service)	
4. Highlights when my financial forecasts differ materially from consensus	
5. For stocks I'm recommending, shows how much future valuation multiple differs from the current multiple	
6. For stocks I'm recommending, includes upside/downside returns to my target prices	
7. For stocks I'm recommending, includes a column for me to adjust upside/downside for risk/probability	
8. Includes ranges of historical forward relative valuation (e.g. relative P/E)	
9. Includes current relative valuation to the market (e.g. relative P/E)	
10. Include relative valuation metrics (e.g. P/E) for stocks in other sectors with similar prospects	
11. Includes how my recommendations have performed since the last rating change relative to my universe of stocks and the overall market	

If you rated any item above "3", note to yourself when you will make the modification in order to better review your performance and thesis.

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Notes

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