

## USA MUTUALS PUBLISHES WHITE PAPERS

*In our continuing efforts to support our shareholders in these volatile markets, we've prepared two white-papers which address where historically investors have sought to generate above market returns.*

Each paper can be found by visiting [usamutuals.com](http://usamutuals.com) or can be requested by calling 866.264.8783.

### [Attributes of Dividend Paying Companies](#)

*Learn how dividends have historically accounted for more than 40% of stock market returns and how focusing on such dividend paying companies may be a good strategy.*

### [Academics Examine Vice Fund Industries](#)

*Learn why sin stocks may have the potential for higher expected returns than otherwise comparable stocks and why having a portfolio of so called 'sin' stocks may be a good strategy.*

# USA MUTUALS + INVEST YOUR KNOWLEDGE

## A Letter From the President

Dear Fellow Shareholder,

It's quite interesting how much has changed in a year. And, yet some things have stayed the same. For instance, anxiety. Last year, everyone was wondering if and when a financial recovery would arrive. Now, pundits are wringing their hands over the idea that perhaps the recovery we have seen in the past year has been too swift, too great. Last year, I suggested the best way to overcome fear is to have a clear understanding of your investments. Today, I still feel that is the best prescription.

Ultimately, no expert or analyst or CEO can say for sure what the market will do. But by taking the time to read our annual report, newsletters like this and other materials, you can make informed decisions that ideally can make you feel more confident.

By now, you probably have noticed the impact of Jeff Middleswart as Portfolio Manager of our funds. As you will read in this newsletter, Jeff provides insights on the contributing factors responsible for past performance as well as providing an outlook for both the Vice and Generation Wave Growth Funds. Most interesting, despite the continued volatile markets, Jeff explains why he believes that both the Vice and Generation Wave Growth Funds have the opportunity to potentially beat the S&P 500 Index over the long term, but as you will read, for very different reasons.

We have also begun to publish white-papers in support of our mission of enabling all investors the opportunity to invest their knowledge. The current papers address the potential advantages of dividends as well academic research relating to the performance of "sin" stocks. Complete copies of each paper can be found by visiting [usamutuals.com](http://usamutuals.com).

In addition to Jeff's insights and outlook for the Vice and Generational Wave Growth Funds, he will offer an inside look at one holding which probably was consumed at a summer picnic or ball game, Anheuser- Bush InBev (BUD).

As always, we remain committed to enhancing shareholder value, and we take great pride in our passion and drive for success. We will always look for new and better ways and opportunities in our quest to deliver superior investment results.

Finally, I would like to express my sincere appreciation to you for your continued confidence in us. I thank you for your support, and the opportunity to continue serving you.

Sincerely,



Eric Lansky  
President

### in this issue

- P1 • A Letter From the President
- P1 • USA Mutuals Publishes White Papers
- P2 • Insights from the Manager: Vice and Generation Wave Growth Fund
- P3 • Anheuser-Busch InBev: Classic Vice Investment Theory in Action
- P4 • Article Reprint, 'Sin' Stocks Outperform, Study



# INSIGHTS FROM THE MANAGER

*From the Desk of Jeff Middleswart*

## The Vice Fund.

*In the period, we saw the S&P 500 Index decline as sluggish job growth, worries over debt problems in Europe, flagging US home sales, and concerns with Chinese economic growth took their tolls. The Vice Fund paid a 17.88 cent dividend payable on 06/29/2010. Our performance was helped primarily by tobacco holdings where three of our four holdings handily beat the index and the fourth was essentially even with the S&P. Chinese gaming stocks also beat the index and helped returns.*

### Thoughts on the Vice Fund Portfolio.

We continue to work to reduce the percentage of the portfolio that does not pay dividends. We continue to believe that dividends represent a great way to create a more defensive portfolio that should outperform in down markets. We expect dividends to help provide solid returns in up-markets too, which add extra return to capital appreciation.

By emphasizing companies with strong cash flows, we expect that many VICEX companies should be able to boost dividends as well as repurchase stock to drive Earnings Per Share (EPS) for our investors. Fifteen of the companies owned in the Vice Fund raised their dividend within the last year.

The **tobacco companies** this quarter demonstrated the power of solid cash flow to shield investors from potential problems. In this last quarter, the tobacco companies faced higher excise taxes in many states and countries looking to boost government revenues. They faced potential litigation – since denied by the Supreme Court and potential regulation on menthol, a risk that has also been largely played down at this point. The relatively cheap valuations and attractive dividend yields (at about 5% and higher), allowed the stocks in this sector to rally during the quarter. With the exception of Phillip Morris, every tobacco stock we own beat the S&P 500 by a wide-margin. Every tobacco company in our portfolio raised its dividend, three repurchased shares, and the fourth paid down debt, all of which directly benefitted shareholders with more income and higher EPS.

**Defense** is where we see some of the cheapest stocks in our universe. 16.3% of the portfolio is invested in our core positions of General Dynamics Corp (GD), Lockheed Martin Corp (LMT), Northrop

Grumman Corp (NOC) and Raytheon Company (RTN). These stocks are trading at less than 10x EPS and less than 6x EBITDA, which are compelling valuations. Add to that, the dividend yield is over 3% for each of those companies, and all boosted their dividends recently. We are finding several ancillary positions that compliment these core positions that also have cheap valuations and good long-term potential as acquisition targets and/or a positive outlook for the growing demand for their products.

**Alcohol** is still digesting its merger wave of the 2005-08 period. We have highlighted Anheuser Busch Inbev (BUD) in this newsletter as a focus stock to demonstrate this trend. The companies primarily focused on spirits have enjoyed steady growth as emerging markets have industrialized. Beer companies have seen enormous gains in the emerging economies, and have focused heavily on cost cutting in domestic markets. The stronger dollar is hurting companies with heavy US production facilities, but we feel this is not a permanent situation, which led us to purchase even more BUD in the period.

**Gaming** continues to be the most volatile sector. Much of the industry has too much debt for our comfort level, and there are few companies that pay dividends. In fact, we only own 6 stocks in the entire Vice Fund that do not pay dividends and 5 are in the gaming area. Macau and slot machines for both new markets and replacement machines in established markets remain our two primary plays here. Both should represent new growth in an industry that is unlikely to generate strong returns on new casino projects domestically, and many of the players will remain focused on balance sheet problems. In the absence of compelling valuations for much of the group, we are likely to remain underweight in this area relative to our other sectors.

## The Generation Wave Growth Fund.

*The Generation Wave fund has the benefit of being a niche fund and as such, has a solid well-defined mission that seeks to beat the S&P 500 Index over the long-run. (continued on page 3)*

We are continuing to actively manage the portfolio with an emphasis on companies that can finance themselves, turn-around plays acquired at attractive prices, and dividends help to enhance returns, while continuing to focus more on the Baby Boomer themed companies. Our best performers were debt restructuring firms acquired in 2008 and 2009. We still own positions in these, but have been taking profits as historically this is an area that attracts significant competition after a few quarters of high returns, resulting in lower returns down the road.

#### Thoughts on the Generation Wave Growth Fund Portfolio.

As mentioned, we have been actively managing the Generation Wave Growth Fund with a focus toward providing above market performance in volatile markets. As such, we have eliminated the following positions, many at a profit for shareholders.

**Bank of America Corp.** While the US banks have rallied based on a wide interest margin and less fear of liquidity issues, we still see that little has been done to correct the growing foreclosure problem or the huge amount of commercial real estate debt. These problems should return to the forefront of the news, especially in California where Bank of America Corp. has heavy exposure. We believe we can find less risky situations and were happy to take the gain.

**BB&T Corp.** This is the same story as Bank of American - a US Bank that recovered in 2009 and produced a profit on the sale of our remaining position.

**ENER1** This company develops lithium batteries and was a position we wanted to eliminate. It has historically been dependent on raising external funds and has never posted a profit. When it received a new round of financing in the quarter the stock rallied and we sold all of HEV.

**MBIA:** We had been eliminating this position in 1Q 10 and finished the remainder in 2Q. This was similar to the banks in that survival was a major risk in 2009 and the fund acquired it at low prices. We did not like some recent attempts by management to move quality assets to a separate company and still believe there is considerable risk in insuring municipal bonds in these days of government budget problems.

**OSI Pharmaceuticals:** This position was bought out in a tender offer.

**Wisdomtree Trust Japan:** This was a position that no longer meets our core focus.

#### The Focus of the Fund.

We continue to hold 23% of the fund in the larger **pharmaceutical** companies such as Pfizer, Eli Lilly, and Bristol Myers. Valuations are very low with Price/Earnings (PE) ratios about 8x and dividend yields greater than 5% on average. We believe drug companies may use their cash flows to acquire new companies with promising drugs to replace those losing patents. They could also likely continue to consolidate to reduce costs and grow EPS via cost-cutting and share repurchases.

We have also been acquiring large profitable bio-tech companies with some solid growth potential such as Amgen and Gilead Sciences. Each of these have large pipelines along with existing products on the market and are valued at less than 10x forward earnings and have been producing real growth.

The **financial** stocks in the fund have been turning over. Our focus is on niche plays that will emphasize people saving money for retirement and insurance. Several of the new purchases have been made below book value and have been paying solid dividends and may in fact be acquisition targets. In the case of investing, we believe that discount brokers will continue to take market share and offer a platform for individuals to purchase mutual funds, stocks, bonds, Certificates of Deposits, and ETFs at very low transaction costs. Asset inflows should help drive growth and higher market share should mean greater volume too.

To go along with our primary themes of saving money for retirement and health care, we believe that more Boomers will spend **more time at home**. Companies such as Comcast for cable and internet and Kroger for people eating at home more frequently look like very good values to us. As of this writing, each pays a dividend and is a dominant player in their industries as well as carrying attractive balance sheets. ■

## Stocks in Focus

# Anheuser-Busch InBev (NYSE: BUD) —

## Classic Vice Investment Theory in Action

While many people focus on Vice stocks from a social aspect, they miss the underlying financial reasons these companies can be so successful. The major reasons are:

1. Consolidation among players creates barriers to entry.
2. Enormous cash flow can be produced.
3. This cash flow can be used for a number of shareholder positive events:
  - a. Dividends
  - b. Share repurchases
  - c. Acquisitions

One of our primary areas of focus is the alcohol industry. There has been enormous consolidation over the last several years in this area with Diageo and Pernod Ricard buying up many spirits companies, SAB buying Miller Brewing, Molson and Coors merging, and of course InBev of Belgium buying Anheuser Busch. The Vice Fund has positions in each of these companies and we see good growth coming from each. However, we wanted to use the new Anheuser-Busch InBev as the example of a Vice stock cycle in action.

In November 2008, Inbev completed the purchase of Anheuser-Busch largely with debt. The goals were to eliminate non-core assets such as theme parks, operate other assets at full capacity by combining the two companies' operations, reduce overhead costs, create better buying opportunities, and focus on the top brands of both.

This even more dominant company has also been taking market share. Major growth has been coming from Brazil, but even in the US and Europe, where emphasis is being placed on the Focus Brands, Anheuser-Busch Inbev have reported sales better than the industry as a whole. That has further enhanced the cash flow position too.

Where has the cash flow gone? At this point, it has been rapidly repaying debt related to the merger. Two points need to be kept in mind. First, interest expense is tax deductible and thus shields more cash flow than a dividend. Thus, the company gets

*(continued on page 4)*

## CHECK IT OUT!

The following is an excerpt from an article that appeared was featured in the *Financial Advisor Magazine* on October 21, 2009:

### “SIN” STOCKS OUTPERFORM, STUDY

A study from professors at New York University and Princeton University concludes investors pay a price for not investing in “sin” stocks - publicly traded companies involved in alcohol, tobacco, and gaming.

[The study indicates] investors [could] gain 2.5% higher returns every year on a risk-adjusted basis by investing in sin stocks versus investing in stocks with comparable characteristics, such as beverage, food, and entertainment companies, respectively, conclude NYU Stern Assistant Professor of Finance Marcin Kacperczyk and his co-author, Harrison Hong from Princeton University, A study from professors at New York University and Princeton University concludes investors pay a price for not investing in “sin” stocks - publicly traded companies involved in alcohol, tobacco, and gaming.

The study indicates investors could gain 2.5% higher returns every year on a risk-adjusted basis by investing in sin stocks versus investing in stocks with comparable characteristics, such as beverage, food, and entertainment companies, respectively, conclude NYU Stern Assistant Professor of Finance Marcin Kacperczyk and his co-author, Harrison Hong from Princeton University, in their paper, *The Price of Sin: The Effects of Social Norms on Markets*.

The paper examined the performance of stocks from 1926-2006. A working paper with the same name by Kacperczyk and Hong that was released in 2006 looked at the 1980-2003 time period and also found outperformance by sin stocks.

Last year Meir Statman, a professor at Santa Clara University, and Denys Glushkov of the University of Pennsylvania released a study that found offsetting characteristics of stocks liked and disliked by socially responsible investors. “We find that stocks of companies with high ratings on social responsibility characteristics outperformed companies with low ratings.

However we also find that ‘shunned’ stocks [i.e., alcohol, tobacco, gambling, firearms, military, and nuclear] outperformed those in other industries ... The two effects balance out, such that socially responsible indexes have returns that are approximately equal to those of conventional indexes.” Last year the paper won the Moskowitz Prize from the Center for Responsible Business at The University of California at Berkeley. In 2006, Herbert Blank and Andrea Psoras of QED International Associates released research that also concluded eliminating “sin” stocks from portfolios reduces returns.

Kacperczyk and Hong concluded that their findings show there is a societal norm against funding operations that promote vice and that some institutional investors, such as pension plans that are subject to norms, hold less of these stocks and, as a result, pay the financial cost of abstaining. In addition, sin stocks receive less analyst coverage than stocks with comparable characteristics.

While sin stocks are neglected by norm-constrained investors and face greater litigation risk due to social norms, they have higher expected returns than otherwise comparable stocks, they say.

“This research shows that social norms are important for economic outcomes and that they affect markets, including investment decisions, stock prices and returns,” said Kacperczyk. The paper was recently accepted for publication by *Journal of Financial Economics*.

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## Anheuser-Busch InBev (NYSE: BUD) — Classic Investment Theory in Action (*Continued*)

repayment by paying only a modest dividend at this point of approximately 1.6%. Second, debt repayment results in greater value transfer to the shareholders. Essentially, if the total company is worth \$120 billion with \$40 billion being debt and \$80 billion being the value of the stock, paying down debt by \$5 billion transfers the \$5 billion to the stockholders even without the total company value changing at all. The company has been on a very rapid debt repayment program at this point.

As debt is paid down, the company will likely be able to refinance at lower rates and help drive earnings as well. Moreover, as debt becomes more manageable the dividend is likely to rise too.

Anheuser-Busch Inbev has great market share in growing markets such as Brazil, Mexico, Russia, and China. Those areas should produce higher profits as will lowering costs in established markets such as the US, Canada, and Western Europe where top-line growth may be modest.

OPINIONS EXPRESSED IN THE INSIGHTS FROM THE MANAGER AND SPECIAL REPORT: ARE SUBJECT TO CHANGE AND SHOULD NOT BE CONSIDERED A RECOMMENDATION TO BUY OR SELL ANY SECURITY.

### FROM OUR EDITOR:

You can find more complete observations, insights and strategies for the both the Vice Fund and Generation Wave Growth Fund by visiting [usamutuals.com](http://usamutuals.com) and clicking manager commentaries.

One of the most important aspects of a successful relationship is an open line of communication. In addition to this newsletter, each month we share important updates on your fund—from recent appearances in the media, to timely updates on events which may impact your investment. For us, the most efficient means of communication is email. If you are not already receiving such updates, please send us your email address to [info@usamutuals.com](mailto:info@usamutuals.com).

Beyond seeking to increase the value of your investments, we also do our best to ensure your full trust and confidence. We thank you for the opportunity and privilege to help you Invest Your Knowledge.

**Past performance is no guarantee of future results.** For current performance, please visit [USAMutuals.com](http://USAMutuals.com) or call 1.866.264.8783.

The views expressed in the referenced articles and study constitute opinions as provided by the author and certain contributors, are not guaranteed, and should not be considered a recommendation to buy or sell any security.

**So-called “sin stocks” can lose money in good or bad economic conditions, and there is no guarantee that a sin stock will not lose significant value in an economic downturn. The average historical returns for “sin stocks” are not representative of the Vice Fund performance. For current performance of the Vice Fund contact us at 1.866.264.8783 or go to [www.vicefund.com](http://www.vicefund.com).**

The S&P 500 Index is a broad based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general. You cannot invest directly in an index. A Basis Point is one hundredth of a percentage point (0.01%). Earnings per share (EPS) is calculated by taking the total earnings divided by the number of shares outstanding. Price/Earnings (P/E) Ratio is a common tool for comparing the prices of different common stocks and is calculated by dividing the current market price of a stock by the earnings per share. Book Value is net asset value of a company, calculated by subtracting total liabilities from total assets. EBITDA is Earnings Before Interest, Taxes, Depreciation and Amortization. An approximate measure of a company's operating cash flow based on data from the company's income statement. Debt/EBITDA ratio: The ratio of debt to “earnings before interest, taxes, depreciation and amortization” is a key ratio used to describe a company's ability to service its debt and make interest payments. Generally, lenders look for Debt/EBITDA ratios of less than five. Forward Earnings are a company's forecasted, or estimated, earnings made by analysts or by the company itself. Cash flow measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expense to pretax income.

**The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory and summary prospectuses contain this and other information about the investment company, and they may be obtained by contacting 866.264.8783 or go to [www.USAMutuals.com](http://www.USAMutuals.com). Read it carefully before investing.**

*Mutual fund investing involves risk; principal loss is possible. The Vice Fund is non-diversified, meaning it may concentrate its assets in fewer individual holdings than a diversified fund. Therefore, the Fund is more exposed to individual stock volatility than a diversified fund. The Fund invests in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods. The Fund invests in smaller companies, which involve additional risks such as limited liquidity and greater volatility.*

*Because the Generation Wave Growth Fund is a “fund of funds”, your cost of investing in the Fund will generally be higher than the cost of investing directly in the shares of the mutual funds in which it invests. By investing in the Fund, you will indirectly bear your share of any fees and expenses charged by the underlying funds, in addition to indirectly bearing the principal risks of those funds. Please refer to the prospectus for more information about the Fund, including risks, fees and expenses. The Fund also invests in ETFs. They are subject to additional risks that do not apply to conventional mutual funds, including the risks that the market price of an ETF's shares may trade at a discount to its net asset value (“NAV”), an active secondary trading market may not develop or be maintained, or trading may be halted by the exchange in which they trade, which may impact the Fund's ability to sell its shares. The Fund may also invest in foreign securities. Investments in foreign securities involve greater volatility and political, economic, and currency risks and differences in accounting methods.*

Fund holdings and sector allocations are subject to change at any time and are not recommendations to buy or sell any security. Please note that as of 06/30/10, the top 10 companies owned within the Vice Fund were: Philip Morris (11.47%), Lorillard (9.06%), Altria Group (6.15%), Lockheed Martin (5.58%), Diageo (5.4%), Carlsberg (5.17%), SABMiller (4.76%), Northrop Grumman (3.67%), Raytheon (3.62%), General Dynamics (3.25%). Please note that as of 6/30/2010, the top 10 companies owned within the Generation Wave Growth Fund were: Mylan Inc. (5.44%), Bristol Myers Squibb Co (5.30%), Eli Lilly & Co (4.60%), Market Vectors Gold Miners ETF (4.36%), Pfizer Inc (3.98%), Vertex Pharmaceuticals Inc (3.68%), Kroger Co (3.31%), Amgen Inc. (3.24%), Unum Group (3.04%), NASDAQ OMX GROUP INC (2.99%)

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