

A New Look At portfolio Management

NAIC

**A New Look At
Portfolio Management**
Or
**“What do I do with it,
now that I own it?”**

When to Sell?
My Favorite question!

Selling is an Art

There is no precise mathematical formula that I can provide

Know what conditions will prompt you to sell

You need to exercise JUDGMENT!

You need a “SELL DISCIPLINE”

Deciding to sell.....

Before Selling, understand why you BUY!

A decision to sell is the opposite of a decision to buy

Let’s use the purchase criteria in reverse to determine if the stock should be sold.....

Deciding to sell.....

looks at the same criteria as deciding to buy

Buy Criteria	Sell Criteria
■ Sales & EPS are growing faster than the economy	■ Sales & EPS growth stalls
■ Profit Margins are maintained or are rising	■ Profit Margins are declining
■ Management is competent	■ Management fumbles

Deciding to sell.....

looks at the same criteria as deciding to buy

Buy Criteria	Sell Criteria
■ Current P/E ratio is equal to or less than 5-year average PE	■ Current P/E ratio is higher than 5-year average P/E
■ Upside/Downside Ratio is 3:1 or better	■ Upside/Downside Ratio is 1:1 or lower
■ Total Return is acceptable	■ Total Return is unacceptable

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Deciding to sell.....

looks at the same criteria as deciding to buy

Buy Criteria

- Stock is undervalued
- Outlook for company is favorable
- Cash is available to invest

Sell Criteria

- Stock is grossly overvalued
- Outlook for company is unfavorable
- Cash is required for non-investing purposes

OK!

Let's look at some valid reasons to Sell

When (Why) Should You Sell?

- Adverse management change
- Profit margins are declining
- Deteriorating corporate financial condition
- Competition is affecting profits
- Dependence on a single product or customer

When (Why) Should You Sell?

- Company proves to be cyclical
 - Is the Industry sector cycle about to start down?
 - Is the product cycle ending?
- To correct major diversification imbalance

When (Why) Should You Sell?

- The club (or you) needs cash
- The stock is grossly overvalued
 - Is the P/E more than 150% of Average P/E?
 - Is the company (E/S) growing at less than 10%?
- A company of equal or greater quality offers more gain on the upside and less risk on the downside

Do Ya Really Wanna Sell?

- One rule has to do with generating cash
- One rule suggests that you might sell to take a profit
- One rule suggests replacing a stock with a low potential, only when you can find one with better potential
- Seven of the rules call for chucking the losers

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**So you now know
When To Sell
Right?**

**A Look at NAIC
Portfolio Management**

Managing a Portfolio of Stocks

- Weeding out the losers.
- Finding replacement stocks.
- Determining if a price drop is a good time to purchase more shares.
- Making sure that the portfolio is adequately diversified.

NAIC Portfolio Management Step-by-Step

- Update data
 - Update prices
 - Quarter
 - Annual
- Modify SSG judgments.
- Begin the Portfolio Review

NAIC Portfolio Management Step-by-Step

- Open PERT
 - Rank by Pre-Tax Profit (PTP)
 - Look for decline in Sales growth rate
 - Determine if Sales growth is lower than projected Sales growth rate
 - Compare PTP growth with projected EPS growth rate
 - Use only reported PTP figures
 - Do not use PTP projected by the software
 - Compare Trailing 12 Month EPS growth rate with original EPS projection

NAIC Portfolio Management Step-by-Step

- Open Portfolio Trend Report
 - Check EPS, Sales, PTP, & Trailing EPS
 - Compare each one to projected EPS growth rate
 - Problem?
 - Drill down to PERT-A and PERT-A graph
 - Determine if transient or long term
 - Investigate on the internet
 - Contact Investor Relations

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NAIC Portfolio Management Step-by-Step

- Return to PERT
 - Sort by Upside/Downside Ratio (Descending)
 - If Relative Value is over 150% and
 - U/D is under 1:1 - Consider selling
- Return to Portfolio Trend Report
 - Consider selling part if holding is too large a part of the portfolio
- Use Challenge Tree to find profitable replacement
 - Another stock of equal quality
 - Money Market Fund

What Do We need to Manage a Portfolio of Stocks?

- Analyze company performance
- Alert investor of changes
- Provide on-going measurement of investment potential and company performance
- Provide comparison with your SSG expectations
 - Differences from expected results should trigger a review and update of the SSG
- Help with buy & sell decisions
 - Always make the buy & sell decision on the basis of an updated SSG study

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We find out how lazy Rich really is!

The Four NAIC Investment Principles

- Invest regularly
- Reinvest the earnings and dividends
- Invest in growth companies
- Diversify

Where does it say... Hold?
Long term?
Forever?

Long Term

- It's A Long Term Job!
- It will take time to accomplish this task
- Grow rich slowly
- No one is telling you it will happen overnight

Simplifying Portfolio Management

- Too MUCH!
 - Detail
 - Many Forms
 - Time
 - Confusion
- Apply the KISS principle...
The SSG is the key

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Keep your eye on the ball

The goal

- 15% overall portfolio return
 - Double every five years

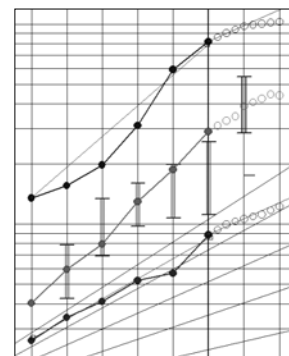
Portfolio Management can be focused

Twice the Fun

- Two SSG's for each holding within the portfolio
- The first is the original SSG
- The second is a current SSG
- Tell everything you need to know about a company as it pertains to the portfolio

The Original SSG

- Do not change the judgments that were used to make the buy decision
- Do add the quarterly data
- Compare the original projections trend line to the quarterly data plot



The Original SSG

The Second SSG

The current SSG

- Updated completely each quarter.
- It is used to tell if it is time to...
 - buy more, or
 - it might be time to sell

Quarterly Portfolio Review

- Approximately 4 weeks after the end of the quarter
 - because it takes that long before all of the quarterly reports are published
- The process takes a few (3-4) hours
 - once all the companies quarterly data are in hand

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The Portfolio List

Create a list of the companies you own
From...

- Highest Projected Average Return
 - Lowest Projected Average Return
- Also list the five year total return

Where do I get these numbers?
SSG - Section 5

The Portfolio List

- Returns are the driving force
- Look for a return of at least 15%
 - Double my money every five years
 - Every stock not have to produce a 15% return
 - Average of the portfolio must produce a 15% return
- Companies less than 12% are suspect
 - candidates to be sold

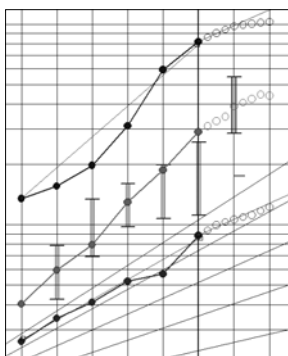
Reasons to Sell

Reasons to Sell are very simple...

1. The Bad News!
The outlook for company is unfavorable
2. The Good News!
The damn thing has gotten overvalued
3. Necessity!
Club (or you) needs cash

Sell Signals come in 7 forms:

1. Total Return is unacceptable
 - < % as a ratio to size
2. Price is in the "Sell range"
3. Upside/Downside Ratio is 1:1 or lower
4. Sales & EPS growth stalls
5. Profit Margins are declining
6. Management fumbles
 - Indicated by flattening or falling numbers in PTP & ROE
7. Current P/E > 150% of 5- year Average P/E
 - A red flag!
 - Indicates the stock is grossly overvalued



Growth stalls
SSG - Section 1

- Sales
- EPS
- Profit Margins

The Original SSG

2 EVALUATING MANAGEMENT											
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Average
A % P/E on Rev	0.0	0.0	0.0	0.0	7.5	9.5	10.1	10.4	7.9	8.9	9.4%
B % Earned on Edy					24.8	16.5	7.8	11.0	10.8	14.2	12.1%

Management fumbles

SSG - Section 2:

Indicated by flattening or falling numbers

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Year	PRICE		C Earnings Per Share	D Price Earnings Ratio		F Dividend Per Share	G % Payout F = C x 100	H % High Yield F = B x 100
	A HIGH	B LOW		E HIGH A = C	E LOW B = C			
1 1995	3.94	2.13	0.17	23.0	12.4	0.00	0.0%	0.0%
2 1996	8.72	3.47	0.21	32.6	16.6	0.00	0.0%	0.0%
3 1997	8.00	4.88	0.26	30.5	18.0	0.00	0.0%	0.0%
4 1998	9.94	5.38	0.29	34.9	18.9	0.00	0.0%	0.0%
5 1999	12.94	5.59	0.44	29.2	12.6	0.00	0.0%	0.0%
6 TOTAL		21.44		150.2	79.3		0.0%	
7 Average		4.29		30.0	15.9		0.0%	
8 Avg PE Ratio		22.9		9	Cur PE Ratio	42.7	0.02	RV=1.86

$22.9 \times 1.5 = 34.35$

Current P/E > 150% of 5-year Average P/E
SSG - Section 3:
A red flag!
Indicates the stock is grossly overvalued

SSG Sell Signals come in 7 forms:

- Section 1: Sales & EPS growth stalls
- Section 1: Profit Margins are declining
- Section 2: Management fumbles
 - Indicated by flattening or falling numbers
- Section 3: Current P/E > 150% of 5-year Average P/E
 - A red flag! Indicates the stock is grossly overvalued
- Section 4C: Price is in the "Sell range"
- Section 4D: Upside/Downside Ratio is 1:1 or lower
- Section 5: Total Return is unacceptable
 - < % as a ratio to size

Candidates to be Sold

- Any company meeting these criteria are candidates to be sold
- If they meet 3 or more they're probably dogs, especially if this has gone on more than two quarters
- Sell off the dogs

Back at the Portfolio List

- Review the companies remaining on the list
- Companies with the lowest potential return
 - Targets to be replaced by "quality" candidates of greater potential
 - BTW, at anytime you may use the current quarter's Portfolio List to apply this rule

Adding to Existing Holdings

- Any candidates that have buy signals be reviewed for possible additional purchases
 - The price of a good quality company meets the criteria of a "Buy"
 - The PE is below the 5-year Average PE

What you need to do

- It's not "to have and to hold"
- It is a process
- Discipline to apply
- Keep your eye on the ball
 - 15% overall portfolio return
 - Double every five years

Be brave!

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What Happens

- This process has turnover between 10% and 20% of your holdings each year
 - Seems like a lot...
- Remember Rule of five
 - 3 stocks do as I expect
 - 1 is outa sight
 - 1 is outa sight
- It's also know as the 80% rule

A Final Few Words

- This process has turnover between 10% and 20% of your holdings each year
- It may cause you to sell some things too early
- It may cause you to sell some things a little late
- But overall your portfolio average should be improved by using this technique

Thank you
for coming to

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