

Rolling Stocks

Investment Club

Presentation on Club Strategy
To Mobius Investment Club

Dave Gaskell
Secretary

Rolling Stocks Investment Club



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- Life Before our current strategy
- Our Club Strategy – 3 sub-portfolios
 - Mechanical Sub-portfolio in more depth
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Rolling Stocks Investment Club

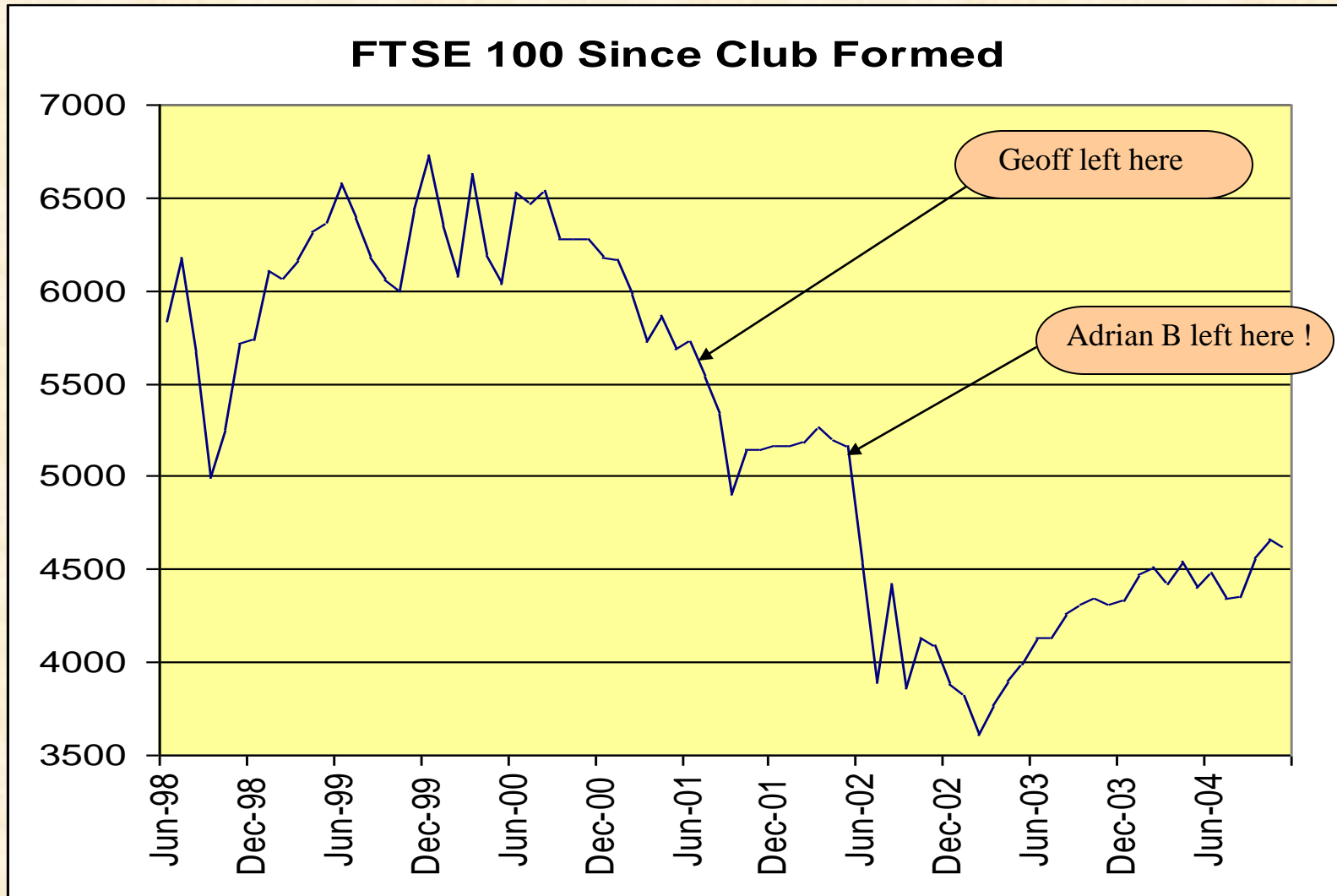
Who are we?

- Formed in May 1998
- Six originating members
 - Richard W pretty experienced
 - Chris B slightly less so
 - Dave G, Kit P, Adrian B and Geoff O all interested novices
 - Geoff liked llamas !
- All IT professionals
- All work in UK Rail
- Came together during Railtrack's Y2k project
- Still six members
 - Four of the originals
 - Geoff left May 2001
 - Adrian B left June 2002
 - Two new members
 - Adrian T joined Feb 2002
 - Simon B joined June 2002
 - Both IT professionals in UK Rail
- Monthly subs £50-£80
- Current net assets of £28,505
- Current profit of £11,870



Rolling Stocks Investment Club

Were Geoff & Adrian really interested novices?





Life Before Our Current Strategy

Initial discipline

- Wanted to define a Strategy
(Investment Planning Meeting June 1998)
- Aims of the initial strategy
 - *To achieve a real rate of return that beats the rpi over 3 years*
 - *To learn about investing capital*
 - *To achieve long term growth rather than short term gains*
 - *Anticipated up to 12 stocks – diversifies but still manageable*
- Established Buy Proposal Form
(still used today)
- No rush to buy
(first purchase was 21st October 1998)



Microsoft Word
Document



Microsoft Word
Document



Microsoft Word
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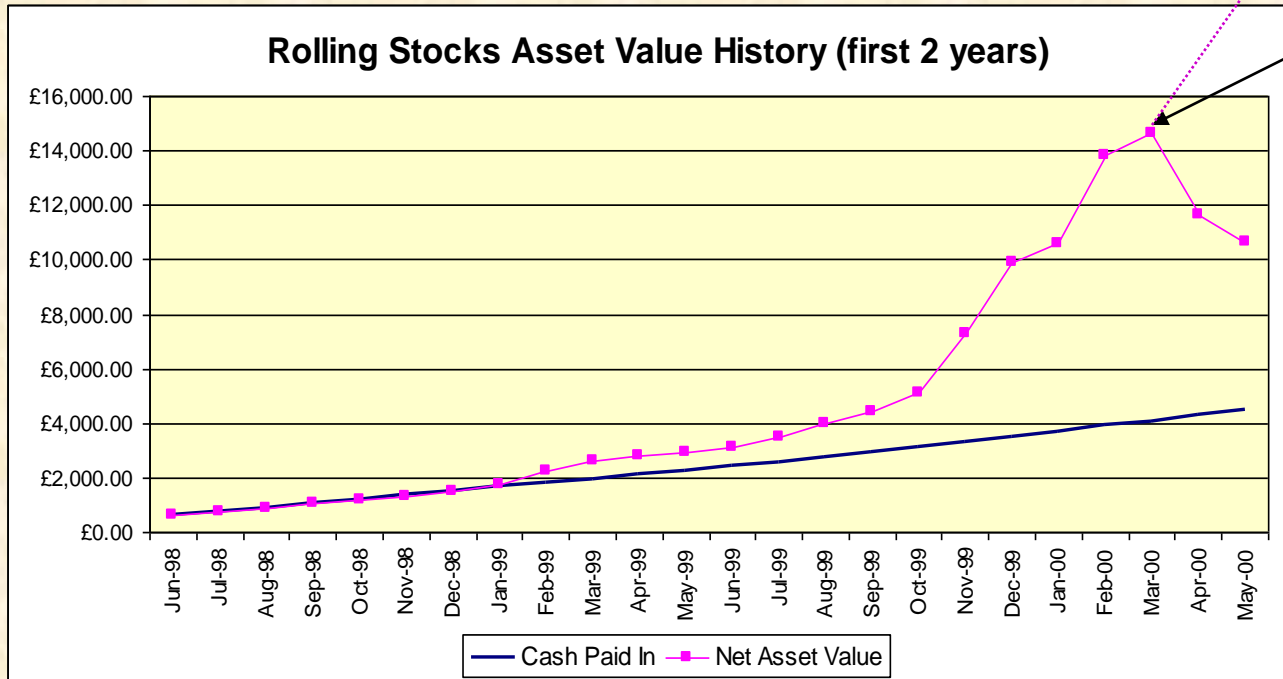


Life Before Our Current Strategy

Early results

- Initial Purchases

Science Systems	21/10/1998
ARM Holdings	20/01/1999
Workplace Tech.	18/05/1999
Total Systems	22/12/1999



At this point, we were due to be millionaires on Sept. 17th 2004 !



Life Before Our Current Strategy

Some problems

- **Psychology of Selling**
Hadn't sold anything yet - were we afraid??
- **Won Competitions !!**
Wanted a speculative punt - but still wanted 'control'
- **Rejected Buy Proposals**
We were each finding different reasons not to buy
- **Buy Proposals Dried up**
Too difficult to find a mutually acceptable candidate?
Resulted in us not having any activity !

“We need a revised strategy...”



Revised Club Strategy

Revised objectives

- a. To Make Money through investment
 - to beat the FTSE 100.....
 - whilst sensibly protecting against significant losses.....
 - yet having opportunity to speculate and make significant gains
- b. To Learn
 - about a variety of sectors (e.g. IT, Transport, Construction, etc.)
 - about a variety of investment products (e.g. Shares, Warrants, Bonds, Options, etc.)
 - about a variety of markets (e.g. FTSE, Aim, Overseas, etc.)
- c. To Have Fun
 - being a member of the Club
 - at Club meetings
 - especially where this also aids learning (e.g. fantasy portfolio) or can make money (e.g. entering competitions)



Revised Club Strategy

Revised structure of the document

- Objectives - *what are we trying to achieve?*
- Timeframe - *have we a long term, short term or day-trading approach?*
- Type of Analysis - *how will we select investments?*
- Type of Trading - *do we want overseas shares, commodities, futures, warrants?*
- Money Management - *how much in each asset?*
- Risk Control - *how will we balance the risk of losses against the need to make profits?*
- Entry/Exit Strategy - *when will be buy/sell?*
- Review - *are we meeting our objectives?*



Revised Club Strategy

Revised portfolio structure

- The 3 sub-portfolio approach
 - Fundamental/Defensive sub-portfolio
 - candidates researched in detail as part of proposal
 - companies with sound finances & good prospects
 - purchases expected to be held for over 1 year
 - monthly report by a 'champion'
 - Speculative/Aggressive sub-portfolio
 - higher risk companies (could double or bust?)
or products unfamiliar to Club
 - less research demanded as part of proposal
 - shorter investment timescale - expect to sell within 1 year
 - Mechanical/Unemotional sub-portfolio
 - 'screened'/filtered list using specific criteria
 - unemotional/unambiguous/repeatable mechanism of selection
 - regular purchases (one every 2 months)
 - fixed holding periods (sell on its 'birthday')



Mechanical Portfolio Objectives

- Achieve annual rate of return that beats the FTSE
- Provide reasonable “safety” so that risks of significant losses within the sub-portfolio are small
- Have a selection mechanism that is explicit, unambiguous, clearly understood and repeatable
- Provide a means of regular share trading so that the Club’s overall portfolio maintains interest
- Contains “Value” and “Growth” shares (similar to those set out in “WWOWS”)



Mechanical Portfolio

Stock Selection Filters - “Value” Filters

- No very small companies
- Cheap compared to revenues
- Has plenty of tangible assets
- Profits expected to grow
- Pays a good dividend
- Forecast good dividend
- Dividends are well covered
- Making a return on capital
- Cheap compared to earnings
- Isn't in significant debt
- Market Cap > 0.04 Allshare
- PSR < 1.5
- PTBV < 2.5
- EPS forecast growth > 5%
- Hist.Yield > 1.2 FTSE avg
- Fcast.Yield > 1.2 FTSE avg
- EPS/dividend > 1.5
- ROCE > 0
- PE < 0.85 FTSE average PE
- Gearing < 75%



Mechanical Portfolio

Stock Selection Filters - “Growth” Filters

- No micro ‘tiddler’ companies
- ‘Cheapest’ compared to revenues
- Cheap compared to forecasted growth
- ‘Best’ forecasted growth over next 2 years
- Market Cap > 0.01 Allshare
- In lowest 30% by PSR
- PEG >0 and <1.5
- EPS forecast growth >0 in each of next 2 years
- In top 30% EPS forecast growth over 2 years combined



Mechanical Portfolio

Which stocks currently pass the filters?

“Value”

- McAlpine (Alfred)
- Taylor Woodrow

“Growth”

- CPL Resources
- Qualceram Shires
- Cape
- Oystertec
- Hyder Consulting
- Havelock Europa
- (31 others)

So how do you choose between those that pass?



Mechanical Portfolio

Weightings - defining them

- List the ‘attributes’ you can unambiguously, unemotionally and repeatably measure
 - e.g. Market Cap, PE ratio, PSR ratio, PBV ratio, PEG, yield, etc.
- Decide which are more important than others and award each attribute a “weighting”
 - e.g. Market Cap weight = 3
PE ratio weight = 7
dividend yield weight = 4
PSR weight = 10
Earnings growth weight = 0
etc.
- “Normalise and average” them across all members



Mechanical Portfolio

Each Member's Weightings ("Value")

	Adrian T	Chris	Dave	Kit	Simon	Richard	
Market Cap	0	0	3	0	1	3	
Price to Book	7	3	8	7	6	7	
Price to Sales	7	8	8	7	5	1	
Return on Capital	6	7	4	5	3	3	
Net Gearina	8	2	5	9	7	10	
Earnings 1vr f/c Growth	8	10	0	7	5	8	
Earnings 2vr f/c Growth	0	0	0	0	0	0	
Earnings across 2vrs	0	5	8	0	6	8	
Historic PE	0	8	0	0	8	8	
Forecast PE 1 vr	0	0	5	7	0	0	
Forecast PE 2 vr	0	0	0	0	0	0	
Historic Div Yield	0	8	0	0	0	9	
Forecast Yield 1vr	7	0	4	7	0	0	
Forecast Yield 2vr	0	0	0	0	0	0	
Historic Div Cover	0	5	0	0	5	7	
Forecast Div Cover 1vr	7	0	5	7	0	0	
Forecast Div Cover 2vr	0	0	0	0	0	0	
	50	56	50	56	46	64	322



Mechanical Portfolio

Normalised Averages (“Value”)

	Chris	Dave	Kit	Simon	Richard	Average	
Market Cap	0.0	0.0	3.0	0.0	1.1	2.3	1.07
Price to Book	7.0	2.7	8.0	6.3	6.5	5.5	5.99
Price to Sales	7.0	7.1	8.0	6.3	5.4	0.8	5.77
Return on Capital	6.0	6.3	4.0	4.5	3.3	2.3	4.39
Net Gearing	8.0	1.8	5.0	8.0	7.6	7.8	6.37
Earnings 1yr f/c Growth	8.0	8.9	0.0	6.3	5.4	6.3	5.81
Earnings 2yr f/c Growth	0.0	0.0	0.0	0.0	0.0	0.0	0.00
Earnings across 2yrs	0.0	4.5	8.0	0.0	6.5	6.3	4.21
Historic PE	0.0	7.1	0.0	0.0	8.7	6.3	3.68
Forecast PE 1 yr	0.0	0.0	5.0	6.3	0.0	0.0	1.88
Forecast PE 2 yr	0.0	0.0	0.0	0.0	0.0	0.0	0.00
Historic Div Yield	0.0	7.1	0.0	0.0	0.0	7.0	2.36
Forecast Yield 1yr	7.0	0.0	4.0	6.3	0.0	0.0	2.88
Forecast Yield 2yr	0.0	0.0	0.0	0.0	0.0	0.0	0.00
Historic Div Cover	0.0	4.5	0.0	0.0	5.4	5.5	2.56
Forecast Div Cover 1yr	7.0	0.0	5.0	6.3	0.0	0.0	3.04
Forecast Div Cover 2yr	0.0	0.0	0.0	0.0	0.0	0.0	0.00
	50	50	50	50	50	50	300
	16%	16%	16%	16%	16%	16%	



Mechanical Portfolio

Weightings - Applying them

- For each “attribute” in turn (eg. Market cap, then PE, etc.)
 - Sort the full list of all companies by the descending value of the attribute (e.g. for market cap: highest at top, lowest at bottom for PSR: lowest at top, highest at bottom)
 - determine where each ‘filtered’ company appears in the sorted list
 - more specifically, which “decile” it falls into (decile 10 = the top 10%, decile 1 = bottom 10%)
 - multiply the company’s decile position by the appropriate weighting for that attribute
 - (e.g. if it’s in decile 4 and the weighted average for the attribute is 4.5, then the company would score 18 for that attribute)
- Add up the weighted scores for each company
- Buy the company with the highest total weighted score



Mechanical Portfolio

Maintaining balance

- Ideally want equal amounts in each holding
- Don't want to be selling/buying small amounts to maintain balance (commission too significant)
- Balance at the time of making a purchase
- For example.....
 - Start off the portfolio by allocating some cash to be “mechanical”
 - Determine how many holdings you want in the portfolio
 - When trading, calculate net worth of portfolio, divide by desired number of holdings, buy that amount (or use all remaining mechanical cash - whichever is lower)



Mechanical Portfolio

Maintaining balance - an illustration

- Initially (as an example)
 - Allocate £6k as ‘mechanical cash’
 - We want to trade every 2 months so will therefore have 6 holdings when “full”
- First purchase
 - Net worth of holdings = £0k
 - Remaining mech cash = £6k
 - Net worth of portfolio = £6k
 - First purchase amount = £1k
- Repeat for remaining five purchases
- After 12 months
 - Let’s imagine that:-
 - 1st purchase is now worth £2k
 - 2nd purchase now worth £1k
 - 3rd purchase now worth £0.5k
 - 4th purchase now worth £1.4k
 - 5th purchase now worth £0.8k
 - 6th purchase now worth £0.9k
 - no spare mechanical cash
 - Sell first purchase
 - Calculate portfolio worth
 - holdings = £4.6k
 - mech cash = £2k
 - total = £6.6k
 - Divide by desired no of holdings to get “optimum” purchase amount
 - = $6.6k/6 = £1.1k$ leaving £0.9k cash



Portfolio/Money Management

Keeping in control

- Diversification
 - Across portfolios
 - 25-50% in fundamental
 - 40-70% in mechanical
 - <25% cost in speculative
 - Across sectors
 - >75% in common UK stocks
 - <40% in any one sector
 - <30% in any one stock
- Knowing when to sell
 - Have defined exit criteria for each holding
 - Exit criteria as entry criterion
- Trading amounts
 - commission <3% of trade
 - fundamental 10-15% of non-mechanical value
 - speculative 5-7.5% of non-mechanical value
 - mechanical = as per previous balancing rules
- Monthly threshold checks
- Monthly champions reports & exit checks
- Annual strategy review



What's Going Well?

- Mechanical portfolio is preventing us “going stale”
- Clearly defined and robustly implemented strategy
- Feeling of being in control
- Amended strategy following annual review
- Monthly checks and champions reports
- Only a handful of holdings require effort
- Fantasy “lucky llama” competition
- Clearly defined exit conditions for each holding
- Get invited to other club meetings!!
- Our Club's performance



What's Going Well?

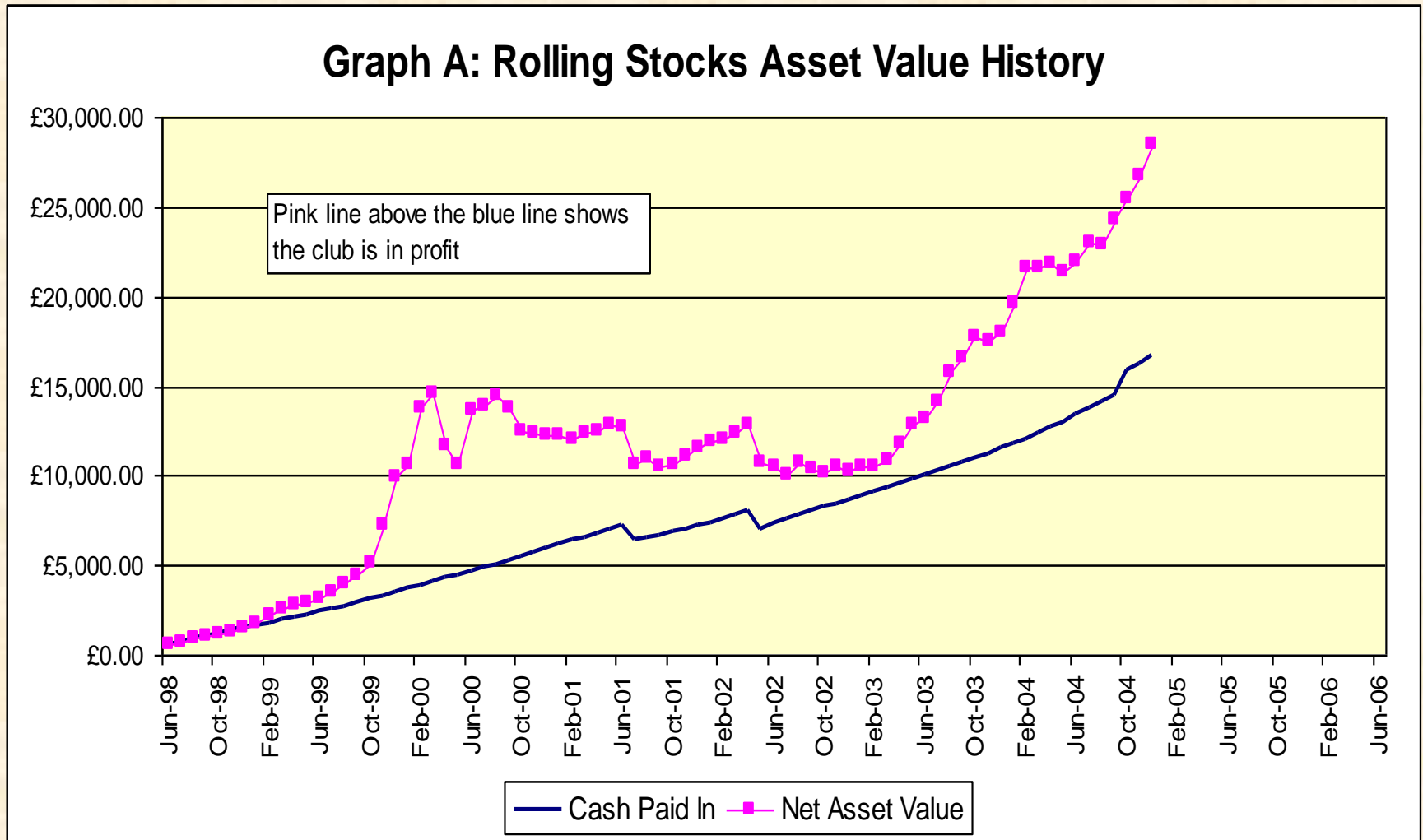
Current portfolio holdings

<u>Company Name</u>	<u>Price</u>	<u>Purchase Price</u>	<u>Trade Date</u>	<u># Shares</u>	<u>Position</u> <u>Notes</u> ▼	<u>Total Cost</u>	<u>Current Value</u>	<u>Total Gain</u>	<u>Total % Return</u>
Interior Services	(p) 197.50	(p) 153.00	22/09/2003	772	F	£ 1,199.07	£ 1,524.70	£ 325.63	27.16%
Infast Group	(p) 18.50	(p) 19.18	08/12/2004	7719	F	£ 1,499.90	£ 1,428.02	£ -71.89	-4.79%
Big Food Group	(p) 93.00	(p) 82.52	18/08/2004	1432	F	£ 1,199.60	£ 1,331.76	£ 132.16	11.02%
CODASciSys	(p) 355.00	(p) 260.00	21/11/2002	378	F	£ 999.71	£ 1,341.90	£ 342.19	34.23%
Parity Group	(p) 10.00	(p) 19.37	29/12/1999	10129	F	£ 1,993.93	£ 1,012.90	£ -981.03	-49.20%
Hyder Consulting	(p) 171.00	(p) 150.00	08/09/2004	730	M(G)	£ 1,112.48	£ 1,248.30	£ 135.82	12.21%
Horizon Technology	(p) 74.50	(p) 66.50	24/03/2004	1587	M(G)	£ 1,082.36	£ 1,182.32	£ 99.96	9.24%
Sportingbet	(p) 186.75	(p) 99.05	21/07/2004	1053	M(G)	£ 1,060.21	£ 1,966.48	£ 906.27	85.48%
Oystertec	(p) 25.00	(p) 24.65	03/11/2004	4512	M(G)	£ 1,129.77	£ 1,128.00	£ -1.77	-0.16%
4Imprint Group	(p) 168.50	(p) 141.50	21/05/2004	710	M(G)	£ 1,021.67	£ 1,196.35	£ 174.68	17.10%
Fyffes	(p) 138.50	(p) 117.34	30/06/2004	897	M(V)	£ 1,079.49	£ 1,242.35	£ 162.85	15.09%
Taylor Woodrow	(p) 253.00	(p) 242.39	03/11/2004	459	M(V)	£ 1,130.13	£ 1,161.27	£ 31.14	2.76%
Bellway	(p) 782.00	(p) 724.40	08/12/2004	168	M(V)	£ 1,235.07	£ 1,313.76	£ 78.69	6.37%
Lambert Howarth Gp	(p) 295.00	(p) 272.00	05/10/2004	398	M(V)	£ 1,094.56	£ 1,174.10	£ 79.54	7.27%
Mcalpine(Alfred)	(p) 297.25	(p) 254.70	18/08/2004	402	M(V)	£ 1,041.01	£ 1,194.95	£ 153.93	14.79%
Wagon	(p) 175.50	(p) 198.00	01/03/2004	514	M(V)	£ 1,034.81	£ 902.07	£ -132.74	-12.83%
Cape	(p) 143.50	(p) 23.00	21/01/2002	2111	S	£ 499.96	£ 3,029.29	£ 2,529.33	505.91%
Jarvis	(p) 11.50	(p) 9.83	09/12/2004	2029	S	£ 200.45	£ 233.34	£ 32.88	16.41%
Egg	(p) 94.50	(p) 92.72	08/12/2004	858	S	£ 799.52	£ 810.81	£ 11.29	1.41%
							£ 4,039.05		
Totals:						£ 20,413.70	£ 28,461.72	£ 4,008.93	19.64%



What's Going Well?

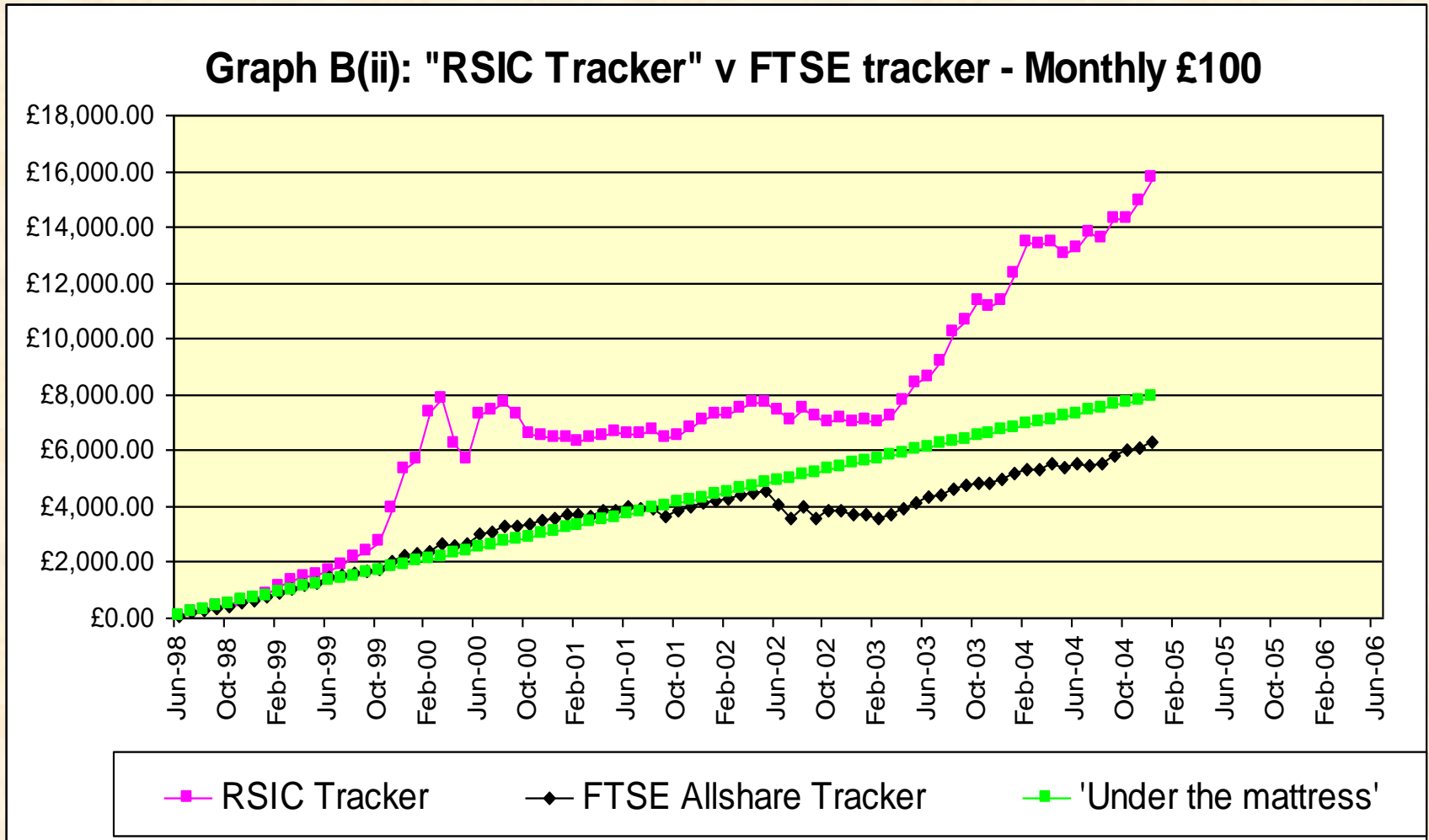
Our Club's performance - some VILGs





What's Going Well?

Our Club's performance - some VILGs





What's Going Well?

Our Club's performance - interesting stats

The Club's current unit value is	511.999	
The Club's effective annualised rate of return since it started is		21.96%
The FTSE's effective annualised rate of return since Club started is		-2.15%
The Club's effective rate of return in the past 12 months is	19.012%	
The FTSE's effective rate of return in the past 12 months is	10.654%	

In the 78 months since comparisons could begin the Club has outperformed the FTSE Allshare in 47 of these.....	60.3%
In the 67 rolling 12-month periods since comparisons could begin the Club has outperformed the FTSE Allshare in 56 of these.....	83.6%



What's Not So Good?

- Not generating enough buy proposals
(though we did actually have 4 last month)
- Buy proposals possibly aren't being sufficiently 'challenged'
- Too much cash
(had £7k at last valuation)
- Fantasy competition isn't generating buy proposals
- We're probably anally retentive!



Summary Of Key Points

- We have a disciplined approach and it works well
- We run a 3 sub-portfolio approach for flexibility
- Mechanical portfolio is unemotional, unambiguous and repeatable
- We have a strategy and stick to it
- We review and revise strategy rather than break it
- We have clear exit criteria for every holding
- We use monthly portfolio management checks to maintain balance
- We're doing pretty well and we're all happy!