Rolling Stocks

Investment Club

(ProShare reference number 12707)

INVESTMENT STRATEGY

1 Objective

Objectives of the Club's investment strategy are (not necessarily in priority order):-

a. To Make Money through investment

- a.1 to beat the FTSE 100…….
- a.2 whilst sensibly protecting against significant losses……
- a.3 yet having opportunity to speculate and make significant gains

b. To Learn

- b.1 about a variety of sectors (e.g. IT, Transport, Construction, etc.)
- b.2 about a variety of investment products (e.g. Shares, Warrants, Bonds, Options, etc.)
- b.3 about a variety of markets (e.g. FTSE, Aim, Ofex, Overseas, etc.)

c. To Have Fun

- c.1 being a member of the Club
- c.2 at Club meetings
- c.3 especially where this also aids learning (e.g. fantasy portfolio) or can make money (e.g. entering competitions)

2 Timeframe

Overall target is to beat the FTSE 100 on a year-on-year basis.

Investments should not be purchased without an expectation of a future sale.

There is no pre-determined wind-up date for the Club.

3 Type of Analysis

Investment decisions are to be based on different types of analysis such that the Club's overall portfolio is comprised of three sub-portfolios; each sub-portfolio having a different strategy, different objectives and different analytical approach. The detailed approach to be used in each of the three sub-portfolios is set out later in this document but can be summarised as follows:-

- Sub-portfolio 1 : Speculative Investment Portfolio
  - Analysis based on identification of speculative selections that could make quick and/or very significant returns on investment and/or assist in the Club's education

- Sub-portfolio 2 : Fundamental Investment Portfolio
  - Analysis based on examination of company fundamentals, appreciation of business area and recognition of growth opportunities or intrinsic value
- Sub-portfolio 3 : Mechanical Investment Portfolio
  - Analysis based on unemotional, mechanical application of clearly defined selection criteria to identify investments that are sound and relatively defensive yet which are still capable of capital growth and provision of income
  - Technical analysis can be used as an aid to prioritising between candidates for purchase should multiple candidate investments be considered and it not be possible/appropriate to purchase all candidates at once.

4 Type of Trading

The primary investment vehicle for the Club shall be shares in common stock as tradable on the FTSE market but no investment vehicle available through the Club's broker is specifically excluded.

Trading should be such that holding periods are expected to be longer than 2 months (i.e. short term "day trading" is not within the Strategy of the Club)

5 Money Management

5.1 Compositions

The Club's overall portfolio should be managed to be within the following thresholds:

- Composition by sub-portfolio
  - 0-25% in Speculative portfolio (calculated as ***cost*** of holdings / Club asset value)
  - 25-50% in Fundamental portfolio (calculated as ***value*** of holdings / Club asset value)
  - 40-70% in Mechanical portfolio (calculated as ***value*** of holdings / Club asset value)
  - 0-25% in cash (excluding cash that is considered part of the Mechanical sub-portfolio)
- Composition by Sector
  - At least 75% of total net assets should be in common UK stocks
  - No more than 20% of invested assets should be in any one sector, where the sector is determined from www.digitallook.com, other reliable source, or as agreed otherwise by a majority of club members
  - No more than 15% of invested assets should be in any one stock

5.2 Fun & Learning Spend

Approximately £300 or 1% of net asset value (whichever lower) should be allocated annually to cover furthering learning (e.g. magazines, software, data feeds, seminars, etc.)

Approximately £300 or 1% of net asset value (whichever lower) should be allocated annually to cover "fun" (e.g. internal prizes for competitions, Club meals, etc.)

5.3 Trading Amounts & Rights Issues

Trading amounts should be such that dealing costs in any one trade (buy or sell) are less than 3%.

Should there be a rights issue for one of the companies held then there should be a vote by the Club to decide whether or not to take up the offer. Default position is not to take up the offer.

5.4 Cash

In order to provide the opportunity for a return on the Club's cash balance, the cash should be managed as follows:-

- Up to two tradable funds (such as Investment Trusts) and one tradable debt (such as a Government bond) to be considered as temporary investment vehicles
- Specific temporary investment vehicles for consideration to be proposed via Buy Proposals with key selection criteria being low capital risk and probability of an overall return higher than placing cash on deposit
- No more than 10% of total club net assets to be assigned to any single temporary investment vehicle
- Between 2% and 10% of total club net assets to be held as uninvested cash
- Decisions on when funds should be transferred to/from temporary investment vehicles, and how much should be transferred, to be made by majority agreement of club members
- Trading amounts for the temporary investment vehicles to be such that transaction charges for "round trip" (i.e. buy and sell) are no more than 2%

6 Risk Control

Risks are controlled primarily by diversification of the investments across the sub-portfolios as per the compositions defined in section 5 above.

This balance will be monitored on a monthly basis as part of each Club meeting.

If the thresholds defined above are breached then the Club should discuss how and when to rebalance the portfolio within the overall objectives.

How the three sub-portfolios and the shares within those portfolios are monitored will be defined in the Strategy of the appropriate sub-portfolio later in this document.

7 Entry Strategy

An investment can only be purchased for the Club if it clearly satisfies the Entry Strategy for one or other of the three sub-portfolios (see later in this document).

8 Exit Strategy

An investment will be sold by the Club if it clearly satisfies the Exit Strategy for the sub-portfolio that the investment belongs to (see later in this document).

Where Exit criteria are defined and subsequently met, they provide a mandate to sell with no further discussion being necessary.

9 Review

The Club will review the Investment Strategy at least annually.

10 Strategy for Mechanical Sub-portfolio

10.1 Objective

Objectives of the Strategy for the Mechanical Sub-portfolio are (not necessarily in priority order):-

a) to achieve an average annual rate of return on investment across the portfolio that beat the FTSE 100

b) to provide a reasonable level of “safety” so that the risks of significant losses within the portfolio are small

c) to have a selection mechanism that is explicit, unambiguous, clearly understood and repeatable

d) to provide a means of regular (though not necessarily frequent) share trading so that the Club’s overall portfolio maintains interest

e) to have a mix of “value” investments and “growth” investments

10.2 Timeframe

Overall target is to beat the FTSE 100 on a year-on-year basis.

Investments will be purchased with clearly defined exit criteria that will typically result in the share being sold after 1 year – see section 10.8 below.

10.3 Type of Analysis

Analysis based on unemotional, mechanical application of clearly defined selection criteria based on company fundamentals in order to identify investments that are sound and defensive yet which are still capable of capital growth and provision of income.

Technical analysis can be used as an aid to prioritising between candidates for purchase should multiple candidate investments be considered and it not be possible/appropriate to purchase all candidates at once – see section 10.7 below.

10.4 Type of Trading

The investment vehicle for the Mechanical sub-portfolio shall be shares in common stock as tradable on the FTSE market.

The sub-portfolio should be managed to comprise 12 holdings each purchased 1 month apart and each held for approximately 1 year (see section 10.8 below). When the portfolio is “full” this will mean that every month will typically involve the sale of an existing holding and the purchase of a replacement.

10.5 Money Management

The Mechanical sub-portfolio should be managed such that each holding represents approximately the same proportion of the sub-portfolio’s value. That is, the sub-portfolio should be balanced in terms of relative weightings of holdings.

Trading amounts will vary depending on the total value of the sub-portfolio so there will occasionally be a cash-balance associated with this sub-portfolio. This mechanical cash needs to be clearly distinguishable from the overall cash of the Club.

The most appropriate method for maintaining some form of balance across holdings will be in setting the cost of purchase of each holding by following the steps below.

1. Complete the sale of any holdings that satisfy the exit criteria this month
2. Calculate the total value of the sub-portfolio after completion of any sales
3. Calculate the optimal cost of next purchase as being one twelfth of the sub-portfolio's value (as the aim is to have twelve holdings within this sub-portfolio)
4. Calculate the available cash by dividing the mechanical portfolio's cash balance by the number of 'gaps' in the portfolio (i.e. 12 – current number of holdings)
5. Purchase the number of shares that would make the cost equal to the optimal value (from step 3 above) or the available cash (from step 4 above) whichever is the lower

All dividends paid from mechanically selected holdings should be incorporated into the mechanical sub-portfolio's own cash balance.

Trading amounts should be such that dealing costs in any one trade (buy or sell) are less than 3%.

Should there be a takeover bid for one of the companies held in the mechanical portfolio then there should be a vote held by the Club to decide whether to sell or to hold. Should the decision be taken (or the takeover force the action) to sell the shares, then the resulting cash should simply be added to the mechanical portfolio's cash. A replacement stock should be selected at the next Club meeting.

10.6 Risk Control

Risks are controlled by combination of the Entry Criteria (see section 10.7 below) and the balancing of the holdings as described in section 10.5 above.

10.7 Entry Strategy

An investment can only be purchased for the Mechanical sub-portfolio if it clearly satisfies the Entry Criteria set out in the Appendices to this document. Appendix A sets out the mechanical entry criteria for "value" based investments and Appendix B sets out the criteria for "growth" based investments.

The selection criteria used will alternate each month between value and growth criteria.

The appropriate mechanical criteria should be applied to identify candidate stocks prior to each Club meeting with a view to the Club meeting ratifying the selection, and the purchase being made at the earliest opportunity following the meeting.

In the event of no suitable share being mechanically selected in a particular month, then the criteria should be re-run the next month and purchases made as appropriate. If this re-run still does not identify a suitable candidate, then a formal review of the mechanical Entry Criteria must be conducted at the next Club meeting.

10.8 Exit Strategy

On purchasing shares, a 'target price' will be set as 150% of purchase price. A trailing stop loss threshold of 15% of purchase price will also be set in pence for the holding. An investment will be sold from the Mechanical sub-portfolio when it has been held for 12 months UNLESS it has passed through the target price within the 12 month period but not yet fallen back by its predefined trailing stop loss pence amount. In this latter situation, the stock will be held until the trailing stop loss is breached. If a share is bought after a particular monthly meeting, then the above exit criteria will be applied at the corresponding monthly meeting of the following year.

It is possible that a holding may be due to be sold yet may also have been selected via the Entry Strategy. If this is the case then, to save on trading costs, the stock should be held for an additional year. The downside of this approach is that the opportunity for re-balancing the sub-portfolio is lost (see section 10.5 above). It will be acceptable to purchase additional shares or sell part of the holding for balancing purposes only if the dealing costs associated with any such trade are less than 3% of the total cost of the trade.

It is possible that a holding is subject to a takeover and that this may create an unplanned “vacancy” within the portfolio. Any holding in this situation should be considered held (i.e. not a vacancy) whilst it is still shown as a holding in the Treasurer’s monthly valuation report.

11 Strategy for Fundamental Sub-portfolio

11.1 Objective

Objectives of the Strategy for the Fundamental Sub-portfolio are (not necessarily in priority order):-

a) To achieve an average annual rate of return on investment across the portfolio that beats the FTSE 100

b) To protect against significant losses and to increase market knowledge by contributing to the Club’s overall diversification across sectors

11.2 Timeframe

Overall target is to beat FTSE 100 on a year-on-year basis.

Investments should be purchased with an expectation of holding beyond 12 months.

11.3 Type of Analysis

No specific, single approach to identifying candidates for the Fundamental sub-portfolio is suggested but a formal buy proposal must be completed and it must be possible to explain what provoked the initial interest in the candidate.

11.4 Type of Trading

The primary investment vehicle for the Fundamental sub-portfolio shall be shares in common stock as tradable on the FTSE market.

Trading should be such that holding periods are expected to be longer than 12 months.

11.5 Money Management

The Fundamental/Active sub-portfolio should be managed to the following targets:

- At least 80% of investments should be in common UK stocks
- No more than 50% of investments should be in any one sector
- No more than 30% of investments should be in any one stock

Trading amounts should be between 10% and 15% of the Club’s non-mechanical asset value and be such that dealing costs in any one trade are less than 3%.

11.6 Risk Control

There will be a “champion” for each holding within the Fundamental sub-portfolio and that champion will be required to submit a monthly report prior to each Club meeting with a recommendation on action to be taken (typically SELL or HOLD) for that holding.

In exceptional circumstances (e.g. if the value of a holding has crashed to make it not worth selling) the Club may decide that it is unnecessary for the champion to continue to produce the report. The report should be re-instated when the Club agrees that it is appropriate to do so.

The balance of investments as defined in section 11.5 above will be monitored on a monthly basis as part of each Club meeting. If the thresholds defined are breached then the Club should discuss how and when to rebalance the portfolio.

It is possible that one of the investments within the sub-portfolio grows to become the dominant member. In this situation, it may be acceptable to breach the thresholds particular to this sub-portfolio provided that the overall thresholds as set out in section 5 above are still met. Should re-balancing be necessary then this will typically be achieved by selling some or all of the dominant investment.

11.7 Entry Strategy

An investment can only be purchased for the Fundamental sub-portfolio if it satisfies all the following criteria:-

a) a Buy Proposal Form has been completed

b) Exit Criteria for the holding have been clearly defined (e.g. based on target price, stop-loss, timeframe, etc.). These Exit Criteria provide the mandate to sell when the conditions are met but, can be reviewed/revised by discussion at Club meetings prior to the conditions being met.

11.8 Exit Strategy

An investment will be sold from the Fundamental sub-portfolio when one of the following conditions have been met:-

a) The Exit Criteria current at the time for the investment have been met

b) The champion for the share recommends that the investment be sold and the Club agrees at a Club meeting

12 Strategy for Speculative Sub-portfolio

12.1 Objective

Objectives of the Strategy for the Speculative Sub-portfolio are (not necessarily in priority order):-

a) to achieve an average annual rate of return on investment across the sub-portfolio that beats the FTSE 100

b) to allow the Club to make speculative or high-risk investments without risking significant funds

c) to allow introduction to investment products that are unfamiliar to the Club (e.g. warrants, options, etc.)

d) to allow introduction to markets that are unfamiliar to the Club (e.g. Aim, Ofex, overseas, etc.)

12.2 Timeframe

Overall target is to achieve an annual rate of return at least as good as the FTSE 100 on a year-on-year basis.

Investments should be purchased with an expectation of sale within 12 months.

12.3 Type of Analysis

No specific, single approach to identifying candidates for the Speculative sub-portfolio is suggested but it must be possible to explain how any particular candidate has been identified and why it is considered suitable for inclusion in this sub-portfolio.

12.4 Type of Trading

The primary investment vehicle for the Speculative sub-portfolio shall be shares in common stock as tradable on the FTSE market but no investment vehicle available through the Club's broker is specifically excluded.

Trading should be such that holding periods are expected to be longer than 2 months (i.e. short term "day trading" is not within the Strategy of the Club) but shorter than 12 months.

12.5 Money Management

The Speculative sub-portfolio should be managed to the following targets:

- At least 50% of investments by ***value*** should be in common UK stocks

Trading amounts should be such that dealing costs in any one trade (buy or sell) are less than 3% but that the maximum trade should be between 5% and 7.5% of the Club's non-mechanical asset value.

12.6 Risk Control

One of the key objectives on the Speculative sub-portfolio is to allow the Club to take risks. The control of risk within this sub-portfolio is relatively unimportant. The Club's overall exposure to risk is controlled by management of the level of funds within each of the sub-portfolios as set out in section 6 above. However, should a holding within the Speculative sub-portfolio double in value since purchase, a "champion" should be appointed in a manner similar to the Fundamental sub-portfolio (see section 11.6 above) and that champion will be required to submit a monthly report prior to each Club meeting with a recommendation on action to be taken (typically SELL or HOLD) for that holding.

The balance of investments as defined in section 12.5 above will be monitored on a monthly basis as part of each Club meeting. If the thresholds defined above are breached then the Club should discuss how and when to rebalance the portfolio.

As this sub-portfolio is inherently risky, it is possible that one of the investments within the sub-portfolio grows to become the dominant member. In this situation, it may be acceptable to breach the thresholds particular to this sub-portfolio provided that the overall thresholds as set out in section 5 above are still met. Should re-balancing be necessary then this will typically be achieved by selling some or all of the dominant investment.

12.7 Entry Strategy

An investment can only be purchased for the Speculative sub-portfolio if it satisfies all the following criteria:-

a) a Buy Proposal Form has been completed

b) exit criteria for the investment are clearly defined

and at least one of the following criteria :-

c) there is a clear possibility of achieving 100% return on investment within 1 year of purchase

d) the investment is in a product or market that is unfamiliar to the Club

12.8 Exit Strategy

An investment will be sold from the Speculative sub-portfolio when one of the following conditions have been met:-

a) The Exit Criteria current at the time for the investment have been met

b) The champion for the share (see 12.6 above) recommends that the investment be sold and the Club agrees at a Club meeting

The default Exit Criteria for investments purchased for this sub-portfolio are that one of the following conditions have been met:-

i. the value of the investment has doubled since purchase and a trailing stop-loss of 15% from high has been breached (For example: this condition would be satisfied by an investment that was purchased at 100p and which subsequently rose to 200p before falling back to 170p, at which point it would be sold).

ii. the value of the investment has fallen to below 50% of the value at the time of purchase

iii. the Club agrees to sell the holding at a Club meeting

Appendix A: "Value" Selection Criteria for the Mechanical Portfolio

To select a "Value" candidate for the Mechanical Portfolio, the following process should be followed:-

Step 1: Data Source

In order for the selection mechanism to be repeatable, consistent and unambiguous, the same source of data must be used; the data source for the Club shall be the Club's own Stock Screener program (RSICSS.EXE)

Step 2: Screening the Data

Apply the following 'filters' to the market data

Measure / Indicator / Ratio	**Condition**	**Comment**
Market Capitalisation	>0.04 of AllShare Market Cap	To ensure that higher risk, small or micro-cap companies are excluded. The precise setting of the threshold is "index-linked" to the FTSE All Share to maintain an appropriate effect of this filter.
Price to Book	<2.5	To provide a level of safety based on underlying tangible assets of company. Ratio calculated as Market Capitalisation divided by Net Tangible Assets
Price to Sales	<1.5	To select stocks that are potentially undervalued. Ratio calculated as Market Capitalisation divided by last 12 months Turnover
Forecast Normalised EPS Growth	>5%	To select stocks that are expected to grow. Measure calculated as % year on year difference between Normalised EPS for the current year and each year in the available consensus broker forecasts
Forecast EPS Growth over 2 years	>15%	To select stocks that are expected to grow more significantly across the next 2 years. Measure calculated using combined % year on year difference between Normalised EPS for the current year and each year in the available consensus broker forecasts
Current Dividend Cover	>1. 5	To ensure that the company is retaining some profits and not just maintaining dividend for market sentiment. Measure calculated as Normalised EPS for the current year divided by dividend paid over last 12 months.
Forecast Dividend Cover	>1. 5	To ensure that the company's dividend strategy is consistent. Measure calculated as consensus forecast for Normalised EPS for the next year divided by consensus forecast dividend to be paid over next 12 months.
Return on Capital Employed (ROCE)	>0%	To select stocks that are potentially making good use of shareholder funds.

Measure / Indicator / Ratio	Condition	Comment
PE Ratio relative to market average	<0.85	To select stocks that are potentially undervalued. Measure calculated as current PE of the stock divided by the average PE of the FTSE AllShare (using normalised earnings)
Current Dividend Yield relative to market average	>1.2	To ensure a level of income from the portfolio. Measure should be calculated as current dividend yield (dividend paid over last 12 months divided by current share price) divided by the average current dividend of the FTSE AllShare
Forecast Dividend Yield relative to market average	>1.2	To protect against selection of companies that have high current dividend purely because share price has slumped – maintains expectation of future income from the portfolio. Measure should be calculated as consensus dividend (forecast of dividend to be paid over next 12 months divided by current share price) divided by the average current dividend of the FTSE AllShare
Gearing	<75%	To protect against selecting companies that have a high level of borrowing.

Step 3: Ranking the Candidates

Should more than one candidate satisfy all the conditions defined above then the candidates will be ranked so that those that 'most exceed' the conditions are given priority over those candidates than 'only just' satisfy them. To determine this ranking, the following rules must be applied

Step 3.1: Each selection filter needs to be allocated a 'weighting' (of between 0 to 10) so that those that are considered more important for a candidate to exceed contribute more to the ranking process than those that are less important. As each Club member may have a different view as to how important each filter is, the weightings to be used must be a combined 'average' weighting based on each Club member's suggested weightings as provided in the table below:-

	Adrian T	Chris	Dave	Kit	Simon	Richard	Average
Market Cap	0	0	3	0	1	3	1.17
Price to Book	7	3	8	7	6	7	6.33
Price to Sales	7	8	8	7	5	1	6.00
Return on Capital	6	7	4	5	3	3	4.67
Net Gearing	8	2	5	9	7	10	6.83
Earnings 1yr f/c Growth	8	10	0	7	5	8	6.33
Earnings 2yr f/c Growth	0	0	0	0	0	0	0.00
Earnings across 2yrs	0	5	8	0	6	8	4.50
Historic PE	0	8	0	0	8	8	4.00
Forecast PE 1 yr	0	0	5	7	0	0	2.00
Forecast PE 2 yr	0	0	0	0	0	0	0.00
Historic Div Yield	0	8	0	0	0	9	2.83
Forecast Yield 1yr	7	0	4	7	0	0	3.00
Forecast Yield 2yr	0	0	0	0	0	0	0.00
Historic Div Cover	0	5	0	0	5	7	2.83

	Adrian T	Chris	Dave	Kit	Simon	Richard		Average
Forecast Div Cover 1yr	7	0	5	7	0	0		3.17
Forecast Div Cover 2yr	0	0	0	0	0	0		0.00
	50	56	50	56	46	64	322	
	16%	17%	16%	17%	14%	20%		

Step 3.2 The weightings in the table above need to be "standardised" so that each member has contributed the same percentage towards the overall averaged weightings. The table below shows the standardised weightings which are to be used in the ranking process.

	Adrian T	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%		

Step 3.3: Determine how well each candidate satisfies each selection filter by carrying out the following steps for each of the selection filters (Market Cap, Price To Book, etc.)

Step 3.3.1: Sort the full population of unfiltered data by the selection filter (e.g. for the Market Cap selection filter, sort the unfiltered data in order of descending market capitalisation)

Step 3.3.2: Assign a score to each candidate based on which 'decile' of the sorted data each candidate is in. For example, if there are 2000 companies in the sorted, unfiltered data then the top 200 are the decile that best satisfy the particular selection filter. Candidates in this top decile should be assigned a score of 10 for the particular selection filter, those in the next decile assigned a score of 9, etc. and those in the bottom decile assigned a score of 1 for that particular selection filter

Step 3.3.3: Multiply the score that has been assigned to each candidate above by the appropriate standardised average weighting that corresponds to the same selection filter to determine how many ranking points each candidate has earned from the selection filter being processed. For example, if a candidate has been assigned 8 points for the Price To Sales filter and that filter has an average weighting of 2.5 then the candidate will have earned 20 ranking points for that particular filter.

Step 3.3.4: Repeat steps 3.3.1 thru 3.3.3 until each candidates ranking points for each selection filter are known

Step 3.4: Sum all the ranking points that a candidate has earned to determine each candidate's total ranking points

Step 4: Selecting the Candidate

Step 4.1: The highest ranked candidate from that also satisfies the following criteria is selected for purchase

a) it is not already held in the Mechanical Portfolio and

b) has a spread (calculated as (offer price – bid price) / bid price) lower than 10% and

c) would not, if a purchase was to be made, result in a breach of the Club's overall Money Management thresholds in section 5 of the Strategy above

Step 4.2: If there are 'gaps' still to be filled within the Value sub-portfolio, repeat Step 4.1 until all gaps are filled or until no more candidates are available for selection

Step 4.3: If there are still gaps to be filled then repeat Step 4.1 but ignoring the condition (c) regarding the breach of the Money Management limits

Step 5: Relaxing the Filters

If gaps still remain to be filled, then the selection filters should be systematically relaxed in accordance with the following steps:

Step 5.1: Sort the unfiltered data in descending order of ranking points as determined by Step 3 above and identify the top 50 from this sorted list as the shortlist of Value candidates

Step 5.2: Apply the filters from Step 2 to the shortlist of Value candidates identified in step 5.1, but with the Market Cap filter relaxed to be 0.02 times the All Share index value (from 0.04 times)

Step 5.3: If a candidate passes these relaxed filters, select for purchase the one with the highest market cap, unless it would be rejected by the constraints set out in Step 4.1 above, in which case select the next highest market cap, and so on

Step 5.5: If gaps still remain to be filled, then apply the filters from Step 2 to the shortlist of Value candidates, but remove the filter on 2nd year forecast criteria, change the filter on historic & forecast PE ratio to 0.93 * market average (from 0.85) and historic & forecast dividend yield to 1.1 * market average (from 1.2) and re-instate the original Market Cap filter

Step 5.6: If a candidate passes these relaxed filters, select for purchase the highest ranked candidate, unless it would be rejected by the constraints set out in Step 4.1 above, in which case select the next highest ranked, and so on

Step 5.7: If gaps **still** remain to be filled, then apply the same filters used in Step 5.5 but with the Market Cap filter relaxed again to 0.02 times the All Share index value

Step 5.8If a candidate passes these relaxed filters, select for purchase the highest ranked candidate, unless it would be rejected by the constraints set out in Step 4.1 above, in which case select the next highest ranked, and so on

Step 5.9: If gaps **still** remain to be filled, then apply the final set of relaxed filters as set out in the table below to the shortlist of Value candidates identified in Step 5.1:-

Measure	**Final Relaxed Criteria**	**Base Criteria**
Market Cap	> 0.02 * All Share Index (in £m)	> 0.04 * All Share Index (in £m))
PTBV	< market average	< 2.5

Measure	Final Relaxed Criteria	Base Criteria
PSR	< market average	< 1.5
ROCE	> 0	> 0
Gearing	< 75%	< 75%
1st forecast EPS growth	Any	> 5%
2nd forecast EPS growth	Any	> 5%
Combined EPS growth	Any	> 15%
Historic PER	< 1.1 * market average	< 0.85 * market average
1st forecast PER	< 1.1 * market average	< 0.85 * market average
2nd forecast PER	< 1.1 * market average	< 0.85 * market average
Historic yield	> 0.9 * market average	> 1.2 * market average
1st forecast yield	> 0.9 * market average	> 1.2 * market average
2nd forecast yield	> 0.9 * market average	> 1.2 * market average
Historic dividend cover	> 1.5	> 1.5
1st forecast div cover	> 1.5	> 1.5
2ns forecast div cover	> 1.5	> 1.5

Step 5.10: If a candidate passes these relaxed filters, select for purchase the highest ranked candidate, unless it would be rejected by the constraints set out in Step 4.1 above, in which case select the next highest ranked, and so on

Step 6: Selecting a "compromise" candidate

If there is more than one gap **still** remaining to be filled, select a 'compromise' candidate by following the steps below. Only one compromise candidate can be selected per month using this method regardless of how many more gaps there are that need to be filled.

Step 6.1: Apply the Growth filters as set out in Appendix B to the shortlist of Value candidates identified in Step 5.1

Step 6.2: If a candidate passes the growth filters, select for purchase the highest ranked candidate, unless it would be rejected by the constraints set out in Step 4.1 above, in which case select the next highest ranked, and so on

Step 7 : Leaving a vacancy

If **still** at least one gap remains to be filled, then make no purchase for these gaps and hold the cash, leaving vacancies in the Value sub-portfolio to be filled next month.

Appendix B: "Growth" Selection Criteria for the Mechanical Portfolio

To select a "Growth" candidate for the Mechanical Portfolio, the following process should be followed:-

Step 1: Data Source

In order for the selection mechanism to be repeatable, consistent and unambiguous, the same source of data must be used; the data source for the Club shall be the Club's own Stock Screener program (RSICSS.EXE)

Step 2: Screening the Data

Apply the following 'filters' to the market data

Measure / Indicator / Ratio	Condition	Comment
Market Capitalisation	>0.01 of AllShare Market Cap	To ensure that micro-cap companies are excluded but to allow some small companies to be considered for selection. The precise setting of the threshold is "index-linked" to the FTSE All Share to maintain an appropriate effect of this filter.
Price to Sales	Within the lowest 3 deciles (i.e. Lowest 30% of values)	"What Works On Wall Street" found PSR to be the best indicator of future share price growth with a near perfect relationship between PSR decile and future growth.
Forecast Normalised 1st year EPS Growth	Positive	To select stocks that are expected to grow.
Forecast Normalised 2ndt year EPS Growth	Positive	To select stocks that are expected to grow.
Forecast EPS Growth over 2 years	Within the highest 3 deciles (i.e. top 30% of values)	Combined with the previous two filters this gives us the companies with the highest forecast growth.
PEG (Price Earnings to Growth) ratio	Between 0 and 1.5	PEG is the PE ratio divided by the forecast EPS growth (first year forecast only). Low values indicate that the stock is valued lowly relative to the anticipated growth. Note that for a company to have a PEG value at all it must have a positive historic PE value and first year EPS growth must be positive.

Step 3: Ranking the Candidates

Should more than one candidate satisfy all the conditions defined above then the candidates will be ranked so that those that 'most exceed' the conditions are given priority over those candidates than 'only just' satisfy them. To determine this ranking, the following rules must be applied

Step 3.1: Each selection filter needs to be allocated a 'weighting' (of between 0 to 10) so that those that are considered more important for a candidate to exceed contribute more to the ranking process than those that are less important. As each Club member may have a different view as to how important each filter is, the weightings to be used must be a combined 'average' weighting based on each Club member's suggested weightings as provided in the table below:-

	Adrian	Chris	Dave	Kit	Richard	Simon		Average
Market Cap	-3	-7	-5		0	-3		-3.60
Price to Tangible Book Value	0	0	5		5	0		2.00
Price to Sales Ratio	5	10	5		6	5		6.20
Return on Capital Employed	0	0	0		0	0		0.00
Net Gearing	0	0	5		2	3		2.00
Earnings 1yr f/c Growth	5	5	0		0	0		2.00
Earnings 2yr f/c Growth	0	0	0		0	0		0.00
Earnings f/c Growth across 2yrs	0	0	0		4	0		0.80
PEG	2	0	0		0	0		0.40
Historic PE	0	8	0		3	5		3.10
Forecast PE 1 yr	5	0	0		0	0		1.00
Forecast PE 2 yr	0	0	0		0	0		0.00
Historic Div Yield	0	0	0		0	0		0.00
Forecast Yield 1yr	0	0	0		0	0		0.00
Forecast Yield 2yr	0	0	0		0	0		0.00
Historic Div Cover	0	0	0		0	0		0.00
Forecast Div Cover 1yr	0	0	0		0	0		0.00
Forecast Div Cover 2yr	0	0	0		0	0		0.00
Volatility	0	0	0		0	0		0.00
High : Low ratio	0	0	0		0	0		0.00
RS-PG	0	0	0		0	0		0.00
1 year price change	5	10	10		10	10		9.00
9 month price change	0	0	0		0	0		0.00
6 month price change	0	0	0		0	0		0.00
3 month price change	0	0	0		0	0		0.00
	25	40	30	0	30	26	151	
	17%	26%	20%	0%	20%	17%		

Step 3.2 The weightings in the table above need to be "standardised" so that each member has contributed the same percentage towards the overall averaged weightings. The table below shows the standardised weightings which are to be used in the ranking process.

	Adrian	Chris	Dave	Kit	Richard	Simon	Average
Market Cap	-6.0	-8.8	-8.3	0.0	0.0	-5.8	-4.81
Price to Tangible Book Value	0.0	0.0	8.3	0.0	8.3	0.0	2.78
Price to Sales Ratio	10.0	12.5	8.3	0.0	10.0	9.6	8.41
Return on Capital Employed	0.0	0.0	0.0	0.0	0.0	0.0	0.00
Net Gearing	0.0	0.0	8.3	0.0	3.3	5.8	2.91
Earnings 1yr f/c Growth	10.0	6.3	0.0	0.0	0.0	0.0	2.71
Earnings 2yr f/c Growth	0.0	0.0	0.0	0.0	0.0	0.0	0.00
Earnings f/c Growth across 2yrs	0.0	0.0	0.0	0.0	6.7	0.0	1.11
PEG	4.0	0.0	0.0	0.0	0.0	0.0	0.67
Historic PE	0.0	10.0	0.0	0.0	5.0	9.6	4.10
Forecast PE 1 yr	10.0	0.0	0.0	0.0	0.0	0.0	1.67
Forecast PE 2 yr	0.0	0.0	0.0	0.0	0.0	0.0	0.00
Historic Div Yield	0.0	0.0	0.0	0.0	0.0	0.0	0.00
Forecast Yield 1yr	0.0	0.0	0.0	0.0	0.0	0.0	0.00
Forecast Yield 2yr	0.0	0.0	0.0	0.0	0.0	0.0	0.00
Historic Div Cover	0.0	0.0	0.0	0.0	0.0	0.0	0.00
Forecast Div Cover 1yr	0.0	0.0	0.0	0.0	0.0	0.0	0.00
Forecast Div Cover 2yr	0.0	0.0	0.0	0.0	0.0	0.0	0.00
Volatility	0.0	0.0	0.0	0.0	0.0	0.0	0.00
High : Low ratio	0.0	0.0	0.0	0.0	0.0	0.0	0.00
RS-PG	0.0	0.0	0.0	0.0	0.0	0.0	0.00
1 year price change	10.0	12.5	16.7	0.0	16.7	19.2	12.51
9 month price change	0.0	0.0	0.0	0.0	0.0	0.0	0.00
6 month price change	0.0	0.0	0.0	0.0	0.0	0.0	0.00
3 month price change	0.0	0.0	0.0	0.0	0.0	0.0	0.00
	50	50	50	0	50	50	250
	20%	20%	20%	0%	20%	20%	

Step 3.3: Determine how well each candidate satisfies each selection filter by carrying out the following steps for each of the selection filters (Market Cap, Price To Book, etc.)

Step 3.3.1: Sort the full population of unfiltered data by the selection filter (e.g. for the Market Cap selection filter, sort the unfiltered data in order of descending market capitalisation)

Step 3.3.2: Assign a score to each candidate based on which ‘decile’ of the sorted data each candidate is in. For example, if there are 2000 companies in the sorted, unfiltered data then the top 200 are the decile that best satisfy the particular selection filter. Candidates in this top decile should be assigned a score of 10 for the particular selection filter, those in the next decile assigned a score of 9, etc. and those in the bottom decile assigned a score of 1 for that particular selection filter

Step 3.3.3: Multiply the score that has been assigned to each candidate above by the appropriate standardised average weighting that corresponds to the same selection filter to determine how many ranking points each candidate has earned from the selection filter being processed. For example, if a candidate has been assigned 8 points for the Price To Sales filter and that filter has an average weighting of 2.5 then the candidate will have earned 20 ranking points for that particular filter.

Step 3.3.4: Repeat steps 3.3.1 thru 3.3.3 until each candidates ranking points for each selection filter are known

Step 3.4: Sum all the ranking points that a candidate has earned to determine each candidate's total ranking points

Step 4: Selecting the Candidate

Step 4.1: Sort the unfiltered data in descending order of ranking points and identify the top 50 from this sorted list as the shortlist of Growth candidates

Step 4.2: Apply the filters from Step 2 to the shortlist of Growth candidates identified in step 4.1

Step 4.3: The highest ranked candidate from the shortlist of Growth candidate that also satisfies the following criteria is selected for purchase

a) it is not already held in the Mechanical Portfolio and

b) has a spread (calculated as (offer price – bid price) / bid price) lower than 10% and

c) would not, if a purchase was to be made, result in a breach of the Club's overall Money Management thresholds in section 5 of the Strategy above

Step 4.4: If there are 'gaps' still to be filled within the Growth sub-portfolio, repeat Step 4.3 until all gaps are filled or until no more candidates are available for selection

Step 4.5: If there are still gaps to be filled then repeat Step 4.3 but ignoring the condition (c) regarding the breach of the Money Management limits

Step 5: Selecting a "compromise" candidate

If there is **more than** one gap still remaining to be filled, select a 'compromise' candidate by following the steps below. Only one compromise candidate can be selected per month using this method regardless of how many more gaps there are that need to be filled.

Step 5.1: Determine the sorted shortlist of Growth candidates as per Step 3 and Step 4.1 above

Step 5.2: Apply the Value filters as set out in Appendix A to the sorted shortlist of Growth candidates identified in Step 5.1

Step 5.3: Select for purchase the highest ranked candidate, if any, that passes the Value filters, unless it would be rejected by the constraints set out in Step 4.3 above.

Step 6 : Leaving a vacancy

If **still** at least one gap remains to be filled, then make no purchase for these gaps and hold the cash, leaving vacancies in the Growth sub-portfolio to be filled next month.

DOCUMENT AMENDMENT HISTORY

Issue	Date	Author	Summary of Change
1	23/09/2001	Dave G.	New document
2	28/08/2002	Dave G.	Amendments as per review as recorded in minutes of the 28th August 2002 meeting. Tidy up of Appendix A values. Mention made of the stock screener as official 'source' of data. Document Amendment History added. Footer amended to incorporate Issue Number.
	11/10/2002	Dave G.	Amended at September meeting to expand Appendix A out to give the detail of the weightings and ranking calculation
3	11/12/2003	Dave G.	Amendments as per review recorded in minutes of the 19th September 2003 meeting and additional text to Appendix to set out approach for relaxing filters in the event of no selection
4	23/03/2004	Dave G.	Second mechanical strategy ("Growth") incorporated into section 12. Appendix B created for this second mechanical strategy. Appendix A revised to be for "Value" mechanical strategy. Money Management thresholds in section 5 also modified as per minutes of 23rd March 2004 meeting
	29/04/2004	Dave G.	Approved at Club meeting of 21/04/2004. Some other minor formatting changes made as part of approving. Change also made to section 12.5 to buy replacement stocks at the meeting following a bid related sale of a mechanical holding.
5	20/08/2004	Dave G.	Amendments as per annual review as recorded in minutes of the 17th August 2004 meeting.
	07/09/2004	Dave G.	Updated Appendix A with DG's revised weightings
	11/09/2004	Dave G.	Updated as per 07/09/2004 meeting minute re appointing champions in speculative and potentially not needed them in fundamental, and to slightly reformat to avoid inappropriate page breaks at start of tables. Re-ordered sections 10 to 12 as part of this change
	21/11/2004	Dave G.	Approved at meeting of 02/11/2004 with minor addition to Appendix B about aiming for spreads below 5%.
6	19/07/2005	Dave G.	Amendments as per actions from 18/07/2005 meeting. That is, changes to wording of section 5 to clarify how the money management checks and to add a statement about rights issues. Also, lifted sector threshold in 11.5 to 50% and removed the bullet about max in one stock.
	23/09/2005	Dave G.	Section 5 split down into sub-sections with a clause added to section 5 about determining the sector, and another clause added about use of temporary investment vehicles for cash, as discussed at the meeting of 21/09/2005. Put the clause back in to 11.5 about max in one stock as per actions at same meeting.
	16/10/2005	Dave G.	Revised section 5.4 bullets 1, 2 and 5 after comments from review of previous version.

Issue	Date	Author	Summary of Change
7	17/01/2006	Dave G	Amendments to Appendix A and B to cover the selection of a 'compromise' candidate, as discussed at meeting of 17/01/2006. Restructured the steps in these appendices to make it easier to understand. Minor modification to section 10.7 to improve clarity also.
	23/05/2006	Dave G	Based of feedback from the review of version 7a:- • applied the check on spread to step 4.1 in appendix A for consistency across the whole mechanical portfolio • amended step 4.1 in Appendix A and Appendix B so that a candidate is rejected if already held in Mechanical Portfolio, not to necessarily reject it if only held elsewhere by the club. Additional paragraph added to section 10.8 to clarify situation with respect to a holding in a takeover situation, as discussed at meeting of 23/05/2006.
8	17/05/2007	Dave G	Amended Appendix A to include new steps 5.9 and 5.10 to cover a new set of 'final relaxed criteria' as agreed in March. Also revised step 5.8 to use select by Rankings instead of Market Cap
	18/05/2007	Dave G	Approved at meeting of 17th May.
9	24/02/2010	Dave G	Based on the meeting of 23rd Feb 2010: • revised Appendix B to relax the constraint on the spread to be 10% rather than 5%, restructuring what is now Step 4.3 as a result; introduced the notion of 'shortlist of Growth candidates' so that selections are only made from the top 50 in the unfiltered list; and reworded other points to refer to the shortlist and the revised step numbering • Revised Appendix A to similarly relax the constraint on spread and, for consistency with Appendix B, used the term 'shortlist of Value candidates'
	27/04/2010	Dave G	Issued as approved as per meeting of 27th April 2010 but also applied the following changes that had been agreed in the August 2008 meeting but not reflected in the strategy: • Money Management check to be revised so that maximum in any one sector be limited to 20% rather than 40% • Money Management check to be revised so that maximum in any one stock be limited to 15% rather than 20%
10	17/09/2012	Dave G	Updated after Strategy Review. Action DG/0228/01 to change minimum % of value held in uninvested cash from 5% to 2%