

# Building a Successful Portfolio in Today's Economic Climate

Presentation by:

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# Building a Successful Portfolio



Maximizing Income & Managing Risk

## **The experts may not be experts**

“It would be like advising my son or daughter to drop out of school to play basketball with the goal of becoming the next Michael Jordan”

Mohamed El-Erian

On being asked if an individual investor could replicate the performance of professional money managers.

## Goldman Sachs

- “S&P 500 valuation is lofty by almost any measure,” David Kostin, equity strategist at Goldman Sachs, wrote in a research note to clients. “
- Since 1976, the S&P 500’s P/E multiple has exceeded 17 times during only two periods. From 1997 through 2000 during the tech bubble and a four-month period that spanned 2003 and 2004.
- “Other than those two episodes, the S&P 500 has never traded at a P/E of 17 times, or above”

## Goldman Sachs



- It seems the Lord works in mysterious ways
- Goldman Sachs Group Chief Executive Lloyd Blankfein says Wall Street's most successful bank is doing "God's work."

# Another view of Goldman Sachs



## What you will learn

- The use of economic data to determine
  - Where we have been
  - Where we are going
- The stock versus bond decision
- The power of simple moving averages
- Some investment ideas – where you go from here

# What is Risk

Definition of risk is best captured by the Chinese symbols for risk:

危機

The first is the symbol for danger

The second is the symbol for “opportunity”



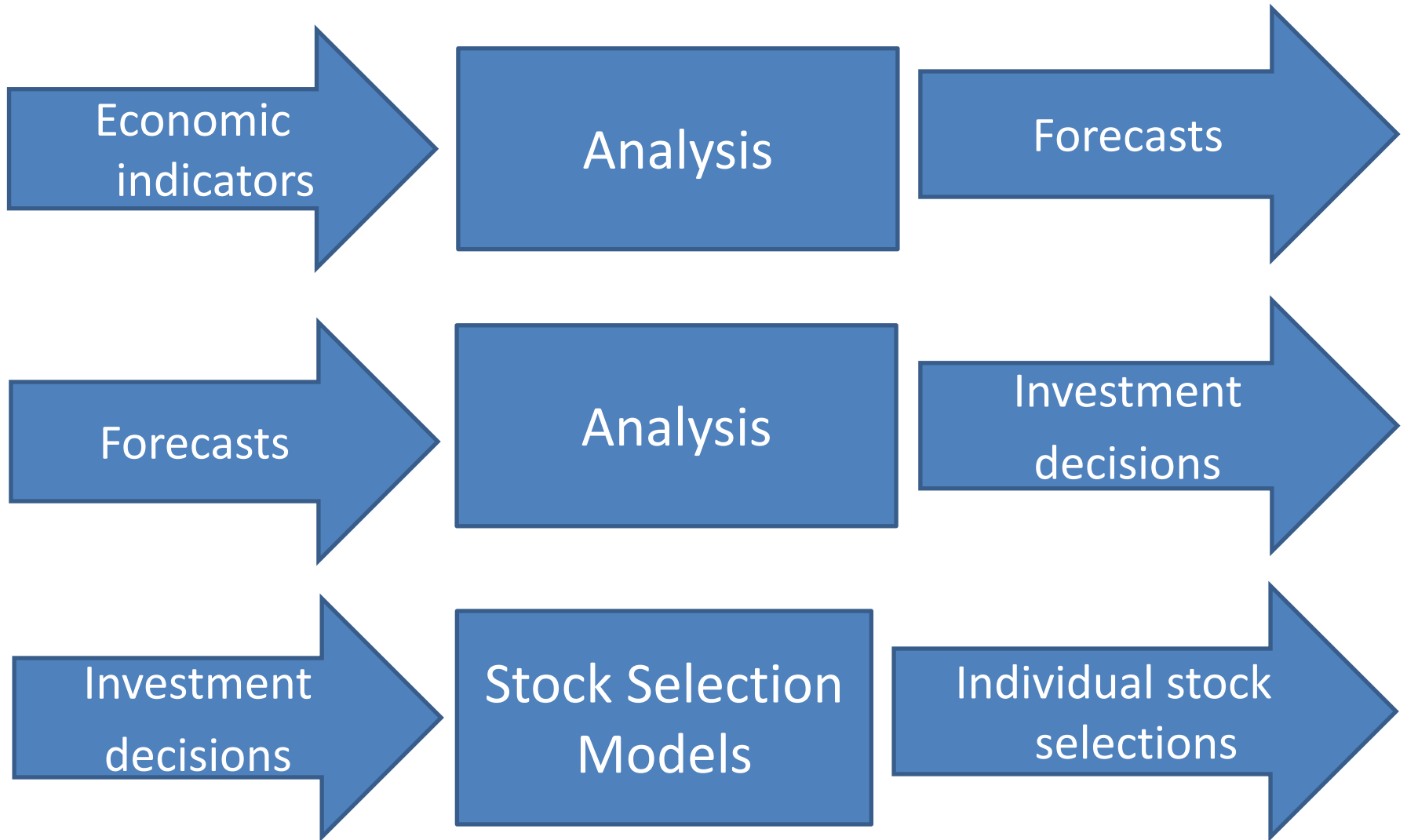
# The Economy



## Economic models

Use one or more economic indicators to predict a level of economic or financial activity

# Path to investment decisions




## Economic Analysis

Investments are impacted by:

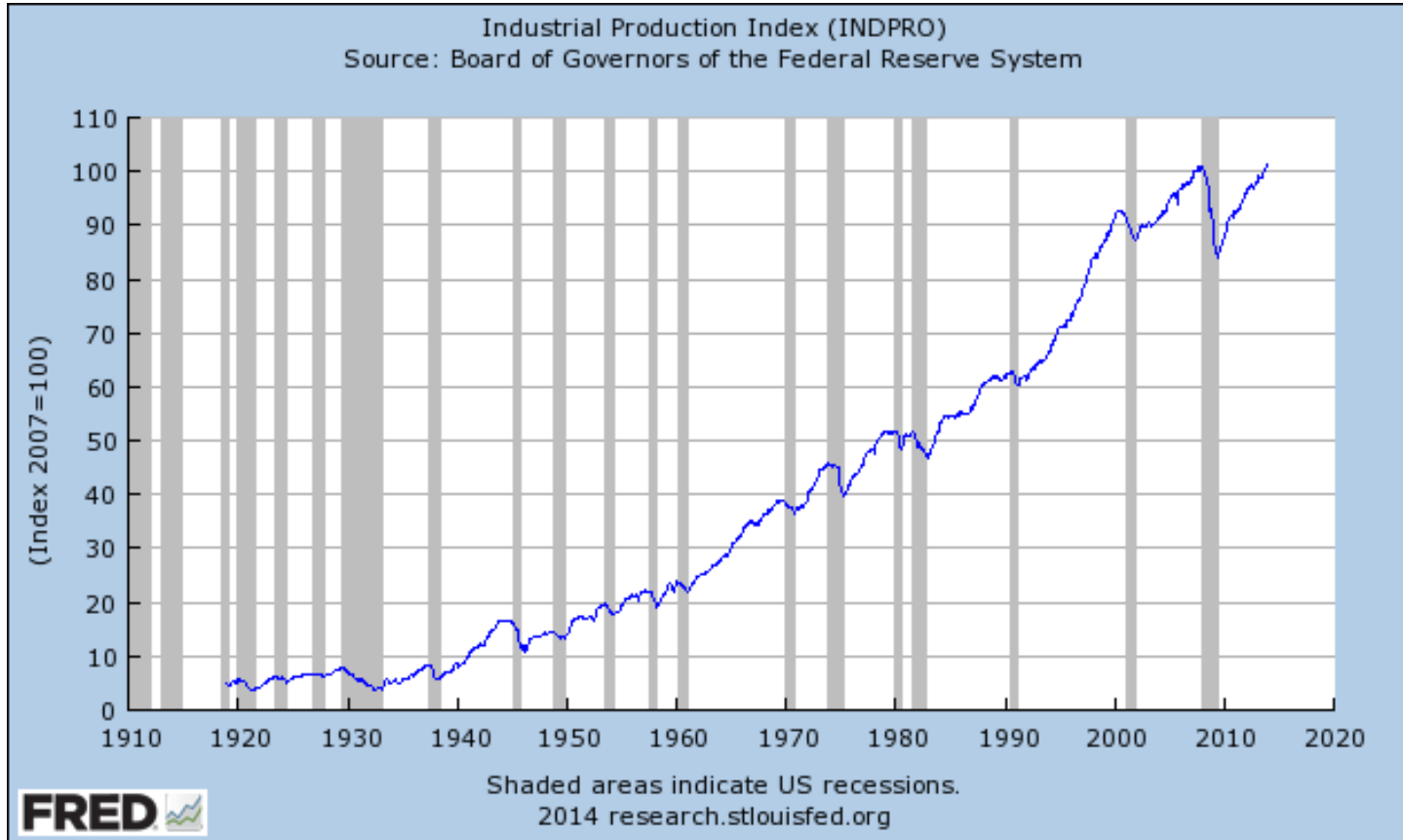
- GDP
- Investment
  - Non-residential 
  - Residential
- Business Inventories
- Government Spending
- Inflation

# Investment – non-residential

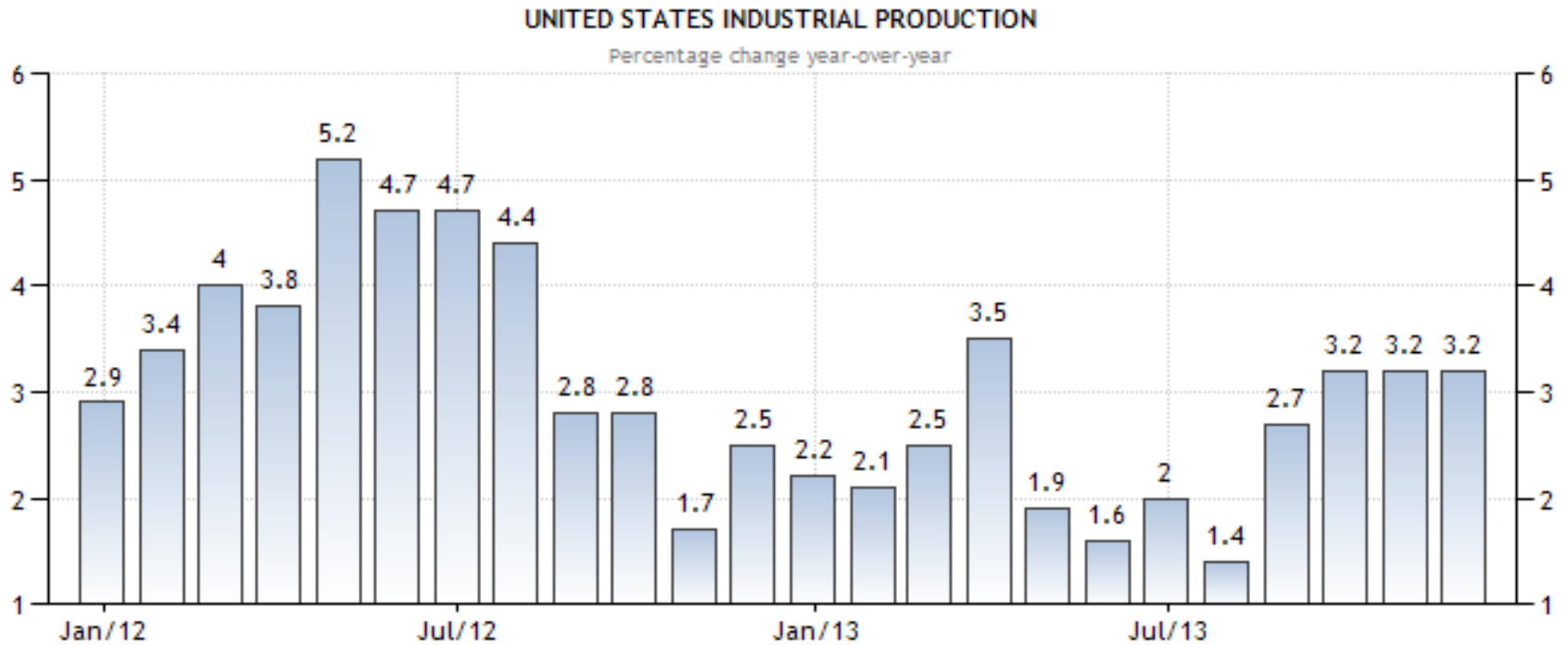
Determined by:

- Industrial production 
- Capacity utilization
- Durable goods orders
- ISM surveys
- Federal Reserve surveys
- Factory orders
- Inventories

# Industrial production



# Industrial Production



SOURCE: WWW.TRADINGECONOMICS.COM | FEDERAL RESERVE

Estimates:

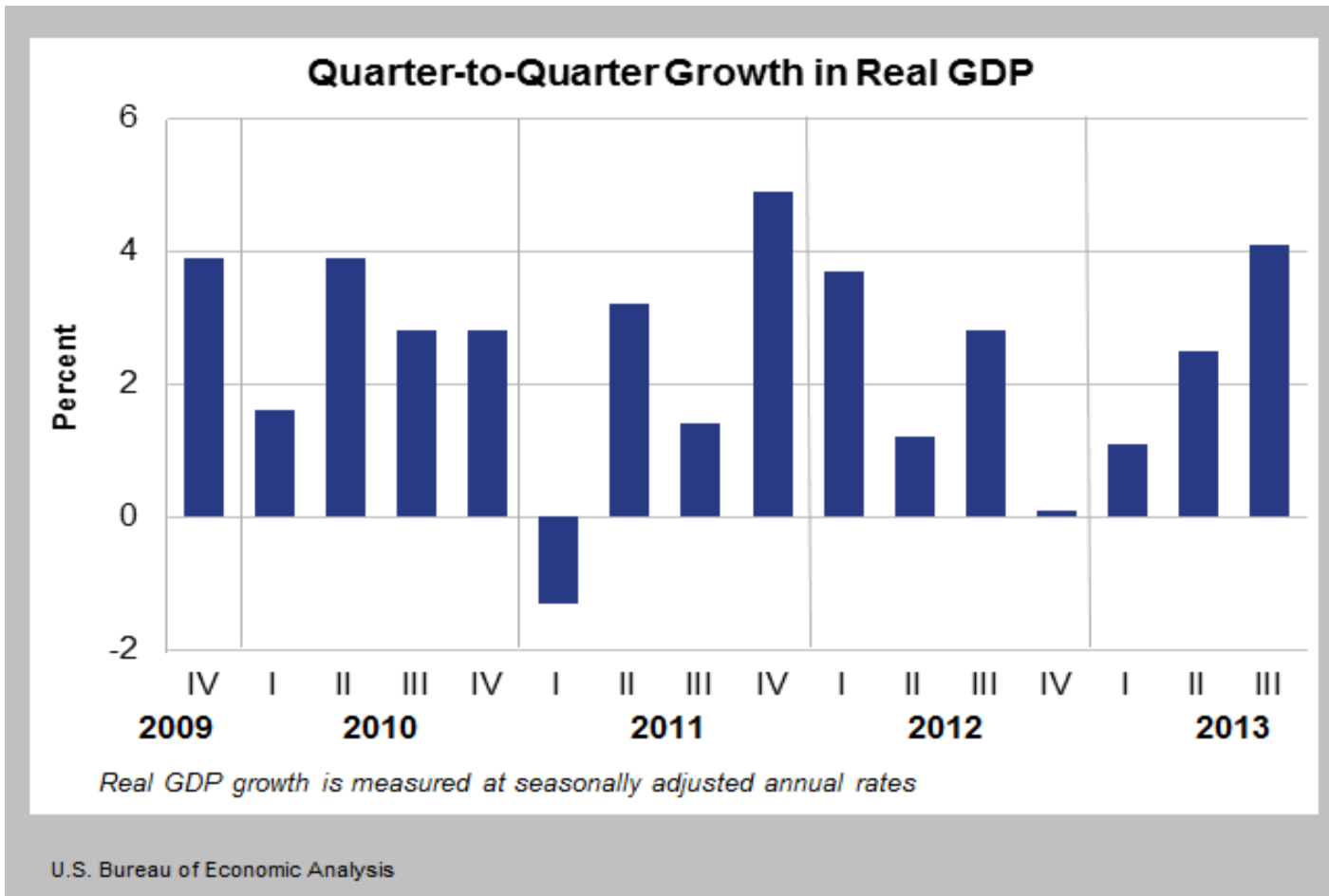
Dec 2013	3.31%
Jan 2014	3.54%
Feb 2014	3.31%

## Forecasts from economic analysis

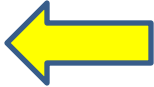
- GDP 
- Investment
  - Non-residential
  - Residential
- Business Inventories
- Government Spending
- Inflation



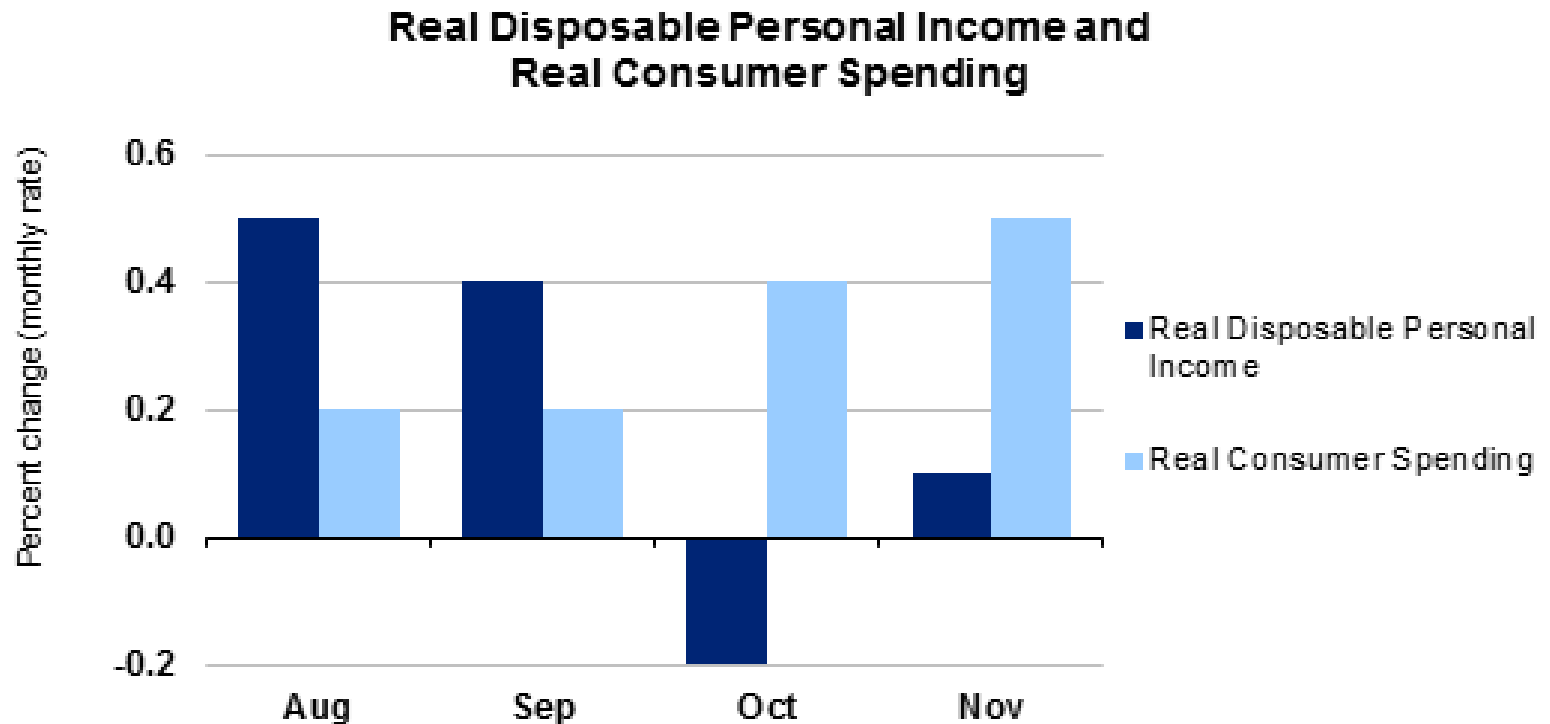
# GDP historically



## GDP performance indicators

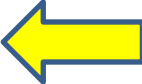
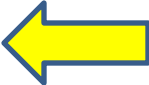
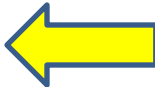
- Retail sales
- Consumer credit
- Personal income and spending 
- Unemployment levels
- Unemployment insurance claims
- Consumer confidence
- Earnings

# Personal income and spending



U.S. Bureau of Economic Analysis

## GDP Performance Indicators cont.

- Retail sales
- Consumer credit
- Personal income and spending
- Unemployment level 
- Jobless claims 
- Non-farm payrolls 
- Consumer confidence
- Real earnings
- Auto sales

# Employment



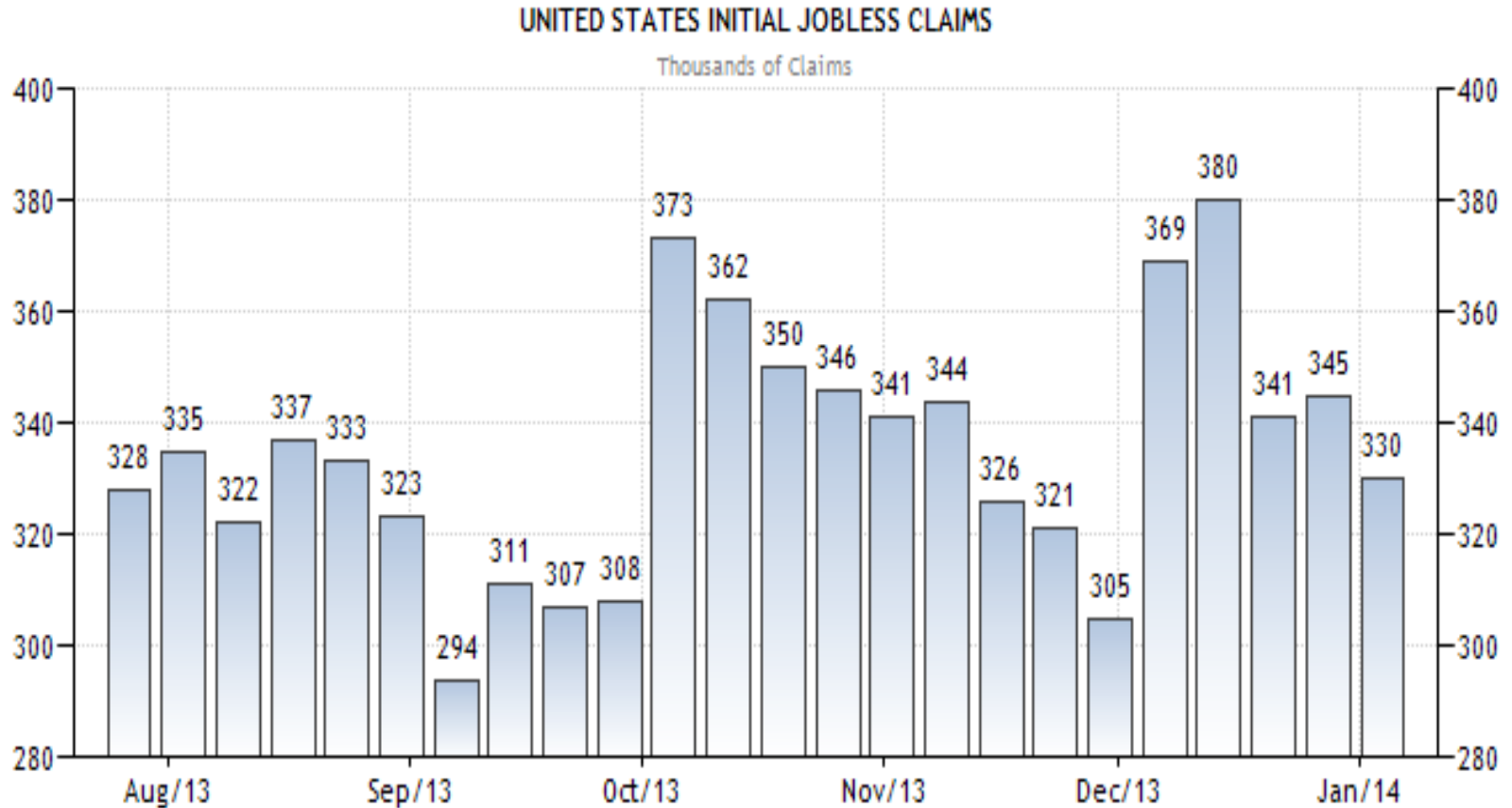
# Unemployment Rate



Note: Cross-hatched area represents recession.

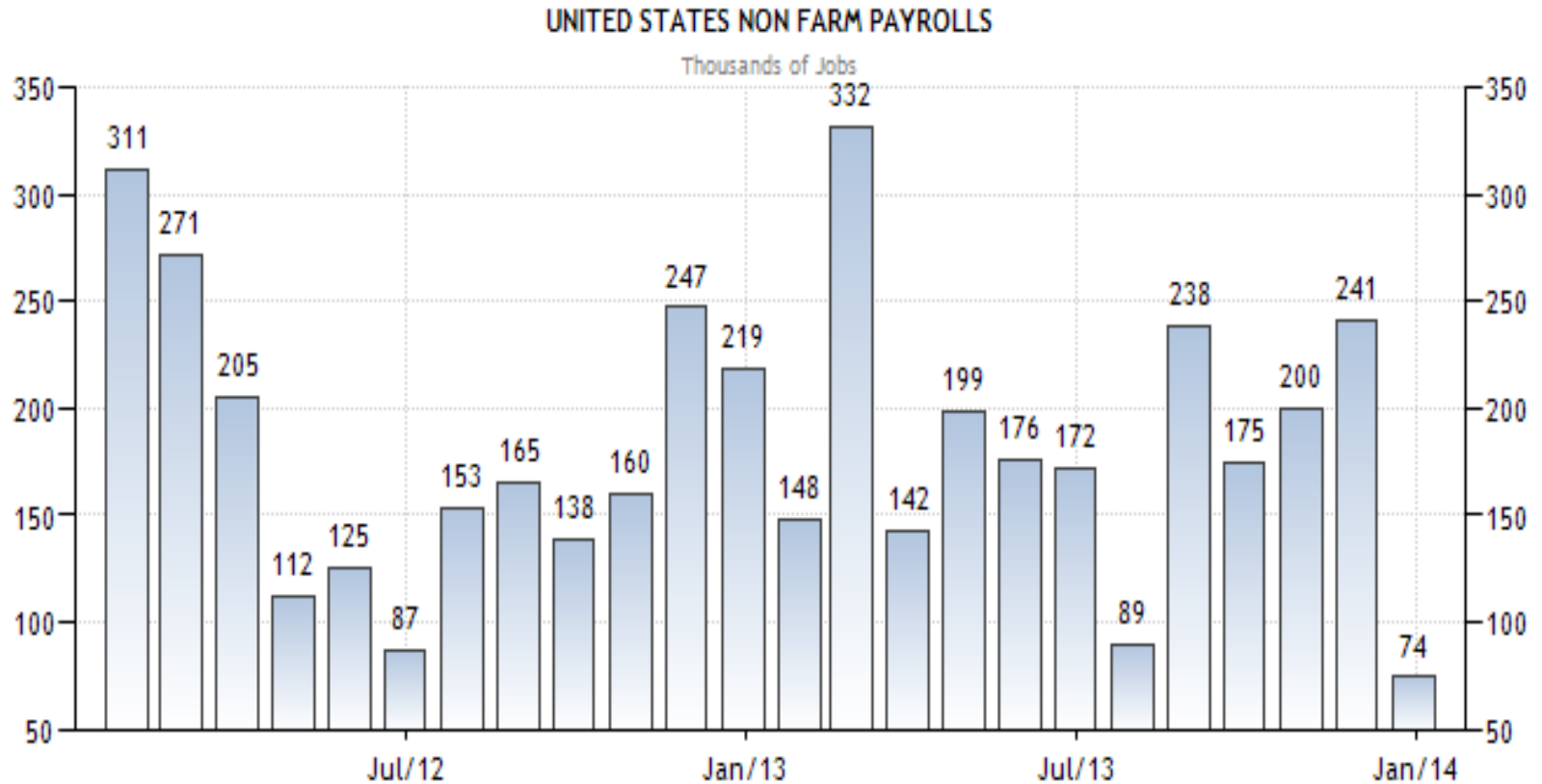
Source: Bureau of Labor Statistics, Current Population Survey

# Jobless Claims



SOURCE: WWW.TRADINGECONOMICS.COM | U.S. DEPARTMENT OF LABOR

# Non-farm payrolls



SOURCE: WWW.TRADINGECONOMICS.COM | U.S. BUREAU OF LABOR STATISTICS



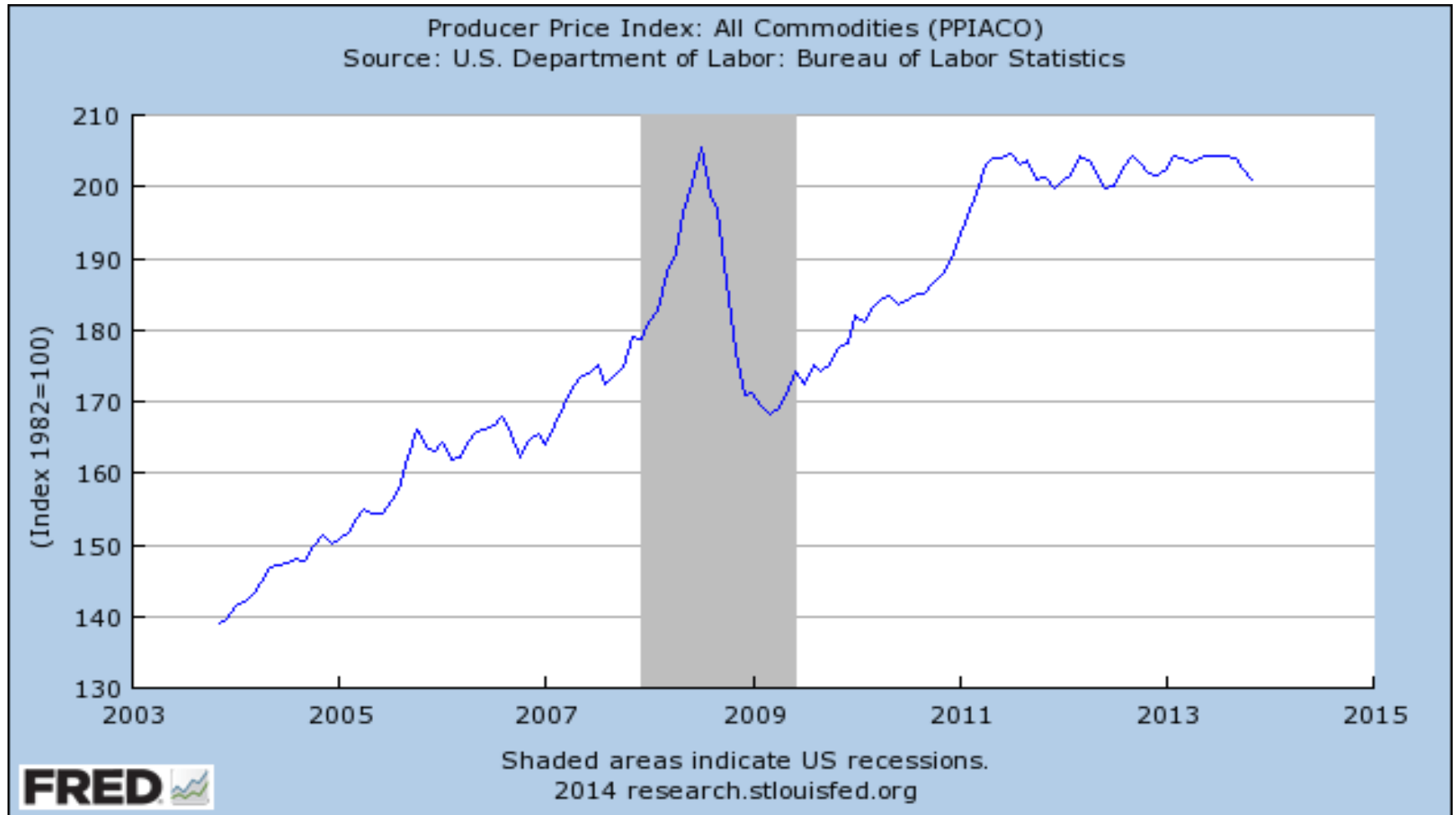
# Economic model outputs

- Real and nominal GDP
- Investment
  - Non-residential
  - Residential
- Business Inventories
- Government Spending
- Net Exports
- Inflation 

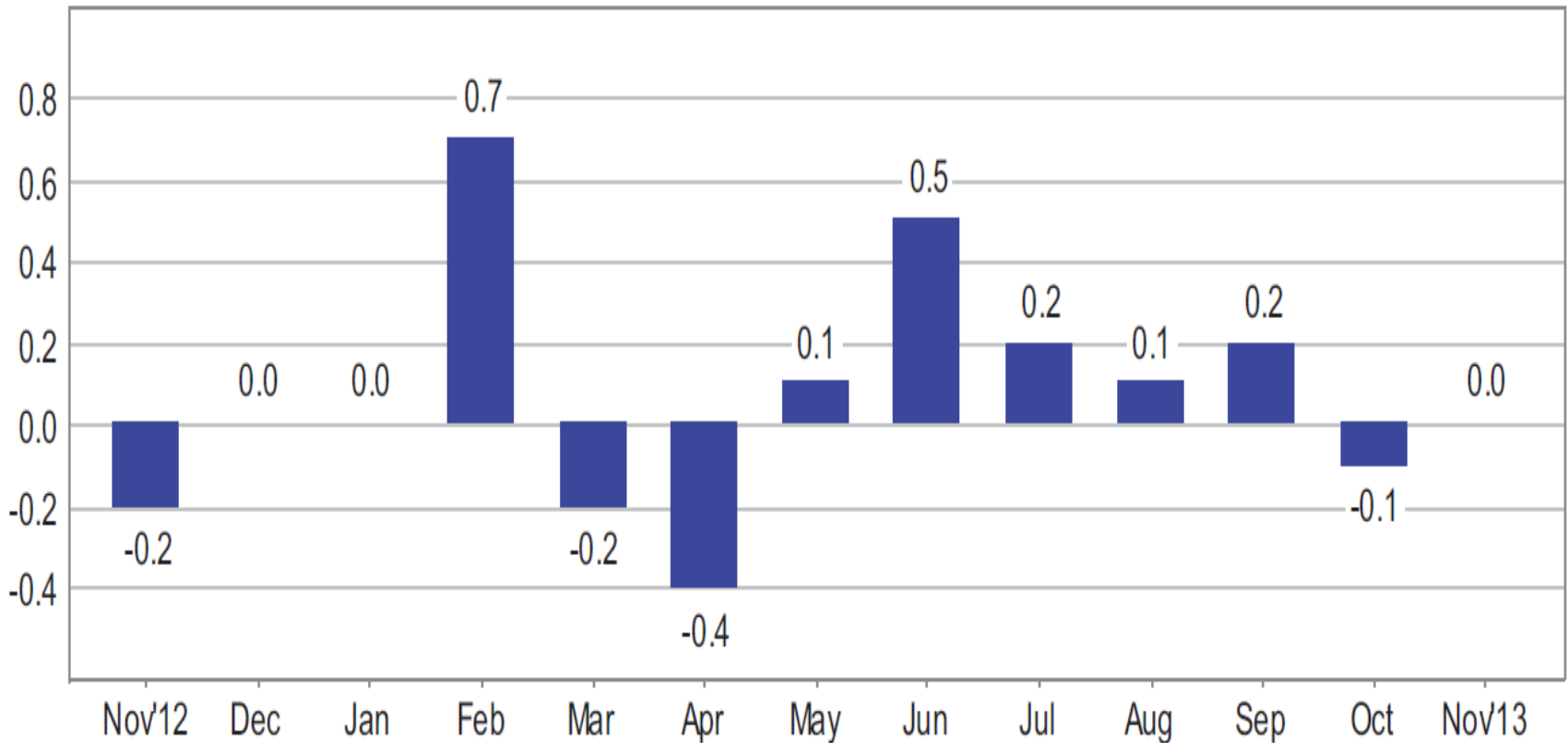
# Inflation indicators

- Producer price index 
- Consumer price index 
- Employment cost index
- Non-farm productivity
- Unit labor costs
- Import and export prices
- Employee compensation
- Actions by the Federal Reserve 

# Producer Price Index (PPI)



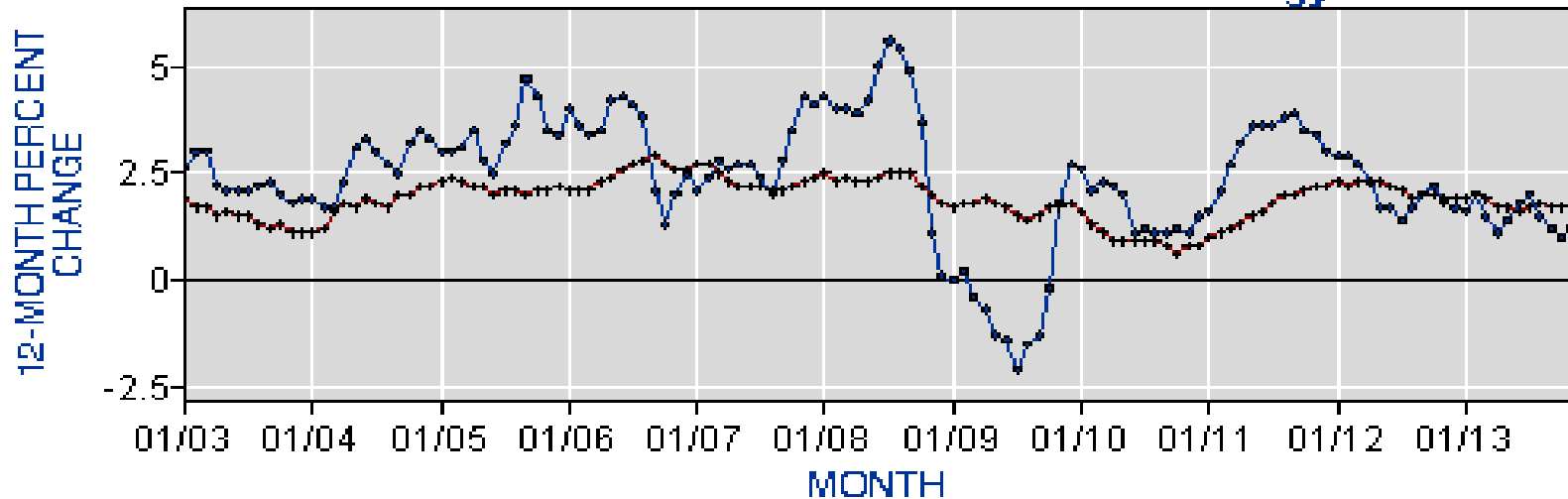
# Consumer Price Index



One month percent change in CPI

# Consumer Price Index

**Consumer Price Index for All Urban Consumers: U.S. City Average,  
All Items and All Items Less Food and Energy**

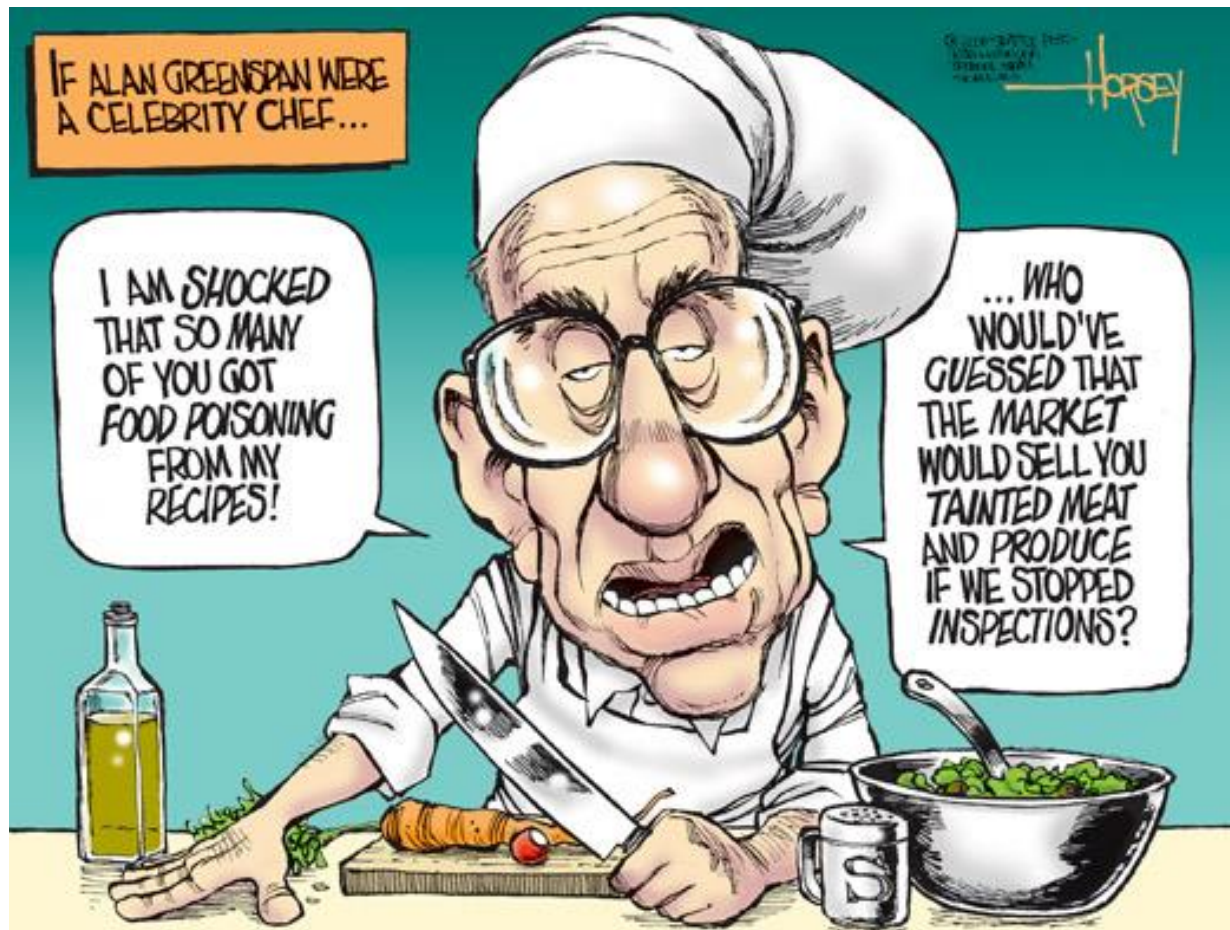


All items  
All items less food and energy

## Inflation indicators cont.

- Producer price index
- Consumer price index
- Employment cost index
- Non-farm productivity
- Unit labor costs
- Import and export prices
- Employee compensation
- Actions by the Federal Reserve 

# The Federal Reserve



# Fed Chairman Ben Bernanke





# Fed Chairwoman Janet Yellen

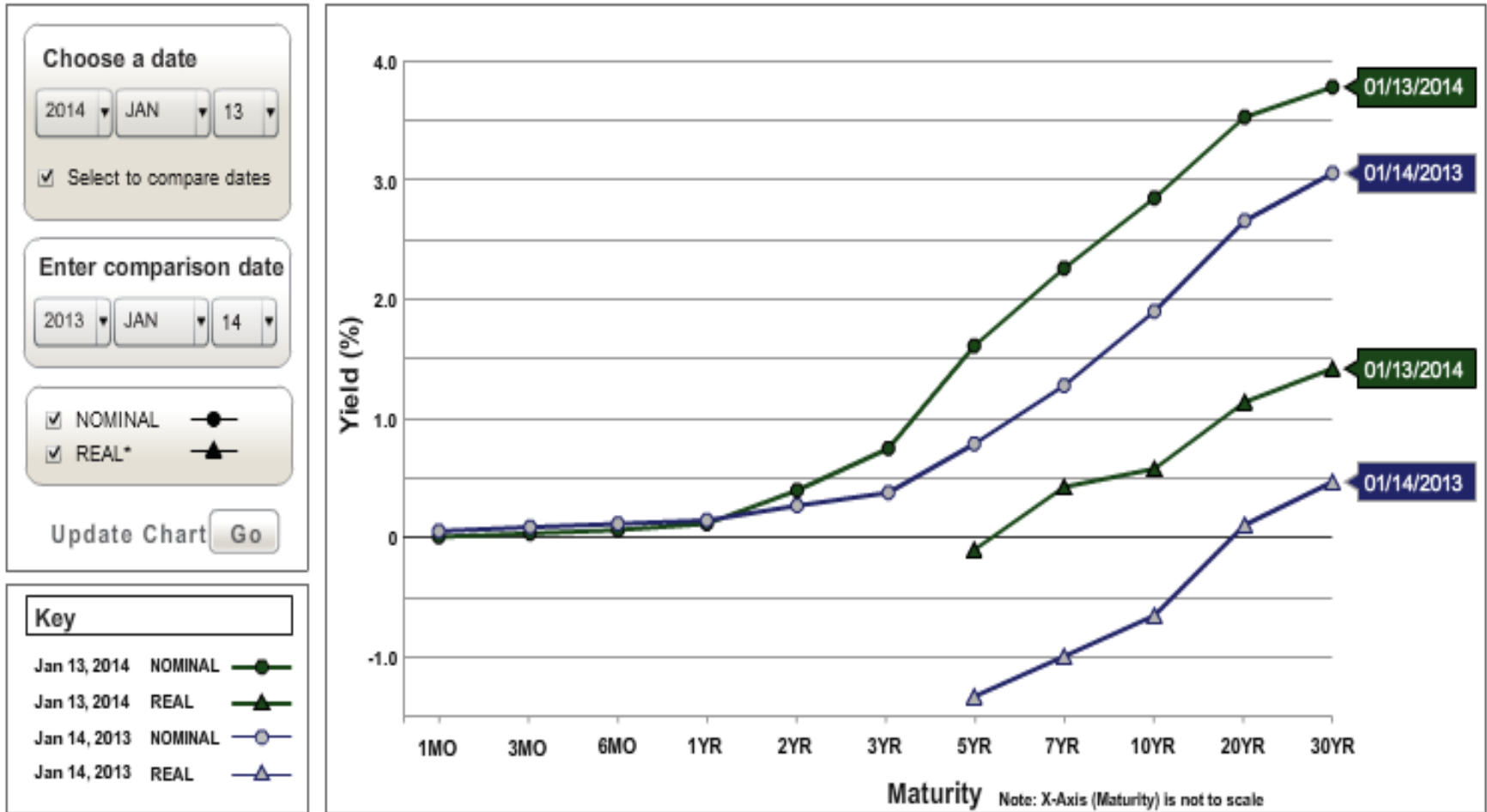


## Interest Rates

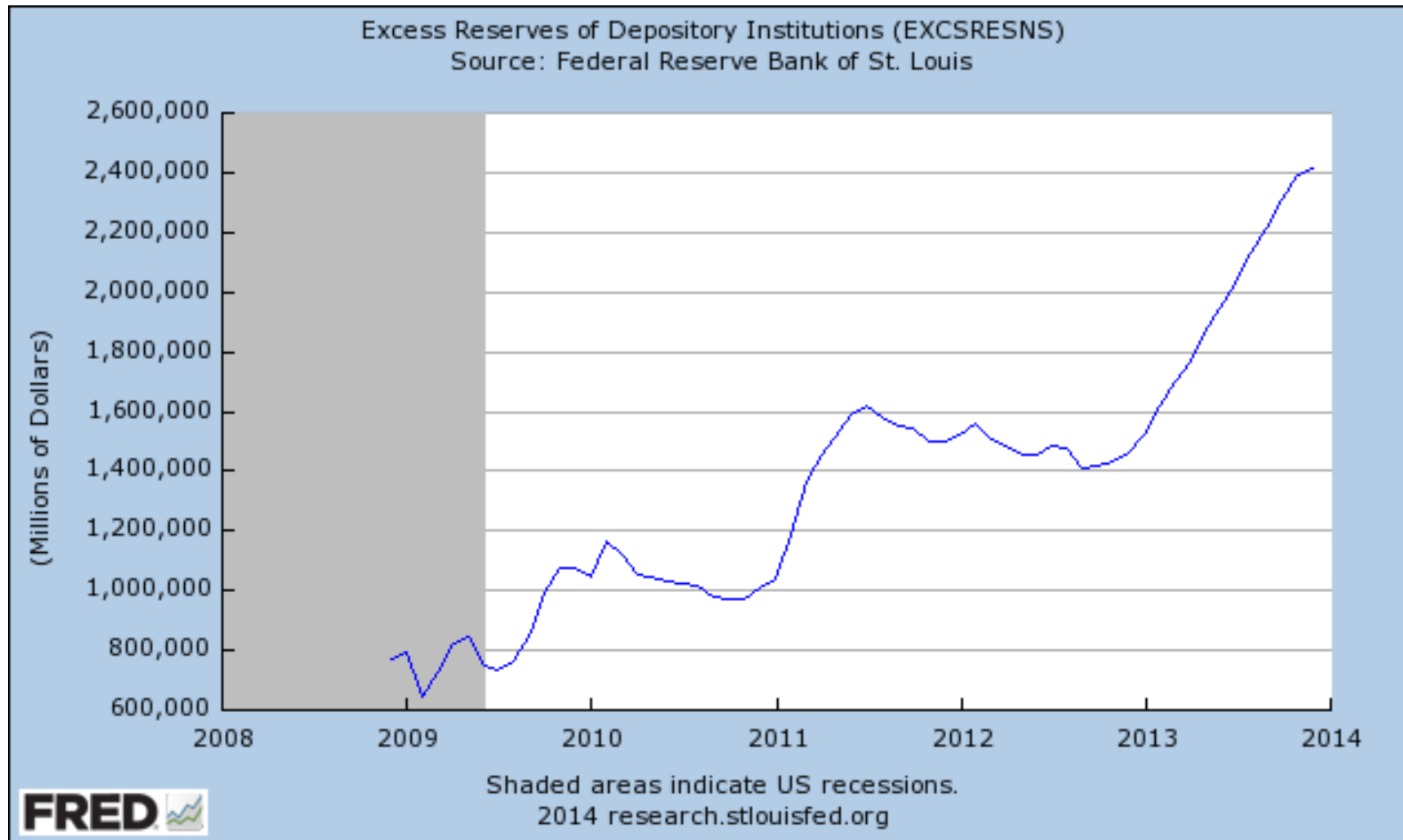
- Raising interest rates does not make sense – For Now
- Unemployment rate 6.7 percent
- Inflation is running well below the Fed's long-term target
- Nonetheless.....

# Treasury Yield Curves

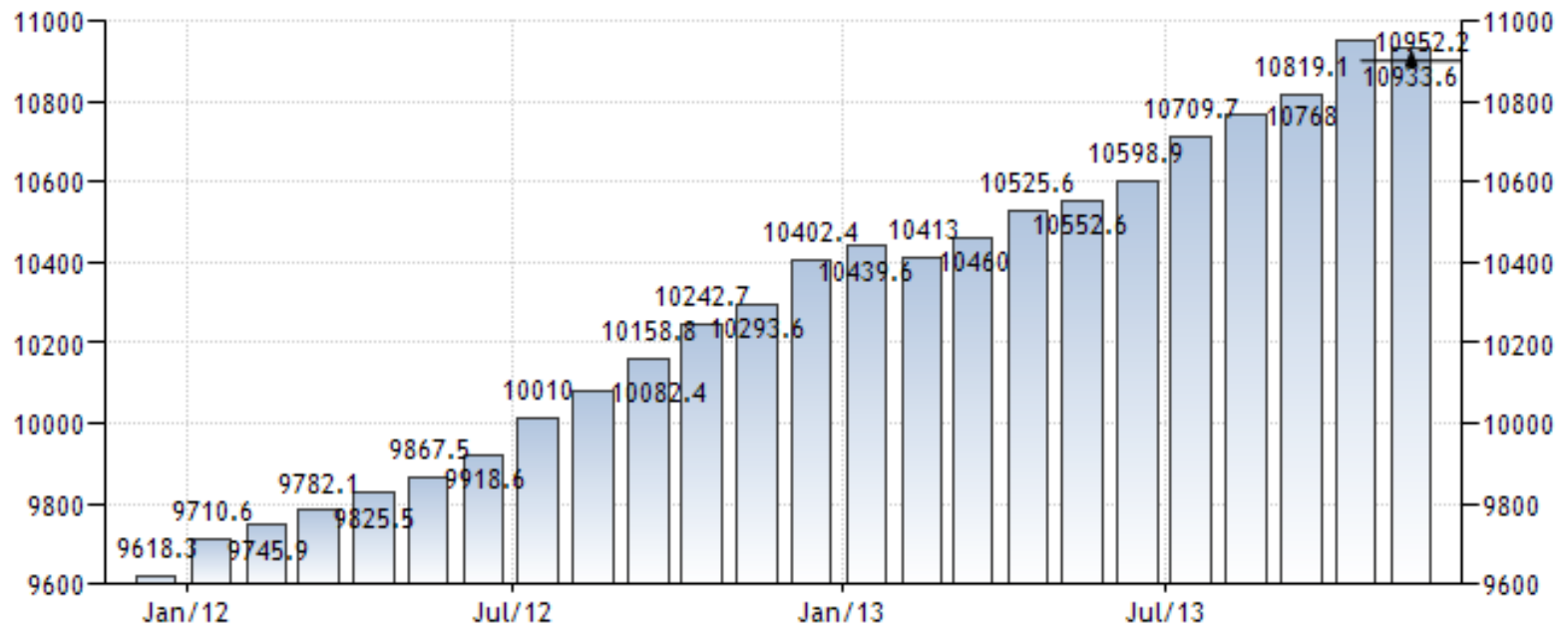
## Treasury Yield Curve



# Excess Reserves Skyrocket



### UNITED STATES MONEY SUPPLY M2



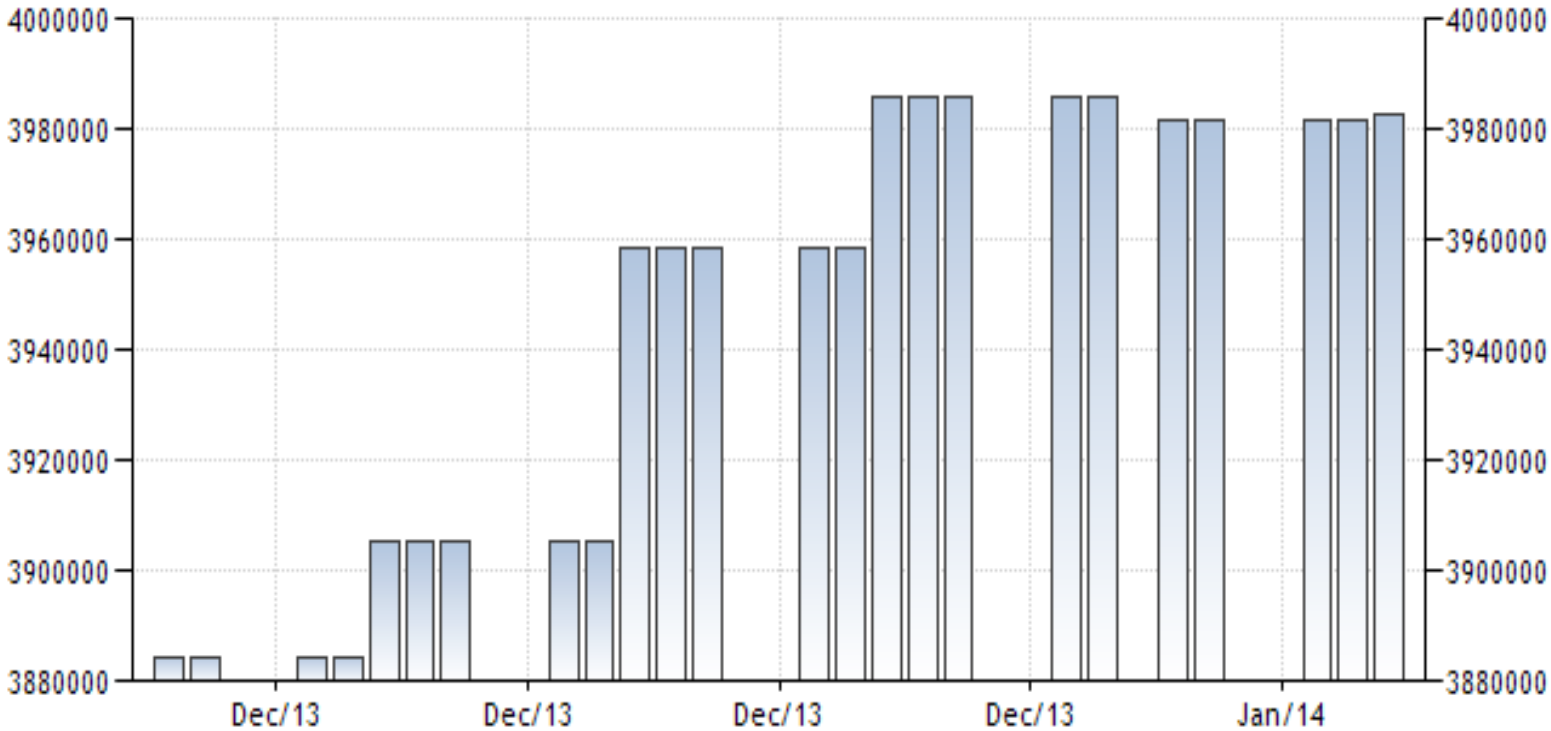
SOURCE: WWW.TRADINGECONOMICS.COM | FEDERAL RESERVE

M1 consists of : (1) currency; (2) traveler's checks; (3) demand deposits at commercial banks

M2 consists of: M1 plus (1) savings deposits ; (2) small-denomination time deposits; and (3) balances in retail money market mutual funds, less IRA and Keogh balances at money market mutual funds.

# Fed Balance Sheet

UNITED STATES CENTRAL BANK BALANCE SHEET



SOURCE: WWW.TRADINGECONOMICS.COM | FEDERAL RESERVE

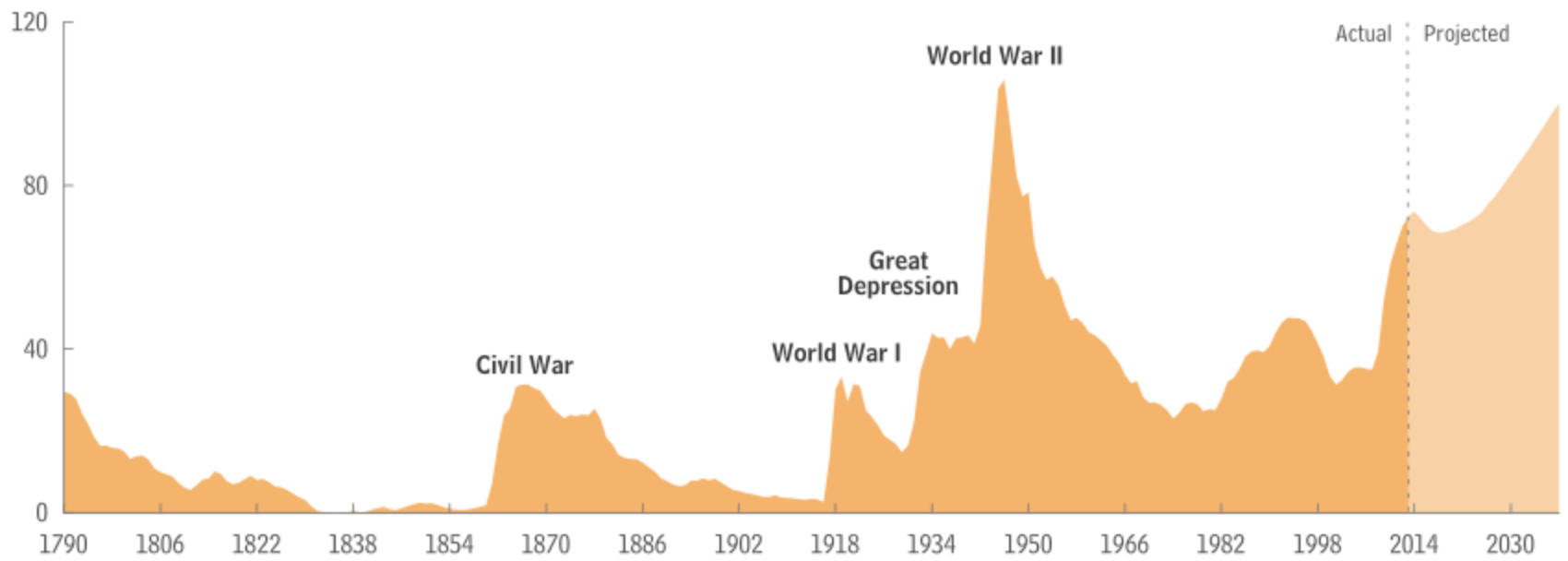
# The Deficit and National Debt



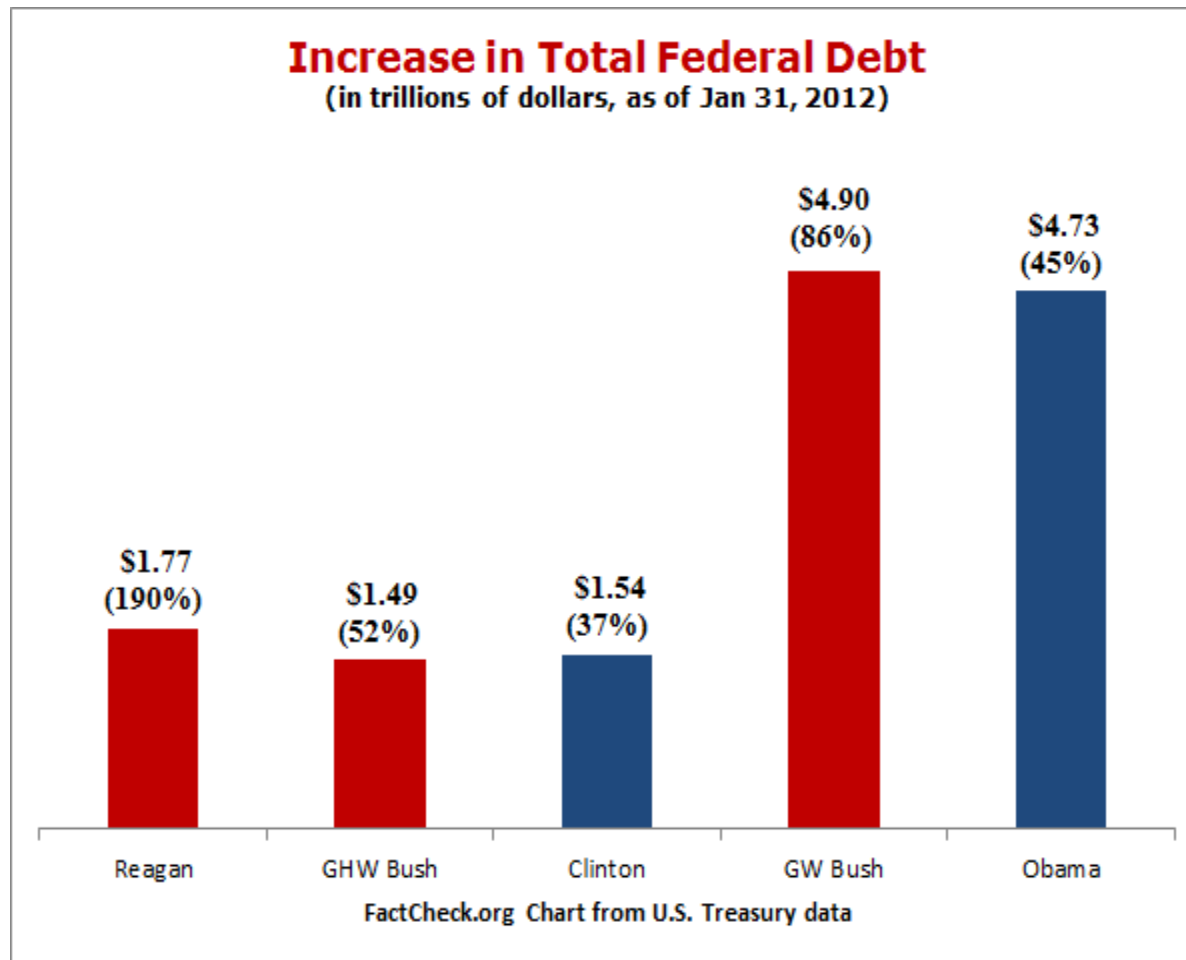
## Federal Debt

Assume 2.5% real growth and 2% inflation, by 2019 equates to \$4 trillion in revenue. So debt service costs due to the next decade's deficits would be less than 6 percent of revenue under current law.





# National Debt



# Falling Dollar



# Dollar Index

**\$DXY - US Dollar Index - Weekly OHLC Chart**



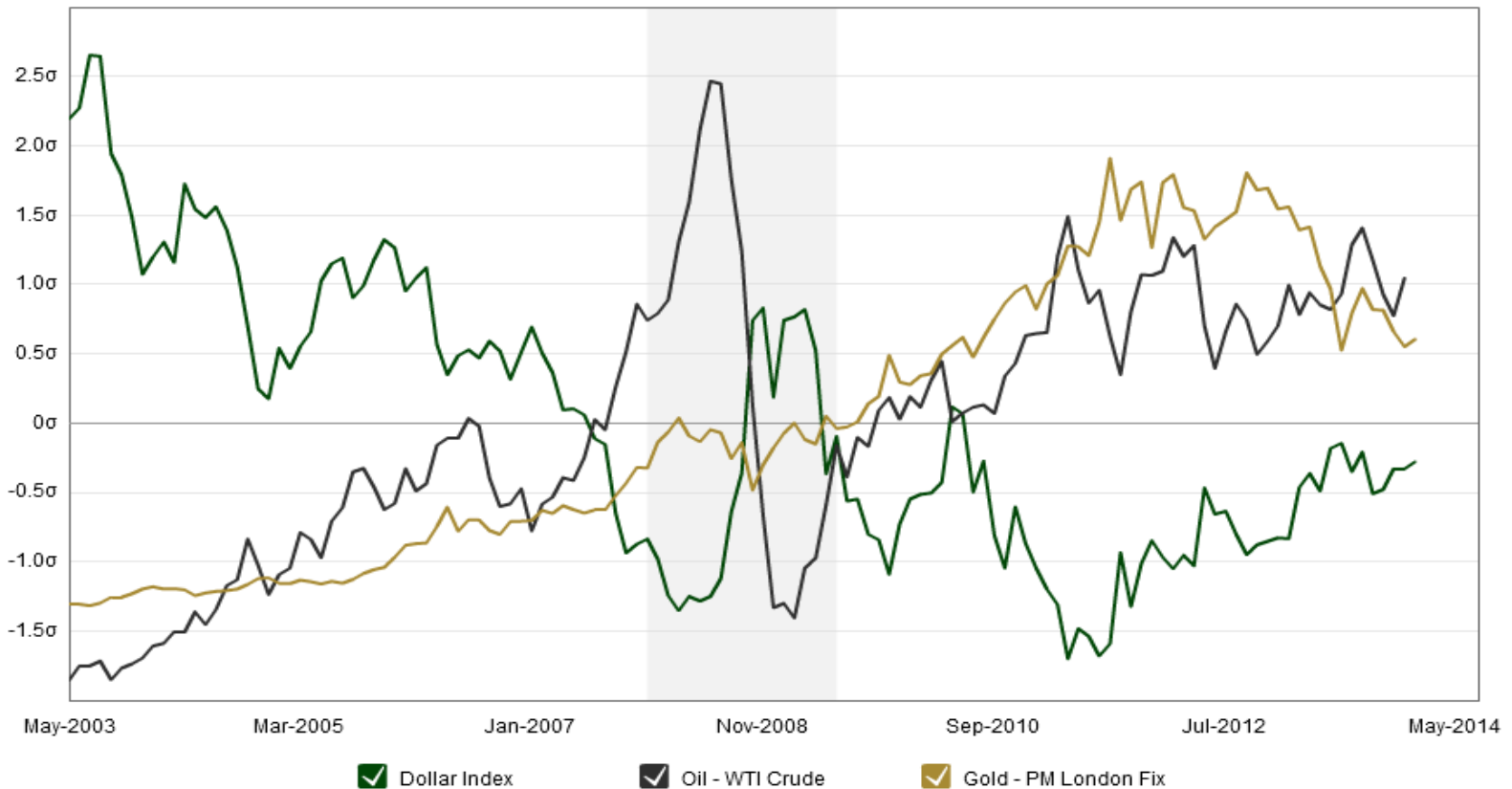
The US Dollar Index (USDIX) is an index (or measure) of the value of the United States dollar relative to a basket of foreign currencies. It is a weighted geometric mean of the dollar's value compared only with "basket" of 6 other major currencies which are:

- Euro (EUR), 57.6% weight
- Japanese yen (JPY) 13.6% weight
- Pound sterling (GBP), 11.9% weight
- Canadian dollar (CAD), 9.1% weight
- Swedish krona (SEK), 4.2% weight and
- Swiss franc (CHF) 3.6% weight

USDIX goes up when the US dollar gains "strength" (value) when compared to other currencies

# Three major commodity indexes

Click the checkboxes to add or remove graph lines | Left-click and drag to zoom in on a specific date range | Click here for more chart instructions. +



# Wall Street



## 5 Ways to lose money on Wall Street

- **Denial** - The trend isn't real
- **Skepticism** - it's too risky
- **Bargaining** - I'll invest if the price is right
- **Regret** - God, I've missed it
- **Panic** - I've *got* to buy in

# So is this the time to invest





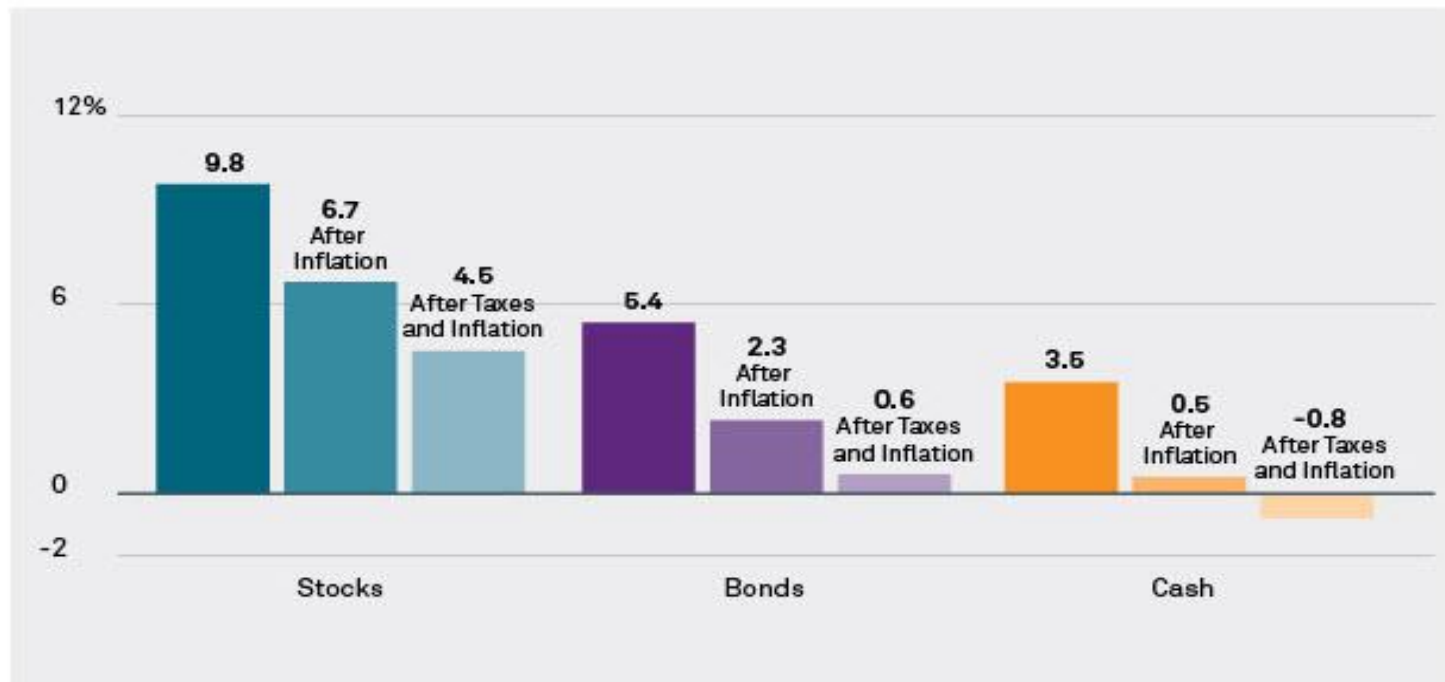
# Portfolio Management Process

**Yes but it all comes down to:**

- How you invest
- What you invest in
- Not fondling your portfolio

## CASH HAS AVERAGED A NEGATIVE REAL, AFTER-TAX RETURN

Compound Annual Returns (1926–2012)



Sources: BlackRock; Morningstar; Tax Foundation. Past performance is no guarantee of future results. Assumes reinvestment of income and no transaction costs. This is for illustrative purposes only and not indicative of any investment. Federal income tax is calculated using the historical marginal and capital gains tax rates for a single taxpayer earning \$110,000 in 2012 dollars every year. This annual income is adjusted using the Consumer Price Index in order to obtain the corresponding income level for each year. Income is taxed at the appropriate federal income tax rate as it occurs. Capital gains for stocks are assessed every five years when there is a cumulative gain from the last high and assume a five year holding period to determine the long-term capital gains rate. Bonds are assumed to be held to maturity. No state income taxes are included. Stocks are represented by the S&P 500 Index. Bonds are represented by the Morningstar/Ibbotson Intermediate-Term Government Bond Index. Cash is represented by the Morningstar/Ibbotson 30-Day US Treasury Bill Index. Inflation is represented by the Consumer Price Index. It is not possible to invest directly in an index.

Perhaps it is self-evident, but it is worth reminding ourselves that inflation is the major downside of holding cash. Even in the low-inflation environments in much of the developed world, returns on cash have not kept up with consumer price increases. So the [value of cash](#) diminishes in real, or inflation-adjusted, terms over time.

# Value Investing

- Low P/E ratio
- Low Price/sales ratio
- Low Price/Cash Flow
- Low Price/book ratio
- High Dividend yield

## Growth Investing

- High earnings growth rate
- High sales growth rate
- High return on equity
- High profit margin
- No or low dividend yield

## Value Guidelines

- Share price < than 2/3 of intrinsic value.
- P/E ratios in the lowest 10%.
- Stock price < than tangible book value.
- Debt to Equity ratio < 0.75).
- Current assets 2X current liabilities.
- Dividend yield 2/3 of AAA bond yield.
- Earnings CAGR > 7% over 10 years.

## Growth Guidelines

Company Size	Minimum 5 Year Growth
Greater than \$4B	5%
Less than \$4B and Greater than \$400M	7%
Less than \$400 M	12%

## Investment criteria models

- Free cash flow to the firm
- Free cash flow to equity
- Discounted earnings
- Discounted dividends

## Screening

- Many investors use "screens" to select investments, meaning that they use a number of quantitative criteria and examine only the companies that meet those criteria
- Warning = Do not throw the baby out with the bath water



## Intrinsic value model- FCFF

- FCFF - the cash that is left over after payment of all hard cash expenses and all operating investment
- $FCFF = NOP - Taxes - Net\ Inv - Net\ Change\ in\ Working\ Capital$
- ValuePro.net

## Intrinsic value – Dividends

- Dividend discount model
- Used by every analyst
- Many varieties
- Can be found on the internet
- Excel program available

# Portfolio Management Process

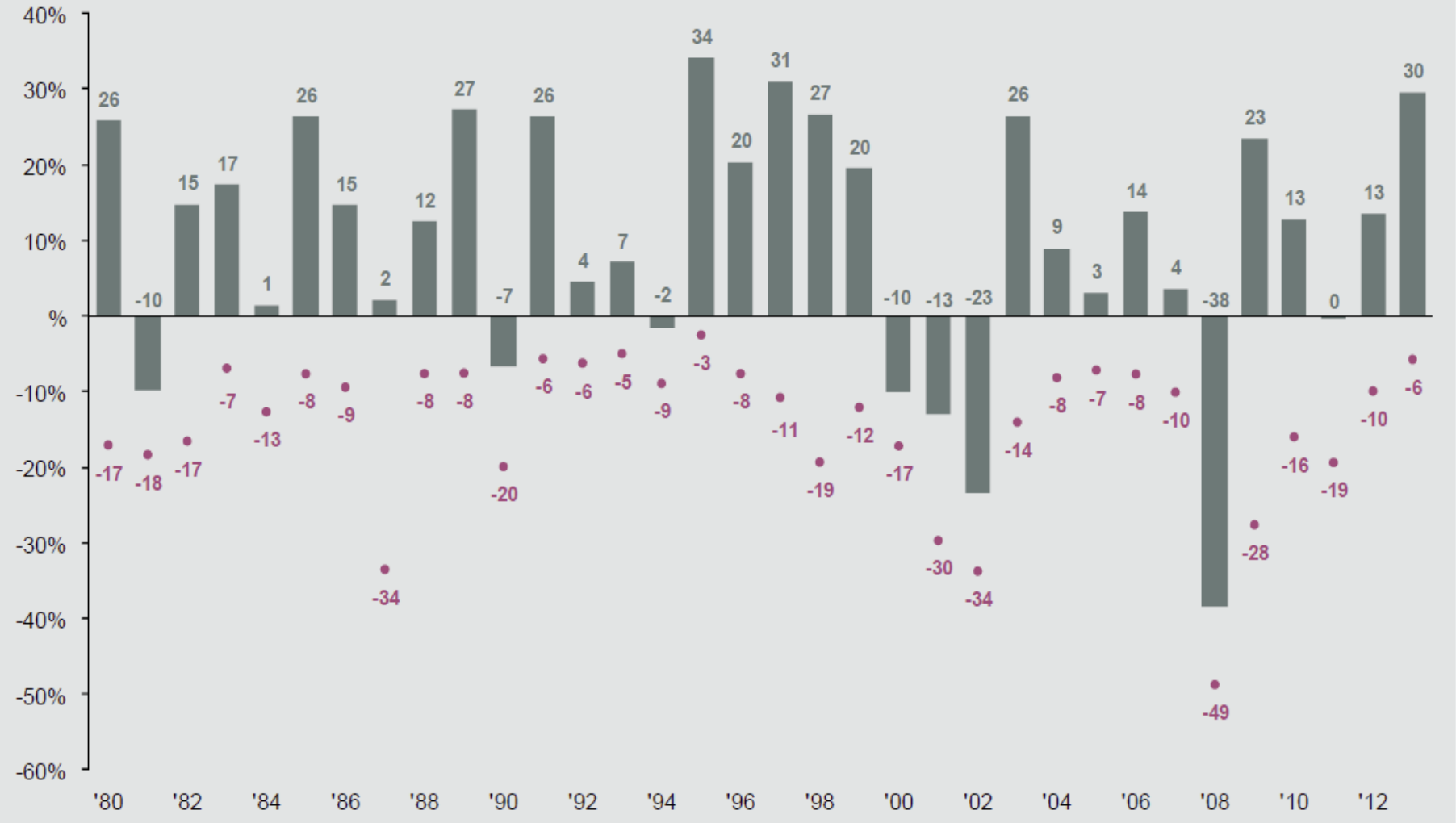
It all comes down to:

- How you invest
- What you invest in
- How do you hold on to your profits

# S&P 500 Intra-year Declines vs. Calendar Year Returns

## S&P 500 Intra-year Declines vs. Calendar Year Returns

*Despite average intra-year drops of 14.4%, annual returns positive in 26 of 34 years*



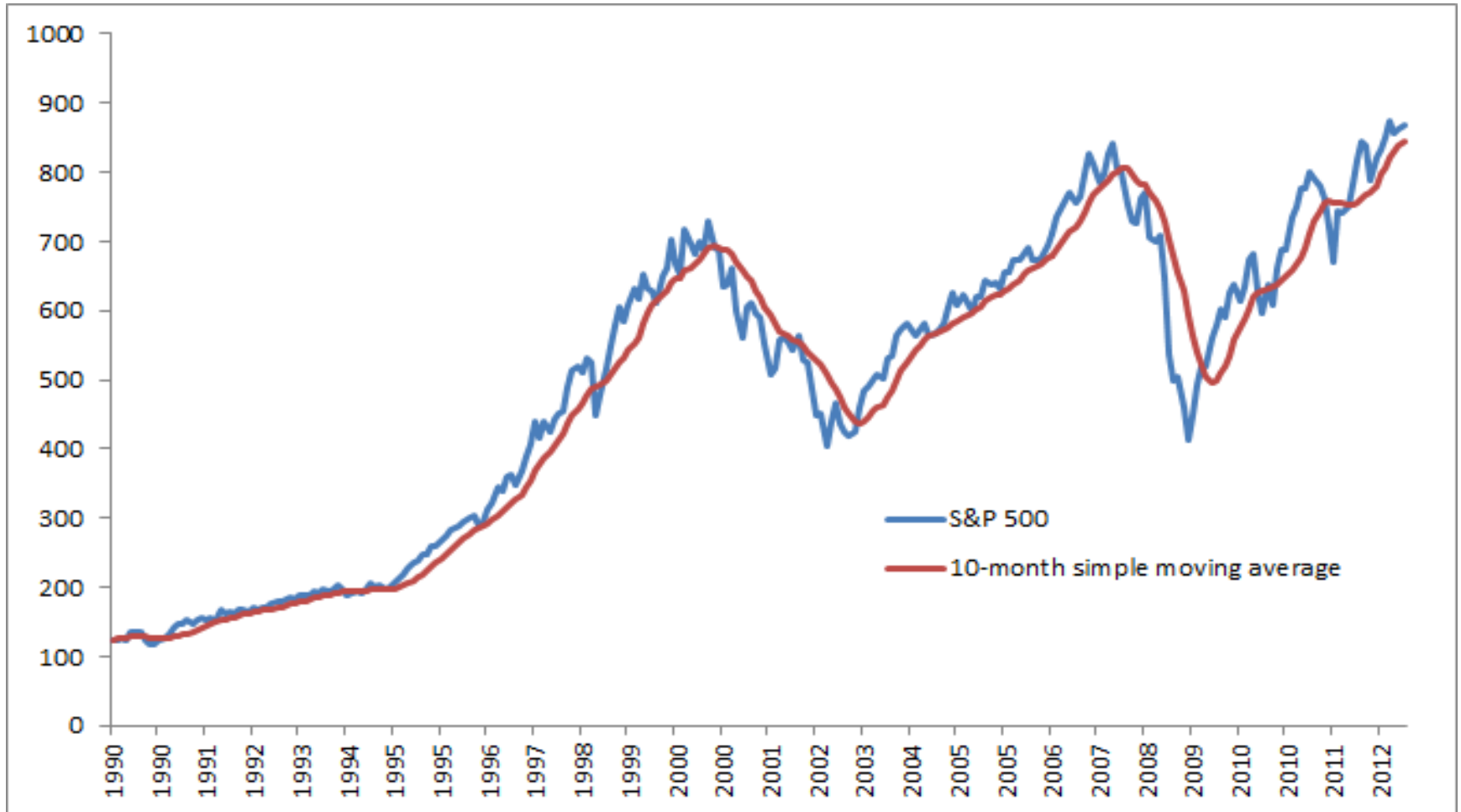
Source: Standard & Poor's, FactSet, J.P. Morgan Asset Management.

01/16/2014

© Rudd International

60

# 10 month moving average



# Buy Sell Rule\*

- **BUY RULE**
- Buy when monthly price  $>$  10-month SMA.
- **SELL RULE**
- Sell and move to cash when monthly price  $<$  10-month SMA.

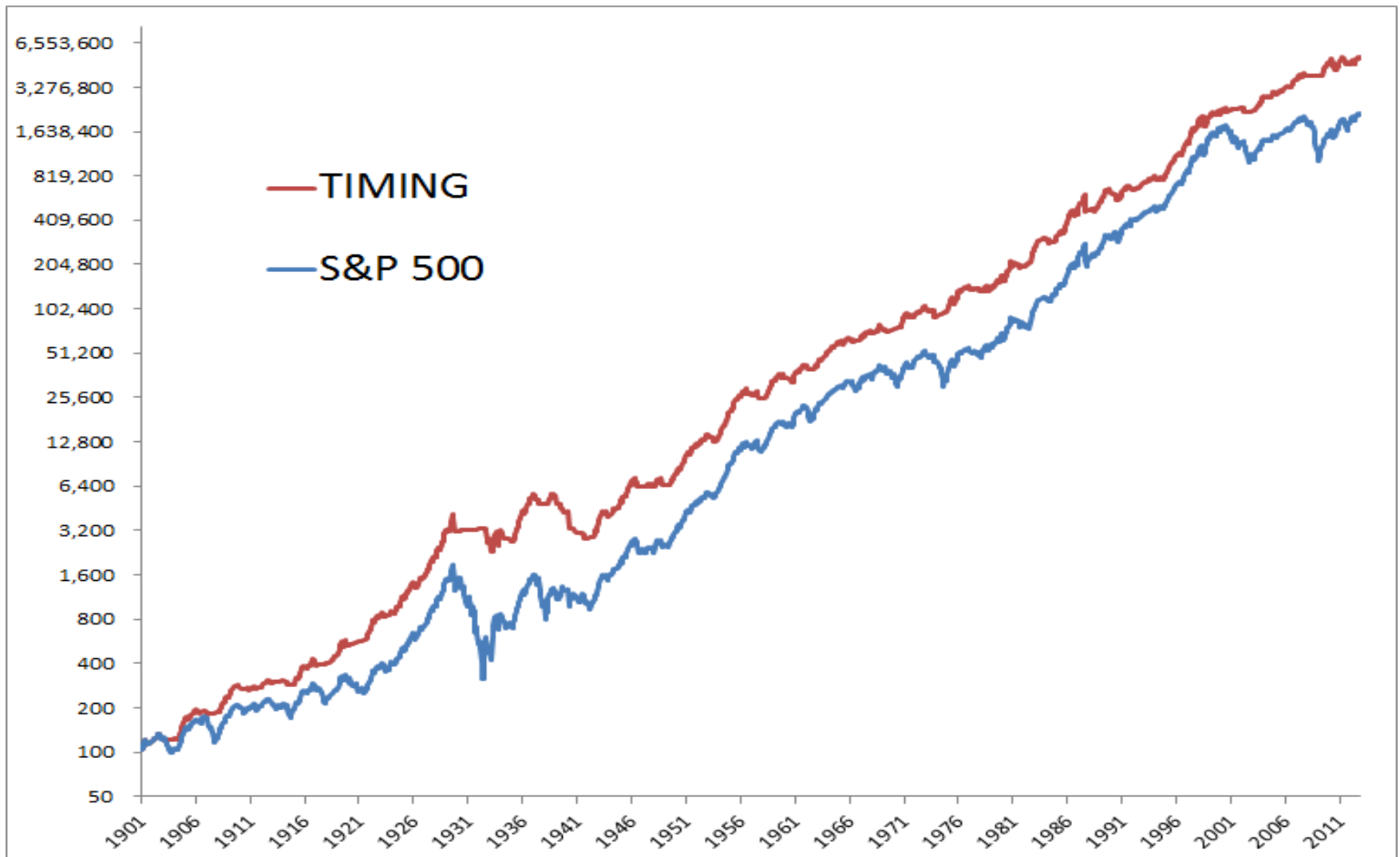
\* A Quantitative Approach to Tactical Asset Allocation Mebane T. Faber Cambria Investment Management

# S&P 500 Total Return vs Timing

- S&P 500 Total Returns vs. Timing Total Returns (1901-2012)

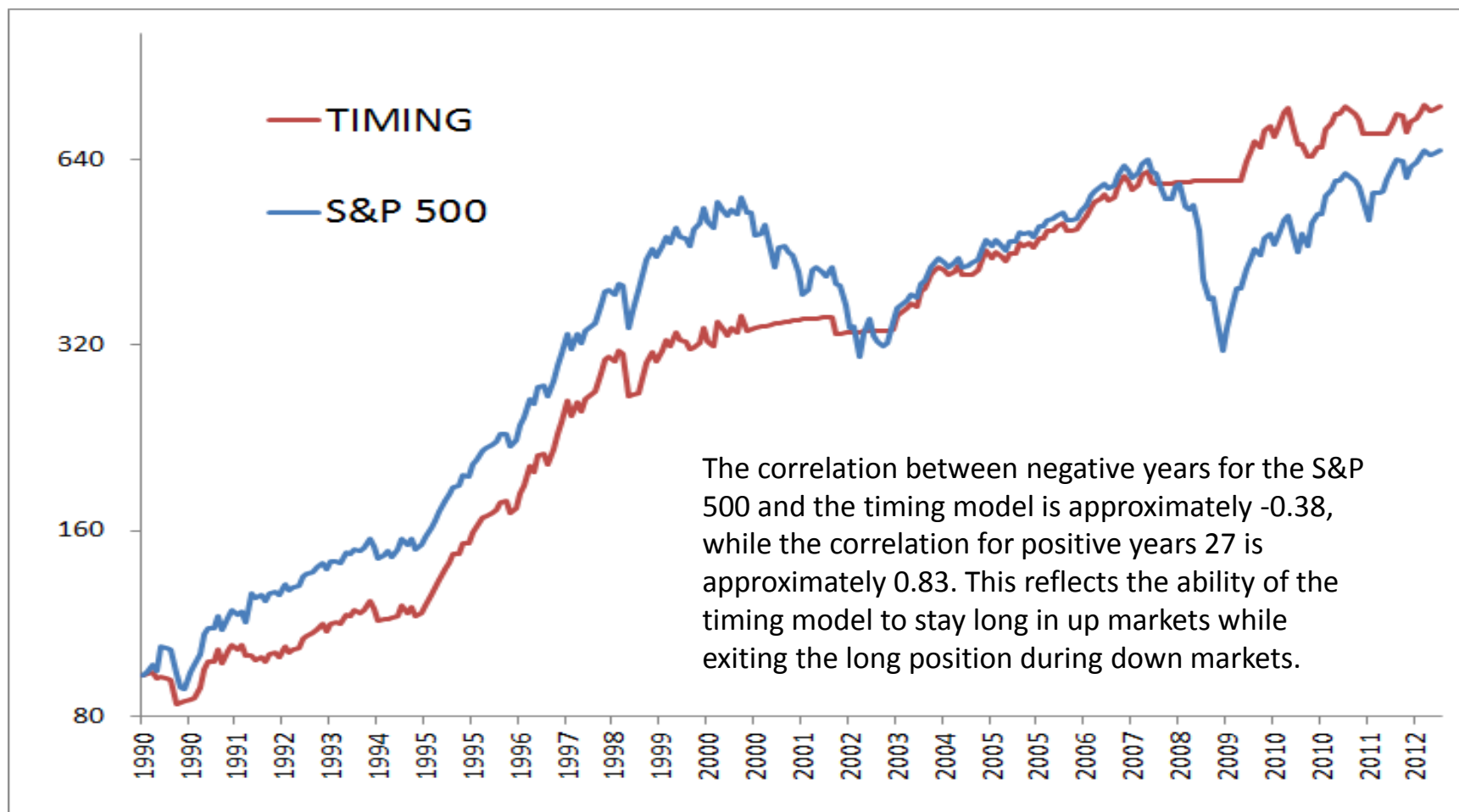
	S&P 500	TIMING
Returns	9.32%	10.18%
Volatility	17.87%	11.97%
Sharpe	0.32	0.55
MaxDD	-83.46%	-50.29%
% Positive Months	61.58%	75.80%
\$100 becomes	\$2,163,361	\$5,205,587
Inflation CAGR	3.11%	3.11%

# S&P 500 Total Return vs. Timing Total Return (1901-2012)





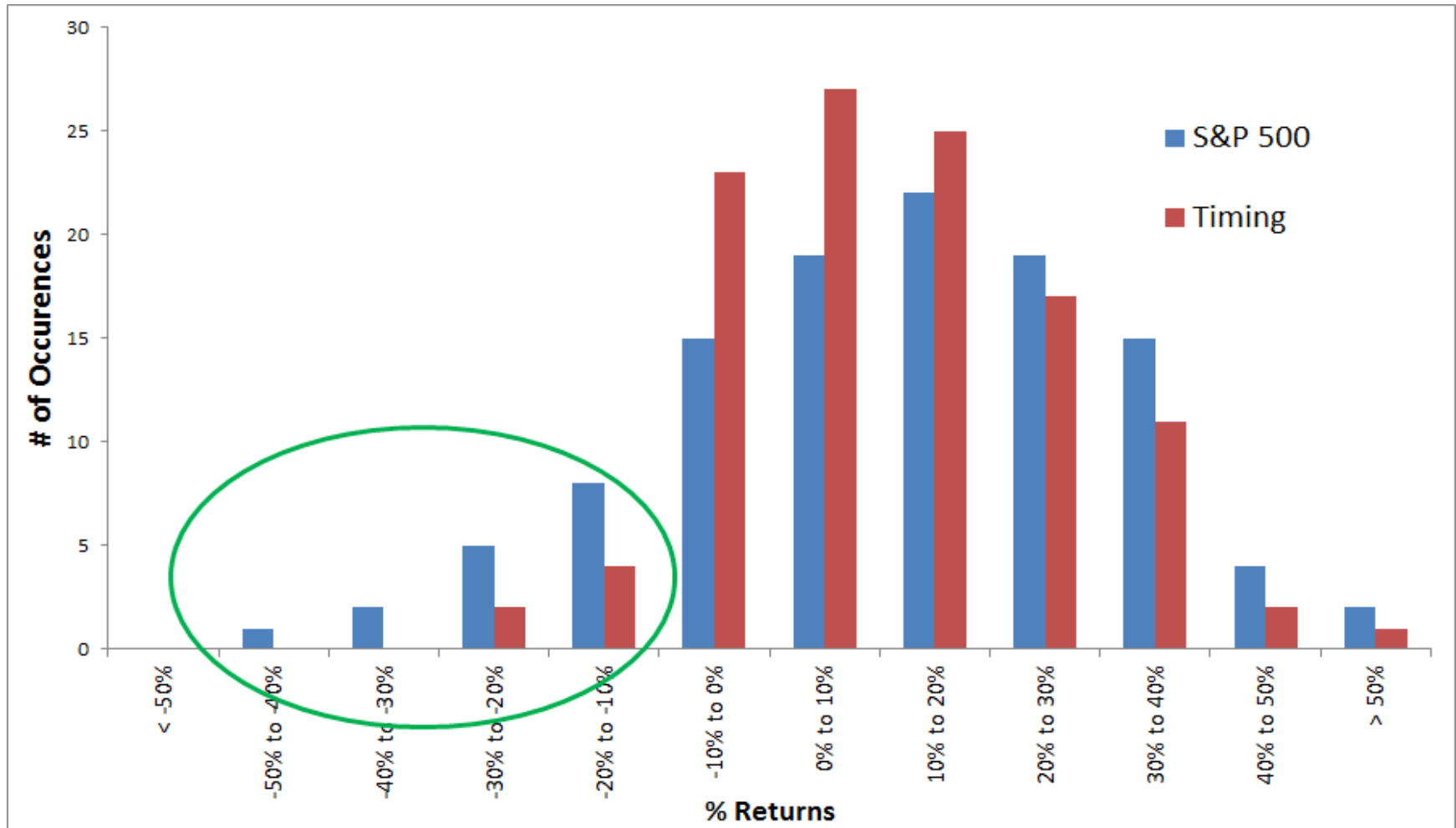
# S&P 500 Total Return vs. Timing Total Return (1990-2012)



## S&P 500 Ten Worst Years vs. Timing, 1900-2012

	S&P 500	TIMING
1931	(43.86%)	1.41%
2008	(36.77%)	1.33%
1937	(35.26%)	(7.65%)
1907	(29.61%)	(0.09%)
1974	(26.47%)	8.16%
1917	(25.26%)	(3.02%)
1930	(25.26%)	2.51%
2002	(22.10%)	(4.62%)
1920	(19.69%)	(4.80%)
1973	(14.69%)	(15.36%)

# Yearly Return Distribution, S&P 500 and Timing 1900-2012



# Global Tactical Asset Allocation (GTAA)

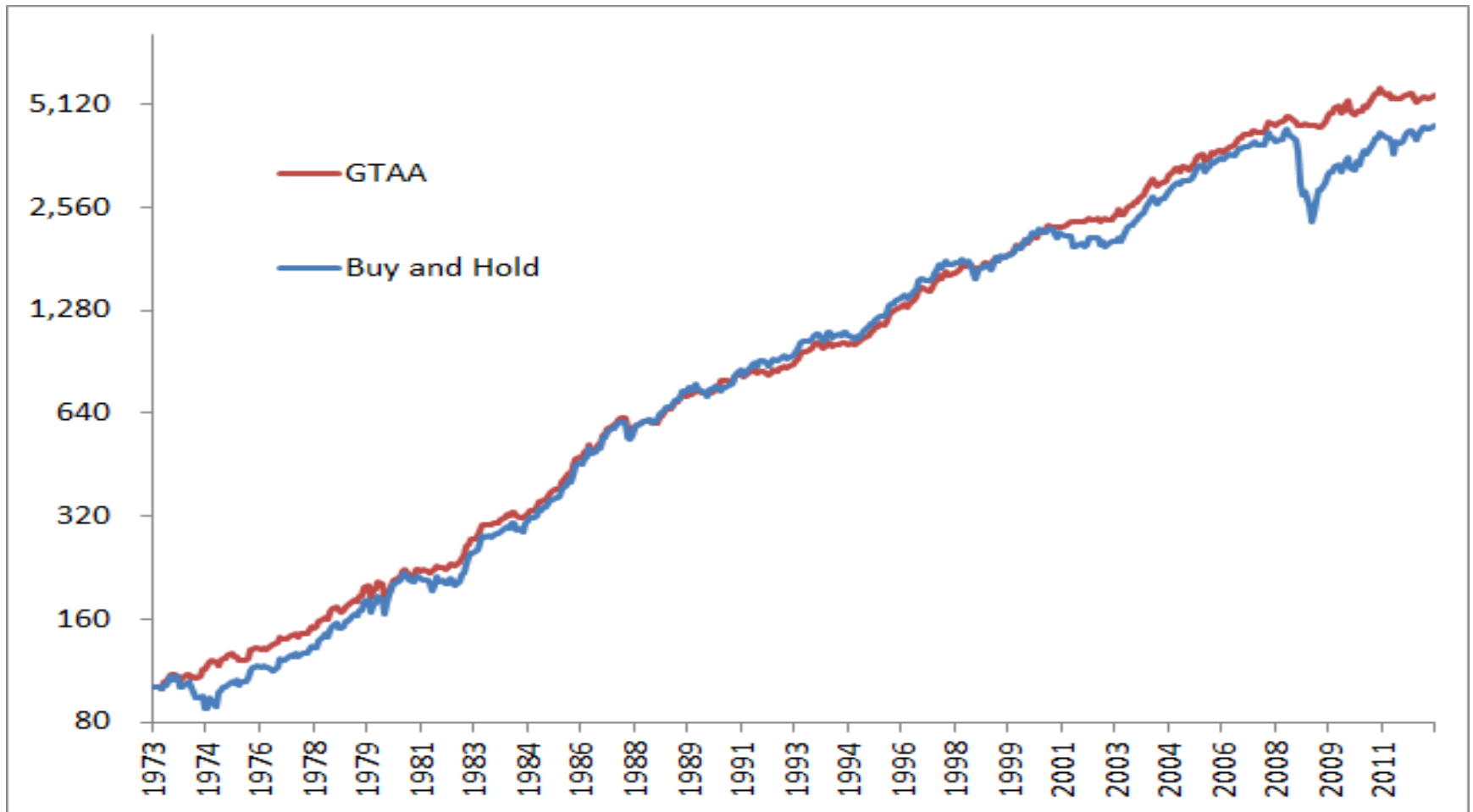
## Five global asset classes

- US stocks
- Foreign stocks
- Bonds
- Real estate
- Commodities

# Global Tactical Asset Allocation (GTAA) cont.

- Buy and hold referenced as “Buy & Hold” or “B&H”
- Equally weighted across 5 asset classes
- The timing model also uses equal weightings
- Treats each asset class independently
- It is either long the asset class or in cash with its 20% allocation of the funds

# Buy & Hold vs. Timing Model, 1973-2012



# Yearly Returns for Buy & Hold vs. Timing Model, 1973-2012

	B&H	GTAA
1973	1.01%	7.34%
1974	-11.80%	11.92%
1975	20.18%	1.46%
1976	14.93%	15.88%
1977	8.25%	7.32%
1978	13.74%	11.98%
1979	17.99%	14.79%
1980	19.18%	11.91%
1981	-3.12%	3.52%
1982	20.46%	21.03%
1983	18.24%	16.33%
1984	9.32%	6.52%
1985	26.03%	25.65%
1986	25.25%	21.28%
1987	8.68%	11.65%
1988	18.49%	11.76%
1989	19.10%	17.96%
1990	-1.08%	4.92%
1991	18.07%	6.20%
1992	3.90%	4.74%
1993	11.89%	12.79%
1994	1.76%	2.45%
1995	22.75%	21.74%
1996	19.31%	19.25%
1997	9.96%	9.94%
1998	-0.49%	7.34%
1999	14.16%	13.06%
2000	12.73%	13.82%
2001	-9.73%	3.15%
2002	1.99%	3.28%
2003	25.88%	20.45%
2004	17.45%	15.06%
2005	11.73%	7.63%
2006	12.04%	14.21%
2007	7.96%	9.80%
2008	-30.01%	-0.59%
2009	18.74%	12.77%
2010	14.04%	3.65%
2011	2.81%	2.49%
2012	11.57%	1.26%
	B&H	GTAA
Return	9.92%	10.48%
Volatility	10.28%	6.99%
Sharpe (5.41%)	0.44	0.73
MaxDD	-46.00%	-9.54%
Inflation CAGR	4.30%	4.30%

## Yearly Returns for Buy & Hold vs. Timing Model, 1973-2012

<b>2006</b>	12.04%	14.21%
<b>2007</b>	7.96%	9.80%
<b>2008</b>	-30.01%	-0.59%
<b>2009</b>	18.74%	12.77%
<b>2010</b>	14.04%	3.65%
<b>2011</b>	2.81%	2.49%
<b>2012</b>	11.57%	1.26%
	<b>B&amp;H</b>	<b>GTAA</b>
<b>Return</b>	9.92%	10.48%
<b>Volatility</b>	10.28%	6.99%
<b>Sharpe (5.41%)</b>	0.44	0.73
<b>MaxDD</b>	-46.00%	-9.54%
<b>Inflation CAGR</b>	4.30%	4.30%



# Stability of Various Moving Average Lengths Timing Model 1973-2012

	BUY & HOLD	3 Month SMA	6 Month SMA	9 Month SMA	12 Month SMA
Return	9.92%	9.54%	10.30%	10.73%	10.59%
Volatility	10.28%	6.92%	6.83%	6.89%	7.09%
Sharpe (5.41%)	0.44	0.60	0.72	0.77	0.73
MaxDD	-46.00%	-17.42%	-9.76%	-10.31%	-14.09%
Inflation CAGR	4.30%	4.30%	4.30%	4.30%	4.30%

## Summary Annualized Returns for B&H vs. Timing 2006-2012

	<b>BUY &amp; HOLD</b>	<b>GTAA</b>
<b>Return</b>	3.94%	6.01%
<b>Volatility</b>	14.96%	7.27%
<b>Sharpe (5.41%)</b>	0.16	0.61
<b>MaxDD</b>	-46.00%	-9.42%
<b>Inflation CAGR</b>	2.20%	2.20%

## What we do at Rudd

- Rising dividends for at least 8 years
- Intrinsic value minimum 10 to 20 percent above market price
- Four intrinsic value models minimum
- Analyze at least 5 years of financial data
- Investigate suppliers, customers, competitors
- 3 year forecast
- Technical analysis of share price
- Low turnover of 40 stock portfolio

# Rudd Performance 2013

## Portfolio-Level Performance Disclosure

The portfolio-level performance shown is hypothetical and for illustrative purposes only. Investor returns will differ from the results shown.

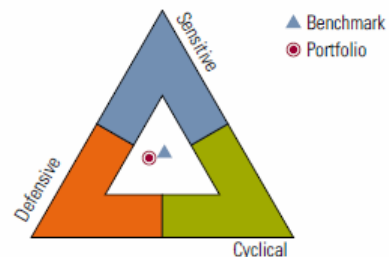
### Investment Detail

Period		Beginning Balance	New Investment	Distribution/ Withdrawal	Total Reinvest	Charges & Fees	Taxes Due	Market Value	Total Return %
Totals		0	1,000,000	33,489	2,413	0	0	1,295,815	33.48
January	2013	0	1,000,000	2,157	148	0	0	1,073,854	7.61
February	2013	1,073,854	0	4,728	273	0	0	1,101,936	3.06
March	2013	1,101,936	0	1,828	156	0	0	1,147,465	4.30
April	2013	1,147,465	0	2,238	164	0	0	1,180,791	3.10
May	2013	1,180,791	0	4,080	276	0	0	1,173,971	-0.23
June	2013	1,173,971	0	1,859	157	0	0	1,158,389	-1.17
July	2013	1,158,389	0	2,646	164	0	0	1,211,400	4.81
August	2013	1,211,400	0	3,487	278	0	0	1,154,619	-4.41
September	2013	1,154,619	0	2,067	175	0	0	1,197,249	3.87
October	2013	1,197,249	0	3,219	165	0	0	1,270,443	6.39
November	2013	1,270,443	0	2,750	281	0	0	1,286,563	1.49
December	2013	1,286,563	0	2,432	176	0	0	1,295,815	0.91

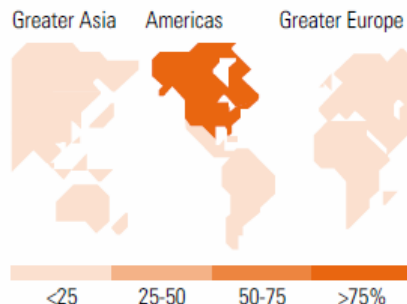
# Rudd Stock Analysis

Stock Analysis 12-31-2013

## Stock Sectors



## World Regions



% of Stocks	Portfolio %	Bmark %
<b>Cyclical</b>	<b>20.35</b>	<b>31.70</b>
Basic Matls	3.57	3.37
Consumer Cycl	4.80	11.26
Financial Svs	2.43	15.39
Real Estate	9.55	1.68
<b>Sensitive</b>	<b>37.10</b>	<b>41.68</b>
Commun Svs	2.01	3.66
Energy	7.10	10.28
Industrials	25.46	11.51
Technology	2.53	16.23
<b>Defensive</b>	<b>42.55</b>	<b>26.62</b>
Consumer Def	14.21	10.66
Healthcare	26.25	13.06
Utilities	2.09	2.90

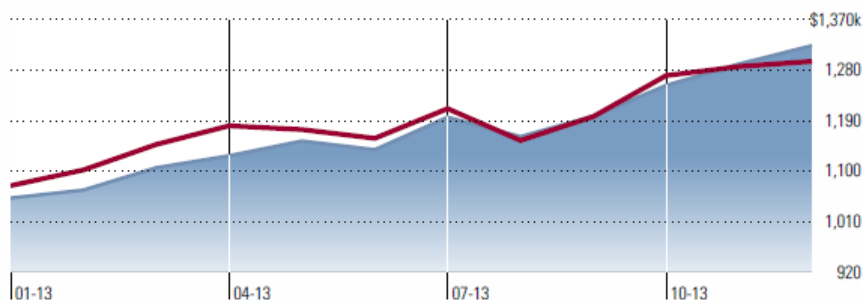
% of Stocks	Portfolio %	Bmark %
<b>Americas</b>	<b>94.84</b>	<b>98.21</b>
North America	94.84	98.21
Latin America	0.00	0.00
<b>Greater Europe</b>	<b>5.16</b>	<b>1.79</b>
United Kingdom	0.00	0.41
Europe-Developed	5.16	1.38
Europe-Emerging	0.00	0.00
Africa/Middle East	0.00	0.00
<b>Greater Asia</b>	<b>0.00</b>	<b>0.00</b>
Japan	0.00	0.00
Australasia	0.00	0.00
Asia-Developed	0.00	0.00
Asia-Emerging	0.00	0.00
<b>Not Classified</b>	<b>0.00</b>	<b>0.00</b>

Performance 12-31-2013

## Investment Activity Graph

— Portfolio  
— Benchmark

Final Mkt Val: \$1,295,815



Trailing Returns	3 Mo	1 Yr	3 Yr	5 Yr	10 Yr
Portfolio Return	8.97	—	—	—	—
Benchmark Return	10.51	—	—	—	—
+/- Benchmark Return	-1.54	—	—	—	—

Best/Worst Time Periods	Best %	Worst %
3 Months	12.16 ( Sep 2013-Nov 2013 )	-0.97 ( Jun 2013-Aug 2013 )
1 Year	—	—
3 Years	—	—

Portfolio Yield ( 12-31-2013 )	Yield %
12-Month Yield	3.00

## Portfolio-Level Performance Disclosure

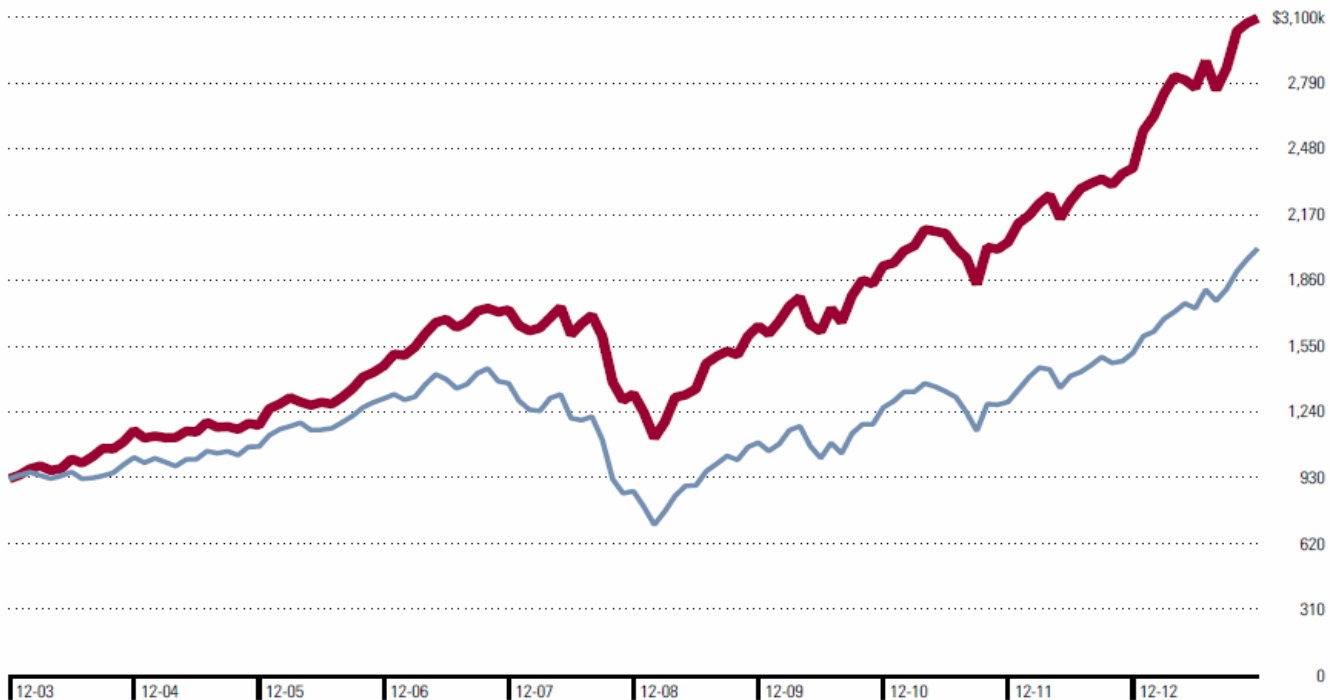
The portfolio-level performance shown is hypothetical and for illustrative purposes only. Investor returns will differ from the results shown.

# Rudd 10-Year Current Portfolio

12-31-2003 to 12-31-2013

## Portfolio Summary

■ Portfolio    ■ S&P 500 TR USD (USD)



## Planning Assumptions

Currency	USD
Rebalance	Annually
Rebalance Threshold% +/-	1.50%
Allocation Update Frequency	None
Federal Income Tax Rate	0%
Capital Gain Tax Rate	0%
State Tax Rate	0%
Tax Paid	Out of Pocket

## Performance

Final Market Value	\$3.10 mil
Average Annualized Return	15.70%
Cumulative Return	330.38%
Cumulative Ret - Benchmark	104.81%

## Portfolio-Level Performance Disclosure

The portfolio-level performance shown is hypothetical and for illustrative purposes only. Investor returns will differ from the results shown.

## Stock suggestions – Newspaper 12

- Biogen Idec
- Gilead
- AbbVie
- Abbott Labs
- Aflac
- MWI Veterinary

- Intel
- Tractor Supply
- United Technologies
- Toro
- AmerisourceBergen
- Cummins

## Additional stock suggestions

- Badger Meter
- Zimmer
- Stryker
- Varian Medical
- Clorox
- Church & Dwight

- Kellogg
- General Dynamics
- Linn Energy
- Illinois Tool Works
- Coach
- Johnson & Johnson



## Epilog

- Need help - email me
- [LVERudd@aol.com](mailto:LVERudd@aol.com)
- Slides on my web site
- RuddReport.com
- Put Seminar in subject line



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# That's All Folks...the editor

