CW FOCUS STOCK PORTFOLIO

Investment Summary

Who's it for?

The CW Focus Stock Portfolio was designed for investors who want to participate in the wealth-creation opportunities of the equity markets, coupled with an objective risk-management tool to reduce the risk of large losses. The portfolio is suited for investors looking for a proactive, disciplined, and unemotional stock selection process that seeks out investments showing consistent outperformance in both Canada and the United States. We are looking for stocks that we believe offer the highest odds of consistent gains – not outsized high-risk/high-reward scenarios. The CW Focus Stock Portfolio was designed to help investors build wealth. And keep it.

Why do we invest this way?

Because we believe that investors should be able to enjoy the wealth-creating opportunities of equity investing without the persistent, nagging fear of experiencing devastating market losses during cyclical Bear markets.

What is it?

The CW Focus Stock Portfolio is a discretionary managed account. The portfolio aims to increase the value of your investments over the long term by investing in the equity securities of companies listed on the senior stock exchanges of Canada and the United States. To be eligible for consideration the company must be listed on the S&P/TSX Composite Index, the S&P 500 Index, or the NASDAQ 100 Index and have a consolidated market capitalization of greater than $1 Billion. The portfolio consists of up to 20 stocks (no more than 10 to each country) and is diversified by industry sector according to our process and policy. This enables the investor to gain exposure to unique opportunities available within an equity pool of over 700 securities and two separate economic climates.

Why Stocks?

The stock market has provided investors with the highest long-term growth rate compared to all other traditional asset classes (bonds, real estate, and commodities) over the last 100 years. Actively managed stock portfolios offer the investor the best chance for above-average returns compared to passive index investing.

Why 20 stocks?

Our studies have shown that concentrated portfolios (15-20 stocks) tend to outperform more widely diversified portfolios (30-100+ stocks) over time. As we are trying to build an investment vehicle that offers the most potential upside during Bull markets, we believe that a 10 Canadian/10 US stock mix offers the best mix of diversification and growth potential. The portfolio is thus concentrated within Canada and the US but diversified as a whole. We focus half the Canadian portfolio exclusively on large capitalization companies listed on the TSX 60, and half the U.S. portfolio exclusively on Large-Cap NASDAQ 100 companies. We tested different mixes of 20/20 and 25/25 models and found the 15/15 model offered better growth rates with similar downside risk. After a certain point, having more stocks in the portfolio does not reduce the magnitude of drawdown during a market decline but often impairs growth potential during rising markets.

Why Equal-Weighted Positions?

Because there are innumerable 'capitalization-weighted' mutual funds and other managed investment products already available to investors, most of which only match or underperform their benchmarks.

Throughout our testing on all our stock models we consistently saw the benefits of equal-weighting our stock allocations. We allocate our money based on the odds of success; when the odds are roughly equal within the stocks we are selecting, then their weightings should be equal too. We're not trying to mirror the market – we're aiming to beat it. (Note that individual stocks were bought with an equal weight at inception, but due to price changes over time current holdings are only closely weighted, not 'equal').

Why an All-Capitalization Stock Portfolio?

- We believe that investors would benefit the most from a straightforward investment approach that offers maximum upside potential in good market climates without getting trapped in the industry-centric labels of 'Value or Growth', or 'Large-Cap or Small-Cap'. Because we use a relative strength approach in our stock selection process, then whatever 'category' is trending favorably will naturally dominate within the portfolio. In other words, if value stocks are outperforming growth stocks, then the value names will push their way into the portfolio over time. If Mid-cap names are strong and Small- and Large-Cap stocks are weak, then Mid-cap stocks will be over-weighted in the portfolio. And when the trend inevitably changes, we will take notice and adapt accordingly.

Why a half Canadian, half U.S. Stock Portfolio?

- We wanted to avoid limiting ourselves to only Canadian stocks. Canada is a great market to invest in while commodity demand is strong – less so when it's weak (like the last few years). By designing the portfolio to be a 50/50 mix of Canadian/US holdings, we avoid the risk of being shut-out of the more profitable market (whichever it happens to be) without the need to make predictions or continual allocation changes.

- The Canadian stock market is quite narrow and lacks sector diversity. Roughly one-third of the Canadian stock market are Financials, and one-quarter are Energy and Materials (each) – the U.S. market, on the other hand, is widely diversified by sector and offers exposure to leading names in Technology, Health Care, Consumer and Industrials stocks that are not available to a pure Canadian equity investor.

Why the wide range in cash allocation (2%-100%)?

We have experienced two major market meltdowns (2000-03 and 2007-09) and we don't intend on riding down the next financial crisis, whenever it happens. We partner with other like-minded research firms to continually evaluate the health of the Canadian and U.S. stock markets all of which gave early warning to reduce risk during the initial stages of the last market collapse. We acknowledge that just because an indicator worked in the past doesn't guarantee it will work in the future. Suffice it to say that we would rather make the mistake of selling out of stocks as the markets roll-over, only to have it recover some weeks to months later and buy-back our positions at slightly higher prices, than making the mistake of NOT selling out of stocks when the markets roll-over and losing half (or more) of our client's money. As this is a discretionary fee-based account, there is no extra cost to our clients to do this. Sometimes it *is* better to be safe than sorry.

What is our investment philosophy?

- **Proactive:** We are impatient with our losers.

- **Trend following:** An investor's best odds of making money lies in aligning their investment dollars with the current positive trends, and sticking with it until the trend ends. We do not underestimate the madness of crowds and how long and high they can push an individual stock, or how low it can go.

- **All in or all out:** We continually measure both the price action of individual securities and the price action of the broad market itself. We apply disciplined investment criteria to each security within the portfolio and deem its performance to be acceptable or unacceptable. If a security's behavior turns unacceptable we sell it immediately. If the broad market's price behavior turns unacceptable we immediately reduce or sell all the positions within the portfolio (note that this is rare, triggering only three times in the last 15 years). In this manner we believe we can keep individual investment losses small and let our winners run, leaving room for high compound returns. It also addresses the most pressing concern of the majority of investors – "When should I sell?"

- **Stick with the winners:** The secret to good long-term performance is in avoiding large losses. Good performance over time comes from holding investments that perform well and to avoid the ones performing poorly. Knowing when to sell is the key to achieving good long-term results.

- **Nearly all**: We make no attempt to 'buy the bottom' or 'sell the top'. To do so is unrealistic, and our experience and testing has shown us that we are able to achieve above-average results by sticking with our winning positions; when they show signs of consistent weakness, they are sold and replaced with other potential market leaders. We aim to keep 'nearly all' the profits, and miss 'nearly all' the losses.

- **Identify the vital few:** Most of the big gains in your portfolio come from a few select winners, and most of the big losses come from a few select losers. Through the process of eliminating the weaker stocks and buying companies showing consistent outperformance, we are stacking the odds in our favor of capturing those positive outliers.

- **Beware "Too":** Underperformance is always a good reason to sell. Too many times we have seen investors buy stocks because they are down "too much", or are "too cheap". Beware the word "too" – it can be used as a justification to avoid the pain of doing the right thing – selling a loser. A loss is a loss, even if you haven't sold it yet.

- **Hope is not a winning strategy**: Our stock selection process is based on the strength of the security relative to the market – it's impossible to outperform the market in portfolios heavy with underperforming stocks. Holding on to these stocks costs you twice – once because of the continued losses and a second time because of the stress they are causing you. Stop hoping and sell.

- **Fact-Based:** We invest based on the reality of the present, not on what "might/could/should" happen tomorrow. Positive and negative trends in stocks and stock sectors can last years at a time – why not use those forces to your advantage? Keep things simple and align yourself with the trend.

- **Anti-Anticipatory:** When the facts change, so will we. But no sooner.

- **Security Agnostic:** When we invest in a stock, we believe we are investing with the best possible odds of success. However, it is never an emotional commitment – we know that we can earn above average returns even if we are wrong half the time – as long as we have the sense to cut our losses short and let our profits run. We are passionate about the process, not the securities themselves.

- **Prediction-Free:** We do not incorporate market forecasts, predictions, or analyst opinions into our investment process. Our belief is that for an investment tool to be useful it has to be reliable (or at least, more reliable than other alternatives), and we have yet to see anyone reliably predict the future. We have unfortunately seen more than a few investors suffer unnecessarily while clinging to misplaced faith in an 'expert' opinion or prediction.

On the Importance of Portfolio Management over Stock Selection

What is Portfolio Management? It is the process by which we manage the investment within the portfolio. The process is the key. For us, the four key elements of money management are:

1. Objective Investment Approach

For a long-term investment process to be effective, it has to be based on objectively determined indicators (i.e. measureable) and not gut emotion. It is very easy to get caught in a trap of 'imagining' a bottom or a top in a stock or a broad market, even when those beliefs are grounded in sound logic. However, markets aren't typically driven by logic. Stick with something measureable and turn off the TV – that's what we do, and our investors are far better off because of it.

2. Discipline

No investment approach is going to outperform over all time frames. There is no 'perfect' process. Although we are confident in what we do and how we do it, we recognize that there will be times when we underperform - when the investment choices we make don't work out. However, these are exactly the times when we find it critically important to stick with our discipline, as good times follow bad and it is the adherence to our process that will help our clients reach their Nirvana (or as close to it as possible).

3. Flexible

Just as important as being disciplined, is the ability to be flexible enough to follow what your process is telling you do, even though the reasons why may not be clear. The best opportunities to shed risk (at major market highs) or buy stock (at major market lows) are often emotionally difficult decisions at the time. It is only in hindsight that the reasons become clear (and by then, the opportunity is gone).

4. Risk-Averse

First and foremost, we are trying to avoid large losses. If we can avoid large losses, then we achieve our twin goals of eliminating investor anxiety and capturing above-average investment returns. Nearly all of the most successful professional money managers we've studied were obsessed with controlling their losses. We believe our investment process achieves this (controlling losses, not avoiding them) both on an individual security level and on the bigger picture, broad market level.

What to do next?

If the idea of building wealth over time without the full measure of market risk appeals to you, contact us by email at dcameron@pifinancial.com or jwoods@pifinancial.com or by phone at 1-877-405-2900, or visit our website at www.cameronwoods.ca .

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