FEBRUARY 2012 e-NEWSLETTER

COMING EVENTS

>StockTalk: February 11th , (Exxon-Mobile), March 10th, and April 14th at Christ Church United Methodist, 9 – 10:30am.

> ToolKit Mechanics – Applied ToolKit with "Hands-On" Computer Lab, February 25th, Colorado Christian University, 9am – Noon

> NEW: Applied ToolKit/SSG Lab – Hands-on Using Toolkit6, February 25th , Colorado Christian University, 1 – 4pm

> ToolKit – Beyond the Basics: March 17th, 9am to noon

> Supercharge Your SSG With Sound Judgment: March 17th, 1 to 4pm

> Spring Investors' Forum: April 28th, 8:30am to 4pm, location TBA

SPECIAL OPPORTUNITY ONLINE

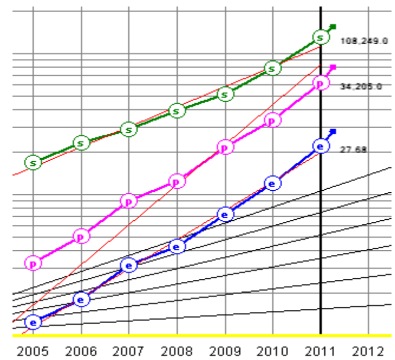
The Puget Sound Chapter will be holding all three of our "Core Classes" online in the winter of 2012. Each class is $25 which is a great bargain

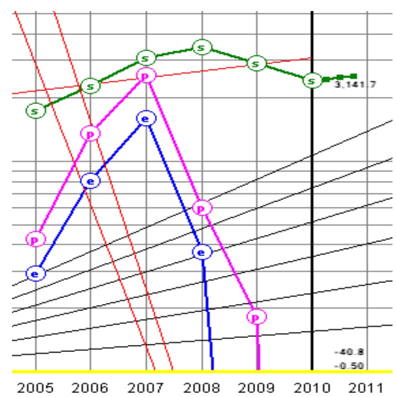
> SSG Judgment, Feb 7 (Tue), Feb 15 (Wed), and Feb 21 (Tue) from 6 – 8 pm MST with instructor Mike Torbenson. >

> SSG Portfolio Management, Tuesdays, March 20, March 27, April 3 from 6 - 8 pm MST with instructor Carol Theine

TALES FROM THE BRIGHT SIDE

"Up, Straight, and Parallel" is the Better Investing mantra for finding a great company. In Section 1 of the SSG, we want the three performance lines for Sales, Pre-tax Profit, and Earnings per Share to be rising steadily. A company with excellent historical performance is one to study further and if you think it can continue this great performance, you may have a good investment opportunity. These three key lines may not be perfectly parallel, but you should insist they be reasonably so. This Section 1 graph is an excellent example of the kind of growth we're looking for. Yes, it is rather ideal and you won't find this kind of opportunity very often, but make it your goal and if you can find the company at a good price, you will do very well indeed. On the other hand, this company is one you might want to avoid altogether.



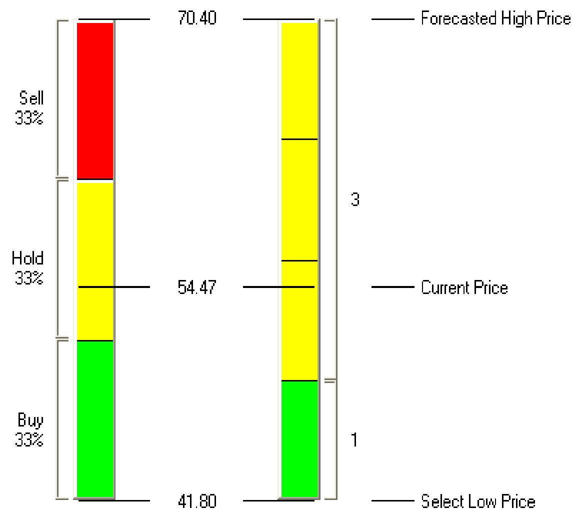


THE MARGIN OF SAFETY

Warren Buffett introduced the concept of the "margin of safety" when determining a buy price for a stock. Only buying a stock with a "margin of safety" protects us from the inevitable uncertainties in predicting the future. In the January newsletter we talked about how Morningstar calculates a "margin of safety" reflective of the uncertainty in the predictability of future performance. The greater the uncertainty, the greater the required "margin of safety".

Our SSGs treat the “margin of safety” idea a little differently. We calculate a range of stock prices over the next five years and divide that range into segments with the bottom segment representing the buy range. The top of that bottom segment gives the Upside/Downside (U/D) ratio. The more segments we have, the smaller the bottom segment and the greater the U/D ratio. Here is how it’s done.

We first project the low and high price of the stock as per the calculations



of Sections 3 and 4 of the SSG. Given a high and low PE range, a projected EPS growth rate, and the most recent TTM EPS, we readily calculate a range of stock prices over the next five years. We then divide that price range into segments. Years ago, we divided the price range into <u>three</u> segments. Today, it has become more common to divide it into <u>four</u> segments. **The buy price is at the top of the bottom segment**. We will consider buying the stock **ONLY** if the current price is equal to or below that buy price. Dividing the range into three segments, the top of the bottom segment gives us a U/D of 2. That simply means that two of the three segments are above the buy price and one segment is below, hence 2 to 1. Similarly, if we divide into four segments the top of the bottom segment marks the point with three segments above and one segment below the buy point, hence a U/D of 3 to 1. Note that as we divide the price range into additional segments, the top of the bottom segment is less and the U/D ratio is greater. This gives us a greater “margin of safety”.

Some companies are less predictable and riskier than others and our buy price should reflect that fact. Let’s work through an example of pushing up the U/D reflective of the degree of uncertainty in our stock.

Using Morningstar’s uncertainty ratings, we find that Chevron (CVX) is given a “low” uncertainty while Apple (AAPL) is given a “high” uncertainty reflecting higher risk. It may be reasonable to buy CVX at a U/D of 3 by dividing its price range into four segments. But perhaps we should demand a higher U/D for AAPL because of the increased risk. It may be prudent to divide the AAPL price range into six segments instead of only four. Let’s see what the difference will be.

Assume the high and low projected prices for AAPL are $971.60 and $358.10 for a range of ($971.60 – $358.10) = $613.50. Dividing that range into only four segments gives us $613.50/4 = $153.38 per segment. So the buy point is $153.38 + $358.10 = $511.48 for a U/D of 3. If we divide the range into six segments because of the increased risk, we get $613.50/6 = $102.25 for a buy price of $102.25 + $358.10 = $460.35 and a U/D of 5. We lowered the buy price for a greater “margin of safety” because of the risk.

<u>WORDS OF WISDOM</u>

“*Price is what you pay. Value is what you get”* – Warren Buffett