JANUARY 2012 e-NEWSLETTER

COMING EVENTS

>**StockTalk:** February 11th, March 10th, and April 14th at Christ Church United Methodist.

> **Introduction to Investing:** January 14th, 9 to 11am

> **Stock Selection Guide (SSG) – Learning the Basics:** January 28th, 9am to 4pm

> ***NEW*: ToolKit Mechanics** – Applied ToolKit with "Hands-On" Computer Lab, February 25th,

> **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

ONLINE EVENTS

> **$12 – How to Use Value Line,** January 12th, 6:30PM

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 Introduction**, Tuesdays, January 10, 17, and 24 from 6 – 8pm MST with instructor Jim Thomas

> **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

WORDS OF WISDOM

"The American Republic will endure until the day Congress discovers that it can bribe the public with the public's money."
- Alexis de Tocqueville (1840)

TALES FROM THE BRIGHT SIDE

"In the December 2011 issue of the *Hulbert Financial Digest*, we were delighted to learn that the *Investor Advisory Service* has been named for the third consecutive year to Hulbert's 2012 Investment Newsletter Honor Roll.

What's more, of the nine newsletters included on the 2012 Investment Honor Roll, *IAS* has posted the largest annualized gain, returning 11.4% a year on average since August 31, 1998.

When it comes to providing greater returns than the market during both bull and bear cycles, no other newsletter can match the *IAS* record, making it the #1 newsletter for consistent long-term performance in the U.S.

For comparison, during the same period since August 31, 1998, the Wilshire 5000 Index earned just 4.6%.

The Investment Newsletter Honor Roll includes only those publications that can claim a track record of outperforming the overall market during both up and down periods. Since first becoming eligible for the accolade in 2010, *IAS* has now been included as an Honor Roll Recipient for three consecutive years.

Of the nine newsletters named to the 2012 Investment Newsletter Honor Roll, just six returned from the 2011 list, including the *Investor Advisory Service*. Fewer than 10% of the newsletters tracked by the *Hulbert Financial Digest* qualify for the Honor Roll each year, whereas if newsletter performance was randomly distributed then 25% should make the grade. According to Editor

Mark Hulbert, "This…suggests that making it onto the Honor Roll really means something." "

Note that the folks at IAS apply the principles taught by Better Investing and complete an SSG for every stock they recommend. If they can do it, so can you. But you must learn the principles well and apply them rigorously. Discipline counts!

THE MARGIN OF SAFETY

Predicting the future is fraught with difficulties since the unexpected often becomes reality and the data isn't always accurate nor does past performance predict future performance well. So our friend Warren Buffett introduced the concept of the "margin of safety" when determining a buy price for a stock. One can do the most conscientious job possible in assessing a company's future performance by looking at its past and making educated guesses about the future economic setting, management performance, and continuing customer interest. The analysts at Morningstar link their margin of safety to their assessment of a company's future performance predictability. This is a judgment call for sure, but it helps to keep one from overpaying for growth which is a common problem for all investors, especially when caught up in a wave on enthusiasm for a stock.

Morningstar calculates a "fair value" for a company's stock based upon a sophisticated free cash flow discount model. Then they assess how well they believe the model actually predicts future performance assigning an "uncertainty" grade to the stock. They then discount the fair value by a certain amount dependent upon that uncertainty. For example, the analyst for Chevron (CVX) believes that the model is quite accurate and reflects a "low" uncertainty. Morningstar then recommends a buy price 20% below fair value for CVX. Currently, the calculated fair value is $116 and when reduced by 20% we get the recommended buy price of $92.80 (116 minus 20% of 116). On the other hand, Apple (AAPL) is currently given a "high" uncertainty which requires a 40% discount. Currently the AAPL fair value is $530 which implies a buy price of $318 which is 40% below the fair value. The higher the uncertainty, the greater the margin of error discount percentage.

Our SSGs come at the problem from a somewhat different perspective in that we calculate a predicted range of stock prices over the next five years and divide that range into four segments with the bottom segment representing the buy range. The top of that bottom range gives an U/D ratio of 3. Most people just use that ratio not realizing that it is just the mechanical calculation built into the SSG. But does it make sense to buy both CVX and AAPL at a U/D ratio of 3 even though the uncertainties are very different? Probably not! It might be more sensible to buy low uncertainty CVX at a U/D of 3 and high uncertainty AAPL at a U/D of 6. In the February eNewsletter, we'll show you how to make the necessary calculation.

But what about the margin of safety calculation done by Buffett and Morningstar? Can we do the same calculation using SSG data? Yes, we can! Our SSG "fair value" is just the stock price where the U/D ratio is 1. Add the projected high and low stock prices and divide by 2. Voila, you have the SSG fair value which you can discount to get a recommended buy price a la Buffett and Morningstar!