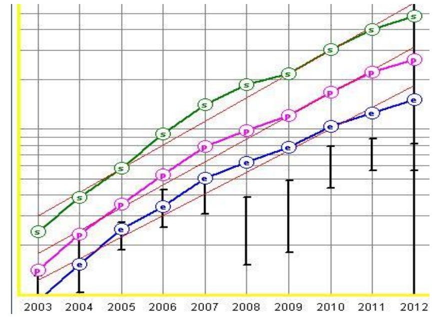
FOURTH QUARTER (OCTOBER – DECEMBER) 2014 eNEWSLETTER



UPCOMING EVENTS AND CLASSES:

- Fall 2014
  - Investor Forum, October 11, 9am – 4pm, Colorado Christian University (CCU), New Academic Building
  - Beginning ToolKit and Lab, October 18, 9am – 3pm, CCU
    - Lab Only, October 18, 1 – 3pm
  - SmallTalk Webinar, October 21, 7 – 8pm
  - Judgment on the SSG, November 15, 9am – 4pm, Christ Church United Methodist (CCUM)
  - SmallTalk Webinar, November 18, 7 – 8pm
  - Advanced ToolKit and Research Tools, November 22, 9am – 3pm, CCU
    - Research Tools Only, November 22, 1 – 3pm
- Spring 2015
  - Introduction to Investing, January 10, 9am – noon, CCUM
  - Introduction to the Stock Selection Guide (SSG), January 24, 9am – 3pm, CCUM
  - Beginning ToolKit and Lab, February 7, 9am – 3pm, CCU
    - Lab Only, February 7, 1 – 3pm
  - Advanced ToolKit and Research Tools, March 14, 9am – 3pm, CCU
    - Research Tools Only, March 14, 1 – 3pm
  - Portfolio Management, April 4

Class and Event Location Addresses

Christ Church United Methodist (CCUM) 690 Colorado Blvd, Denver Co 80206	Colorado Christian University (CCU) 8787 W Alameda Lakewood, CO 80226

AMAZING FACT

"When we took over Berkshire, gold was at $20, and Berkshire was at $15. Gold is now at $1,229 and Berkshire is $205,635 as of September 14, 2014." – **Warren Buffett, CEO of Berkshire-Hathaway.**

WORKING TOGETHER

The Rocky Mountain Chapter board of directors see their main duties as 1) supporting clubs and individuals, and 2) providing quality education for everyone. All directors are unpaid volunteers who want to “give back” for the support they’ve received in the past.

The board meets monthly over the internet using GoToMeeting. But the chapter has the special challenge of providing for a membership spread across Colorado, Utah, Wyoming, and the northern 2/3 of New Mexico. If you live in one of these areas, please volunteer to become a contact for those in your area. For more info email our chapter president.

THE EXCHANGE TRADED FUND AND THE INVESTMENT CLUB – PART 1

The very first mutual fund was an investment trust launched in the Netherlands in 1774. For the first time, smaller investors could invest in a basket of stocks at a reasonable price and enjoy the benefits of risk reducing diversification.

The first mutual fund in the US was the Boston Personal Property Trust formed in1893. It was organized as a “closed-end” fund. A closed-end mutual fund sells shares in the fund with an initial public offering (IPO) and then uses the money raised to buy stock in a number of companies. Fund shares are traded just like common stock and are sometimes confused with the newer exchange traded funds. Closed-end funds are still popular today but not nearly as popular as the modern “open-end” mutual fund. The capital value of a closed-end fund can differ substantially from the underlying capital value of its investment portfolio and that is a problem for many.

The advantage of the open-end fund is that the capital value of the fund exactly matches the value of the underlying portfolio less expenses. Our investment clubs are organized along the lines of the open-end mutual fund.

People like the fact that the closed-end fund trades just like stock, but they don’t like the fact that the capital value of the fund is typically less than the capital value of the underlying assets. On the other hand, they like the open-end fund since it matches the value of the underlying assets almost perfectly, but it isn’t traded like a stock and many consider that as a draw-back.

Enter the modern day exchange traded fund (ETF) which trades like a stock and uses an arbitrage mechanism to track the value of its underlying assets very closely while keeping management fees low. For the arbitrage mechanism to work, the fund portfolio must be totally transparent. In short, the ETF combines the best features of the closed-end and open-end mutual funds at lower cost. But you do have to pay a brokerage fee just like you do when you trade common stock. As with any ordinary stock, you must also watch the bid-ask spread and liquidity.

Why might a club be interested in ETFs? There are ETFs covering domestic stock, foreign stock, emerging markets, bonds, currencies, etc. just like regular mutual funds. You can even use ToolKit to value an ETF which we’ll cover in a later newsletter. There are capital weighted ETFs and fundamental ETFs. Again, unlike actively managed mutual funds, the ETF portfolio is of necessity completely transparent and open. You know exactly what stocks are in the ETF portfolio at all times.

In coming quarterly newsletters, we'll learn more about ETFs and the role they may play in your club.

BRINGING MEMBERS AND CLUBS TOGETHER

The SEC prohibits the chapter from actively helping clubs and members to get together. So the following information is not a solicitation or recommendation.
Clubs looking for members: If your club has openings for new members, one good way to let others know is to list your club on the chapter's Find-A-Club roster. To list your club, just send an email to contact@rmchapter.org with the following information:

- Meeting location; dates, times
- Club composition (all male or female; mixed)
- Name of club
- Contact name and email address
- Alternate contact name and email address

Visit the chapter's Find-A-Club webpage for more advice on how to connect with members looking for a club.
Members looking for clubs: If you are a BI member and would like to consider a club, the chapter maintains a list of clubs open to visits. The decision to visit or join a club is strictly between you and the club. The Rocky Mountain chapter makes no recommendations one way or the other.

DOGS OF THE DOW

The Dow Jones Industrial Average (DJIA) is a stock market valuation metric based on the stock prices of thirty industrials. It was first calculated by Wall Street Journal co-founder Charles Dow and statistician Edward Jones in 1896. Today, the DJIA is maintained by Dow Jones & Company and contains 30 of the largest and most influential companies in the US.

The Dogs of the Dow is a very simple investment strategy popularized by Michael Higgins in 1991. According to the strategy, an investor selects the ten highest yielding stocks from among the DJIA industrials and creates an equally weighted portfolio. Then each year, usually the end of December, the portfolio is adjusted to contain the current ten high yield stocks by selling those no longer meeting the criteria and adding those that do.

The rational for this strategy is that the DJIA list of thirty companies contains only companies with strong fundamentals such that the dividend yield reflects the valuation. A high yield points to a good stock at a good price just as a low P/E does and for the same reason. By only investing in the Dogs of the Dow, one invests in good companies at a good price. By adjusting annually, one keeps a portfolio of ten good companies purchased at a good price.

What really makes this strategy especially interesting is its general compatibility with BI teachings and its utter simplicity. Dow Jones & Company watches the fundamentals and the investor only has to consider the yield.

But does it work? Is it just too easy to be believed? Well, there is an exchange traded fund (actually an exchange traded note), DOD, that has followed the Dogs of the Dow strategy since late 2007 and we can see how it has fared in this graph.

You can see that over this period, DOD outperformed the S&P500. DOD is up 51% while the S&P500 is up only 37%, an outperformance of 38%. But also note that the S&P outperformed DOD from late 2007 to mid-2011, so DOD hasn't always outperformed in all time periods.

WORDS OF WISDOM

"Some academics, citing the Modigliani-Miller theorem, argue that it doesn't matter whether a company pays a dividend. A company that holds back earnings, they claim, clearly has good investment opportunities to further grow profits. However, a 2003 paper by Robert Arnott and Clifford Asness showed that, contrary to common wisdom, higher dividend payouts predicted increased earnings growth for the aggregate U.S. stock market. A 2006 study on 11 countries also showed the same relationship, though it was weaker. Ping Zhou and William Ruland found in a 2006 study that high dividend payouts predicted strong future earnings growth among individual firms. The broad sweep of evidence strongly supports the idea that dividends enforce discipline on managers who may otherwise binge on empire-building. Further poking holes in efficient-market thinking is the fact that dividend-paying stocks have outperformed non-paying stocks in almost every market studied, with lower volatility." **- Samuel Lee, Morningstar**

Figure 1. **Rising Dividend Stocks Outperform Every Other Stock**
Total Return 1972 - 2013