Buy Strategy Given Current Market Volatility

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The Elite LWM East-West Value Fund was launched on December 1st 2008 and began purchasing stocks in January 2009.

Prior to the Fund's launch, we were extremely cautious about global economic fundamentals. Today we remain so. Accordingly we have adopted a purchasing strategy designed to enable us to gradually build towards full investment whilst significantly reducing risk.

(*See http://www.loweswealth.com/pdf/Our_New_Year_Outlook_January_2009.pdf for details.).*

To achieve this, we are employing two complementary approaches. This combination allows us to both reduce and exploit ongoing volatility, with the goal of building long-term positions in tremendously undervalued companies, positions that we intend to hold for the long term.

1. Pound-Cost Averaging

The first approach is to use pound-cost averaging. Each month we purchase, on average, 1-3 stocks that we have reviewed and that we consider offer unmissable value. These are companies that our research says have no risk of bankruptcy. For us, the risk associated with purchase is not that we buy too early and a company falls further before recovering, but that the stock price appreciates massively and we miss an opportunity to buy at an incredible price.

An example of such a stock is Canon from Japan. At the time of purchase, Canon was available at the same value as its net tangible assets. It offered strong and resilient earnings, a dividend of nearly 5% and almost zero debt. Its price and ratios were vastly lower than its average historical levels. We bought Canon in anticipation of a long-term rise that could be in the hundreds of percent, whilst at the same time having the security of a near 5% dividend yield. Its miniscule debt and the strength of its cash holdings and revenue streams meant that, even should global macro conditions deteriorate further, the company would not only survive, but would be in a position to grow its market share at the expense of its weaker competitors.

2. Selling Puts

The second approach involves writing (selling) puts on 1-3 stocks per month. This means that we guarantee that we will buy these stocks for a defined period (typically 3-6 months) at a price some way below the current market price (typically 10-30% below the current price).

These are stocks that we have reviewed and consider excellent value, but for whatever reason we are not prepared to purchase them at the current price. Reasons for this could be that we feel that the price could easily fall further given current market conditions, or that we already have exposure to this sector and do not want to increase our exposure at the current price level.

When we write a put we are paid a premium for providing the guarantee. This premium is typically 5-25% of the current stock market value. The greater the volatility in the price of the stock, the higher the premium that we will receive.

A good way of explaining this strategy would be to equate it with buying property. Assume that, on the basis of extensive research, you decide that a property on the market is undervalued and will provide good long-term capital appreciation plus a solid rental income. However, you think that the housing market might fall further before bottoming out. You therefore decide to sell the owner of the property a guarantee that, if the price of the property falls a further 20% during the next 6 months, you will buy at that reduced price. (And your research says that at this reduced price, you would be getting the property at a fire sale price.). But in return for providing this guarantee, you are paid 10% of the property's current market value.

It is critical to bear in mind that we only write puts on stocks that we would be delighted to purchase at the strike price. Also, that once purchased, we intend to hold these stocks for the long term.

Disney offers a good example of a stock for which we have written a put.

We reviewed the stock at $18.76 and felt it offered exceptional value. However, we felt that there was too much of a risk that it could fall further given the current climate. We therefore wrote (sold) a put on Disney at $12.50 expiring in October. This means that from now until October, we guarantee that we will buy Disney at $12.50. Our research tells us that Disney's revenue will be affected by the current situation, but that the company itself is solid and has no risk of bankruptcy.

We received $1.25 per share for providing the guarantee (which was equal to approximately 6.5% of the share price at the date of review.). To us, this is a win-win situation. If Disney falls to below $12.50 we will have to buy the stock at $12.50. But our research shows that at $12.50 we would be buying a great company at an

unbelievable price. (And our net price would be even less as we received the options premium of $1.25). If we do not pick up Disney we still get to keep a 6.5% premium that has been earned in only 6 months.

Impact of Buying Strategies

By combining the above two approaches we move gradually into the market whilst reducing the overall level of risk to our investors. If markets fall further, the cash that we hold (plus the dividends and options premiums that we receive) will dramatically reduce losses to our clients.

If markets are horizontally volatile, the dividends and options premiums are likely to mean that we outperform (with lower volatility).

If markets rise strongly (we believe any rise will be short lived as it will not be sustainable) then we will lag but the dividends and options premiums (plus capital appreciation on the stocks that we have purchased) should still mean that we achieve positive returns.

The success of this strategy can be seen when comparing our performance in since we began trading with global markets. We have outperformed the MSCIW with much lower volatility.

Depending on how events unfold, we would anticipate that we will become fully invested within 5-9 months. We believe that this makes the Elite LWM East-West Value Fund ideal for investors who are looking to take advantage of the turmoil affecting global markets but who feel that putting all of their money into the market at this time represents too high a risk.

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