THE SUCCESSFUL INVESTOR

JULY 2015

Semi-annual letter

In this letter

The World's Greatest Investment

Capitalism has been and continues to be the best economic system in raising the standard of living for the people around the world.

While there are many ways to measure this, one way is to look at world population growth.

The World Population has ballooned to roughly seven billion people and has experienced most of the growth in the past several hundred years which coincides with our country's existence.

Technological advancements across all industries have contributed to increasing the sources of food supply to feed the world and has delivered health care to the remote areas of the world.

The way we get to invest in Capitalism is by investing in the publicly traded companies of the world. These companies have lead the way in driving the technological innovations we see in our daily lives.

These companies are managed and operated by real life people with families who have monetary incentives to produce great products and provide great services.

Even while doing so, they are the most regulated and audited companies in the history of the world which is a bonus for us as investors.

The result of their relentless pursuit is that as investors we get to share in their profits in the form of dividends and capital gains.

In our portfolios, we own over 12,000 publicly traded companies around the world residing in forty-four (44) different countries. We own the global economy with the U.S. Economy leading the way.

The Science of Investing

It is the search for truth. Knowledge comes from rigorously testing ideas and data so that it can be used for our benefit.

With the advent of the computer in the 1960s, academic researchers have been able to apply the scientific method to investing as well.

While being unable to determine a predictive system to accurately forecast security prices, researchers have been able to document statistically a collection of knowledge that empowers us to build portfolios to help us retire, educate our kids, and build wealth.

R.J. CLOUD Tel 918-665-0826 randy@legacyadvisor.net

THE SUCCESSFUL INVESTOR

JULY 2015

SEMI-ANNUAL LETTER

There are four principles we use to build your portfolios.

PRINCIPLE # 1 -- MARKETS WORK: Avoid Speculation, Marketing Timing, and Stock Picking

Today's securities prices reflect all publicly known information and opinions of all investors around the world. Superfast computers and networks make this our reality as investors.

Today's prices reflect the opinions and forecasts of 1) what tomorrow holds for the economies of the world, 2) what the Federal Reserve will do with interest rates, 3) the future of individual companies, 4) the likelihood and the outcome of government failures, and 5) the possibility of a Hollywood version of an epic global destruction of mankind.

The point is this, when one believes he or she knows something that others do not, he or she is betting against the millions of investors around the world.

PRINCIPLE # 2 -- RISKS AND RETURN ARE RELATED: Ownership, Company Size, Market Price, and Profitability Matter

Statistically speaking, academic researchers have found that portfolio returns are driven by the percentage of investment that the portfolio has in certain groups of companies.

In other words, investors can earn higher returns in their portfolios by allocating greater percentages to certain categories of companies.

Companies can be categorized into groups based on 1) their offer to us to be an owner or lender to them, 2) their size, 3) the price of their stock, and 4) profitability.

The tradeoff for higher returns is that investors must accept greater volatility or change in market value from month to month and year to year.

Market Premium: Stocks outperform Bonds

Being an investor in a company (owning their stock) rather than being a lender (owning their bonds) to a company provides greater investment returns over time.

Size Premium: Small Companies outperform Large Companies

Small companies as a group outperform large companies as a group from an investment standpoint over time. Using a banking analogy, who presents more risk generally speaking to a banker of not repaying a loan? The small company is less likely to repay so the banker demands a higher return by charging a higher rate of interest.

R.J. CLOUD TEL 918-665-0826 RANDY@LEGACYADVISOR.NET

Value Premium: Lower Price Companies outperform Higher Price Companies

Value Companies as a group outperform Growth Companies as a group from an investment standpoint over time.

Value companies are ones whose stock prices are depressed and out of favor with the public. We can buy these companies at deeply discounted prices.

Profitability Premium: Higher Profit Margin outperform Lower Profit Margin

Whether companies are large or small, lower price or higher price, U.S. or International, those who are more profitable provide greater investment returns over time.

PRINICIPLE #3 -- DIVERSIFY BROADLY AND GLOBALLY

Academic researchers have asked the question, “Is it better to own a small number of companies or many companies in a portfolio?” Owning many companies means to <u>Diversify Broadly</u>.

Intuitively, the question can be answered with other questions if answered honestly, “Can you as a public investor control the technology of any one company or industry, or the timing of the change of the technology within an industry, the honesty and integrity of any one company’s management to report its financial statements truthfully, the quality of any one company’s products or services, and/or the ability of anyone company’s management team to manage its cash flow?”

The obvious answer to this question was documented in the earliest statistical academic research in the 1960s by Harry Markowitz.

He demonstrated statistically that investors can own a portfolio consisting of a large number of companies that would generate a better than or equal to return at a lower level of risk as compared to a portfolio with fewer companies.

In other words, company specific risks can be diversified away.

<u>Diversifying Globally</u> is to invest in the companies around the world being indifferent as to specific countries.

It means to own all the companies in Europe, Australia, and Japan while also including countries who are emerging in Asia, South America and the Far East.

Not only will <u>Diversifying Broadly and Globally</u> help you to pay for your retirement years, it will deliver peace of mind and help you sleep better at night.

PRINCIPLE # 4 -- INVESTOR DISCIPLINE

Many people struggle to separate their emotions from investing. Markets go up and down. Reacting to current market conditions may lead to making poor investment decisions at the worst times.

THE SUCCESSFUL INVESTOR

JULY 2015

Semi-annual letter

Daily market news and commentary can challenge your investment discipline. Some messages stir anxiety about the future while others tempt you to chase the latest investment fad.

When tested, consider the source and maintain a healthy long-term perspective.

Winston Church was quoted as saying "The further we look back, the further we can see ahead."

In spite of world wars, natural disasters, economic recessions and depressions, famine, disease, threat of nuclear destruction, presidential assignations, civil war, Capitalism continues to survive and prosper.

A Moment In History
The Energy Crisis: 1913 to 1920

The period from 1913 to 1920 was a difficult one. The First World War began in August 1914 which eventually took the lives of an estimated 13 million people. The war was the first that involved men using machines to kill one another. Motorized vehicles including tanks allowed the armies to motor about.

With the advantages of using motorized vehicles, the emerging oil industry took center stage. Soon after the beginning of the war, the fear of running out of oil became a national concern among all the countries involved in the World War. The price of oil doubled during the course of the war resulting in producers holding back reserves believing in higher prices. Mexico supplied approximately 20 percent of our country's demand during World War I (Daniel Yergin, The Prize)

Daniel Yergin wrote that the American oil industry and many in government became gripped by the fear of depleting U.S. oil reserves. He noted the fear turned into an obsession toward the end of WWI and into the 1920s. During the war, the common phrase "gasolineless Sundays" depicted the time accurately. President Woodrow Wilson commented "There seemed to be no method by which we could assure ourselves of the necessary supply at home and abroad."

Observers believed American consumption of oil had increased by 90 percent from 1911 to 1918. From 1914 to 1920, the number of registered automobiles increased from 1.8 to 9.2 million. One U.S. Senator asked the U.S. Navy to reconvert its ships from oil back to coal. This statement highlights the knee-jerk tendencies of public sentiment when faced with uncertainty.

In the U.S., severe winters in 1917 and 1918 caused the U.S. to additionally fear running out of coal. The shortage extended to the point where the Fuel Administration ordered all industries east of the Mississippi River to close for a week in 1918 to allow coal ships on the east coast to be loaded so the nation could re-supply our troops in Europe. Subsequently, all industries were ordered closed on Mondays to conserve coal supplies.

With shortages in oil and coal, the poor and rich alike lived through hard times. Not surprisingly, Colonel Edward House who was President Woodrow Wilson's political adviser commented that "Bedlam broke loose. I

R.J. CLOUD Tel 918-665-0826 randy@legacyadvisor.net

have never seen such a storm of protest." The Prize, Daniel Yergin, pg. 163.

In due course and being a common thread in U.S. History, the war ended and was followed by the Roaring Twenties, a time of economic prosperity for the United States.

The public fear of running out of oil was just that and not reality. A continuing story in our country's history is that when faced with problems, people develop new technology to solve problems and are rewarded.

FINAL THOUGHT

For the public, fear and greed drive their behavior spurred by forecasts which ultimately result in losses and missed opportunities.

For us, statistical data and financial economic science drives our behavior enabling us to have a Successful Investment Experience.

Peace of mind comes from knowing wherever and whenever capitalism manifests itself, we will be there to capture the investment returns and build growth in your portfolios by being Broadly Diversified Globally.

Disclosures

This investment letter is for Investment Education Purposes only.

Past performance does not guarantee future results.

Diversification does not eliminate market risk. General investment risks includes fluctuating market value. International investing involves special risks such as currency fluctuation and political instability.

The reader should not believe the phrases "The Successful Investor" and "Successful Investment Experience" mean the absence of volatility. In fact, the phrases imply there is a direct relationship between risk and return. Without risk, there is not a possibility of positive returns. There is volatility and risks inherent with a Successful Investment Experience.

R.J. CLOUD Tel 918-665-0826 randy@legacyadvisor.net