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RISE & FALL OF MUTUAL FUNDS – BY MARTIN TAYLOR

Index

1. **DEVELOPMENT OF MUTUAL FUNDS**
2. **FUNDS NOW FAILING**
3. **RISE OF PORTFOLIO MANAGEMENT**
4. **OUR SOLUTION FOR YOU**
5. **MARKETS CURRENTLY AVAILABLE**
6. **STOCK SELECTION – POLICY AND OBJECTIVE**

1. DEVELOPMENT OF MUTUAL FUNDS

In Europe during the 1930's investors wanted a secure means of obtaining the returns available from the sharemarket. Individual investors often had insufficient expertise, time, money, or information to secure, and get the most out of their investments.

In 1933, a Dutch company, Robeco, came up with the answer. By pooling the investment monies available from many individuals, a wide spread of portfolio investments could be obtained to minimize the unavoidable risk in any investment. Reputable, properly licensed firms would be engaged to hold assets securely. A skilled professional would be engaged as Fund Manager to maximize returns to investors. Individuals could add to, or withdraw from, their investment at will.

Thus the Mutual Fund was born. Since the original in 1933, the concept has come a long way. Equity funds, as an example, have proliferated internationally, and with consistently reasonable performance over time, investors have been attracted in many millions. In the UK there are several thousand funds – called unit trusts. In the USA there are many thousands called Mutual Funds. There are now many variations of the original fund to cater for investment into equities, bonds, fixed interest, currency, forex, property and many other asset classes.

The major players in these markets are insurance companies, banks and a few large independents. In earlier days the insurance companies, perceiving the possibility of independents taking a major slice of pension funds, made a huge effort to capture the biggest share of this new market. They used their sales force, who were used to receiving large commissions at the expense of clients, to attract and maintain both new and existing clients. These sales people often had limited knowledge to advise clients upon investing.

With the passage of time education about investing did improve but still advice was clouded by the drive of the sales people to get another commission. The banks, with a minimum of training of their branch staff also set themselves up as investment fund managers and used branch staff to talk investors into putting large sums of money into the funds operated by each particular bank. The independents, faced with the highly organized sales efforts of the banks and insurance companies were forced to look for the highest commissions available to them and often gave their clients advise based more on the commissions than on investment performance. The most successful independents were quickly "bought' by the larger funds.

2. FUNDS NOW FAILING

As time passed, the mutual fund industry grew much larger, with the occasional scandal blotting their copy books and attracting the attention of regulators around the world. With new regulations, into which the insurance companies and banks had input, it was found that these 2 groups grew even stronger because they have the resources to cope with the ever increasing regulatory costs. The red tape that funds are contending with is now at the point of choking the funds. There is a squeeze. The declining profit margins are soon gobbled up by rising costs.

The funds perform no better (and often much worse) than the indices they are measured against. The managers are afraid to really manage fund money, or step out of line with their opposition by boldly looking at under-lying fundamentals and using the many techniques available to them. They must follow the herd because they serve the even bigger herd. So, in spite of the hard sales talk, mediocre fund performance means total funds under management just mark time and thinking investors look for alternatives.

The global financial crisis hit many mutual funds quite hard. Many are still in the process of recovering with several years of investment return still trying to recover the pre GFC position. The hardest hit are those investors who rely on the funds for their superannuation both today and tomorrow.

3. RISE OF PORTFOLIO MANAGEMENT

About the time that mutual funds began the super wealthy had already developed what became known as Family Offices. They employed the best brains available to take full care of their own family assets and investments. As employees working for the family there was no need to comply with any of the red tape that mutual funds subsequently attracted. Costs were lower. When you add the lower costs to the better performance you get a vastly superior end result. The rich do indeed get richer. This situation has still not changed. The superior returns are still available to family offices.

In more recent years as fund costs have risen, more money has been directed to family offices until today they have become a significant part of the market. The question is "How can the method and results become available to even more investors?" The answer is quite simple. Instead of the family office looking after one family they look after a relatively small number of medium wealthy investors. Each investor has his / her own portfolio tailored especially to that investors needs. To be sure, each investor has their own bank accounts and probably a simple investment structure in which to hold assets. The portfolio manager and the administrator usually have Power of Attorney to properly manage the assets but they do not usually have the authority to withdraw any of the assets from the portfolio. This structure is to prevent the possibility of assets being stolen or otherwise used by the employees. With higher returns accruing to the investors they have been able to reward their employees in a way that Mutual Funds do not. The higher rewards have in turn attracted the best fund people to portfolio management. With portfolio management everybody wins!

4. OUR SOLUTION FOR YOU - PORTFOLIO MANAGEMENT OFFICE

Realizing that the Family Office portfolio management structure is likely to attract ever increasing numbers we have decided to offer our services to those investors who have a minimum of US$10,000 (or equivalent) in money available to invest in international equities that meet our high standards. We will call this your PORTFOLIO MANAGEMENT OFFICE. Martin Taylor has an existing portfolio that is using services of Clegg & Mopitt. He has converted this portfolio into a series of funds by creating weekly unit prices for the individual funds. He has now opened these up to other private investors to enable you to use these services previously called Family Office but now developed for your use as your own PORTFOLIO MANAGEMENT OFFICE. This is possibly a worlds first and you can benefit from it. Oh, and by the way, technically we are employed you to look after your investment and as employees we do not have to comply with the myriad of red tape that reduces your return.

5. CURRENT MARKETS AVAILABLE

Currently available are the short / medium term equity trading funds originally called The Edge. These are available now covering the following listed markets:
USA and Canada
China – both Hong Kong and Shanghai markets
Australia
Singapore
Malaysia
Philippines
Indonesia
Thailand
Asia & Emerging Asia
Global

We also have access to about another 20 markets but presently we stay out of them for a variety of reasons that are kept under review.

6. STOCK SELECTION – POLICY AND OBJECTIVE

Our objective is very simple – to outperform the market as measured by the appropriate indices. To do this we must spot winning trades earlier and have a sound exit strategy.

Once we determine we are operating in an up trending general market, we select the superior stocks. Potential winners will have strong earnings and sales growth, increasing profit margin and high return on equity. They also should be in a leading industry group. This is the first filter. We then gauge the following parameters to find the potential winning stocks: price, volume, momentum, up trend, shorter term trading.

The only way to make trading profits is to predict future events that have a better than 50% probability of coming true. When we speak about the future, we are in the world of probabilities. No strategy is 100% correct. By filtering those with the greatest strength we exceed the 50% probability.

Stocks rising on unusual volume

Volume is a valuable trading filter that can be used to confirm the price trend of a stock. Prices do not move without buyers and sellers. Volume flow precedes price and is the key to measuring the validity and sustainability of a price trend. What constitutes the momentum is the heavy volume trading by big institutions. Since the pros take weeks or even months to complete their buying, we have time to move in.

Momentum trading is holding a fast-rising stock for a few days, weeks, or months. It is a strategy where we try to capitalize on a stock's trend in the expectation of it rising further.

THE TRAILING STOP STRATEGY

In the stock market, you must have a strategy that makes you methodically cut your losses and lets your winners ride. If you follow this rule, you have the best chance of outperforming the markets. Our advice is to follow this simple plan: We ride our stocks as high as we can, but if they head for a crash, we have our exit strategy (a trailing stop) in place to protect us from damage.

The main element to the trailing stop strategy is a 25% rule. We will sell positions at 25% off their highs. For example, if we buy a stock at $50, and it rises to $100, when do we sell it? When it falls back to $75? Or 25% off our high?

If you do hold onto a falling stock too long, the loss will often be far more than just 25%. And all it takes is one big loss to set an investor back for years.

Let's say you start off with $10,000. A year later you've made 25% ($12,500). For the next year you move $15,625 and the following $19,530. But then after three years of 25% annual gains, the fourth year, you take a loss of 50%. It puts you back below where you started, at $9,766.

Now, let's say you had a 25% trailing stop during the year you lost 50%. You would have been stopped out at $14,648. Then during the following three years (when you again profited by 25% each year), your holdings would be $28,600 at the end of that entire seven-year stretch.

However, if you didn't have a 25% trailing stop in place, after the same seven-year period, you would only have $19,073, still below where you were prior to the 50% drop! Over the seven years of this example, you'd be up 186%. That's an average return of over 26% per year.

TIME CONSUMING

To carefully and methodically search for suitable stocks to buy, purchase them, monitor daily, prepare each on-line live portfolio, and generally take care of all individual portfolio's is extremely time consuming. There are no short cuts to these procedures. They have to be attended to in an orderly disciplined manner. In addition trained back up staff to attend to all procedures is essential to protect our clients' interests. We do all of these things. If you consider that you can perform to this high standard you are free to adopt our strategy. Realistically, you know that you are better served by getting the experts to do it.

At the end of each quarter, assuming that we have done everything correctly (and you, our client, has prospered) we will be adequately paid.