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CastleMoore Investment News

Uniquely Superior Portfolio Management

The Day the Reporter Called Me

By
Ken Norquay,
Partner

Newspaper reporters are an interesting lot. Their job often is to make something that is really *boring* sound like something that is really interesting.

What a difficult job!

In late May, a financial reporter called me to ask how I interpreted the sharp decline that had just occurred in the stock market: Was this the beginning of a big down turn, or just a small correction within an up trend? Interesting question: financial reporters love to entertain their readers with brilliant quotations from eccentric experts. Then they add their own spin, and cook up an intellectually tantalizing morsel of financial journalism. Fun, fun, fun.

One expert said he thought it was the beginning of the end because interest rates were going up, the central bank was tightening, and all this was going to cool off the economy *and* the stock market. The next expert said it was merely a correction in an on-going bull market because demand was so strong. The Chinese demand for base metals was so strong. The American demand for oil and gas was so strong. And the central banks of the world were about to buy tons and tons of gold: the demand for precious metals would continue to be strong. And with all this demand, stock prices were going even higher.

The reporter asked me what I thought. I answered rather offhandedly: "I try not to think... it spoils my portfolio performance." I then explained that CastleMoore is not paid to think in conventional ways using pretty words. We are paid to own investments that are going up and we do that in a uniquely superior fashion which highly differentiates us from almost all stock pickers. For the record, I added that that we did not own Canadian stocks or US stocks at that time.

He interpreted this to mean I was bearish.

"No," I explained, "We are not bearish or bullish. We simply do not own Canadian or US stocks at this time."

What I didn't explain to him was this: *it is not our opinion that makes money.* What makes money is our investment position. Our investment position does not flow from our opinion; it flows from our unique methodology. "Opinion" is how stock brokers and salesmen sell stocks to their customers. However, we are not securities salesmen. We believe that we have to 'be there' for our clients in rising markets and 'not be there' in falling markets. My "opinion", I told him, is no better than the two experts he had already interviewed. I may have an *interesting* opinion; I may be witty and charming , but, opinions, wit, and charm are the stuff of salesmen and journalists. We` make money for our clients by participating in financial up trends and not participating in financial down trends.

And, unfortunately, the way we achieve that is fairly boring! It involves statistics [very boring!] and mathematical probability [extremely boring!]. But most of all it involves discipline!

As the reporter hung up the phone, I felt sorry for him. I thought; "Poor guy. He probably won't call ME back for another story..."

But my sorrow was short lived. I read the article. He wrote that because CastleMoore has sold Canadian and US stocks, we are super-bears! Apparently, we agree with the expert who said we were entering a severe stock market decline.

Amazing! He had put his own spin on it! Being a financial reporter is not as difficult as I had thought.

Looks like I am not allowed to be boring.■

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THE MONKEY IN US ALL

By
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President and Fellow of the Canadian Securities Institute

I recently came across a study of Capuchin monkeys that reinforces why investors and money managers must act from a discipline which separates their instinctive tendencies from their portfolio management decisions.

A Yale study under review by the Journal of Political Economy found that Capuchin moneys are strongly pre-disposed to loss aversion over acquiring new resources. Conventional economic theory has always known that investors have statistically acted in this way, but the study reveals that it is a deep rooted trait—a primal one.

"A large body of the study suggests that losses are more then twice as psychologically powerful as gains" according to Keith Chen, assistant professor at the School of Management.

In the first component of a two part experiment, the monkeys were able to purchase with a token one visible piece of food that half the time gave them a second piece of food as a bonus when the transaction was completed. In the second part one token allowed them to purchase two pieces of visible food that half the time only gave them one piece of food. The monkeys overwhelmingly preferred the first proposition.

Chen goes on: "The economic view says people are aware, rational and in control of their major decisions. Social psychology cuts in the opposite direction, maintaining that people are often unaware of the forces that dictate behaviours. What we've shown is that Capuchin monkeys look remarkably like us; making rational decisions in many of the same settings that humans get right; but also making many of the same mistakes we make".

A Capuchin Monkey enjoying the summer on his deck knowing he's kept his human instincts at bay

Our clients, like us, recognize our aversion to suffering loss; however empirical evidence would suggest that if left to our natural sociological tendencies, even if we think we are acting with common sense, we can make these decisions frequently at precisely the wrong time.

For example, the prospects of suffering a continued loss by an investor naturally inclines them to sell before they suffer more when this may have no bearing on the eventual outcome. This should point should not be confused with knowing what will happen tomorrow and just riding through the discomfort of today. It's about having a process that removes us from ourselves.

This current sell off in many markets emphasizes the strength of the CastleMoore's methodology. We sold all our client's Canadian and US equity positions over a month ago based on our rules and methodology and not based on trying to think through a significant down trend. We avert client loss by *judicious* selling. We applied the same technique even more recently in selling one of our most profitable investments to date, namely Japan.

"If I showed a string of capuchin monkey data to an economist," said Chen, "he couldn't, with any statistical test, tell the difference between a capuchin monkey and your average American stock-market investor."

Having a strict model-based (40 yrs of back-testing on some) approach to the market, as CastleMoore does, helps keep the monkey motives – present in us all - away from the real purpose of investing: to make money. That's CastleMoore's uniquely superior difference. We know when to buy, how long to hold, and most importantly….when to sell!

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"Buy, Hold...And *Know When To Sell*"

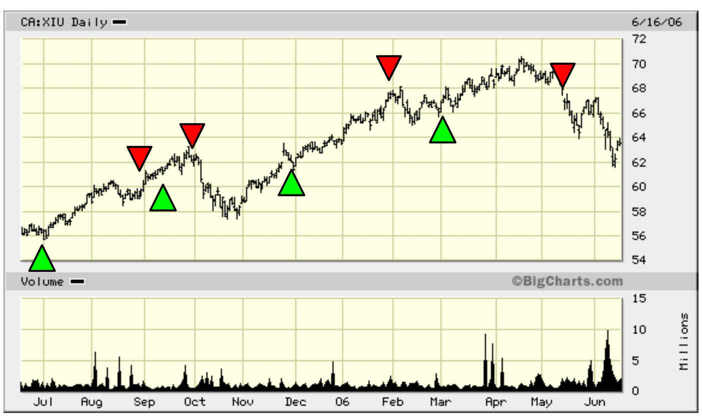
CastleMoore Inc. helps investors manage their life savings. We are not stock brokers or mutual fund salesmen. We are discretionary investment managers specialising in "buy low, sell high" strategies instead of "buy and hold" strategies like the other guys.

At CastleMoore we manage our clients' investments through a methodical and disciplined set of systems that virtually removes any individual bias and emotion from the investment process. What we do works. We rely heavily on loss avoidance techniques when making investment decisions.

Our clients are investors that pay particular attention to asset prices, have little tolerance for investment losses, and strong expectations of getting their money's worth. Clients appreciate CastleMoore's all-inclusive, comprehensive fee schedule. If we are required because of volatile markets, to be more active within our client accounts CastleMoore bears all the costs associated with more frequent transactions.

Our team's previous experience in large national firms and small boutiques provides us the ability to deliver a high quality professional portfolio management service while adding truly independent advice to our clients for reasonable costs. A CastleMoore client enjoys the benefits of having focused portfolio management without the distractions of also providing a "super market" of financial services. We just manage investment portfolios effectively – plain and simple. CastleMoore is uniquely superior portfolio management. To know more, including the first step in transitioning your portfolio, contact us.

MODEL PORTFOLIOS



THE VOLATILE CANADIAN MARKET

THE BIT MORE PROSAIC JAPANESE MARKET

The last nine months have been quite volatile in some of the major asset class markets. The Canadian & US equity, bond (Canadian & US) and bullion markets all recorded significant price movements. Our models for the Canadian and US equity markets resulted in a little more activity that we would like, but we don't argue with our methodology. The "Class Low" portfolio which holds more bonds and less equities than the "moderate" or entrepreneurial has been impacted by falling bond prices and rising yields –effects of inflation fears impact bond investors most. As we have recently undertaken new bond positions things may change for this more safety conscious investor. We expect a high level of volatility for all asset classes for the foreseeable future.

"CLASS PORTFOLIO" Group

Low: -1.80% Moderate: 9.17% Entrepreneur: 15.84% *Since Inception*

Zzzz …

By
Sheldon Liberman

Portfolio Manager

There's a time and a place for adventure. Your investment program should be neither.

Do you enjoy skiing? So do I. But nothing gets in the way of the enjoyment of a day on the slopes more than the thought that your portfolio is going downhill faster than you are!

Do you like sailing? What's worse, while sitting atop the water, than the realization that the can't-miss IPO you bought last month is under water.

Do you like going south in the winter? Well…you get the idea.

It is sometimes said that the amount of risk an investor is willing to assume reflects his or her preference between eating well (return) and sleeping well (risk).

That investors would prefer to eat well **and** sleep well goes without saying. But making intelligent choices given the inevitable trade-off is what Modern Portfolio Theory is all about.

We'd like to suggest that the business of portfolio management, as least as regards to its core discipline of allocating assets between risky and risk-free assets, is to intelligently and systematically (and not emotionally) minimize risk.

Why? Because if the stock market was expected only to rise, there would be only one strategy: buy and hold stocks. This would be true even without regard to expected return, for what ever return that is, it's virtually certain to be greater than the return to cash in rising markets.

But since the risk of stock market decline is always a part of the investment landscape, there exists a need for alternatives to the buy-and-hold strategy.

Portfolio managers rely on methodologies that have proven to work in the past. If they didn't, they would have since been discarded. We've touched upon one, stock market seasonality, in the February-March issue of the Castlemoore Investment News, and undoubtedly more discussion is forthcoming.

For now, suffice to say that, although we enjoy adventurous vacations, there's much to be said for restful ones.

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Some relevant business quotes….

Wall Street has a uniquely hysterical way of thinking the world will end tomorrow but recover in the long run, then a few years later believing the immediate future is rosy but that the long term stinks. (Kenneth Fisher, Wall Street Waltz)

Wall Street's graveyards are filled with men who were right too soon. (William Hamilton)

Big money is made in the stock market by being on the right side of major moves. I don't believe in swimming against the tide. (Martin Zweig)

There are three kinds of people or companies: 1. Those that make things happen; 2. Those who watch things happen; and 3. those who ask, "What happened?" (from Stock Traders' Almanac)

Successful investing is anticipating the anticipation of others (John Maynard Keynes) ■

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