

BUFFETT AND BEYOND...

BestSit	0	
Biologic	0	
BioPlex	0	47/8
BioSce	0	93/8
Biomtrcs	0	261/16
Biomel	0	435/16
Biomira	0	715/32

The Best Income Portfolio For Every Market Condition

The All Seasons Hedged Portfolio

Dr. J.B. Farwell

About the Author.



Dr. J.B. Farwell, author of a best-selling investment book, "*Buffett and Beyond*" is the World's foremost expert on the continuing

application of a stock selection method and predictability model called Clean Surplus. Clean Surplus, developed by the accounting profession is the only statistically tested method able to truly compare the operating efficiency of one company to the operating efficiency of any other company just the way you would compare returns from one bank to another bank. Clean Surplus allows portfolio creation of the most efficient companies which research has shown consistently outperform the market averages.

Warren Buffett is known to use this method and Dr. Farwell, through his research, book, courses and seminars, takes Buffett's methods and Clean Surplus one giant step *BEYOND...*

Clean Surplus is a model developed by the accounting profession which allows investors to both compare stocks and predict future portfolio returns relative to the benchmark S&P 500 index. Comparability and predictability are not available through the use of traditional accounting methods. The research and later CPA reviewed portfolios indicate that portfolios made up of stocks with higher Clean Surplus ROEs (Return on Equity) outperform portfolios made up of stocks with lower Clean Surplus ROEs. The statistically measured comparisons (correlations) of high Clean Surplus ROEs and high future returns are statistically significant.

THE ALL SEASONS HEDGED INCOME PORTFOLIO

Dear Readers: You are about to learn the intricacies of the best income portfolio I have come across during my 33 years of portfolio research. To this portfolio that has but two losing years since 1981, we have added two enhanced income methods. This portfolio is a hedged portfolio that can be implemented in your own personal account under your own name. This is not a hedge fund, but rather your own account that is hedged. This account may be the only income account you will ever need heading into the tumultuous future.

Warren Buffett is the greatest investor of all time and has but two simple rules that he has followed during his many decades of security management. His first rule is, "Don't lose money." And his rule #2 is, "Always remember rule #1."

BACKGROUND

In 1981 a fellow named Harry Browne took heed in what Buffett said and created a portfolio that was termed an "all weather portfolio" which would not only survive but make money in all market cycles.

Our Growth 30 Stock Model Portfolio Results using the Buffett and Beyond Methodology

Compounded Model Returns as of June 30, 2012								
Period	9 yr	7 yr	5 yr	3 yr	1 yr	YTD	Comp	Avg.
PORTFOLIO	169%	46%	25%	91%	15%	13%	169%	18.4%
S&P 500	91%	46%	10%	65%	15%	9%	91%	9.8%
OUT-PERFORMANCE	78%	12%	15%	26%	0%	4%	78%	9%

Here's something from Browne's list of rules taken from his website: ***Create a bulletproof portfolio for protection.** For the money you need to take care of you for the rest of your life, set up a simple, balanced, diversified portfolio. I call this a “Permanent Portfolio” because once you set it up, you never need to rearrange the investment mix— even if your outlook for the future changes. The portfolio should assure that your wealth will survive any event — including an event that would be devastating to any individual element within the portfolio. In other words, this portfolio should protect you no matter what the future brings. It isn't difficult or complicated to have such a portfolio this safe. You can achieve a great deal of diversification with a surprisingly simple portfolio.*

Yes, this is a portfolio in which at least one asset class will work in any economic environment. The modified portfolio (our All Seasons Portfolio) may be constructed with as little as \$50,000 while Browne's original Permanent Portfolio may be constructed with even less money than the modified portfolio. This strategy can be implemented in your own account, in your own name, at any reputable brokerage institution.

THE THEORY

Back in the 1950s, a future Nobel prize winner named Dr. Harry Markowitz came up with his now famous Modern Portfolio Theory. His thesis was to try and develop a portfolio that had the greatest return relative to the amount of risk one must take. Markowitz

measured risk by standard deviation. Standard deviation is simply a measurement of how much a security or portfolio goes up and down. Let's apply a number to the stock market. The stock market as measured by the S&P 500 index has a standard deviation of about 17%. If your portfolio has a higher standard deviation than 17% it means your portfolio is riskier (more volatile) than the market. By the same token, a standard deviation number lower than 17% means your portfolio is less risky than the market.

Here are some standard deviation or volatility numbers for some different asset classes since 1981 to the present. We are also including average returns since 1981.

<u>Asset Class</u>	<u>Standard Deviation</u>	<u>Yearly Return</u>
Stocks	17.1%	11.4%
LT Treasuries	14.0%	11.4%
Gold	16.3%	4.2%
Cash/ST		
Treasuries	7.0%	8.3%
Permanent Portfolio	6.7%	8.8%

The lower the standard deviation, the lower the portfolio risk. The Permanent Portfolio as a whole has a lower risk than any one of its asset classes by themselves

Harry Browne's Permanent Portfolio had just two losing years since 1981 through 2012. In 1981 it lost 3.9% and in 1994 it lost 2.5%. In 2008 when the market fell by 36%, the Permanent Portfolio actually **gained** 2%. Stocks were down heavily, but gold, cash/short term bonds and long term bonds were all winners in that year.

Following is the amazing point that both Nobel prize winner Dr. Markowitz and Harry Browne tried to bring out in their work. If you can put **non correlated** assets in your portfolio, you will lower the overall risk of that portfolio while still generating a good return.

What is correlation? If two assets move exactly in tandem, say your stock portfolio and the general market, then they have a correlation of up to one or up to 100%. This is true of most stock portfolios. They move in tandem with the market. The market goes up and your portfolio goes up. The market goes down and your portfolio goes down. The key to Modern Portfolio Theory was to add assets or asset classes that went up when the stock market went down so you could reduce the overall risk of the portfolio. The first asset class that comes to mind is of course, U.S. Treasury Bonds.

As you can see from the table above, the standard deviation (risk) of the entire Permanent Portfolio is **less than the risk of any one of the individual asset classes of the portfolio.** Yet the return is almost as high as stocks alone or bonds alone even in these years when income instruments are paying almost nothing.

The old rule of thumb was to put both stocks and bonds in a portfolio which in turn would reduce the overall risk of the portfolio. However, the return is also reduced to a large extent.

Most of the time a stock-bond portfolio works pretty well. Except in times of inflation that is. How could one protect against the ravages of inflation? Harry Browne added gold to the stock-bond portfolio because gold rises during times of inflation while stocks go down and bonds tumble. As you can see from the table above, gold has a high standard deviation (risk) but when added to the stock-bond portfolio gold adds a large degree of stability because it is non-correlated (does NOT move in tandem) with either stocks or bonds.

THE ALL SEASONS PORTFOLIO

How to Add Value to an already Great Portfolio

We here at Buffett and Beyond Research have an extremely good stock selection method. Over the past nine years we have returned 70% more than the returns of the stock market as measured by the S&P 500 index on a compounded basis without taking on any more risk than the overall market.

Since 2003, the Permanent Portfolio returned 10.7% per year while our basic model All Seasons Portfolio returned 12%. This was accomplished simply by substituting The S&P 500 index portion of the Permanent Portfolio with our 30 stock portfolio. Yes, it's that simple.

However, we are not finished yet. Investment advisors told us that their clients desired more stable income on a monthly basis. Thus, we added a fifth component to the basic Permanent Portfolio. Our expertise for the past 33 years has been selling covered calls on utility stocks. This is a rewarding, but rather cumbersome strategy and could only be accomplished with relatively large portfolios. However, now there is an Exchange Traded Fund which pays a 3.7% dividend and represents over 30 utility stocks. With the introduction of this ETF, Advisors are now able to employ an option writing strategy on over 30 stocks with just one ETF by selling covered calls on this ETF.

THE ORIGINAL PERMANENT PORTFOLIO

Harry Browne's Permanent Portfolio became popular in 1981 but was very difficult to implement as one had to purchase actual gold bullion. Folks would also have to purchase individual Treasury bonds and all 500 of the S&P 500 stocks. Thus, it was really a fantasy portfolio.

Stocks with Higher ROEs Outperform Stocks with Lower ROEs over the Long Term

THE STRUCTURE OF THE ALL SEASONS PORTFOLIO

Today, with the advent of so many mutual funds and ETFs (Exchange Traded Funds) we can purchase gold bullion with one single ETF for a price of \$16 a share. We can purchase 20 Treasury Bonds through an ETF for as little as \$122 a share. We can purchase an ETF investing in over 30 individual utility stocks for just \$37 a share and as an added bonus, we are able to sell covered call options on this ETF in order to generate added income. Our only drawback is we must purchase 30 individual stocks but this drawback pays very large dividends without added risk.

We use five asset classes with 20% of the portfolio invested in each asset class. The five asset classes are Stocks (our 30 stock portfolio), Long Term treasuries, Cash and/or 6 month Treasuries, Gold and finally an ETF comprised of over 30 utility stocks upon which we sell covered call options once a month.

The next step is to rebalance the portfolio either once a year or when an asset class becomes extremely over-weighted or extremely under-weighted relative to the other securities in the portfolio.

The All Seasons Portfolio has shown great resilience to market gyrations and market cycles. We are very fortunate in the advent of recent developments in the market in which Exchange Traded Funds have developed so that we may, with a relatively small amount of money, participate in such a wonderful portfolio.

Following is a table exhibiting our Model All Seasons Portfolio relative the original Permanent Portfolio. As you can see, our added value has greatly increased the overall return of the original Permanent Portfolio without greatly increasing the overall risk of the portfolio.

2012 Port										
ALL SEASONS MODEL PORTFOLIO VS. PERMANENT PORTFOLIO										
Permanent Port		12/31/11	7/30/12					Port	Port	After
		Price	Price	Div	option			Weight	Return	Fees
Gold	1 IAU	\$15.23	\$15.77	\$0.00		3.5%		25%	0.9%	
LT Bonds	2 TLT	\$121.25	\$129.19	\$1.66		7.9%		25%	2.0%	
ST Bonds	3 SHY	\$84.50	\$84.50	\$0.03		0.0%		25%	0.0%	
S&P 500 Stocks	4 SPX	\$1,257	\$1,383	\$0.00		8.4%		25%	2.1%	
									4.98%	4.48
All Seasons Port		12/31/11	7/30/12					Port	Port	
		Price	Price	Div	option			Weight	Return	
Gold	1 IAU	\$15.23	\$15.77	\$0.00		3.5%		20%	0.7%	
LT Bonds	2 TLT	\$121.25	\$129.19	\$1.66		7.9%		20%	1.6%	
ST Bonds	3 SHY	\$84.50	\$84.50	\$0.03		0.0%		20%	0.0%	
B&B Stocks	4					13.8%		20%	2.8%	
XLU	5 XLU	\$34.73	\$35.00	\$0.73	\$2.68	11.0%		20%	2.2%	
									7.26%	7.26
Diff									46%	62%
Hypothetical results are not indicative of future performance										

Please note this is a model portfolio and may or may not be indicative of actual portfolio implementation. Future results may or may not be indicative of the model portfolio.

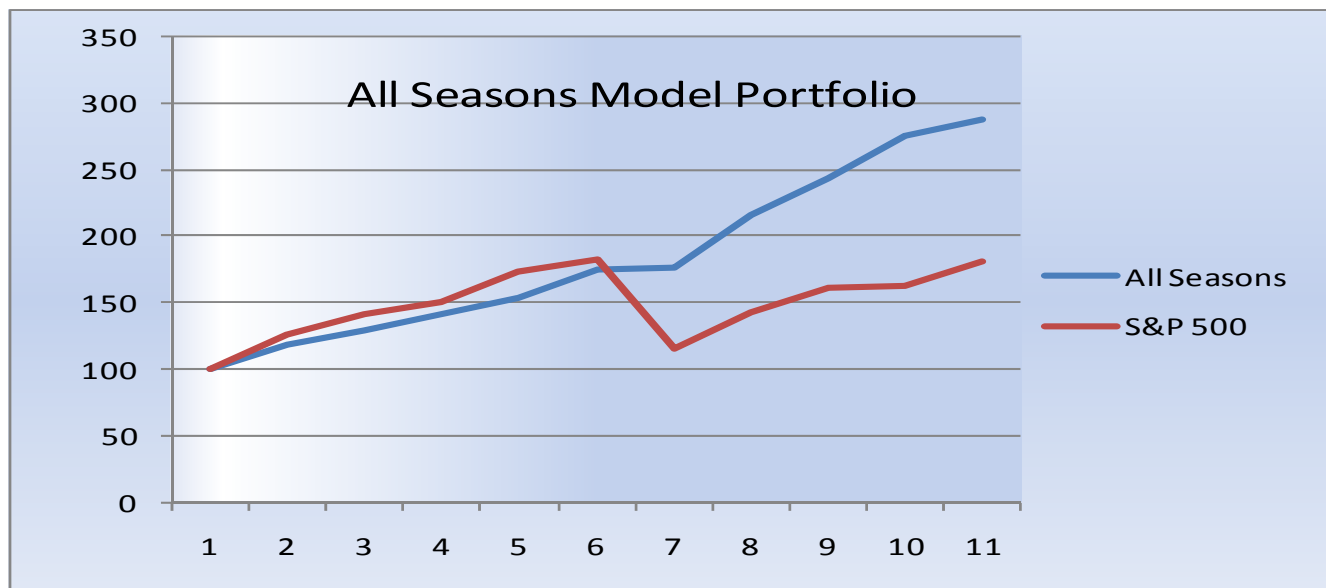
Looking at the chart above which covers the first seven months of 2012, you will see that our Buffett and Beyond Research stocks are outperforming the S&P 500 stocks 13.8% to 8.4%. Our fifth leg which is covered option writing on the XLU ETF (consisting of 30 utility stocks) is generating an 11% return including dividends. Since the XLU represents 20% of the overall portfolio, it is adding 2.2% to the total portfolio so far this year.

From the chart which covers the first seven months of this year, we can see that stocks are performing the best followed by covered option writing which together are adding 2.8% and 2.2% respectively to the portfolio.

Following these winners we have Long Term Treasuries adding 1.6% to the portfolio and finally gold which is adding 0.7% to the overall portfolio.

As an added benefit, we employ added enhanced income techniques several times each year which generate enough income to cover the cost of fees. This income technique is very similar to covered call writing.

Again we would like to remind you that the original Permanent Portfolio has had a negative return in just two years since 1981. Below is a graph that shows model returns since 2000 which includes the bear market years of 2001 and 2002 as well as the market crash of 2008. Impressive? Yes, I would say so.



Notes:

- 1) This is a back tested portfolio using actual individual asset class results from 2001 to 2011.
 - 2) Returns for S&P 500 are calculated on the actual index numbers.
 - 3) Returns for S&P 500 index include dividends.
 - 4) Stock Portion (20%) reflect CPA reviewed portfolio results of the Buffett and Beyond 30 stock portfolio except for 2001, 2002 and 2003.
 - 5) Covered Option returns on the XLU ETF (20%) are representative of returns from actual option writing portfolios.
- Buffett and Beyond Research, Inc.

If you are interested in this portfolio, just give us a call and we will have one of our affiliated Investment Advisors speak with you.