The Oxford Club
Privacy, Prosperity, Tradition

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From: The Oxford Club Research Team
For: Oxford Club Members

How to Build a Million-Dollar Portfolio From Scratch

The Investment Secrets of Superior Investors: How They Maximize Profits and Minimize Losses

It may surprise you that numerous surveys of investors indicate that most people think of themselves as logical and rational, weighing risks against rewards in order to maximize value and profit for themselves. And when they make investment decisions, they think they're being intelligent, analytic, thorough individuals with perfect self-control in pursuit of their goals – unaffected by emotions and feelings.

Talk about delusional… these people are pulling the wool over their own eyes!

Unfortunately, when it comes to investing, most of us have almost nothing in common with these ideal investor qualities. In fact, it's highly likely you have many self-destructive investment habits (that you may not even be aware of).

Don't despair. It's nothing to be ashamed of. As you'll soon see, we're all guilty of bad investment habits. However, do understand that your bad habits are costing you money.

More importantly, understand that successful investing involves only a few real secrets. Almost all of the world's best investors use the same basic principles. Learn them and quickly get yourself on the way to building a million-dollar portfolio.

SECRET #1: Use a Proven, Time-Tested Investment Strategy

For starters, can you admit that you have some self-destructive investment habits? Or at the very least confess that you've made several "bone-headed" investment mistakes in the past that could have – and should have – been avoided. Well, you're not alone. Unfortunately, most of us are making the same mistakes… over and over again.

We're not psychologically wired to make rational decisions with our money. We're actually foolish, sentimental, illogical and badly flawed.

According to behavioral economists, we say we're going to do thorough research, pick fundamentally solid companies and remain logical about our decision to sell. And we mean it. But then we do no such thing!

Without going into the gory details, study after study shows that *nearly all* individual investors make irrational stock market decisions. From regret avoidance, which explains why you do "nothing" with your current portfolio; to hindsight bias, which explains why you think you've done a remarkable job managing your portfolio – even when you haven't; to loss aversion, which explains your reluctance to sell losing positions.

The fact is, what drives a lot of investors' behavior is not simple, rational greed, but a desire to avoid feeling stupid!

It turns out, we feel worse when we make dumb moves than when we fail to make smart ones. Behavioral studies completed at the University of Chicago even determined that "losing money feels twice as bad as making money feels good."

So the first step towards improvement is admitting that most likely, you're no "ideal investor," and that you'd better start doing things differently if you want to build a million-dollar portfolio.

At *The Oxford Club,* we follow an investment formula that won Dr. Harold Markowitz the Nobel Prize in Finance in 1990. Since we started using this formula, combined with *The Oxford Club*'s investment philosophy, we've achieved remarkable results. **In fact, *The Hulbert Financial Digest* ranks our newsletter in the top five in the country for risk-adjusted return.** We're proof that having an effective system – that you can stick to regardless of the circumstances – is extremely valuable.

SECRET #2: You Must Asset Allocate Your Portfolio

At the heart of Dr. Markowitz's formula – and a key component of our *Oxford Club* investment system – is asset allocation.

Asset allocation.

Those two words represent the Holy Grail of investing. They're the secret of how so many of our long-time members get rich and stay rich.

Quite simply, asset allocation is the process of determining the most effective, optimal mix of investment opportunities. Regular readers of *The Oxford Club Communiqué* already know that these investment opportunities are likely to include stocks, bonds, cash and real estate arranged in a diversified mix that suits your investment style, your risk tolerance, and how fast you need to cash in returns.

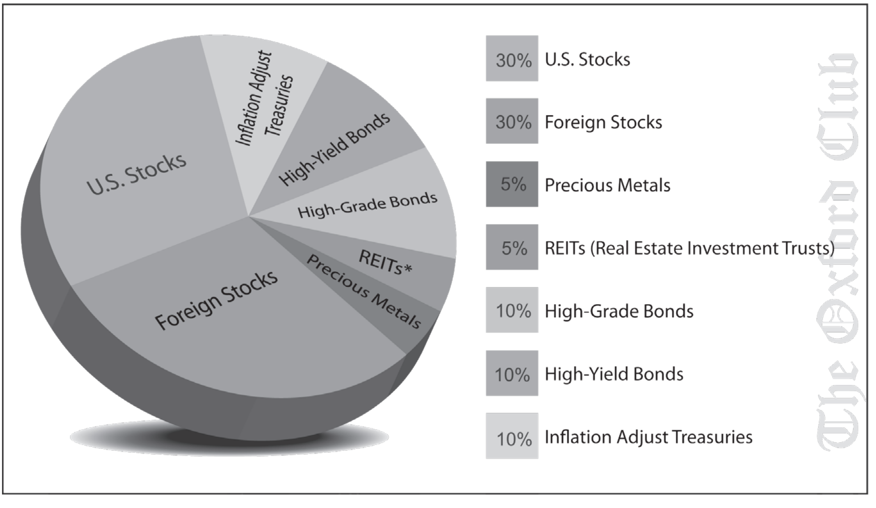
How important is asset allocation? Extremely.

Ibbotson Associates, a highly regarded financial research firm, did a study to identify the primary reasons for the success or failure of different investment portfolios. The answers it came up with certainly weren't what Wall Street wanted to see. It found that only 5% of investment returns could be explained by "investment selection." Far more importantly, it found that asset allocation accounted for nearly 90% of investment returns!

Let's take the first steps to breaking down your total investment funds into asset classes. An asset class is a group of securities that have similar financial characteristics. There are a lot of asset classes available today. But the five principal types of long-term investments are stocks, bonds, real estate, precious metals and cash (meaning highly liquid and secure short-term instruments such as T-bills, money market funds and CDs). When astutely mixed together, they can smooth out the volatility (or variability) of your returns – even while increasing them! And that's the whole point of proper asset allocation.

Investors who are looking forward five to 10 years or more should consider the following *Oxford Club* allocation. It serves as a basic outline of a portfolio mix that can help target high returns with relatively low risk:

- 60% stocks
- 20% bonds
- 10% cash
- 10% alternative investments
- 5% precious metals
- 5% real estate



Mastering the Rebalancing Act

So what happens when one asset class does extremely well while another does poorly? Do you abandon the "dog" and put more money in the top performer? Quite the opposite.

You only rebalance your asset allocation once every 366 days. This way, your moves will qualify for long-term capital gains tax rates. When your annual reallocation date arrives, simply reset your portfolio to how it was originally established.

At the end of each year, you sell off enough of the appreciated asset classes to return them to their predetermined allocated level. This strategy has some very powerful advantages.

It requires you to always sell high and buy low – something that eluded a great deal of investors during the dot.com and real estate crashes of the recent past.

During the brutal bear market of 2000 to 2001, the hardest-hit investors were those who bought the "New Economy" story hook, line and sinker. Ignoring asset allocation, they piled most or all of their money into the same class of stocks (technology), only to see their portfolios decimated by the Nasdaq implosion.

Asset allocation is not a market-timing tool. Yet it can and should take into account everything from the current market conditions, to falling interest rates, to whether the economy is slowing or expanding rapidly. Having said that, if you find yourself at the tail end of a bear market, and you want to reallocate your portfolio prior to or later than the suggested 366 days... go ahead and take advantage of the situation. Who doesn't like to grab a bargain if the market is holding a sale?

SECRET #3: Never – Ever – Lose Big Money in the Stock Market

Buying stocks is easy. The hard part is knowing when to sell. But it's essential to building a million dollar portfolio.

Among investors who lose money, the biggest reason is usually failure to protect profits and cut losses. Many investors are unaware that they can do that by using a safe and effective strategy: the trailing stop," or what we refer to as our "safety switch."

While most investors think of trailing stops as "stop losses," that's only half the story. Trailing stops also help us protect our profits as our investments move up.

The main element to *The Oxford Club's* trailing stop strategy is a 25% rule. We will sell positions in our shorter-term oriented *Oxford Club* Trading Portfolio at 25% off their closing high since we purchased the stock. For a stock purchased at $10, your initial stop is $7.50. Over the next several months, if the stock moves higher, you periodically raise your trailing stop to correspond with the new highs.

So, if the stock's highest close is now $15, your trailing stop is $11.25 (15 x 0.75), virtually assuring you of a profit if the stock drops. However, the stock continues to meander higher and now has a closing high of $25, making your stop $18.75. At this point, the stock runs into unexpected trouble and, shortly thereafter, closes below $18.75, triggering your sell stop. (We also base our sell decision on the closing price, not intra-day prices.)

All great traders and investors consistently cut losses short and let their profits run, and *The Oxford Club* has found that trailing stops are one of the easiest and most effective ways of doing that. Let me add that there is no "magic" to a 25% trailing stop. That's what we use at *The Oxford Club*, but you can use whatever percentage you are comfortable with. The important point is to have an exit strategy, and a designated trailing stop is a great discipline to help you stick to it.

Note: Several of our recommended portfolios in *The Communiqué* – The All-Star Portfolio and The Gone Fishin' Portfolio – do not use trailing stops. They use a "rebalancing" strategy suited for those investors with a long-term oriented approach.

SECRET #4: Size Does Matter… Understand Position Sizing

Position sizing is the technical term that answers the question "how much." Essentially, position sizing means how big a position any single holding in your portfolio should be.

We know nothing about your individual net worth, investment experience, risk tolerance or time horizon. But we do have a position-sizing formula you can use to determine how much to invest in a particular stock: *no more than 4% of your equity portfolio*. That way, using *The Oxford Club's* suggested 25% trailing stop, you never have more than 1% of your portfolio at risk in any given position.

One of the main reasons to have a position-sizing strategy is to have equal opportunity and equal exposure across the portfolio.

If you want to be conservative, invest less. If you want to be aggressive, invest more. But not too much more. If you have a stock that seems to have a much higher probability for success, then maybe invest a little more… but again, not too much.

The saddest stories we hear in the financial press are those of people who took a serious financial hit late in life because they were overconfident. In short, they liked an investment so much they plunked too much in it. Big mistake.

Yes, you could hit the jackpot that way, and we suppose some people have. But that's a roll of the dice and we don't recommend it.

SECRET #5: Exploit Clear Trends

At *The Oxford Club*, we spend a great deal of time trying to identify very clear trends that are likely to shape the economy over the next decade. Once the trend is identified, we analyze specific companies that we think will be big beneficiaries of that trend. From that group, we narrow it down to the best-of-the-best, and these stocks become our recommendations for *The Oxford Club* portfolios.

We search out sectors that have tremendous growth trends behind them. That means they will persist regardless of what's happening in the economy right now, regardless of the Federal Reserve's next move and regardless of the estimates for the next few quarters.

During the last several years, *The Oxford Club Communiqué* has focused on these trends, which have already brought us some of our best individual stock gains. But there are plenty more double- and triple-digit gains to be had...

- **Commodities:** This can be one of the strongest global themes in play right now. Not only are specific commodities – namely, gold, silver and platinum – great bear market holdings (because they normally move opposite of the stock markets direction) and excellent inflation hedges, but most commodities are experiencing strong demand around the globe. China, India and an assortment of "third-world" countries are quickly modernizing their economies, and that requires a full assortment of natural resources.
- **Oil and Oil Services:** This is another very clear trend. I'm sure you've heard us talk about China's seemingly unquenchable thirst for oil. And of course, it's not alone. The fact is, we are running out of oil, but the global economy is still "married" to it. And it will remain the fuel of choice for at least the next 20 years. You'll hear plenty of talk about alternative fuels and alternative energy sources, but these are all minor players compared to "big oil."
- **Infrastructure:** Surprisingly, this may be the "sleeper" trend of the bunch. Although you don't hear that much about the infrastructure buildup and modernization going on around the world, this is a huge global trend. Streets and highways are being expanded and rebuilt, bridges built and repaired, sewage systems put in place and maintained. And there's equipment needed to find, harvest, clean and refine commodities around the world. Any

newly industrialized nation has a "laundry list" of infrastructure projects that must be done. These are not usually headline-grabbing projects – but they are generally huge, long-term, well-paying jobs that give these companies huge backlogs and exceptional visibility regarding earnings in the years ahead.

- **Agriculture:** We've doubled the world's population since 1960, adding over 3 billion people to an already crowded planet. Global data indicates that the food pinch is already taking a toll on the planet's agricultural resources and on consumers. And the situation will only worsen from here because food is one of the few absolute necessities in life.

Secret #6: Cut Investment Expenses and Leave the IRS in the Cold

Let's start with expenses. If you look at our Oxford All-Star Portfolio, you'll see we've done an end-run around Wall Street's outlandish fees.

Instead of buying the nation's largest and best-performing bond fund, the Pimco Total Return Fund, we're recommending the **Managers Fremont Bond Fund** (MBDFX). You still get the nation's top-performing bond fund manager, Bill Gross, but you forego the high fees and expenses associated with Pimco Total Return. Fremont is a no-load fund.

Likewise, we opted for the closed-end **Templeton Emerging Markets Fund** (NYSE: EMF) instead of the open-end Templeton Developing Markets Fund. Both funds invest exclusively in emerging markets. Both are run by Mark Mobius, the top manager in the sector.

But the Templeton Developing Markets Fund has a high front-end load. The Templeton Emerging Markets Fund – like all closed-end funds – has none.

In fact, there is nothing in our portfolio that has a front-end load, back-end load, 12b-1 fees or surrender penalties. Furthermore, you can act on any of our recommendations through a no-load fund company or a deep-discount broker.

In short, we're cutting portfolio expenses to the bone. Lower investment costs are the one sure-fire way to increase your net returns.

Five Tax-Managing Tips

The second way is to tax-manage your investments. That means handling your portfolio in such a way that reduces the IRS' cut.

Here's how you do it:

1. **Stick to quality.** Higher-quality investments mean less turnover. And less turnover means less capital gains taxes. The less you trade your core portfolio, the less tax liabilities you incur. As Warren Buffett warns, "The capital gains tax is not a tax on capital gains, it's a tax on transactions."
2. **Try to hang on 12 months.** Anything sold in less than 12 months is a short-term capital gain. And short-term gains are taxed at the same level as earned income, which can be as high as 38%. But long-term gains are taxed at a maximum rate of 20%. Even better, do your short-term trading in your IRA, where the gains are tax-exempt.
3. **When you stop out in less than 12 months, offset your capital gains with capital losses.** The IRS allows you to offset all of your realized capital gains by selling any stocks that have joined the kennel club. You can even take up to $3,000 in losses against earned income. Not selling your occasional losers is not only poor money management, it's poor tax management.
4. **Avoid actively-managed funds in your non-retirement accounts.** Managed funds often have high turnover and Federal law requires them to distribute at least 98% of realized capital gains each year. You can get hit with a big capital gains

distribution even in a year when the fund is down. In parts of Texas, this is known as "the double whammy."

5. **Own high-yield investments in your IRA, pension, 401(k) or other tax-deferred account.** There's no provision in the tax code to offset your dividends and interest. So do the smart thing: own big income-payers like bonds, utilities and real estate investment trusts (REITs) in your IRA.

Your remaining choices are simple ones like owning tax-free rather than taxable bonds if you reside in the upper tax brackets.

If you reduce your annual investment expenses and tax-manage your portfolio, the effect will be dramatic. For example:

The Vanguard Group of conducted a study that indicates that the average investor gives up 2.4% of his annual returns to taxes. If you trade frequently, it's likely much higher. We can also estimate that most investors give up at least 1.9% a year in commissions, management fees, 12b-1 expenses and other costs.

Time is Money

The old expression "time is money" is particularly true in investing. **Some think time is the most important factor in investing. The reason is compounding.** Each year you earn a return on your original investment. And as time goes by, you also earn a return on the returns. But compounding can also work against you. Unfortunately, expenses benefit from the miracle of compounding, too. A few percentage points a year lost to taxes and commissions makes a huge difference in the long run.

<u>What counts is your purchasing power – after expenses, taxes and inflation</u>. By reducing your expenses to 0.3% annually and tax-managing your portfolio, you'll retain an additional 4% of your portfolio's return each year.

Here's how our strategy will affect your portfolio over time. The difference is NOT subtle.

	Average Portfolio	Oxford Portfolio
5 Years	$140,255	$168,505
10 Years	$196,715	$283,942
15 Years	$275,903	$478,458
20 Years	$386,968	$806,231

The U.S. market has returned roughly 11% a year over the past 200 years. The previous chart reflects how a $100,000 stock portfolio grows at this rate – with the drag of taxes and high expenses, and without.

In other words, after 20 years, our cost-efficient, tax-managed portfolio is worth $419,000 more. (A million-dollar stock portfolio, of course, would be worth almost $4.2 million more.) This is without factoring in any superior investment performance whatsoever! It's simply the difference achieved when watching investment costs and taxes.

SECRET #7: Have a "Rainy Day" Investment Stash

Many of the investment books for beginners tell their readers to keep three months' pay in a savings account in case of a layoff or an unexpected medical expense occurs. Good advice if you just want to keep up with your bills. But it falls short if you want to become a successful investor.

What if an ugly bear market rears its head? Do you have any reserves to handle that? Most likely, no!

Good financial planning means not only having a rainy day fund for unexpected family emergencies – but also having a stash of cash to handle unexpected stock market turbulence.

Being fully invested is a common mistake that many investors make. You should always have cash on the sidelines ready to put to work. The tail end of a bear market is a fantastic time to pick up some beaten-down bargains. Having that cash will be the difference between a mediocre portfolio and an outstanding one.

There's still money to be made in the throes of a bear market… if you can keep your head while everyone else is losing theirs. Stick to our investment formula: asset allocate, position size, use trailing stops and exploit clear trends. In a bad downturn, you'll start hitting trailing stops and get knocked out of many of your positions – but don't despair. You are preserving capital and building cash to use when the next bull market begins.

We don't recommend averaging down in a prolonged bear market. Instead, wait for stocks to hit bottom and start working their way back up. You may miss investing at the bottom, but you'll avoid repeatedly averaging down and, if the next bull market cycle is truly underway, there'll still be plenty of upside left. This is a good method of systematically getting your cash back in the game.

If you don't currently have an investment stash and you find yourself in the midst of a bear market, there's some ways to quickly remedy this situation.

- If you're still working, consider increasing the percentage of your pay going into your 401(k). Allocate this new money to some domestic and international index funds. You'll be buying low and reaping the rewards in the next bull market.
- Max out your eligible IRA contribution. Most IRA custodians will let you do this using a systematic investment plan, which allows you to invest a small amount each month. Put the funds into your self-directed brokerage account. Or periodically buy into stocks on your watch list. Your capital gains will accumulate tax-free.

Mind you, once the market starts heading up again, we're not investing in any old beaten-down stocks – we're moving into stocks off our watch list.

This brings up another key point about maintaining an investment stash. Always have a “watch list” of stocks that you are following. Your watch list contains companies that you have a high level of confidence in and are looking to buy on price dips. Bear markets speed up this process, often taking down excellent companies to historic lows. We witnessed this in March 2009, when dozens of outstanding companies hit new lows. It turned out to be an excellent time to invest. Many of these companies doubled, tripled and quadrupled over the next six months.

This is really when your cash comes in handy. Buying solid companies at bargain basement prices will multiply your money many times over in the years ahead.

Start Creating Your Own Million Dollar Portfolio Right Now

Like other similar decisions you make about the direction of your life, your financial future is largely decided by the decisions you make along the way. One of the most important investment principles you need to comprehend is that nobody can outsmart the market. Nor can you predict what stocks will do in the short-term.

But *The Oxford Club* investment panel and research team have been using these seven secrets for years to generate market-beating returns in every type of market. Along the way, we’ve helped members build million-dollar portfolios. They’ve told us so in some of the hundreds of testimonials we’ve received – and we hope to do the same for you.

Fact is, we’re more than happy to continue to do the “heavy lifting” for you and bring high-quality investment ideas to your attention. But it’s essential for you to realize that the basis for my success – and of countless *Oxford Club* members and also the world’s best investors – boils down to these seven investment secrets or principles… principles you can easily use and put into action in your own portfolio. OC

From time to time, *Oxford Club* will recommend stock investments that will not be included in the VIP Trading Circle or in the *Communiqué's* Portfolios. There are certain situations where we feel a company may be an extraordinary value but may not necessarily fit within the selection guidelines of these existing portfolios. In these cases, the recommendations are to be considered as speculative and should not be considered as part of the *Club's* more conservative *Communiqué* portfolio.

Also, by the time you receive this report, there is a chance that we may have exited a recommendation previously included in a VIP or *Communiqué* portfolio. Occasionally, this happens because we use a disciplined "trailing stop" philosophy with our investments, meaning that any time a company's share price falls 25% from its high, we sell the stock.

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The Oxford Club | 105 West Monument Street | Baltimore, MD 21201
North America: 800.992.0205; Fax: 1 410.263.2650
International: 410.864.2526; Fax: 1 410.263.2650
Email: customerservice@oxfordclubinfo.com

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