

Portfolio Management Overview – Market Beating Stocks Approach

In this article, we outline the basics of the Market Beating Stocks approach to Portfolio Management and Investing. In subsequent articles, we provide more depth and detail on each of our strategy's critical components.

Overview, How Did We Get Started?

My passion for the stock market started as a young investor and student of finance. During those years, I did not have the time to devote to full time trading and investment. My goal was to develop a strategy that investors could use without a large commitment in time or money, a strategy that had a better chance of beating the market and large institutional investors. I knew that I could leverage technology to develop a logical and systematic investment strategy that was better than anything I was seeing in the marketplace. Over time, my strategy evolved into a method for managing the time consuming but important process for researching and selecting stocks. Let's face it, without a strategy, how can one person effectively cover 9000 stocks. Later, I developed and tested methods for buying and selling stocks that maximized returns and minimized risks through a systematic portfolio management approach. After several years of rigorous testing and market research, I placed my own funds into investment portfolios and launched Market Beating Stocks, both of which have been very successful.

Institutional Investors, Can the Little Guy Really Beat the "Smart Money"?

Most research suggests that 75% of professional money managers ("Smart Money") fail to consistently beat the market returns. That is an incredible statistic particularly in light of all the fees paid to professionals for managing your money. Paying professional fees does not seem like a smart use of your hard earned cash. Why pay for professionals to manage your money when you can do it yourself with as good or better chance of beating the market? Market Beating Stocks thinks that individual investors have several advantages over professionals that can help them beat the market and to earn even better returns than the "Smart Money".

Advantage: Individual Investors Can Carry Fewer Stocks

Professionals often control very large funds with mega millions or even billions of dollars to invest. Professionals collect large fees from funds like this, but typically have to spread their dollars across a very large number of investments. Very few institutional accounts hold less than 20 stocks due to liquidity concerns. In fact, most funds carry a much higher number of stocks. The problem is that the more stocks that are carried in a portfolio, the closer that portfolio return will approximate performance on the market index. Diversification is important, but most research suggests that investors can diversify with as few as eight to fifteen stocks. As the number of stocks in a portfolio grows, the closer the portfolio return will approximate that of the market return. Our goal is to beat the market, and our best chance of doing that is by holding fewer stocks,

but enough stocks to be adequately diversified. For our strategy, our research and performance testing suggests that the ideal number of stocks to hold is between 8 and 15.

Advantage: Investors Can Move More Easily In and Out of Stocks

Individual investors can be more nimble than their professional counterparts. Professional managers typically carry very large positions in stocks due to the size of the cash they have to invest. This again is a burden in that the size of their positions makes it harder to move in and out of a particular stock. They create their own selling pressure when trying to sell, and often cause prices to rise when they are buying. Imagine trying to dump \$10 million worth of a stock gone south. In short, it is more costly for institutional investors to enter and exit a stock as a result of the buy/sell pressure they themselves create based on trading volume. Individual investors can move in and out of a stock much more easily without the same impact on price slippage.

Advantage: Take Advantage of Smaller More Thinly Traded Stocks

Individual investors have better access to “thinly” traded stocks, stocks that typically trade less than 200,000 shares per day. Often these companies are smaller capitalization stocks. Small cap stock prices will often move much more on a percentage basis than very large Fortune 500 companies. As companies grow in size, it becomes harder and harder to sustain high growth rates. Certainly there are a number of large companies that have been exceptions, but as a general rule smaller companies often have greater prospects for strong growth. That growth is what fundamentally drives higher stock prices. Many smaller companies with high growth potential are too thinly traded for large institutional investors. These stocks can be very hard for large investors to enter and exit without diminishing their own returns from the buying/selling pressures they create. Individual investors can more freely trade small cap stocks without undue influence on transaction prices.

Advantage: Wall Street is Not Looking Over Your Shoulder

Professional money managers are always under the gun to show performance and to justify holdings on a quarterly and annual basis. This creates pressure on money managers that influence their trading strategies by encouraging buying or selling at the wrong time to satisfy set reporting periods. For example, managers may dump the “out of favor” stocks for the “hot stocks” just prior to when holdings are released in order to minimize questions from management and investors – safer to follow the crowd. Unfortunately, following the crowd is often not the best strategy particularly at those times. The marketplace for professional money managers is very competitive, with extreme pressure on performance, and this clearly impacts trading behavior. On the other hand, individual investors do not have those competitive pressures and artificial reporting periods. Individual investors have more freedom with the stocks they select and the trading decisions they make.

Basic Strategy, What Do We Buy

Market Beating Stocks looks for stocks and options that are experiencing high demand (i.e., investors are buying), that are attractively priced, have analyst support, and that have favorable chart patterns with strong resistant levels and minimal overhead. Our strategy, which we call Momentum At Reasonable Prices (MARP) was built over many years and is based on a foundation of educational studies, empirical stock research, and actual performance results. Market Beating Stocks developed a search algorithm that searches 9000 stocks across all of the US exchanges that evaluates specific fundamental data and price performance criteria. Each stock selected for review must meet every criterion in our search algorithm. We then rank the pool of selected stocks using a proprietary ranking system that was built and proven over many years of successful testing and simulation. After ranking, we review the charts for price and volume trends in order to create our short list. From the short list, we review each stock's fundamentals and assess risk and fit within our portfolios.

Say No to Market Timing

Our approach to stocks and options investing is to remain fully invested, for the most part, over the long haul. There will be times where there is extreme market volatility where we will sit on cash over the very short-term, but generally we will try to stay mostly invested in good times and bad. We do not try to time market swings, and do not think market timing is a viable long-term strategy towards beating the market. No one has the foresight to accurately predict market movements over short or even long term periods. Without that foresight, market timing will surely fail and produce below market returns.

How Do We Manage Risk?

We use a portfolio management approach to managing our stock investments in order to maximize returns while minimizing risk. To do that we invest no more than 10% of the portfolio value into any one stock, which translates into a portfolio of 10 stocks. We believe we can get adequate diversification and thus reduce risk by holding a minimum of 10 stocks across a number of different industries. In addition, we maximize returns by keeping the overall number of stocks that we hold to a minimum. Research will show that the larger the number of stocks that are held, the closer those returns will approximate that of the market return. We are not satisfied with earning the market return. Our goal is to beat the market, and to beat the market by a large margin. To achieve market beating returns, investors need to keep the number of stocks held to a minimum, while at the same time, managing risk. Our research and testing shows that 10 stocks is the ideal number to hold in order to maximize returns and minimize risk using the Market Beating Stocks strategy.

Risk: Will all Selected Stocks Go Up In Price?

As investors, you have to expect to have some losers. At least three stocks out of ten that we purchase will not make money over the short-term. You may find this surprising, but most investors and money managers will experience an even higher percentage of losers. Our research shows that a success ratio of 60% or better is very good and Market Beating Stocks expects to do even better over time. Our portfolio returns greatly exceed market averages, despite having at least three losers out of every 10. Again, not even Warren Buffet can pick 100% winners each and every time. The stock market is not the best place for an investor who is not ready to assume that risk of loss.

Risk: Preserving Capital and Cutting Losses

To manage risk, Market Beating Stocks does invests no more than 10% of their capital into any single stock investment. This diversification ensures that no one investment will have a significant negative impact on the overall portfolio. Capital preservation is critical to long-term success in the stock market. Investors should target limits on risk of loss and position size to ensure preservation of their capital. For example, if Investors cut losses at 15% and hold a 10% position, the overall portfolio loss will be limited to 1.5% ($15\% \times 10\%$). Market Beating Stocks goal is to limit individual stock losses to 1.5% of portfolio capital and 3% on options. That is, we would expect to lose no more than 1.5% of our portfolio value on any one single stock investment. Setting these targets helps to minimize risk and preserve capital.

Setting targets on loss limits is critical to successful investors. No doubt cutting losses is easier said than done, but applying set sell rules upon exit can be very helpful. Market Beating Stocks minimizes losses by constantly monitoring portfolios against our sell rules and stop targets, and cuts losses as soon as those target levels are hit. There are no guarantees that we can exit an investment precisely at our stop point due to market behavior, but overall we do expect to do better on losers than our stop loss limits. For investors to be successful in the stock market, they must learn the importance of cutting losses when investments don't go in the direction intended. When we sell losers, our mindset is that we now have cash freed up for reinvestment into an even better opportunity. In other words, cut your losses and invest the money into a better performing alternative. Knowing that your money is going into a better performing alternative makes it easier to sell an underperformer. Investors tend to hold stocks too long, particularly those that have lost money. Market Beating Stocks believes that the discipline of applying sell rules and setting exit targets helps remove "emotion" from investor behavior. Emotion, particularly fear and greed, is known to influence buy and sell decisions, and can result in devastating impacts to your portfolio.

Emotion, Help with Overcoming Fear & Greed

The Market Beating Stocks strategy uses a set of five quantitative sell rules for making decisions on when to sell. If a stock meets any one of the five sell rules, the stock is sold and a sell alert issued to subscribers. The measures we look for are focused on price performance relative to the market, our price targets for gains and losses, and our holding period. We continuously research and test our sell rules and make

adjustments only as market conditions warrant. Some investors may find this surprising, but our research confirms that the sell strategy has a tremendous impact on portfolio performance, particularly over time. Most information provided to investors is focused solely on the buy strategy, i.e. which stocks to buy. This perspective is wholly inadequate, as the sell side is as important to portfolio returns, if not more so. Market Beating Stocks separates itself from competitors by offering information on not only what to buy, but when to sell.

Where's the Value

The Market Beating Stocks strategy allows busy investors to focus on a smaller group of high potential stocks. It is simply not possible for investors to monitor all 9000 stocks that are traded every day across the US exchanges. Our strategy uses a proven stock selection algorithm that narrows down the selection pool from 9000 stocks to under 20. By doing that, investors can focus more time and energy evaluating truly the best performing stocks and can ignore the noise from everything else. The sell rules on when to exit a stock are absolutely critical to strong market beating performance. We have spent years refining our strategy and back testing our results. In addition, we continuously research, test, and monitor results and tweak our buy and sell parameters. Investors will benefit from access to our strategy, one that is constantly monitored and refined as market conditions change. Most investment sites do not provide information on when to sell a stock. Market Beating Stocks distinguishes itself by offering real time alerts on when we sell and why. Another distinction, Market Beating Stocks offers complete transparency to all buy and sell transactions we make, along with specifics on each portfolio's performance. We offer that detail to build investor trust, since we know that is important towards building long term subscriber relationships.